China Business

China-US trade war poses a risk for NZ

Fran O'Sullivan

New Zealand is keeping its head down as the two elephants of world trade embark on the opening skirmishes of a potential trade war.

China is hugely important to the New Zealand economy. So is the United States, for both trade and security reasons.

The last thing New Zealand wants – along with multiple trading partners of both major powers – is to be manoeuvred into a situation where it is forced to choose.

But Trade Minister David Parker is sure of one thing – that the importance of the Comprehensive Progressive Trans Pacific Partnership (CPTPP) which the Labour-led Coalition Government signed up to earlier this month has now increased, providing an alternative rules-based agreement for countries that want to work together "rather than put up barriers".

Parker now wants to add the upgrade of New Zealand's existing free trade agreement with China to the notches on NZ's trade belt.

"In terms of the negotiations some good progress has been made," he says.

He also affirms if the upgrade goes to plan it will be a modern, "inclusive" agreement with a strong focus on the environment, competition policy, e-commerce and the expansion of the services trade. He notes that over the decade since the original FTA was signed by the previous Labour Government in 2008, "a lot has obviously changed".

Not only has China made significant domestic reforms but it has widened its trade agenda to embrace environmental standards and e-commerce.

David Parker wants to upgrade New Zealand's FTA with China.

FONTERRA:
Let's talk about China
– E4-5

Parker says the proposed e-commerce chapter in the upgrade is of particular importance to New Zealand.

"Ecommerce pushes the benefits of trade down to smaller organisations," he says.

"You don't have to be a large multinational with offices in lots of countries to trade when you are doing so through ecommerce."

Fonterra has led a push to have "safeguards" – higher tariffs which kick in once certain volume thresholds are exceeded for NZ dairy exports to China – made a key negotiating outcome.

But NZ dairy exporters face a risk that powerful Chinese ministries might seek to renegotiate provisions in the 2008 agreement, which is currently set to result in all dairy tariffs reduced to zero by 2024.

Parker says the negotiations are not at the point where trade-offs have emerged.

But Todd McClay, who was National's Trade Minister, cautions that China can be expected to push for better access for investment and for labour.

"The revised TPP has doubled the OIO investment threshold from $100m to $200m for China under a most-favoured-nation clause, but this has already been banked," says McClay, now National's foreign affairs and trade spokesman.

"Given the importance of China to the economy you can expect this will be a hot topic for negotiation."

Parker says the focus on non-tariff barriers (NTBs) established by the previous Government will remain a priority.

But he said NTBs are an important focus not just with China but also with other economies, including Europe.

Parker also makes the point that if New Zealand is to increase its export growth to markets (not just China) it needs to grow new points of comparative advantage with the world.

The Government plans a new national interest criteria for foreign direct investment in NZ. "That policy work will commence after we have done the more pressing investment screening issues going around housing and the like," says Parker.

He stresses the criteria will not be directed at any one country, but that New Zealand should have criteria that go beyond the current reliance on issues like character and financial competence.

● **E3: Charles Finny – "tough times for trade"**
● **E6: Todd McClay- "words matter"**

Double dose of shopping

Tim McCready travelled to China to experience 24 hours of shopping on a scale that has never been seen before.

Sales hit a new record of US$25.3 billion on Double 11 Day 2017 – up 40 per cent from 2016.

Inside, McCready looks at some of the innovation taking place that is helping to blur online and offline, and drawing customers back into physical stores.

He visits Alibaba's new supermarket chain, which is redefining what fresh groceries mean in China.

McCready considers how Chinese payment giants are taking on the world – and what traditional banks are doing to fight back, and speaks with leading Australasian nutritional companies to understand more about their expansion in China and how e-commerce is shaping their business.

McCready was a guest of Alibaba in China.

Tim McCready's report from China is on E8 and E10-E13.

Chinese-owned dairy firm plans NZX listing

Milk New Zealand has an ambitious plan to list a company on the NZX within the next 3-5 years.

Milk NZ managing director Terry Lee says a stock exchange listing will give Kiwi dairy farmers who are currently in co-operatives different options for supply and ownership.

"The benefit for the New Zealand dairy farmer is that we will have more and more consumer products and we will be able to pay a premium for high protein milk and A2 milk."

Milk NZ was setup after Chinese billionaire Jiang Zhaobai's vehicle Shanghai Pengxin bought the Crafar farms in April 2012. It has since expanded to be one of the largest dairy farm groups in New Zealand, managing 29 farms milking 30,000 cows on 12,000 ha, producing around 10m KgMS each year. Milk NZ exports UHT and fresh milk to China under the Theland brand. Its export products are manufactured by Miraka and found in at least 25 Chinese provinces and carried in 4700 stores. "We have expanded very rapidly online and through TV shopping channels," says Lee. "Our business model of partnering with supermarket giants has led Theland to being the fastest-growing New Zealand brand in China.

Terry Lee

"Currently Theland covers 60 per cent of the consumer market and has become the number one selling imported UHT brand in the stores that carry Theland."

In 2015, Jiang restructured his company. Shanghai Pengxin now has 55 per cent of publicly listed Hunan Dakang International Food and Agriculture which holds the interest in Milk NZ.

The initiative to export fresh milk was driven by Theland New Cloud (Shanghai) Digimart, which was formed in 2015 as a subsidiary of Hunan Dakang and minority shareholders.

In December 2017, the Alibaba Group and founder Jack Ma's venture company injected fresh capital into the TheLand New Cloud, emerging with a 57 per cent controlling stake. Hunan Dakang remains a shareholder of TheLand New Cloud with 33 per cent, and minority shareholders retain 10 per cent. In turn, Theland New Cloud now has 100 per cent of the shares of Milk New Zealand Dairy.

Pengxin and Dakang own Theland Tahi Farm Group and Theland Purata Farm Group separately in New Zealand.

Lee stresses listing these farms on the NZ stock exchange is an option for Pengxin and Dakang , "but it is not a plan yet".

Lee says the company's head office will be in New Zealand. But it has ambitions not just to be a dairy company but a multinational, bringing in more premium products from other countries including Australia and New Zealand, America, Europe and Germany. The company will supply five categories to Alibaba as part of its "new retail" strategy – meat, fruit, water, dairy and grains.

"Our growth target is to double our revenue every year over the next three years to a target of 3 billion RMB," says Lee.

"Currently we are at 700m RMB."

Restructuring the company's supplier and production relationships in New Zealand is key to stable growth. "One of the ideas we offer is options for our key suppliers to own shares in our company," explains Lee. "This is in the early stage of discussion. But it may be the future for securing suppliers and to bring confidence into New Zealand . . . our partners not only enjoy the new sales opportunities but the opportunity to share capital for growth."

Lee says the Alibaba relationship has already enabled Milk NZ to better sell into the competitive China consumer market.

He is proud that Alibaba selected New Zealand for their first investment in content for their sales channel.

"We tried several times online but were not successful, that is why we needed support from Alibaba.

"Today, Alibaba has four groups working in our head office to help us setup the HR system, supply chain management system and help with accurate sales and accurate promotions to their A+ members."

Lee explains that Alibaba not only has a large number of customers but it can provide access to its 15 million strong A+ customer group – those with 100,000 RMB expenditure in one year – to trial products.

New Fund

Lee also revealed the company also plans to setup an Agrifood Fund to invest and help New Zealand producers to have new facilities, new technology, new knowledge and new equipment.

"The Agrifood fund will be established this year," says Lee. "The name is Jack Ma's decision."

China Business

The era of Xi Jinping

China's president has extended his term to life — what does that mean for his country?

China Business
David Mahon and Charlie Gao

Since the global financial crisis, educated Chinese people have lost a degree of confidence not only in the Western neoliberal economic model, but also in the West's democratic political systems.

But there is still a deep shared aspiration in China that the country will develop its own unique model adopting the best international principles of democracy, transparency, and the rule of law.

Some now feel that the Chinese Communist Party is leading them away from that goal; the reality is more nuanced.

The party's decision to remove the constitution's presidential term limit has come as a surprise to many.

The change is not in itself crucial, given Chinese president Xi Jinping's consolidation of power over time.

He has been in an unassailable position for some years, having been named the party's "core" leader, with his political thoughts added to the constitution.

Xi's actions have certainly empowered the party, but it remains to be seen whether the removal of the presidential term limit is a personal power grab or more about buying time to ensure that his radical agenda is preserved.

Less reported than the term-limit change was the Government's recent announcement of major restructurings aimed at empowering the country's environmental protection, financial regulation, and anti-corruption agencies, among others.

It would be a misreading to think the party is totally subservient to Xi or that his political longevity is guaranteed; much will change over the next seven to 10 years neither he nor the party can forecast.

Unless the party, with Xi at its head, can continue to deliver results for the people, it will lose its mandate to govern, as emperors who were perceived to have lost the mandate of heaven never held on to power for long.

Out of chaos

From the mid-90s, Chinese provincial governments and the central administration were able to lobby for their own interests and engage in limited debates on both social and economic policy. Years of high economic growth flowed from China's relative openness and often-chaotic commercial experiments. China became and remains one of the most internally competitive economies in the world. Villages, counties, cities and provinces compete with each other relentlessly, driven by ambitious business leaders and officials.

A degree of graft bound state and private sector interests together; the state released assets or conferred use-rights to private companies, fuelling a period of sustained economic growth. China's middle class grew and prospered as its markets expanded and privatised.

But corruption got out of hand as officials and their business cronies became increasingly profligate and greedy.

Environmental degradation accelerated, and the Chinese-language internet teemed with images of officials sporting $20,000 watches, gorging at expensive banquets, and driving imported luxury cars.

It was in this context that President Xi came to power in late-2012, implementing a harsh anti-corruption campaign, which reduced the potential for economic instability and social unrest.

In his first term, Xi gained unprecedented popularity among the masses and garnered fear and respect from Party officials. He restructured the military, arresting and dismissing corrupt officers while empowering the police and judiciary.

He confronted interest groups centred on powerful political families which had been distorting the economy and stoking the ire of ordinary Chinese people. Xi consolidated his power to a degree unknown since the era of Mao Zedong, but critics miss the fact he has also empowered the courts to become more independent and strengthened legal institutions.

Government and Party

Chinese and foreign observers alike have expressed concern at what they see as Xi's personal power grab, possibly setting up life-long rule.

If Xi wanted to rule indefinitely, he need not have expended political capital to change the constitution.

He could have instead given up the presidency at the end of his current term while retaining his posts as General Secretary of the Chinese Communist Party and Chairman of the Central Military Commission — neither is bound by a term limit.

It is striking that he chose to consolidate his power through legal means, by amending the constitution. Counterintuitively, some observers have noted that this may reflect the actions of a man who does recognise the importance of the rule of law.

Instead of risking the political imbalance of ruling through the party while placing a figurehead in the role of president, Xi has restructured the constitution to reflect the fact that there is no real separation between the government and party.

As head of the Party, military, and state, Xi sets a precedent that the leader chosen and supported by the party will have unquestioned control and sufficient time to advance the party's agenda, but that this person must in turn be bound by the diktats of the party and its constitution.

None of this resolves the difficult question of what happens when Xi dies or is no longer able to rule.

Xi's legacy will depend as much on his ability to leave behind a more participatory political system as on his ability to continue to deliver prosperity and stability.

The enduring masses

Western analysts have long assumed the Chinese middle class would evolve to challenge China's one-party rule. In fact, moderately affluent Chinese may perceive they have the most to lose in the event China becomes politically unstable.

From 1990 to 2016, China's per-capita GDP rose from around US$300 to over US$8000, and average wages grew more than 30-fold. This was a period in which wages remained stagnant in the West. A conservative estimate of the number of people China will add, over the next decade, to the ranks of its already large urban middle class is 100 million.

> Xi consolidated his power to a degree unknown since the era of Mao Zedong, but critics miss the fact that he has also empowered the courts to become more independent and strengthened legal institutions.

As long as China's middle class continues to grow and prosper under the rule of the party, significant political activism aimed at regime change is unlikely. Educated Chinese people do express concern with the dangers of political power becoming overcentralised. But this tends to be balanced with a concern that there is too much to lose if the political structures established by the party are discarded without consideration for what would replace them. Incremental progress is preferred over bloody, chaotic revolution.

There was little sympathy among ordinary mainland Chinese people toward the student protesters in Taiwan and Hong Kong agitating for independence from the party's influence; this goal is not a practical reality or desired by most people in China now, and it is unlikely to become so in the foreseeable future.

The view from the West

Condescending views of China and its people are still prevalent among citizens of developed Western countries. They stem from a colonial mindset which produces an enduring sense of Western exceptionalism, and a propensity to dehumanise cultures that they cannot or are unwilling to try to understand.

There is a lack of appreciation that Chinese people — and particularly the growing middle class — aspire to the same material and emotional well-being as people around the world.

Over 300,000 Chinese students study in the United States each year (as did President Xi's daughter), and a further 200,000 in other developed countries. In 2016, 135 million Chinese tourists travelled the world, observing social and economic models different from China's.

Years of exposure to Western systems have had an impact on this cohort, and their growing expectations and demands for better environmental conditions, safer food, and greater transparency are changing China. This force is more subtle and gradual than disruptive.

The determination and common sense of the increasingly technologically connected masses in small towns and the countryside is another, equally important pressure on the Chinese leadership.

The party may be able to control public dialogue to some extent, but it cannot alter the shared experience of millions of increasingly globally minded people. Instead, it is more focused on understanding their needs.

The people look ahead

Social network conversations and anecdotal evidence indicate a significant number of China's middle class are apprehensive about the term-limit change, as it may open the leadership (more probably a successor of Xi) to a dictator like Mao.

There has been no widespread negative reaction, in part due to media censorship and the government's disruption of social networks. In China, surveillance is extensive and the internal security budget exceeds that allocated to external defence.

But private debate is generally unrestricted, and while people may disapprove of some of Xi's actions, he remains widely popular.

No one in China, let alone China watchers in the West, can accurately predict the implications of recent events. But Chinese people will likely deal with this and future challenges as they have over the preceding heady decades, waiting to see how their own prosperity and freedom is impacted before deciding whether and how to make a stand.

Just as the party sets long-term strategies, the Chinese people have become used to maintaining a longer-term view.

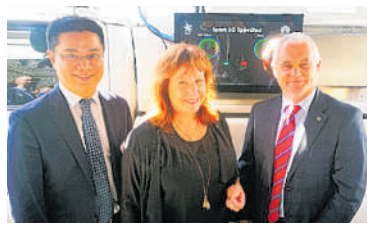
● *David Mahon is executive chairman and Charlie Gao a partner in Mahon China Investment Management*

Inside

Bin Liu looks at China's economic transformation — E6

Liam Dann on why there may be no meltdown — E7

Gabriel James looks at consumer confidence and blockchain — E9



Huawei leads next-gen digital push — E16

Michael Barnett on the prospects for SMEs — E17

Hong Kong — gateway to Asia — E18

China Business 2018

Executive Editor: Fran O'Sullivan
Writers: Bill Bennett, Liam Dann, Gabriel James, Tim McCready
Opinion: Michael Barnett, Charles Finny, Stephen Jacobi
Subeditor: Isobel Marriner
Graphics: Isobel Marriner
Production Assistant: Gabrielle Penn
Advertising: Neil Cording
nzherald.co.nz

China Business

Tough times for trade relations

China Business
Charles Finny

On our Friday, President Trump signed an executive order enabling the imposition of 25 per cent tariffs on some US$60 billion of Chinese imports. The actual products are as yet unlisted but reports suggest that the measure is likely to affect 1300 product lines in the technology space — aeronautics, modern rail, new energy vehicles and other high tech products have been mentioned. The actual list will be published within 15 days and then there will be a 30-day period for public comment before a final decision is taken.

The President is justifying the measure as a response to Chinese trade practices that allegedly involve the stealing of US intellectual property by Chinese firms. His speech suggested this was also driven by a concern at the size of the US trade deficit with China.

This move follows the announcement two weeks ago that the US was going to impose 25 per cent tariffs on many steel imports and 10 per cent on aluminium imports. This was justified on national security grounds. Originally these steel and aluminium tariffs were targeted globally but many countries look as though they will be exempted, temporarily at least. Australia, Mexico, Canada, EU, Brazil and Korea appear to be in that category. We don't know yet about New Zealand and Japan, but it looks as though China will face the tariffs — should they ever be imposed. These exemptions are interesting. The US seems to be saying you are exempted until May but during that period you need to negotiate some alternative arrangement. Are we talking about the voluntary restraint arrangements that were so common in the 1980s?

This could all be a negotiating tactic. Trump suggests he is a great deal-maker. Maybe this is all about getting countries to the negotiating table.

Until recently only Korea (because of the FTA renegotiation) and Canada/Mexico (because of the Nafta renegotiation) were willing to have serious engagement. China has been sending a series of high level emissaries to Washington DC and does appear willing to enter talks on the future shape of the trading relationship with the US.

There are people in Washington and Beijing suggesting the best way to diffuse tensions would be a FTA negotiation between the US and China. I can't see this being politically acceptable in the US at present but the idea is out there.

Likewise, senior EU figures have noted that President Trump seems to be talking about leveraging the steel and aluminium tariff threat to get the EU to drop protections against US imports. This had led to talk about sitting down with the US to consider re-starting the Transatlantic Trade and Investment Partnership (TTIP) negotiations which were suspended at about the same time the US withdrew from TPP.

If the result of all this sabre rattling is talks (or talks about talks) this is a good thing. But if some of these tariffs actually get imposed we have a problem.

First there is a direct impact on New Zealand. We do export steel and aluminium to the US and, unless we are exempted, we may lose our market there. I know that from Prime Minister Jacinda Ardern down, strong efforts are being made to achieve this exemption but we have yet to have this confirmed.

But even if we are exempted there could be indirect impacts. Where will the steel and aluminium from China and other non-exempted products go? What impact will this have on global prices — and specifically prices on products exported to New Zealand? And we have already seen negative reactions to these moves on global financial markets.

Perhaps just as important as these trade impacts is the fact that the US seems to be acting in breach of World Trade Organisation (WTO) rules in imposing the steel/aluminium and the technology tariffs. The national security argument looks extremely flimsy and there really is nothing I can think of to justify the technology tariffs (maybe — just maybe — some action after winning a WTO complaint might be justifiable, but this action is being proposed ahead of WTO action).

And these actions are a clear breach of US tariff commitments made in the WTO. This opens the potential for retaliation by China and others. China has already signalled to its importers of US grains that they might like to be considering alternate sources (eg Poland). And a list of potential retaliations has been made public — in retaliation for the March 8 announcement, not March 22.

China is saying it will fight this US action "until the end". Any retaliation involving agriculture risks impacts on global prices. There is a direct link between grain prices and meat and dairy prices in the US.

These developments also raise major issues of principle for New Zealand. Our exporters depend on this set of WTO rules and their subsequent improvement through bilateral or regional FTAs to underpin our trade.

If the US or anyone else can justify increasing steel tariffs on flimsy grounds, why can't they start restricting meat or dairy imports?

We, and others, are going to have to think hard about whether this needs to be challenged in the WTO. It could be another major test for our Government. And it will be another test for the WTO.

How will Trump react when his actions are ruled to be illegal?

● *Charles Finny is a trade commentator. He launched the China-New Zealand FTA as New Zealand's lead negotiator. He was later contracted by the New Zealand government to lead the negotiation on the trade agreement between New Zealand and the Separate Customs Union of Taiwan, Penghu, Kinmen and Matusu.*

GOING GLOBAL
NOW A LITTLE EASIER
As New Zealanders, we've often looked overseas to give our big ideas the scale they deserve. As ANZ is present in 33 markets offshore, we can help customers looking to expand or launch overseas. Our local knowledge, combined with our global connections make it easier for you to stay on top of your growing business.
ANZ Institutional
ANZ3421-INTERNATIONAL_NZH
ANZ Bank New Zealand Limited.
ANZ

China Business

Fonterra negotiating

Fran O'Sullivan sat down with Fonterra's John Wilson and Theo Spierings to talk about their China position

Fonterra's news that it was writing down its $774 million investment in Chinese infant formula company Beingmate by $405m inevitably dominated news headlines after the dairy co-operative announced its 2018 interim result to the NZX.

But that was eclipsed when chairman John Wilson announced the seven-year reign of his chief executive Theo Spierings was in its final phase.

It was a brutal press conference.

But after news media (including this columnist) had put both men on their mettle it was time to talk about the big picture — why the co-operative stays invested in China.

Fonterra estimates its Greater China operations accounts for $4.7 billion of its overall $16b-plus enterprise value based on current share prices, and, China itself, $3.4b of annual sales revenue.

Beijing laid three conditions on Fonterra as the price of accessing what is becoming the world's largest middle-class consumer market. "We have to farm at scale, have to have consumer brands in the market and a Chinese partner," says Wilson.

Clearly both men have been frustrated by Beingmate's performance. They have faced questions about the level of due diligence Fonterra performed before the acquisition.

But there is also the matter of the ropey financial information which led to several directors, including two appointed from Fonterra, taking issue with their integrity. And an opaque governance structure at Beingmate.

Fonterra's Spierings (left) and Wilson.

Wilson says the reality is that the company must access the China market. Other — perhaps easier markets with better governance structures — also have hefty trade barriers.

"We're very grateful for those opportunities to invest significantly alongside the dairy industry in China and drive significant revenue and earnings out of China," says Wilson.

"It doesn't come without risk and we have to continue to balance that risk."

Beingmate's issues have been well-canvassed. In February, it reported a loss of about $208m. Founder Sam Xie has been guided to step back in and the company is on the hunt for a new chief executive.

Its business has been disrupted by the rapid transition to e-commerce in China. But it has also succeeded in registering its brands under stiff new conditions.

What is notable is that the Chinese Government expects Fonterra to stay invested in Beingmate, and, together with Xie and another key shareholder, sort it out.

"The Chinese Government, when they laid down the rules they did for us, had three requirements," says Spierings, "They never change them. They never want to compromise."

> We enjoy a number one reputation in China in dairy which is an extraordinary privilege to hold. But it gets knocked around a little bit and it tends to happen from here rather than up there. That's our reality.
> John Wilson

> It is difficult to convince a founder who has created massive success with his recipe that the cook or the chef has to change the recipe, when that's being told by a Dutchman working for a Kiwi company.
> Theo Spierings

Wilson places great store on the relationships Fonterra has built with their key Chinese ministers and government and commercial leaders.

He freely admits Fonterra has faced a number of what he prefers to call "roadblocks" in China including biosecurity scares.

continued on E5

China gets creative with dairy

China Business
Bill Bennett

Fonterra chief operating officer NZMP Kelvin Wickham says when it comes to finding new ways to consume dairy products, the Chinese are incredibly creative.

He looks after operations for Fonterra's NZMP business — the division that sells dairy ingredients to food makers. Though dairy ingredients are used in obvious places they are also now turning up in products that are uniquely Chinese.

There are the well-known international staples such as slices of cheese on hamburgers and melted mozzarella on pizza. Wickham says these are now popular in China. Fonterra's butter and cream can be frequently found in cakes, biscuits and other cooking.

No surprises there. Yet Fonterra's cheese now makes its way into lollipops, as well as into a brand of fish and cheese-flavoured sausage. Chinese consumers also enjoy having cream cheese in glasses of "tea macchiato", a popular drink.

Wickham says: "This creativity mixes Chinese tastes with Westernisation. Consumers in China love fast food, which can use a lot of dairy, but with food like fish and cheese sausages they are making it their own."

He says another popular fad is the so-called muddy bun. It's a form of chocolate cake where the whole point, and part of the fun, is to leave smears on your face, which can be licked off. NZMP dairy ingredients are an essential part of the experience.

There is more serious innovation. Like everywhere else in the world, the Chinese are interested in their health and wellbeing. Another trend helping NZMP is that consumers want to see a transparent supply chain. In some cases this can mean tracing the milk they drink right back to a farm. More regularly it is about knowing their milk comes from grass fed cows.

Fonterra is seeing a growing demand for paediatric dairy products in China. In effect this is an extension of the infant formula business where parents want their children to go on drinking milk as they grow.

Chinese consumers are also looking for medical dairy products. Wickham says Fonterra has recently introduced a fast-acting milk concentrate product. This helps with muscle recovery and works within two hours. It can be used after workouts, but is also given to people experiencing trauma or recovering from disease. It also helps the elderly.

Wickham says the gold standard for this kind of product has always been whey protein, but that's not popular because it has an unpleasant taste. Using milk gives it a better flavour and makes it easier to digest. It can be made into a drink or included in foods such as a protein bar.

This creativity is helping ensure Fonterra's China business continues to grow at a clip. Its food service business in China grew 48 per cent last year and has doubled in the past four years. Chinese dairy imports are expected to double again by 2020.

"The business is strong, it is growing and it will continue to grow and expand into new areas." says Wickham.

> As people and nation move up the GDP curve, they put more protein in their diet and one of the first proteins they choose is dairy.
> Kelvin Wickham

Fonterra is riding a trend which means it has the right product in the right place at the right time. He says: "The growing affluence and urbanisation in China helps. As people and nation move up the GDP curve, they put more protein in their diet and one of the first proteins they choose is dairy."

He says the numbers are huge: today Chinese consumers drink 1000 glasses of our milk every second.

This has led to a point where one out of every four Fonterra tankers on the road is collecting milk that will go to China. The country is Fonterra's number one market and accounts for about a quarter of its value.

Wickham says there is plenty of room left for growth. Though dairy is established on China's eastern seaboard, there is scope for it to reach people living in inland or secondary cities.

"At the moment the average Chinese person eats about 100 grams of dairy a year. In Western markets that number is around 2.6 kilograms", he says.

Fresh milk is another area where Fonterra can see considerable expansion. In January it launched a new fresh milk product in China. The company worked in partnership with Hema Fresh, an Alibaba offshoot that mixes traditional and online shopping.

Wickham says until now most milk sold in China has been the long life variety. Its name, Daily Fresh, reflects the difference. It is sold from refrigerated cabinets.

For now Fonterra and Hema Fresh sell their refrigerated milk in 14 stores in Shanghai and Suzhou. Freshness is a huge part of the product's appeal. The milk comes in 750ml bottles marked with the day of the week to emphasis their freshness. Each store is restocked overnight. The milk comes from Fonterra-owned farms in China.

Though volumes are modest for now — sales are around three tonnes a day — the plan is to scale up as Hema Fresh rolls out more stores across China. Fonterra says the business is part of a move upmarket as Chinese consumers become more sophisticated.

Wickham says the Daily Fresh project shows how Fonterra intends to progress with partnerships in China and elsewhere in the world.

He says business partnerships are often tested, sometimes to breaking point, and China is no different. Yet he continues to see huge value in the partnership model for Fonterra.

It means companies can bring different strengths to the relationship.

"NZMP is not a spot trader. We're looking for long-term partnerships. Some may involve equity, others are joint ventures. We may partner with companies in some areas and compete with them in others," he says.

Last year Fonterra's revenue from China was around $3.4 billion; it's earnings were $209 million — that's up 60 per cent on a year earlier.

During the year Fonterra's foodservice business, Anchor Food Professionals, passed the $2b annual revenue milestone. The target is for this to reach $5 billion by 2023.

Wickham says the business is important for Fonterra, as it means a move to high-value products and gives the business a more positive long-term outlook.

China Business

'roadblocks' in China

continued from E4

"To be absolutely respectful, they have dealt with all those issues very, very well. They recognise what we do with it, a lot of others don't, or haven't.

"We have to think what our responsibilities are. It's a privilege to operate in that market."

Wilson says the biggest gain is in the underlying milk price. "That's the biggest gain for our farmers, being able to sell to that market at scale. Shift volume off our farms in New Zealand of high quality ingredients.

"That's what this entire discussion actually underwrites, and over time, maybe our lifetime, maybe not, it will be an entirely different product that's sold up there, and that's the direction of travel, but this stuff takes time."

Turning round Beingmate

Fonterra has an 18.8 per cent stake in Beingmate and just two directors on the Chinese company's board. This gives it influence but not control.

Fonterra directors Simon Israel and Clinton Dines — who Wilson says is experienced not only in China but also in when things don't go well in China — have been deputed to assist.

Wilson concedes there are always a few risks when investing with a very successful entrepreneur with a very successful business as to what happens next.

Spierings and Xie formed a strategic committee after Fonterra made its investment. Spierings says there were initially very good and solid discussions.

"But it is difficult to convince a founder who has created massive success with his recipe that the cook or the chef has to change the recipe, when that's being told by a Dutchman working for a Kiwi company.

"So that's not an easy conversation to have. But that realisation is definitely there at the moment when the company's almost in distress.

"Because we all have a like interest to protect our value."

Spierings explains the relationship with Beingmate was formed because "Sam was a key customer for us and growing fast. At that point the relationship naturally was good and the strategic partnership was quite clear. But when the market shifted, we had to really embrace change in a drastic way. His and my opinions started to differ.

"So, the biggest shift in my opinion is the acceptance that the change needs to happen quickly; that management capability needs to be added very quickly, because he is also aware that there is another shift, to omnichannel. And he is clearly saying to us right now, 'I should not lead this transformation'."

Both Wilson and Spierings are convinced the initial decision to invest in Beingmate remains the right one. They point out that in 2013, Beingmate was the leading local infant nutrition brand and its founding shareholder had been crowned Entrepreneur of the Year.

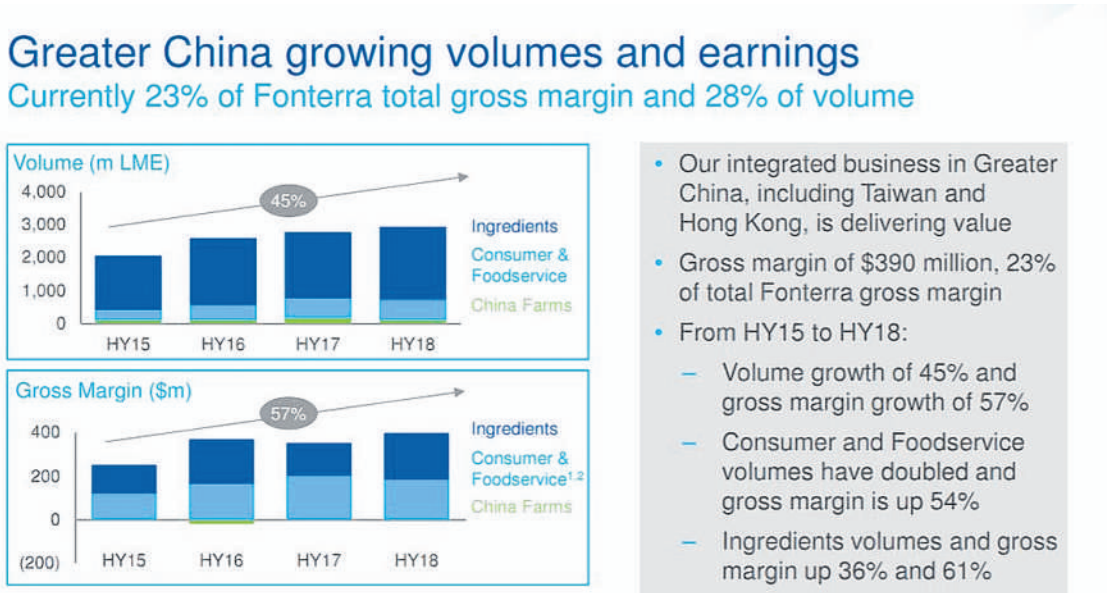
But they have learnt a valuable lesson — that China evolves very quickly. "Having 18.8 per cent in a publicly-listed company in China with regulations increasing pretty quickly is not the easiest, to say it mildly," says Spierings.

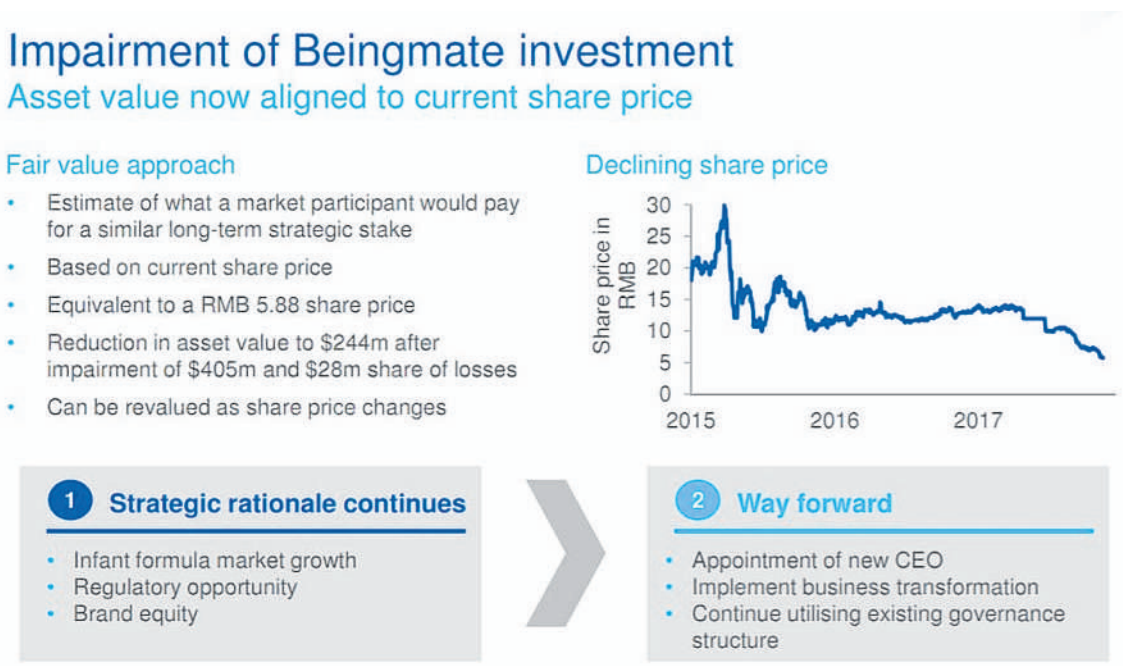
"The other learning is really that the market changed so quickly away from sales in normal retail. The kind of stores that were full of people three years ago now are empty.

"So the market has shifted.

"The channels have shifted to e-commerce very rapidly, and if there's a management and a founder who is not recognising that shift early enough . . . that's a learning that with 18.8 per cent these changes are not made easily.

"Now, the situation is what it is, and these discussions are much better and are accepted. So, we definitely have learned."





Source: Fonterra

New opportunities

The focus on the Beingmate debacle should not obscure the relative success of Fonterra's other China businesses.

But what excites the Fonterra duo is the new opportunities to forge a partnership with Alibaba, for example, to leverage omni channels.

Wilson points to the ability to use milk produced by Fonterra's China farms to sell into the developing "super fresh" market.

Then there are the ingredients and foodservice businesses.

"Because of the sheer scale of what we do, we're always attempting to think well out into the distance and having to invest accordingly," says Wilson.

"None of us like to be in the position that we are at the moment with Beingmate but those other key strategic and tactical investments are really starting to pay dividends.

"The only way that we can have the sort of conversations that we are having with the likes of Starbucks and Alibaba to really accelerate is because we have 400 million litres of milk — probably the finest fresh milk in China," he explains.

"To build a 35,000-cow, highly efficient, dairy farming enterprise in China, takes time. If you talk to the very best New Zealand dairy farmer and ask them how long it takes them to build a dairy farm down the road in Canterbury or Southland or Central Waikato, it takes time.

"And we've done this in China. And that now gives us a footprint to do a whole lot of other things to support our business out of New Zealand, and that's important."

Spierings is excited by the visionary stuff — "to go super-fresh".

"What we can do extremely well in China is we can milk a cow. And if we have a factory or a box factory close by, we could be having that milk in bottles in four hours.

"If you can have it with the consumer in, let's say 24 hours, and, you have daily fresh milk with seven-day bottles, then you have a maximum 48 hours cold milk. So, super-fresh and super-safe. I don't think there's anybody else that can do that.

"And then 400 million litres sounds like a lot of milk, but it's not."

Spierings says the Chinese are highly demanding when it comes to fresh food, seafood and meat.

"Nowhere else in the world would you have the super fresh concept."

"It's expensive to ship water, fresh air, and packaging from New Zealand to the world. That will always be our constraint," he adds.

"We're shifting fresh milk into that market, and, you can see us being a lot more enthusiastic about what we're doing with Alibaba with fresh milk from our farms out there. It's hard to do.

"The point is right now we have multiple touch points. We have created the Behavioural Hub. There is Alibaba's interest in blockchain development. And the interest in the fresh milk."

Spierings says he is now talking with Alibaba CEO Daniel Zhang about taking a holistic approach to the two big companies doing stuff together. "He is extremely interested and was blown away when I actually explained what we're doing, especially in the innovative field. We're moving extremely fast."

Wilson says in the meantime the noise over Beingmate is not helpful.

"We enjoy a number one reputation in China in dairy which is an extraordinary privilege to hold. But it gets knocked around a little bit and it tends to happen from here, rather than up there.

"That's our reality."

China Business

A resilient transformation

China Business
Bin Liu

According to the 19th National Congress of the CPC and the Central Economic Work Conference, "improving the quality of economic growth" will become an important focus of China's macro policy in 2018.

In light of this requirement, China is expected to maintain its prudent, neutral and somewhat tight monetary policy. The central bank will stabilise the liquidity by "cutting the peak to fill up the valley", and may pursue a targeted easing policy for small and micro enterprises and agriculture, countryside and farmers.

Its fiscal policy will focus on targeted poverty alleviation, environmental protection and revitalising idle fiscal funds, so as to realise more efficient resources allocation.

In the real estate market, it will continue adopting differentiated control policies.

According to the policy that "housing is for living in, not for speculation", real estate policy is unlikely to be loosened in 2018. However, developing multi-tier housing leasing market and building a market-oriented housing leasing mode will be greatly supported and encouraged by the Government, and a breakthrough will be made in pilot projects including same rights for leasing and sales, common property rights and house property tax reform.

The country will continue its financial opening-up, including lowering market access thresholds for foreign investors and furthering capital account liberalisation — though the move will be taken realistically and cautiously.

GDP growth is estimated to reach around 6.7 per cent in 2018, down slightly from the previous year, but the quality of economic growth is expected to improve. The growth of investment will remain stable due to the restraint of fund sources of infrastructure investment, though consumption will maintain a growth of more than 10 per cent.

A newly opened upscale mall in Beijing: the CPI grew 1.6 per cent year-on-year in 2017.

The growth rate of exports might be lower than that in 2017, due to the big base and possible slowdown of overseas direct investment.

The policy of "prevention of financial risks" and "deleveraging" sets the tone of a tight balance of liquidity.

New rules on asset management will be released in 2018, making it possible that liquidity will become tight temporarily.

With that, and the central bank's possible passive interest rate rise in 2018, market interest rates will remain volatile and are likely to go up at certain times. However, market interest rates are less likely to rise sharply, since the central bank's money market operations have become more forward-looking and accurate, and the co-ordination of regulatory policies has been enhanced after the establishment of the Financial Stability and Development Committee.

Exchange rates of RMB against USD are expected to fluctuate within the range of 6.50-6.75 in 2018. This is due to the expectation that China's economic stability will lay the foundation for RMB stability, and the possible negative impact on the United States' economy and treasury in the short term because of the US exit from QE policy and the Trump administration's tax reform.

Higher than expected

China reported a higher-than-expected economic growth in 2017, thanks to the higher contribution of net exports.

GDP grew 6.9 per cent year-on-year, higher than most economists' forecasts of 6.8 per cent, indicating visible economic recovery.

Judging from the three driving forces of the economic growth, stable consumption was the biggest contributor to GDP, accounting for 58.8 per cent; contribution of net exports to GDP rose from 6.8 per cent in 2016 to 9.1 per cent in 2017, becoming a critical factor for the higher-than-expected economic growth.

Infrastructure investment played a role of stabilising growth — investment in infrastructure, real estate and manufacturing grew 14.9 per cent, 7.0 per cent and 4.8 per cent respectively in comparison with the previous year.

Optimised structure

In 2017, the new momentum of Chinese economy was experiencing a critical transformation from quantitative change to qualitative change. The value added in nine new economic industries — including energy saving and environmental protection, new-generation IT and information services and new materials — accounted for approximately one-third of GDP.

New business models have emerged in the information, rural, and green economies, including cross-border e-business, smart city and remote education and telemedicine. The value added in high-tech and equipment manufacturing industries rose 13.4 per cent and 11.3 per cent year-on-year respectively.

Financial deleveraging

Liquidity was tight on the whole, and the mean of market interest rates went up. The amount of base currency kept dropping in 2017, but the central bank did not cut the reserve requirement ratio, indicating a clear policy orientation of the central bank to maintain a tight monetary balance.

M2 (broad money) growth has been slowing since early 2017, with a balance of RMB167.7 trillion at the end of December, a year-on-year increase of 8.2 per cent and 3.1 percentage points lower than the growth of the previous year. The mean of market interest rates continuously went up while liquidity tended to be tight. The daily average interest rate of seven-day collateralised repurchase agreement in the interbank market rose from 2.55 per cent in 2016 to 3.35 per cent in 2017.

RMB gains

RMB appreciated against USD, easing the pressure of capital outflow temporarily. In 2017, the central parity rate and spot rate of RMB against USD appreciated 6.2 per cent and 6.7 per cent respectively.

With the appreciation of RMB against USD, China's pressure of outflow of funds declined. This was consistent with the data of foreign exchange reserves: as at the end of December, China's foreign exchange reserves stood at USD$3.14 trillion, increasing month-by-month through the year.

Strong consumption

In 2017, the Consumer Price Index (CPI) grew 1.6 per cent year-on-year, with this growth fluctuating within a small band of 2 per cent since February.

The Producer Price Index (PPI) rose 4.9 per cent year-on-year, turning around a negative growth and maintaining its growth momentum since the beginning of 2017. However, it started to decline after reaching a peak of 7.4 per cent in March, due to the loss of momentum of raw material price hike caused by the de-capacity policy.

The year-on-year growth rate of Purchasing Price Index of Raw Material, Fuel and Power exceeded that of PPI, but the difference between the growth rates tended to decrease in 2017, suggesting an improvement in the operating status of industrial enterprises. Gross profits of industrial enterprises grew 21.9 per cent from January to November 2017, up 12.5 per cent year-on-year.

Bin Liu is deputy general manager ICBC New Zealand

Words matter — and so does trade

Todd McClay

New Zealand's economic relationship with China has grown since the NZ-China Free Trade Agreement (FTA) was signed in 2008, almost as quickly as the mutual respect that has developed between our two nations.

That the two-way trade is nearing $27 billion and is responsible for thousands of Kiwi jobs speaks volumes for the ongoing importance we must place on this relationship.

Trade flows remain remarkably balanced for two countries whose economies are of such different size. This is not by chance, but a direct result of successive governments, officials and particularly Foreign Affairs and Trade Ministers regularly visiting China, to secure opportunities for Kiwi exporters. It's a valuable relationship we must nurture and maintain. To not do so would be to the detriment of our relevance in Asia, our economy, and to the livelihoods of New Zealanders.

We share a considerable number of firsts with China. It was impressed on me just how important this is during my many visits as Trade Minister. The first to agree China's membership of the WTO, first to recognise China as a market economy, the first country to conclude a Free Trade Agreement, the first developed nation to become a member of the Asian Infrastructure Investment Bank — and now the first to launch an FTA upgrade.

We must strive to add two more firsts to this list — the first to successfully conclude an upgrade of an FTA, and a first visit to China by our Foreign Minister — on behalf of the Coalition Government.

The FTA upgrade launch was not always certain, and nor is its successful conclusion. A number of significant challenges were worked through prior to my meeting with then Minister of Commerce, Gao Hucheng at Apec in Peru in 2016.

Many hours of work were put in before our announcement that negotiations could commence.

The mutual respect and trust that had been earned by successive New Zealand Trade Ministers in no small part laid the foundations for this announcement. It's important that the new Government puts aside any bias and continues to build on this trust if we are to achieve all we need to in the upgrade.

That China is large and we are small puts us at a disadvantage — that we are fair-minded and respectful proponents of a rules based trading system assists us greatly. As a parliamentary colleague often says "words have meaning". This is particularly true when Ministers speak of our international relationships. In fact when it comes to trade, "words have consequence".

> That China is large and we are small puts us at a disadvantage — that we are fair-minded and respectful proponents of a rules based trading system assists us greatly.

The FTA upgrade has the potential to push our economic relationship to a new level.

It will help us break the ceiling on the $30b two-way trade goal set by Prime Minister John Key and President Xi Jinping 2014. It can ensure New Zealand exporters remain competitive against those who seek to replace us in the Chinese marketplace. It must offer us privilege and advantage over those who are yet to achieve the same trade status.

More than that, it can become another first that helps keep a small trading nation relevant to the world's second largest economy.

So what's up for grabs? On our side we must achieve certainty around market access and further tariff liberalisation. Though much was achieved in the original FTA, in a number of areas Australia now has a better deal, particularly in dairy. This must be addressed.

Of growing importance are clear rules and procedures to deal with non-tariff barriers. NTBs are a great frustration for business, with all countries we sell to. The upgrade allows us to achieve a win for New Zealand producers in the Chinese market and add real value to our Chinese trade.

We must also deliver a clear and concise framework to enhance e-commerce. The China FTA was concluded before the sheer might of e-commerce was contemplated. Good rules and an enabling environment will mean every Kiwi can share in the benefits of free trade through the internet.

China can be expected to push for better access for investment and labour. The revised TPP has doubled the OIO investment threshold from $100m to $200m for China under a most favoured nation clause, but this has already been banked. Given the importance of China to the economy you can expect this will be a hot topic for negotiation.

So too will be access for temporary labour. It is a demand they have made of others and it is likely to be a demand they will make of us.

The stakes are high, there's much to gain. Words do matter, but don't they always?

● *Todd McClay is National Party Foreign Affairs and Trade Spokesman*

China Business

Xi moves China towards softer landing

China Business
Liam Dann

The risk of a hard landing for the Chinese economy doesn't seem to be worrying economic commentators the way it used to.

A few years ago there was a great deal of debate about whether the powers in Beijing could engineer the rebalancing of the economy — from a rapid growth, export focus to slower higher quality growth, led by consumer consumption.

In fact, it was dubbed *the great rebalancing* and the goals and targets were widely embraced by the public in China with typically patriotic zeal.

But with its high levels of corporate and local government debt, a building and infrastructure boom of historic proportions and vast manufacturing sector in full flight it was hard for many Western commentators — including myself — to understand how the transition could be achieved without some kind of financial crash — perhaps a property or equity market meltdown.

Now, Beijing appears to be in greater control of the economy than many in the West expected.

Of course the reality is that Beijing appears to be in greater control of everything.

For those who were hoping to see an ongoing transformation towards liberal democracy, this is worrying.

As was made very clear at the National People's Congress earlier this month, there has been a centralisation of power back to Beijing — and specifically to one man, President Xi Jinping.

The biggest change — and the one that got the most attention in the West — was the one that effectively allowed President Xi to extend his term in office indefinitely.

But other big changes included the merger of numerous ministries and regulatory bodies, including China Banking Regulatory Commission combining with the China Insurance Regulatory Commission.

There were also many more subtle changes to wording and meanings within the constitution.

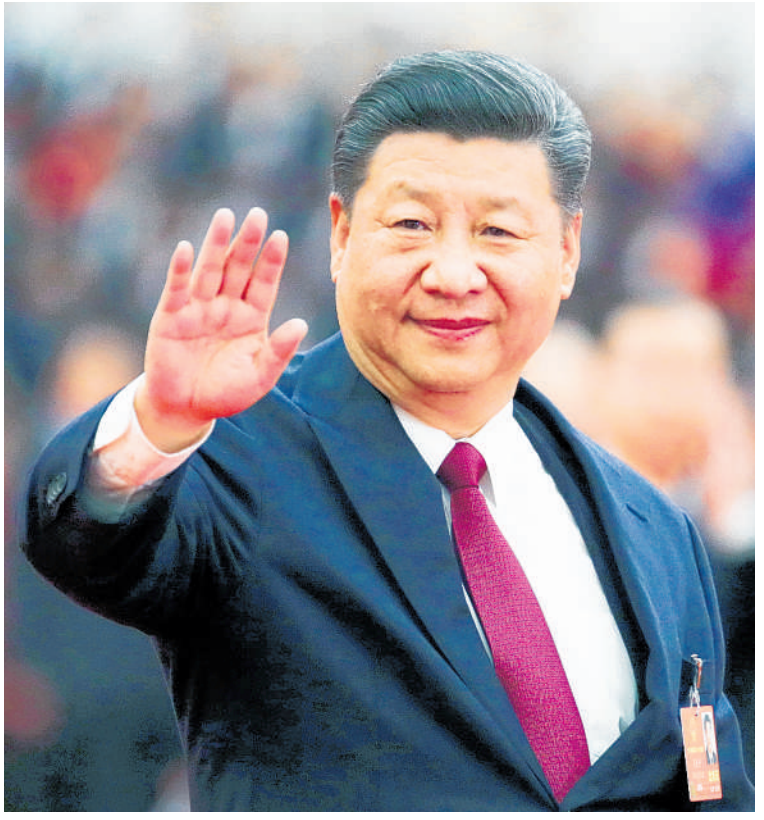
Their approval this month brings to the surface a trend which has been under way for some time.

To be fair, some Western journalists and academics operating inside China have been quietly noting the expansion of Xi's power for several years.

Beijing based US economist Michael Pettis was one of the first to pick up on the strategy and recognise its importance to the process of economic rebalancing.

Pettis, a professor of finance at Peking University's Guanghua School of Management, wrote last year that Xi's strong man act may be the only logical way for China to rebalance without a calamitous debt crisis.

"China does not really need a more liberalised economy, doesn't need to eliminate capital control. It does not need a larger degree of market role in the decision-making process. What it needs is a significant transfer of wealth, and for that we need to centralise the decision-making process," he told the *South China Morning Post*.



Power is now centralised in one man — President Xi Jinping

Pettis argues that, putting aside the politics, and from a purely economic point of view, the reforms China needs require strong leadership over an extended period.

"My big fear if he didn't have a third term is that he would be really reluctant to implement the reforms during this term because there's almost no way you can do so without slowing the economy for many, many years," Pettis said.

"So there's no way he could've really reformed sufficiently without leaving 2022 in a pretty bad state."

Pettis had for many years warned that China was at risk of a debt fuelled meltdown.

From a Western perspective it looked like a gloomy prognosis — because it was hard to see how an increasingly liberalising economy could reign in spending and production and rebalance.

But with Xi firmly in control Beijing has enhanced its ability to direct spending and borrowing and control production. Pettis believes it will avoid that hard landing.

This hypothesis raises difficult diplomatic questions for New Zealand.

Clearly, with New Zealand exports to China worth about $12 billion last year — plus billions more in Chinese direct investment — the last thing our economy needs is for our largest trading partner to suffer a financial crisis.

China's economy will overtake Europe this year if everything goes to plan. And let's face it, in China it usually does.

Bloomberg data shows China's gross domestic product is forecast to reach about US$13.2 trillion in 2018, beating the US$12.8 trillion combined total of the 19 countries using the euro.

So we are positioned to benefit from Xi's success.

But as Chinese interest in this part of the world grows — with New Zealand enthusiastically tacked on the end of *The Belt and Road* — we may have to learn to make sure our political voice is more clearly heard.

● *Liam Dann is the Herald's Business Editor-at-large*

Together we take to you more of China

Flying non-stop from Auckland to Beijing and Shanghai on the 787-9 Dreamliner

Book through your preferred travel agent
airnewzealand.co.nz | airchina.nz

A STAR ALLIANCE MEMBER

China Business

Payment giants battling the banks

Tim McCready

Tencent is probably most well-known around the world for WeChat – which has transitioned from being an instant messaging system to more of an ecosystem and way of life in China. WeChat is used for everything from chat and games to paying bills, ordering a taxi, booking doctor's appointments, and filing police reports.

Government policy dictates WeChat users register with their real names, and a pilot programme by WeChat has seen virtual ID cards launched through the platform, which serve the same purpose as traditional state-issued ID cards.

The platform has more than one billion monthly active users; 400 million use its payment system Tenpay (which includes WeChat Pay). Alibaba's Alipay, run by Ant Financial, has 520 million users.

The transaction figures are astounding. Between those two major players, they control nine out of every 10 renminbi of the US$5.5 trillion (NZ$7.6t) spent by Chinese consumers on mobile payment platforms – and both have lofty ambitions to move beyond China.

China's payment companies have begun expanding into global markets. Alipay and TenPay chose to first introduce their payment facilities in popular destinations for China's increasingly affluent and digital-savvy travellers – South Korea, Japan, and Thailand.

The World Tourism Organisation estimates Chinese tourists spent US$261b abroad in 2016. Retailers and service providers taking up the payment systems are hoping to entice Chinese shoppers to spend their renminbi with them.

Finland is an increasingly popular destination for Chinese tourists, and

The Chinese use Alipay more than credit cards. They trust it and know how it works.

Justin Watson
Christchurch Airport

became the first country to offer Chinese tourists an entirely cashless experience when they visit. Partnering with Finnish payment platform ePassi and tourism group Visit Finland, Alipay introduced the "Smart Travel" initiative to connect local businesses with Chinese travellers at every point during their visit. Shopping, services, activities and experiences can be paid for using Alipay – even receiving duty-free refunds at the airport.

Last year Christchurch Airport signed a memorandum of understanding with Alibaba, agreeing to promote Alipay in the South Island, and in the past month Smartpay announced a partnership with Alipay that will see Alipay capabilities rolled out to Eftpos and credit card terminals for up to 25,000 merchants.

Alipay Australia New Zealand's managing director George Lawson says Alibaba now partners with approximately 2000 merchants here and expects this to grow dramatically.

"The recent Smartpay announcement will drive a lot of this growth as it gives Alipay access to tens of thousands of merchants with one software update. This is very exciting as it makes it much easier to accept Alipay with existing terminals."

Increased use of Alipay in New Zealand means Chinese visitors can more easily find, rate, and pay for goods and services using their mobile phone app, providing a platform for Kiwi businesses to promote themselves and form a relationship with tourists before, during, and after they visit.

More than 400,000 Chinese visit New Zealand each year, and spend around $1.7b per year. MBIE estimates this figure will grow to $4.3b by 2023, and as independent travel grows in popularity the scale of the opportunity for business is clear.

Christchurch Airport's Chief Aeronautical and Commercial Offer Justin Watson believes making the payment process easy and familiar will benefit businesses that take up the technology.

"The Chinese use Alipay more than credit cards," he says. "They trust it and know how it works; our Chinese guests are more likely to spend with a business that offers Alipay than one that doesn't."

Lawson agrees: "The Alipay brand is a beacon for Chinese tourists as they are familiar with it, receive the best exchange rates and it reduces anxiety associated with dealing with another currency. It also breaks down language barriers."

Though these payment services are initially targeting Chinese tourists, they are hoping to rub off on China's growing diaspora – and ultimately more widely – encouraging locals to make use of mobile payments.

To support this ambitious growth strategy, Alibaba and Tencent are quickly expanding their presence outside China through partnerships and investments in global brands and foreign payment networks.

Tencent has acquired a stake in over 15 foreign companies at a cost of US$4.3b, including 10 per cent in Snap (the parent company of social media craze Snapchat) and 5 per cent in Telsa.

Tencent's music unit recently exchanged equity stakes of just under 10 percent with Spotify.

Alibaba has also been investing globally over the past few years, including Southeast Asian e-commerce company Lazada, India's largest online food and grocery store BigBasket, and Indian payment app Paytm.

Analysts say these investments are made for a variety of reasons: to help Alibaba and Tencent capture data and gain intel from market leaders, to export what they have learned from their operations in China to other countries, and in some cases to encourage customers in global markets to use their online payment system, cloud services, and other infrastructure.

Cracking the global payment system will lay the foundation to provide other services, including insurance, loans, and investment offerings.

Despite this growth in acquisitions, the US is starting to hit back at China's expansion. Ant Financial made a US$1.2b move to acquire MoneyGram – an American money transfer company with around 350,000 remittance locations in over 200 countries.

This takeover was under a year-long regulatory review as questions were raised over customer data and privacy.

In January, the US Committee on Foreign Investment – a multi-agency government panel – scuppered the deal over national security concerns.

This has been the most high-profile Chinese deal to be axed by the Trump administration to date – occurring despite Alibaba's founder and executive chairman Jack Ma wooing then-US President-elect Donald Trump prior to his inauguration with a promise to bring a million jobs to the US.

Piyush Gupta, chief executive of Singapore's DBS bank, also recognises Alibaba and Tencent as among the bank's biggest competitors and considers their rapid rise in China a salient reminder of the disruption that can occur if banks don't react swiftly to innovation.

Gupta told McKinsey that it is not enough to apply digital "lipstick".

"In 2013, the DBS board therefore took the view that the future for us and for our industry would have to be digital. We felt that if we didn't lead the charge, frankly, we might die," he says.

DBS recently launched its mobile-only bank to take on China's e-banking giants. The bank is using the service as a strategic tool to strengthen its presence in emerging Asean markets – where the World Bank estimates 264 million people do not have access to banking facilities, and just 30 per cent of adults have debit cards.

The opportunity is significant, and the race to cash in is well and truly under way.

China Business

Putting trust in blockchain

As Chinese consumers place a premium on food safety, a technological tool is providing the answer

China Business
Gabriel James

Kiwi companies are developing and using cutting-edge technologies to ensure their food products are trusted within a discerning Chinese market where millennials are extensively researching brands before making purchases.

China has been beset by multiple food scandals in the past. But today's middle class Chinese consumers are increasingly putting a premium on the safety and provenance of food, traceability and premium brands.

New Zealand companies are at the forefront in tackling these challenges.

In April 2017, Alibaba and PwC signed a memorandum of understanding with Fonterra, Blackmores, NZ Post and Australia Post to create a global traceability framework for food and brand protection to give consumers further confidence when purchasing food products online.

AsureQuality and PwC had earlier inked a deal with COFCO, China's largest agricultural and food products supplier, to embed best practice in food safety and quality across the Chinese food and agriculture industries.

Fonterra's Tim Kirk says the memorandum of understanding looks at various technologies, of which blockchain is one.

"We're in the final stages of pulling that together," says Kirk, who is GM — Food Safety, Quality and Regulatory at the dairy co-operative. "The outcome is commercially sensitive across the partners. Once the body of work is concluded, the next stage is for Alibaba to explore the commercial feasibility of the solutions.

"There then needs to be the piloting of one or any of the solutions and an implementation plan around the chosen solution, which partners will move forward."

Kirk confirmed the core foundation group might be extended to more partner groups. "It's about commercial feasibility, implementation planning and moving forward with the partners."

He stressed blockchain is an emerging technology with the potential to transform New Zealand's digital economy. "It's centred around trust, and authenticating data. There are a number of providers for blockchain technologies — it's somewhat of an endless list.

"There is a lot of global interest around blockchain. We're all assessing the technology, running pilots, seeing what the capability of blockchain can and cannot deliver; what are its limitations, what are its constraints, how easy is it to adopt, and ultimately, how does it improve our experience and our consumers' experience, and how does it deliver trust. Trust is extremely hard to build, but very easy to lose.

"Personally, I think there needs to be some sort of global standard, or at least a global agreement, over how blockchain needs to be formatted and what its construct is. I think until we get to that point it is going to be hard to implement blockchain solutions at a global commercial scale."

Blockchain may well be in its infancy, as Kirk points out, but it is fast developing as a technology in this area.

China's second largest ecommerce player, JD.com, has made several announcements on food quality and safety using blockchains.

Last December, the Blockchain Food Safety Alliance was established between JD.com Walmart, IBM and Tsinghua University to enhance food tracking, traceability and safety in China.

In February, JD.com announced a new accelerator focused on blockchain startups to develop technologies for supply chains.

And in March, an InterAgri Partnership was formed to ramp up Australian exports into China of Pure Black Natural Angus Beef, leveraging the Blockchain Food Safety Alliance.

"For Chinese consumers, one of the most important things they are buying when they purchase Australian and New Zealand products, is an assurance they can have confidence in the products," says Josh Gartner, Vice President of International Corporate Affairs at JD.com.

"For Australian and New Zealand products that is particularly important, because if they're not 100 per cent sure that they're getting the quality that they're paying for, then what's the point of buying those products?"

Gartner says JD.com is looking at multiple tracks and multiple uses for blockchain. "You've seen the partnership we have with IBM and Walmart and that's focused very much on food quality and is a much more mature technology.

"We're also looking at helping smaller companies get into the blockchain game. I think there are a lot of potential uses for it and that's what the accelerator is about.

"So far, we've looked at fresh products with blockchain, but I think we want to look at every type of product. Obviously, there have been safety scandals in China — where their products are coming from, whether that's beef or even something like toothpaste."

Gartner says the company has partnerships with New Zealand firms and the agricultural sector. "In terms of the supply chain going into China, we're definitely keen and very eager to expand co-operation in the blockchain area, which I think will give consumers the confidence in those products and boost demand.

"Blockchain technologies for food traceability can really make a huge difference for New Zealand and Australian farmers."

At Milk New Zealand — which now has substantial investment from Alibaba and its founder Jack Ma's venture fund — managing director Terry Lee points out that China's supply chains have become much more efficient, with less wastage. Middle-class consumers have more purchasing power and there is an emphasis on fresh products.

"Previously, New Zealand fresh products like fresh milk and fresh yoghurt were too expensive for the Chinese market. But the middle-class can now afford these products because incomes have come up over the past two years," says Lee.

The company now delivers fresh milk in 72 hours from the paddock in New Zealand to the supermarket shelf in China. The fresh milk has a shelf life in China of 10 days.

About 6000 to 10,000 litres per week of fresh milk are being exported,

Milk New Zealand also exports nutritional milk power and UHT milk to China.

Three kiosks in New Zealand supply Milk New Zealand Fresh Milk to the local market at a retail price of $2.40 per 1L bottle. But a 1L bottle of the fresh milk retails in China for 79 yuan ($17.29).

"In New Zealand we are a big dairy country and our dairy products are commodities," observes Lee. "The Chinese consumer can now pay for consumer dairy products, but we are not ready for that. Processing facilities are designed for the local consumer market, but not for export in terms of the packaging, the research and development, and the capacity."

Lee reckons the Chinese market offers very good opportunities for New Zealand dairy processing companies to make premium products with good margins. Companies like Alibaba — which is the largest online channel with about 70 per cent of the Chinese e-commerce market — have also invested heavily in the supply chain and efficiency has improved dramatically, with low wastage and improved customer experience.

Milk New Zealand is also developing a trust system through its relationship with China Certification and Inspection Group (CCIC) laboratories in New Zealand. (CCIC is the Chinese regulatory quality testing agency).

Theland Farm Fresh Milk is the first fresh milk product to be exported to China without bureaucratic problems because of the new working methods and an established trust system using QR Code technology and the CCIC testing laboratory

Alibaba also has an offline channel (through majority shareholding investments in supermarket chains) which will sell the New Zealand product. "This model will attract a lot of suppliers like Milk New Zealand to bring more and better products into the supply chain," says Lee.

"Another benefit from the new retail is to get recommendations from suppliers to say this is the right product for the family, this is the best package for you. For us, this is accurate brand, product and sales promotions."

Milk New Zealand is the first customer of AsureQuality to adopt their QR code system to trace the provenance of Theland Farm Fresh Milk products exported to China. .

Lee says Milk New Zealand has not adopted blockchain technologies for food traceability. It is waiting for Fonterra and Alibaba to trial the technology.

The use of traceability and blockchain is not confined to the dairy industry. JD.com's Gartner highlights two additional factors: "Because of our business model, there we do a lot of direct sales; when we work directly with suppliers and brands, we have big flexibility in that supply chain and it is easier for us to implement some of these technologies and make sure we have visibility all the way to the farms.

"We've mainly talked about agricultural products. I think there a wide range of other products that this applicable to like every day consumer goods like New Zealand wines because there's been an issue of counterfeit wines in the market. It's just something people don't generally think of first."

Clockwise: Alibaba founder Jack Ma tries his hand at milking on a visit to NZ; Tim Kirk; Josh Gartner.

TECHNOLOGIES PROTECTING SUPPLY CHAINS

Established technologies
Producers and manufacturers provide tamper-evident packaging on products for consumers to visibly detect product tampering. Overt and covert technologies are used to protect brands from counterfeiting; QR codes on packaging provide links to websites for product traceability. This can include full electronic traceability from raw source on-farm through every stage of manufacturing and the ingredients in each product.

Emerging technologies
QR codes on packaging linking to blockchain ledgers for entire supply chain traceability and audibility. Today these are mostly private blockchains; in the future, public and hybrid blockchains are expected to integrate the global supply chain. QR codes inside food linking to websites that validate the authenticity of the food or ingredients using biosensors. Virtual reality environments enabling consumers to interact from farm to manufacturer for consumer visibility and building trust and loyalty.

What is Blockchain
Blockchains are chains of information blocks cryptographically linked to create a permanent ledger. Blockchains are distributed across multiple computers using consensus mechanisms so the ledgers cannot be modified.

Creating a new ecosystem

Kiwi blockchain company Centrality has announced a major deal with Wanda Internet Technology Group to create an ecosystem connecting consumers, retailers and other aspects. The first phase of the co-operation is mainly technical integration of the public-private technology PL^G of Centrality into the Wanda Group.

"Wanda have an interesting business; a lot of people don't know necessarily who they are. But they own Legendary Pictures and have an involvement with the New Zealand film industry through Hoyts," says Aaron McDonald, CEO and co-founder of Centrality.

Wanda has been active in blockchain development and joined the Linux Foundations Hyperledger project in 2016.

McDonald says the strategic alliance is a natural fit for Wanda because of Centrality's focus on mass-market consumer experiences.

"They've got all these different retail channels and all these different experiences — 350 million consumers touch their products on a regular basis," says McDonald.

> We're a little Kiwi company exporting to one of the biggest businesses in that market.

"There's 100 5-star hotels. They serve food. That food comes from somewhere. People who eat there want to know where that food comes from, so that's an obvious case. You have 300 malls selling products, same type of thing."

Centrality has quite a big Chinese team. "Probably 25 per cent of our developers are New Zealanders with Chinese parents or have recently emigrated to New Zealand. So we've got a good internal Chinese community and they have relationships in China and in the case of Wanda," says McDonald.

Wanda Internet Technology is a tech spin-off from giant Chinese Conglomerate Dalian Wanda Group, which was ranked 380th on the Fortune Global 500 list in 2017 with revenue of US$28.45 billion and assets of US $152.7b.

Centrality is a blockchain venture studio partnering with industry to create a marketplace of blockchain applications. The venture now employs 75 staff in Auckland and is the first blockchain company Callaghan Innovation has got behind through an R&D Growth Grant worth 20 per cent of eligible R&D expenditure, capped at $5m per annum.

So far, the start-up has raised US$160m through three token sales in the past six months (despite the cryptocurrency markets being down since December).

"This is the cool thing about it," says McDonald. "We're a little Kiwi company exporting to one of the biggest businesses in that market at a relatively early stage in our development."

China Business

Blurring online with

Tim McCready visited Alibaba's supermarket chain Hema, to understand what the future of retail has in store.

Hema's supermarkets are more reminiscent of department stores.

Alibaba's ambition is to blur the boundary between shopping online and offline – so much so that last year's Double 11 shopping festival was themed around it.

Nothing showcases this "new retail" convergence of bricks and mortar retailers with online shopping better than Alibaba's new Hema supermarkets. They offer a fascinating insight into where the company is heading, and, for those of us living outside China, a peek into what the future of retail shopping might look like.

Fresh focus

The first thing you notice when stepping into a Hema supermarket is how remarkably tidy it is. The store is reminiscent of walking into a high-end department store instead of a supermarket.

Alongside with cleanliness, Hema is rigorous about the freshness of its products. In order to keep stock moving quickly off the shelf, items are packaged in very small qualities – enough for a single meal or for a family (bearing in mind Chinese families tend to be small).

My visit to the Hema supermarket was on a Saturday, and all bags of salad were branded 'SATURDAY' – indicating they had arrived in-store that day. Fish, crabs and shellfish are kept alive in large tanks. Cartons of eggs are labelled to show they were laid less than 48 hours ago. Butchers prepare cuts of meat for display, fill packs with ready-to-cook family-sized portions, and perform cooking demonstrations.

Hema's app can be used by customers, allowing them to scan QR codes that accompany every product with their phone and receive details about the product, including its provenance, how to prepare it, and recipe ideas.

Prices are reasonable by New Zealand standards. A small pack of bok choy is 12.80RMB (NZ$2.81), a tray of Tim Tam's 19RMB ($4.16), and a pack of six Zespri golden kiwifruit sets you back 29.91RMB ($6.55).

The Hema stores include a dining area that encourages customers to "eat as you shop". Along with regular food-court cuisine, an in-store chef cooks up seafood that customers have hand-selected.

Dispatch

One of the most fascinating aspects of the Hema supermarket are the chains whirring high up in the ceiling, carrying green canvas bags across the supermarket like something out of Willy Wonka's chocolate factory.

This is all part of the secret behind Hema's ability to get products out the door quickly.

Hema's mobile app allows customers to browse the aisles of the supermarket from home and add items to a virtual shopping basket. If you live with a 3km radius of the store, they aim to have products delivered within 30 minutes of ordering – if you realise you're missing an ingredient for a recipe, it can be delivered before you finish cooking.

There are 25 Hema stores spread across seven Chinese cities: 14 in Shanghai, five in Beijing, two in Ningpo, and one each in Hangzhou, Shenzhen, Suzhou and Guiyang. Hema's rapid growth continues, with Alibaba expecting to open 30 new stores in Beijing by the end of the year, and expand into Fuzhou, Chengdu and Guangzhou – opening up rapid delivery of fresh produce to millions more customers.

Alibaba's use of smart logistics technology ensures the inventory inside your local store matches exactly with what is shown online – meaning all products are immediately available and ensure Hema's supply-chain management system runs efficiently.

The supermarket doubles as a warehouse, and dozens of packers (Alibaba calls them "order-fulfilment specialists") rush around each department armed with reusable shopping bags and scanners. When an order for home delivery is placed, they receive

continued on E11

NZ products selling well on 11:11

Tim McCready

Alibaba's 2017 11.11 Global Shopping Festival attracted a high demand for New Zealand brands.

The festival comes from Single's Day in China (the date is 11.11 – four singles) and is also known as Double 11 Day.

Over the 24-hour sale period, Alibaba Group reported RMB168.2 billion (NZ$36.81b) of transactions through Alibaba's retail marketplaces. As evidence for China's phenomenal uptake of mobile devices, mobile sales accounted for 90 per cent of the total sales figure. Alibaba now offers more than 400 New Zealand brands through its B2C platforms Tmall.com and Tmall Global.

Maggie Zhou, Alibaba's Managing Director of Alibaba Group Australia & New Zealand, says there is a rapidly increasing demand from Chinese consumers to source the highest quality products from all over the world. Brands from Australia and New Zealand have seen excellent sales figures during the shopping festival.

"Australia and New Zealand products are perceived as high quality and continue to outperform in China.

"We are working closely with New Zealand merchants and partners to further encourage this growth.

"When we launched Alibaba Group's Australia and New Zealand office earlier this year, one of our key goals was to show the outstanding performance of New Zealand brands in previous 11.11 Global Shopping Festivals," she says.

"We are thrilled New Zealand brands have continued to see success on the world stage, adding further proof of the growing appetite for high-quality New Zealand goods among Chinese consumers."

> Australia and New Zealand products are perceived as high quality and continue to outperform in China. We are working closely with New Zealand merchants and partners to further encourage this growth.
>
> Maggie Zhou

Zhou says Alibaba's Chinese shoppers are drawn to products from Downunder, particularly skincare, health supplements, and high-quality organic goods such as fruit and wine. Rapid improvements in logistics mean that fresh items such as beef, seafood and dairy are also becoming more sought after.

Some of the highest performing brands on the Chinese e-commerce giant during the shopping festival were ecostore and Antipodes.

"The opportunity for ecostore to expand its consumer base is significantly increased through sale days such as 11.11," says Pablo Kraus, managing director of ecostore.

"Chinese consumers are very sophisticated and their demand for an eco-friendly lifestyle continues to grow, so ecostore is honoured to be a brand that consumers choose for its reliability, authenticity, and being safe for all the family."

CEO and founder of skincare company Antipodes, Elizabeth Barbalich, says: "11.11 presents and amazing opportunity for us to raise awareness of Antipodes in the China market.

"The Chinese market is key for us, with traditional plant remedies long considered an essential part of Chinese medicinal and beauty practices."

Offshore companies that participate in the 11.11 Shopping Festival are required to store their products in Alibaba's warehouses ahead of time, so customers receive their products as soon as possible after purchasing.

After midnight marked the start of Double 11 Day, the first package was in the hands of the buyer 12 minutes later. "This delivery speed makes for a far better shopping experience," says Zhou.

offline

continued from E10

a list of those items that fall within their area of responsibility, scan the items, fill the basket, and place it on a hook attached to the conveyer belt system.

Items from various departments are collated in an area at the back of the supermarket and packaged — ready to go on the back of a motorbike and to the customer's door — or perhaps to their car in the nearby carpark, timed to coincide with when the customer's movie wraps up.

Alibaba says the first two years of Hema's operations have yielded promising results. Online purchases account for more than 50 per cent of total orders. For mature stores this number can be as high as 70 per cent.

By linking to a customer's Alibaba account, the Hema supermarket allows Alibaba to learn more about its shoppers. Collecting data on every move a customer makes means Alibaba can leverage shopping habits and product inquiries to hyper-optimise its offering.

Payment

The supermarkets run almost exclusively on cashless payment. Alibaba's Alipay technology uses facial recognition at self-service checkouts to identify the customer and charge their account.

Payment is made in seconds, and means the customer walks out with their goods without ever reaching for their wallet or a phone — let alone speaking to a real person.

I asked a shop assistant what happens if an elderly customer doesn't have a mobile phone or an Alipay account, or — as in my case — if a foreign tourist wanted to buy a bottle of water to rehydrate.

She was surprised by my question — mobile phones and AliPay have become so ubiquitous in China. But after checking with store management she was able to confirm there was a counter in the corner of the store that could accept cash.

The Future

In China, innovation and competition follows fast. Already this year, JD.com — one of the other major ecommerce players in China — has followed Alibaba's lead and opened its first bricks and mortar supermarket in Beijing.

Like Hema, JD's 7Fresh supermarket offers a mobile app, digital payments, and 30-minute delivery. It also offers smart shopping carts, which follow a shopper around while avoiding obstacles (and other customers). JD says it plans to open 1000 supermarkets in China over the next three to five years.

American ecommerce giant Amazon has recently opened Amazon Go — a supermarket with no checkouts — in Seattle earlier this year.

Instead, cameras and sensors identify customers and keep track of the items they select. Amazon calls this "grab-and-go" shopping, where customers can walk out of the store without any human interaction. They are emailed an electronic receipt as they leave.

If this convergence of innovation tells us anything, it's that those pesky "unexpected item in the bagging area" self-service machines — and the queues we all dread — could soon be a thing of the past.

● *Disclosure: Tim McCready was a guest of Alibaba in China.*

Fonterra partners for milk supply

Fonterra announced earlier this year that it has partnered with Alibaba's Hema, to supply a new Daily Fresh milk range to the supermarkets. The fresh milk comes in 750ml bottles, sourced directly from Fonterra's farm hub in China's Hebei province.

The New Zealand dairy giant says initial volumes of its fresh milk are around three metric tonnes a day, with plans to scale up over time and expand with Alibaba as it progresses its rapid expansion of stores across China.

In addition to fresh milk, Fonterra also offers Anchor UHT milk products and its range of butter, cream, and cheese products in Hema. The in-store bakery uses Fonterra's Anchor Food Professionals products in its items.

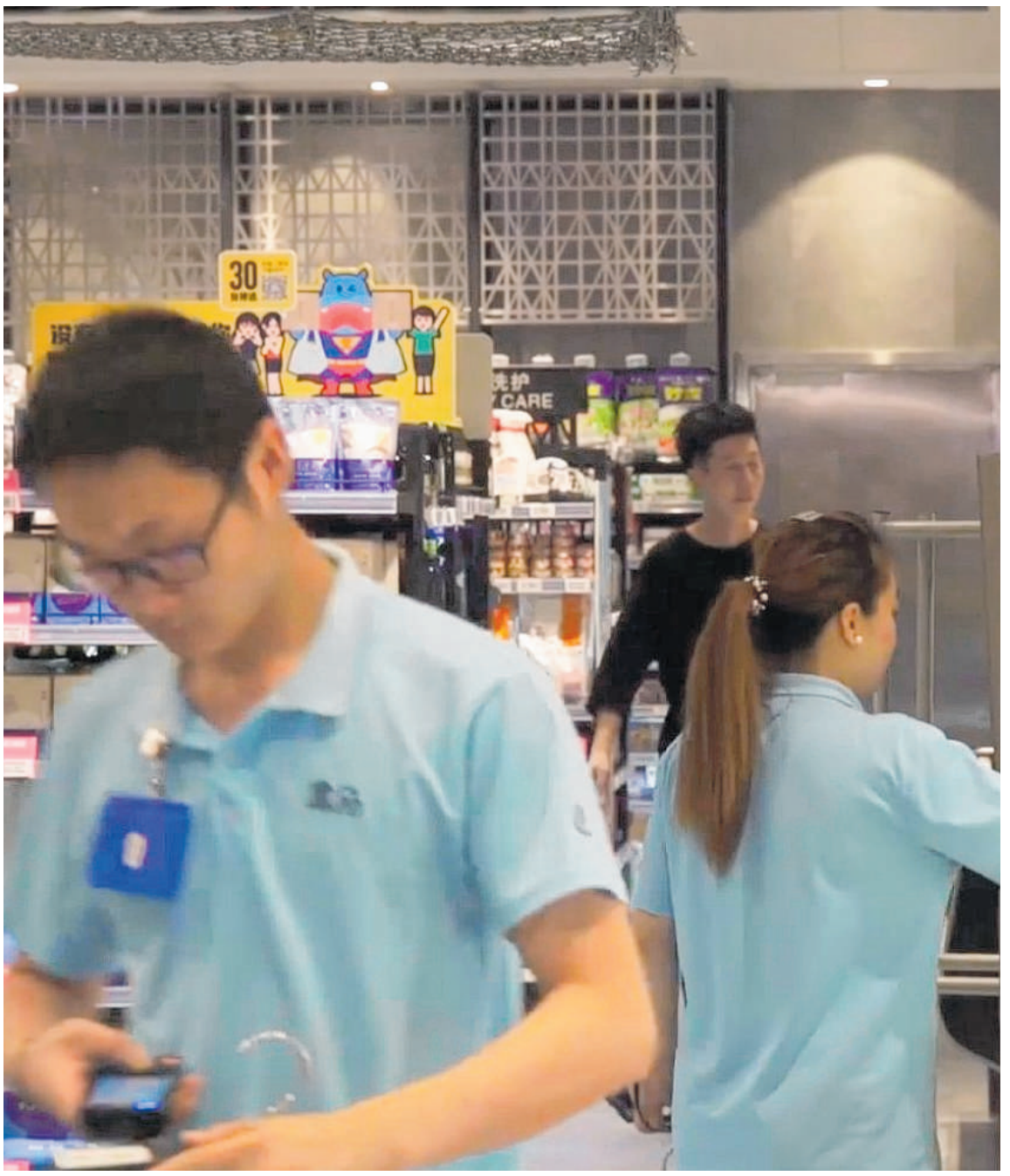
Hema Fresh's CEO and Founder Hou Yi says he is excited by the strategic co-operation between the two companies.

"This co-operation between two powerful companies is set to redefine the concept of fresh milk in the new retail era. As a global leader in the dairy industry, Fonterra is well-known for quality milk pools, world-class breeding techniques and advanced experience in food safety and quality, which matches well with what we advocate."

President of Fonterra Greater China Christina Zhu says the new product highlights how Fonterra's business in China is leveraging the strength of its local milk pool, spread across three farming hubs.

"No other multinational dairy company in China has a local milk pool to draw from, so we are in an advantageous position.

"This milestone with Hema is a sign of things to come and indicates that our push to shift more of our local milk into higher-yielding consumer and foodservice products is well-and-truly under way."



From top: Hema supermarket's "order-fulfilment specialists"; orders can get from phone to home in 30 minutes; the entrance to a Hema supermarket.

Collecting data on every move a customer makes means Alibaba can leverage shopping habits and product inquiries to hyper-optimise its offering.

China Business

Tapping into the food chain

Tanne Andrews

Peter Osborne

Christina Zhu

Leading nutrition companies spoke to **Tim McCready** about expanding into China. Among topics discussed with Sanitarium's China Country Manager Tanne Andrews, Blackmores' Asia Managing Director Peter Osborne, and Fonterra's Greater China President Christina Zhu were challenges they face in the market and the impact of e-commerce.

Herald: Could you describe your presence in China?

Christina Zhu: We refreshed our China strategy five years ago and we've gone from strength to strength in that time. China is our largest and most important strategic market accounting for a volume of 5.5 billion liquid milk equivalents (LMEs) which is equivalent to over 1000 glasses of milk sold every second. Today, we have a fully integrated model that enables us to capture value for our farmer shareholders — from the farm gate through to the end consumer.

Our business model is unique in China. No other multinational or local dairy company has the same mix of businesses and reach across sectors that we have. We have a strong in-market presence and operate a range of business units — including consumer brands, foodservice, ingredients and farms, as well as a number of strategic partnerships. In the past 12 months we have made great progress integrating these businesses more closely to capture the opportunities being created by rapid changes in China's food industry, such as growing household affluence, demographic changes in the population and the rapid growth of technology and e-commerce.

We are the market leader in food service, Anchor is the number one imported milk brand both online and offline, we have around 35,000 cows producing a significant amount of milk each year and we are a leading supplier of dairy ingredients to major international and local food companies in China.

At the same time we are Fonterra's biggest employer off-shore with close to 1700 people in the greater China region (mainland China, Hong Kong and Taiwan).

Tanne Andrew: We've been an export business into China for about five years, and have had a functional office in China for about the past 18 months.

Chinese consumers increasingly want to try things from the West and there is massive growth in breakfast cereal in China. We are building trust in Sanitarium's brand, which we want to expand on. Light 'n' Tasty will likely be the next product we bring to the China market.

Peter Osborne: We've been here since 2012. We have a wholly-owned foreign enterprise in Beijing, our head office is in Shanghai, and a team of 50 in China — spread across Beijing, Shanghai, Guangzhou and Chengdu. We have an A$250m business in China, with over 3000 points of retail presence across China and an extensive presence on e-commerce — both domestic and cross-border.

What are the challenges you have noticed specific to China compared to New Zealand or other parts of the world?

Zhu: The Chinese consumer is unique and like all markets we operate in, it's essential to appeal to local tastes and trends. Chinese consumers are very discerning and companies work tirelessly to meet their ever-increasing expectations.

This is both a challenge and opportunity — to capture the opportunity we need to have innovation at the heart of everything that we do. That can mean new packaging, taste profiles, or the way you engage with consumers. The market is evolving so quickly, businesses need to run fast just to stay where they are. Only by running faster though will they ever move ahead.

One area where we have really captured the essence of innovation is through our foodservice business — Anchor Food Professionals. The dairy beverage category is rapidly expanding and we've been able to capitalise on this trend by working with our customers to create innovative taste sensations, such as the tea macchiato. This is made using a blend of flavoured Chinese tea with a creamy cap of whipped cream and cream cheese. Thanks to innovations like this, we are now selling around 80 million drinks per year and this is growing rapidly.

Andrews: While the opportunities in China are big, the challenges are also big. China is not the easiest place in the world to do business — complicated sales channels, language barriers, different consumer laws, professional shoppers — these are just a few of the challenges you face that you don't have to worry about in your own domestic market.

China is very different to Australia and New Zealand — it's the antithesis really, when you look at lifestyle. And it is extremely fast-paced. Everything changes so quickly, it's like a different planet and you have to keep up.

As an ex-pat, if you can't speak Chinese, you don't have an interpreter, you don't have a driver — you will find it very difficult. I found it surprising how little English is spoken.

We used to put a lot of emphasis on using Chinese agencies that could speak English. But now we have a local team in China we're using some very good local agencies. That might mean they don't necessarily speak English, but we're finding we get a far better result.

Osborne: As a health product company, we're used to highly regulated environments, so that's not the biggest challenge. Keeping up with the speed of consumer evolution is. This includes changes in the regulatory environment, how to engage with consumers online, and customer preferences and demand. In a category like ours, preferences can shift rapidly based on key opinion leaders and influencers. Our category has a long supply chain which means it can take months to get a product to market. That's a big challenge for any foreign brand in food or fast-moving consumer goods (FMCG).

How are you currently using e-commerce in China?

Zhu: E-commerce in China is such an important platform and it's moving at a rapid pace. We're really capturing this opportunity — over half of our consumer business is online and Anchor is the number one imported dairy brand both on and offline in China.

Our strategic partnership with Alibaba is helping us deliver significant growth. Alibaba has created a huge digital ecosystem in China encompassing all online channels and we're working in partnership with them to get more and more of our products to consumers across China. For example, Tmall.com, Alibaba's online retail market place, is an extremely important channel for us, and enables retailers to sell Anchor, Anlene and Anmum to consumers.

A key development in the China e-commerce landscape has been the growing integration of online and offline channels — or what people are calling 'new retail'. This year we launched a partnership with Hema — Alibaba's supermarket chain — where we will sell our current product range, launch new products and offer cooking classes to engage our consumers. The signature product is daily fresh milk, an unprecedented development in China. This milk comes from our farms in China, which shows how our integrated business model is coming to life. We have also signed a memorandum of understanding with Alibaba on blockchain.

Andrews: This is what is difficult for people to get their head round in Australia or New Zealand. The majority of our target buy their groceries on line, over 80 per cent of our purchases are made on a mobile device. For the consumer it's convenient and delivery is both quick and inexpensive.

If you work in FMCG in New Zealand, the majority of your goods are sold through large supermarket chains. Think how much your strategy would have to change if suddenly your goods were now sold predominantly online.

Osborne: We've had a long relationship with Alibaba and entered China in 2012 with a flagship store on Tmall — we were the first brand in our category to have a Tmall store. We sell on various Alibaba platforms — Tmall, Tmall Choice, AliHealth, Taobao — and we also work with them on big strategic projects including a blockchain project for food safety and a Global Healthcare Initiative with Tmall. We have a deep relationship with them, which has really helped drive our business in China.

Online and cross-border e-commerce is a big part of our business, and Double 11 Day is a big feature of the yearly calendar. We work up to it with a range of activations — it is about consumer engagement and brand awareness as much as it is about sales. For a long-term business in China this is important, because it allows you to keep engaging with your consumers.

We did a three-hour livestream prior to Double 11 Day. We used Chinese celebrities and Chinese pop-stars as part of a broader programme produced by Hunan Television [a satellite TV station]. At its peak we had 480,000 people online viewing our livestream and we added 13,000 fans to our flagship store.

Can you give an example of an online success you had in China?

Zhu: One example of our online performance is Double 11 Day — a very important festival that has expanded to become weeks of promotion. During Double 11 Day last year, our overall online business achieved RMB100 million (NZ$22m) in sales volume, 67 per cent higher than the previous year.

This year we ranked in the top 10 of all food and beverage companies on JD.com, another e-commerce giant and also a significant partner. That puts sales of Anchor milk up there with brands like Coca-Cola and the local giants Yili and Mengniu. This is a massive achievement and reinforces that Anchor is standing strong among the biggest food and beverage brands in China.

Andrews: Our Chinese distributor got Weet-Bix onto *Ode to Joy* [a Chinese television series]. It appeared for over one minute on screen with actress Liu Tao — one of China's most famous actresses — and was seen by over 350 million people. Daigou in Australia and New Zealand rushed out to buy Weet-Bix to send to China. That was when Sanitarium realised the potential China offers.

Since then, due to a trademark battle, we have had to rebrand in China to Nutri-Brex.

But Nutri-Brex retains the Weet-Bix colours and branding. It is selling very well, and the bonus for us is that Daigou don't have access to Nutri-Brex as it is exclusive to China. This gives Sanitarium more control over the Chinese market and eliminates problems associated with parallel imports.

Osborne: We learnt a very good lesson in China from our vitamin E cream — a product we have been selling for 30 years.

There was some social media chatter two years ago that Fan Bingbing — a very famous Chinese actress — was using our vitamin E product. Our sales went from 3000 tubes a month to one million tubes a month.

This really had very little to do with us — but we had to crank up production rapidly to meet this demand we hadn't anticipated, all because of social media which is so dynamic in China.

Although things have calmed down now from that peak, we are still selling considerably more vitamin E cream than we used to — up into the hundreds of thousands of tubes a month.

China Business

Rethinking the future of retail

Tim McCready

Last year Alibaba announced its "New Five" strategy, which comprises New Retail, New Finance, New Manufacturing, New Technology, and New Energy.

At the time, Alibaba founder Jack Ma told shareholders the Chinese Government's push for the One Belt One Road initiative presented Alibaba with a unique opportunity to grow its business globally:

"New Retail will bring about a restructuring of the global supply chain and change the complexion of globalisation from the domain of big companies to small businesses."

Alibaba's vision is to use its ecosystem – which now includes commerce, logistics, entertainment, cloud, and physical stores – to support its new strategy and provide a platform for individuals, SMEs and large corporates to do business globally.

This strategy has seen Alibaba experiment with new technologies over the past year, culminating in a showcase of technologies during last year's 11.11 shopping festival that demonstrated the increased blurring between online and offline shopping.

Customers can apply makeup using augmented reality "magic mirrors". This means they can apply as many different colours and styles as they like, and then – through the use of the mirror – immediately buy the makeup and have it home delivered.

Providing customers with the means to test different shades in a short amount of time adds an extra layer of confidence and assurance they are buying makeup that will suit them. In addition to being placed instore and in mall kiosks, the mirrors are also undergoing trials in public restrooms.

Alibaba customers can apply makeup using augmented reality "magic mirrors".

> Traditional retailers must look at ways to restructure and enhance the customer experience and the physical retail space. New Retail is the way forward.
>
> Maggie Zhou

Clothing stores have begun introducing similar technology. Alibaba's virtual dressing rooms allow customers to quickly try on a wide variety of clothes – without removing any. A shopper can find a pair of jeans they like instore, try them on virtually, then receive suggestions using artificial intelligence and their previous shopping history on alternative styles and colours that might be of interest.

"In 2016 we had a small trial of augmented reality, and we are now starting to use it on a much larger scale – this is the future," says Maggie Zhou, Managing Director of Alibaba Group Australia & New Zealand.

Alibaba has also started rolling out its technology to transform traditional retailers throughout China, providing them with data-backed point-of-sale systems.

This will allow stores, even some in rural areas which may not have previously used any technology whatsoever, to obtain access to Alibaba's marketing, delivery, inventory management and payment capabilities.

One example is a point-of-sale kiosk that can use facial recognition cameras to track what shoppers do, identify who they are or estimate their age, and make insights into shopping preferences – effectively bringing what already happens online into physical stores.

Alibaba's chief marketing officer Chris Tung says the enormous pool of data and analytics expertise will help change the offline shopping experience and bring retailing back into the real world.

"We know a lot. We can model the lifestyle of 500 million people," he says. "Bricks and mortar retailers are suffering today, but there is a way to make them just as successful as online."

Zhou adds: "As we continue to adapt operations to better suit the digital world, traditional retailers must look at ways to restructure and enhance the customer experience and the physical retail space. New Retail is the way forward.

"By leveraging the Alibaba ecosystem and technology such as big data and smart logistics, merchants can offer consumers a more efficient and flexible shopping experience, while also improving their bottom line."

Zhou says the success of Alibaba has been possible thanks to the internet, and believes big data will become increasingly important to business in the future.

"The next 30 years will see the era of the internet flourish. We have the opportunity to change the world and to change people's lives," she says.

Will we see magic mirrors, virtual dressing rooms, and Alibaba's point-of-sale kiosks in New Zealand?

Ultimately, that is part of Alibaba's globalisation strategy. But for now, Zhou says China's scale makes it an ideal market to test new e-commerce innovation before taking it global.

"China is a very large market, with millions of digitally savvy consumers. This makes it a great environment to trial new technologies, fine tune them, and see what works."

DUAL CURRENCIES, ONE CARD

No Fee Withdrawal in NZ on Union Pay ATM.

Enjoy the convenience of NZ Local and Global Union Pay Eftpos transactions.

TERMS AND CONDITIONS MAY APPLY

ICBC

Call 09 374 7266 Email: operation@nz.icbc.com.cn

Address: 2 Queen Street, Auckland CBD, New Zealand

www.icbcnz.com

The Belt and Road: Four ways we can benefit

Stephen Jacobi makes the case for proactive but careful involvement in China's Belt and Road Initiative.

China's Belt and Road Initiative (BRI) has provoked strong opinion in New Zealand and around the world.

Some see it as a welcome plan to increase connectivity between nations, and a more inclusive, development-led model of globalisation. Others cast it as an attempt by China to develop soft power, and even as a means of projecting its industrial strategy.

Regardless of where one stands, no one doubts the BRI is here to stay. It is now seen as a central pillar of China's economic strategy, supported at the highest levels of the Chinese Government.

BRI is increasingly the framework through which China engages with the rest of the world.

Today New Zealand is facing greater competition than ever for attention in China. Australia has negotiated a very good FTA, Chile has already upgraded its FTA, European states are making a huge push to develop people-to-people links, and Latin American countries are already staking out their roles in the BRI.

Where does this leave us? There's no doubt we can be on the BRI map if we want to be. On the other hand, if we choose not to engage, others almost certainly will and we could find our position in the Chinese market further eroded.

The smart option is to try to develop our participation in a way that builds on our comparative advantage and matches our interests and values.

The ability to co-operate for mutual benefit despite fundamental differences is a hallmark of the New Zealand-China relationship, and our involvement in BRI need not be any different.

On the upside there will be tangible benefits to a number of our key sectors, as long as we develop carefully our thinking around the specifics of our contribution and how this can be presented to our Chinese partners.

So where do we begin? Premier Li Keqiang's visit a year ago provided the two governments with a non-binding Memorandum of Arrangement, which gives us a mechanism firstly to define our contribution, and secondly to present this under a framework for bilateral co-operation.

Premier Li Keqiang's visit a year ago provided our two governments with a Memorandum of Arrangement. Here he is welcomed to Government House in Wellington by kaumatua Professor Piri Sciascia. Picture / Mark Mitchell

The New Zealand China Council is working on a strategic pathway to identify the big opportunities for New Zealand. We expect these are more likely to be in "soft infrastructure" rather than "hard infrastructure" — the way goods, services, capital and people move along the belt and road, rather than building the road itself.

Specifically, four areas where New Zealand can make a unique contribution are: trade facilitation and supply chain connectivity, linking China with South America, innovation, and the creative sector.

Trade facilitation could leverage our world class biosecurity regime, expertise in cross-border movement of goods, and experience in working across jurisdictions on trade hubs. Our geographic location and trade and tourism relationships with China and South America position us as a natural connection between the two.

In the innovation space, New Zealand can utilise its strong capability in science and technology and advance our existing collaboration and commercial links in these areas.

For the creative sector, opportunities exist to use creative properties to expand people to people links, cultural awareness, understanding and exchange.

These areas will need further thought and refinement, as well as identifying who should pursue the opportunities — government, business, universities or cities. The NZ China Council will release a report in May setting out our final recommendations.

As we move forward to implementing our BRI strategy, we will of course need to continue to monitor developments in China, and give thought to any risks in pursuing this course. One obvious risk may be to underestimate or overestimate the value of participation.

The BRI, much like our wider relationship with China, should not replace other important relationships and arrangements with the rest of the world. We can pursue BRI and initiatives like CPTPP at the same time.

BRI will not require us to surrender our sovereignty or our independent foreign policy. It is up to New Zealand and New Zealanders alone to make the running and come up with ideas for how we can take part and add value to our existing relationship. This is work we have to do ourselves.

It will require innovative new thinking, open minds and classic Kiwi ingenuity as we work together to chart our own path along the Belt and Road.

● *Stephen Jacobi is Executive Director of the NZ China Council (www.nzchinacouncil.org.nz)*

OIO changes send mixed messages to investors

Martin Thomson

In November 2017, the incoming Labour-led Government issued a new ministerial directive letter to the Overseas Investment Office (OIO).

The directive acknowledged the importance of foreign investment for New Zealand's economic growth. For rural land, it required the OIO to place particular importance on factors generating economic benefits (such as increased production and jobs).

For forestry assets, it required the OIO to place particular importance on investments resulting in increased domestic processing of wood. The parties comprising the Labour-led coalition Government campaigned on changes to the OIO regime, including further restrictions on foreign investment.

This was proposed against a back drop of anxiety about New Zealand losing control over land assets. There was little consideration of the economic benefits of foreign investment.

The new directive took effect from December 15, 2017 and applied to all future applications including those already being considered by the OIO.

In summary, the letter makes the purchase of lifestyle rural properties of any size difficult — these had often previously relied on non-economic benefits to secure OIO consent.

Professional investors buying farms may not have been similarly affected: their consents are usually obtained on the grounds of significant economic benefits to New Zealand.

But the letter may have changed the tone or emphasis of assessment. The OIO is now most likely applying a higher standard to the assessment of economic benefits. I understand the OIO has indicated a number of applications being considered under the directive letter are likely to be declined, though there has not been any public notice of a decline.

This change of emphasis will create uncertainty for investors. It is hard to reconcile it with the directive letter.

Residential land

The Government introduced the Overseas Investment Amendment Bill, which proposes to make all residential land "sensitive" for the purpose of the Overseas Investment Act. It will effectively ban anyone who is not a citizen or resident from purchasing residential land. The goal is to make homes more affordable for New Zealand buyers, particularly first home buyers, and ensure housing prices will be shaped by New Zealand-based buyers alone.

Concerns have been raised about unintended consequences of this legislation, such as capturing commercial transactions where residential land is bought for non-residential purposes or facilities such as retirement villages. It may discourage large-scale residential developments, where developers retain ownership to rent them out. The jury is out on what will happen.

Forestry

The Government has just introduced legislation to bring forestry rights within the OIO regime. Concurrently, it has eliminated the counterfactual test and proposed a "light-handed checklist" screening regime for consents involving forestry assets.

This light-handed checklist will apply to freehold forestry land and cutting rights, which will make it easier for overseas investors to gain consent to buy forestry assets.

These changes demonstrate a pragmatic approach by the Government, recognising the importance of foreign capital to the industry and the difficulty investors were having obtaining consent. They will be a major step in the right direction to support the industry, particularly to realise the Government's ambition of significant further planting of trees.

It contrasts with the approach of the OIO in relation to farmland, despite the terms of the directive letter. This is likely to reduce levels of foreign investment into the agriculture sector, when there is a need for significant capital to reduce existing debt levels, address material environmental issues, facilitate the consolidation of non-economic farms, and increase overall productivity.

It is difficult to see where the required capital will come from for farming, particularly given the level of investment made here by New Zealand-based fund managers, which allocate only a limited proportion of total assets to New Zealand; many do not hold any direct investments in assets such as farmland.

All this should be read in light of the OECD's recent survey of the country's economy which indicated the Government should be removing barriers to foreign investment.

A final influence in the mix is the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) — the resurrected TPP. This will raise — from $100 million to $200 million — the values at which investors from countries party to the agreement must get approval from the OIO for purchasing significant business assets. This is for non-sensitive land deals only. It is quite possible the upgrade of the New Zealand-China FTA may include a proposal to make the same change.

Again, this opens the door for more foreign capital on big deals.

In summary

In summary, it's a mixed picture. Will the OIO restrict foreign capital more readily? Will investors be scared off? What will be the effect on the housing market? Time and politics will tell.

● *Martin Thomson is a partner in DLA Piper and chair of the NZ China Trade Association.*

TIGHTENING UP ON OVERSEAS INVESTMENT

Overseas Investment approvals were arguably already tightening before the change of Government, says Martin Thomson.

- OIO approvals totalled 98 in 2017 — 136 in 2016 and 129 in 2015.
- Just three forestry consents were made in 2017; 13 in 2016.
- Last year's approvals all had a strong focus on domestic processing of logs. Thomson says the changes demonstrate the historic difficulties in obtaining consents for established forests.
- While total freehold land consents decreased from 87 to 61 between 2016 and 2017, the number of consents in relation to rural farm land actually look to have increased. The total net area of freehold land proposed to be transferred into foreign ownership under these consents was approximately 17,000 hectares, a reduction from 25,000 hectares in 2016.
- There was a 30 per cent increase in the number of active applications being considered by the OIO — from 68 to 89 — between December 2017 and February 2018. This is likely to reflect an increase in the time being taken by the OIO to consider applications, particularly those affected by the labour-led Government's new ministerial directive letter, rather than an increase in applications.
- In the last 12 months, the average number of applications being assessed at any one time was approximately 65.
- In both 2016 and 2017, the number of applications declined was two. But Thomson says this is likely to be an understatement: "A number of applicants withdraw their applications rather than have them declined."

Noisy diesel trucks are starting to be replaced by quiet and efficient rubbish trucks powered by electricity, funded by Chinese foreign direct investment.

Show us the green, say investors

Foreign direct investment is playing a key role in improving New Zealand's environmental impact across a range of industries, writes **Stuart McKinnon**

Rubbish collection days in parts of Christchurch are much quieter and cleaner thanks to some smart new technology funded by Chinese foreign direct investment.

Noisy diesel trucks are starting to be replaced by quiet and efficient rubbish trucks powered by electricity. It is world-leading green technology, being implemented by a local New Zealand team that has the potential to be used in other cities around the world.

Talk to any sovereign wealth fund or fund manager investing in New Zealand, and they will say how clear environmental goals and practices are of vital importance in their investment decisions.

Increasingly, foreign direct investment (FDI) is also seeking the same thing.

Traditionally seen as providing macro-economic benefits that fuel growth and productivity, provide employment and expand the economy, today there are many examples of FDI seeking to invest and build sustainable businesses, particularly those with strong environmental objectives.

With its clean green brand, New Zealand is well placed to attract investors looking to support businesses, technologies and practices that reduce environmental impacts.

Green investment makes sense on many levels. Demonstrating a commitment to the environment is now a requirement for significant industrial or commercial investment worldwide, with suppliers, shareholders and customers demanding transparent environmental practices under environmental, social and governance criteria.

When it comes to convincing regulators about investing here, strong environmental credentials and a commitment to contributing to

sustainable development are major points in any investor's favour.

Consumers are more environmentally conscious, with sustainability a key factor in buying decisions. As such, there are considerable competitive advantages for investors being environmentally conscious.

Taking that a step further, some companies are using FDI to not only green their own operations, but to develop innovative green technologies that are transferrable and transformative. In addition to investing and developing new technologies and business practices, these businesses are also reviewing their supply chains and are demanding similar practices.

Foreign direct investment in New Zealand is playing a leading role in this regard with strong demand from foreign capital for investments with the potential to develop green technologies. This is occurring over a number of sectors and with strong momentum, which we have seen across a number of ANZ clients.

This year, Christchurch became the first city in the Southern Hemisphere to have its side-load waste collection trucks powered by electricity as part of a pilot by their contractor, Waste Management, to transition towards a plug-in electric collection fleet.

This was just two years after Waste Management was bought by Beijing Capital Group, who undertook to invest in green technology as a stated benefit to the company and the New Zealand economy.

Waste Management's conversion programme began with both trucks and light vehicles. Out of a fleet of 200, around 80 will be transitioned by the end of next year, a number the company plans to increase.

Their trucks travel around 140km a day, stopping and starting to pick up around 1200 bins each. While that made them a perfect use case for electric power, there were no manufacturers offering electric trucks that met their requirements.

Rather than wait for suitable trucks to become available, Waste Management identified a conversion partner, EMOSS in The Netherlands, who developed collection trucks with electric drivetrains.

The company's sustainable landfill and energy parks can capture more than 95 per cent of the gas emitted from waste as it breaks down. Their generators turn this gas into electricity which is fed into the grid. The Redvale Landfill and Energy Park is Auckland's largest renewable energy generator, generating enough electricity to power more than 12,000 homes.

In the agriculture sector, Bright Dairy, a subsidiary of Bright Food Limited — one of China's largest dairy companies — approached Canterbury's Synlait Milk in 2010 to discuss a business partnership. Bright became a major investor and early infant formula customer, enabling Synlait to grow from a closely held private company into a sophisticated, listed (NZX50) company in New Zealand's largest export industry with a market capitalisation of over $1.4 billion.

Bright Dairy's current investment represents 39 per cent of Synlait Milk shares, which are traded on NZX (SML) and ASX (SM1). Synlait has grown substantially since Bright Dairy's investment and it continues to have a governance role on Synlait's Board of Directors.

In 2013 the board decided to create incentives for dairy farmers to reduce their impact on the environment and improve sustainability of dairy farming.

Lead With Pride™ is an on-farm quality assurance programme that recognises and financially rewards dairy farmers who achieve best practice in dairy farming.

To become certified, Synlait's suppliers must achieve excellence in environmental protection, animal health and welfare, social responsibility and milk quality.

The environmental component is extensive and includes efficient water and irrigation management, effective effluent management, improved biodiversity, soil quality, emissions and energy management.

Bright Dairy believes Synlait's value is in the quality of its raw milk supply. Therefore, protecting the natural environment is not only good farming practice, but it is good for long-term business and social sustainability.

There are many similar examples where FDI is playing a key role in improving New Zealand's environmental impact across a range of industries, which is important for a market that is known globally as being clean, green and a leader in environmental stewardship.

This was echoed at the recent KangaNews New Zealand Capital Markets Forum in Wellington where Minister of Finance Grant Robertson spoke about the importance of New Zealand's clean green brand, how it is a significant competitive advantage and one we must continue to uphold and invest in.

Conscious of the need to preserve New Zealand's natural capital, many local industries are looking at ways to improve their own environmental performance through investment in new technologies and processes.

The capital constraints to developing green technologies are also much less than they were just a few years ago. This includes initiatives such as the Government's NZ$100 million green investment fund to develop green practices and create green intellectual property that New Zealand can export to the world — as well as helping New Zealand meet its obligations under various international agreements.

As New Zealand continues to invest in technologies to meet its obligations under various climate change initiatives, foreign capital will continue to be an important source of funding this transition.

● *Stuart McKinnon is Head of Institutional Relationships at ANZ Bank NZ.*

China Business

Huawei leads next-gen push

Bill Bennett

Last week Spark held the first public demonstration of a 5G mobile network in New Zealand. Huawei provided the technology. It was, says Huawei New Zealand managing director Yanek Fan, a display of leadership.

The demonstration took place outside Parliament in Wellington. Communications Minister Clare Curran was the first to test 5G, downloading data at more than nine gigabits per second.

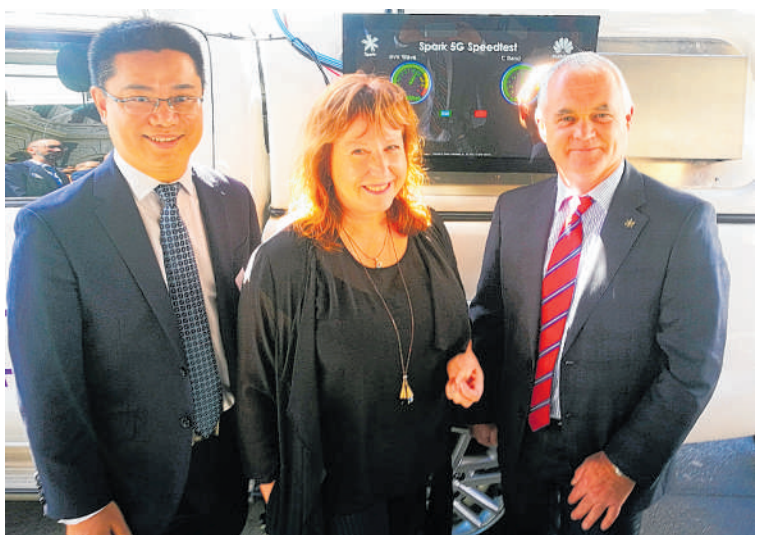
To put this in perspective, that is 100 times faster than the best you'll see on today's 4G cellular network. It is about nine times the speed of a fast fibre connection. Yet, because users share wireless spectrum, few people will see these speeds in practice when the network opens for the public.

Spark is pushing mobile technology hard. It wants to be the first in New Zealand to have a 5G network. Huawei is leading the 5G charge worldwide. Since 4G arrived about nine years ago, Huawei has emerged as the world's leading telecommunications equipment company. It dominates the market worldwide, especially outside the US.

Fan says Huawei has helped with similar recent 5G demonstrations in, among others, Japan, Canada, the UK and Germany. There are also trials under way in Singapore, Spain, South Korea and, of course, China.

Huawei has vast resources. It turned over around NZ$110 billion last year.

Fan says it spends 10 per cent of revenue on "solving customer issues".



Huawei's Yanek Fan, Communications Minister Claire Curran and Spark managing director Simon Moutter at the 5G demonstration in Wellington.

This includes research and development.

"We have been working on 5G for three years now. We have 18,000 research and development staff working worldwide in 16 centres.

"Eight laboratories are in China. There are specialist wireless research centres in Sweden and Finland. Huawei has a research establishment in Moscow which has a focus on mathematics. Russia has the best mathematicians. Another centre in Paris works only on 5G and there is a 5G innovation centre at Surrey University in the UK."

Fan says the move from 4G to 5G is not the same as the move from 3G to 4G. That was about giving mobile users greater download speeds. In effect 4G made it practical for phone users to watch video while on the move.

He says; "5G is different. Users will see more speed. But that's not the important thing. Its higher performance becomes an enabler for the telecommunications companies and for industry. In a small country like New Zealand, it is going have the biggest effect on vertical markets. This upgrade is not aimed at consumers."

Huawei lists 10 vertical markets that will benefit most from 5G. Fan says from a New Zealand point of view the top one is the connected car. "Connected cars need 5G because it offers low latency."

Latency is the time is takes for a communications network to respond. It is different from raw data speed. You can have a fast network that takes a long time to crank up.

He says: "The first wave of connected cars will relieve a driver's feet. The technology will handle breaking and acceleration. A second wave will then relieve their hands — steering wheels will be a thing of the past.

"A further wave will then relieve a driver's eyes. Technology will look out for hazards and so on, but, for some time yet, drivers will need to ask and answer questions.

"One day the technology will relieve drivers' brains".

Fan says connected cars need to act fast when something happens, so they need latency of less than one millisecond. Low latency is also important in smart manufacturing. Fan says this is the second most important vertical market for 5G in New Zealand. Overseas manufacturers use robots to build cars, but they need to respond fast.

Smart manufacturing includes using technology in agriculture and the Internet of things. Fan says this can also mean the transport sector.

The Internet of things doesn't need 5G — not every device needs to handle large amounts of data. Yet Fan says 5G will bring a lot more connectivity and that will change things.

"At the moment every cow in New Zealand can have its own IoT connection. Farmers can use sensors to determine the status of a cow, then milk it at the best moment to get the highest possible yield. In the future, we may reach the point where every bottle of milk has its own connection. We see there being 100,000 times as many connections as there are today."

New Zealand's mobile companies are planning their 5G strategies and testing hardware. Most insiders expect them to start building networks from 2020 on, but they have to clear some hurdles first.

Fan says they need three things: "The most important is spectrum. The second is the network and the third is developing the business cases.

"From our point of view the technology is manageable. The network is easy to deal with. The most difficult part of that is to move the current network from 4G to 5G. That's made easy because many of our customers, including Spark, have already started building 4.5G. The upgrade from there to 5G is quite smooth."

He says the success of the Wellington demonstration shows the 3.5 to 3.7GHz C band will prove to be the best 5G spectrum for New Zealand. "We're also testing 25 to 28GHz. This is likely to be the highest frequencies used in New Zealand, at least for the first phase of 5G."

In New Zealand Huawei provides the network equipment for both Spark and 2degrees. Fan sees the Wellington 5G demonstration as affirmation of the relationship between the two companies.

Spark chief operating officer Mark Beder says: "We have been partnering with Huawei since 2013 on the Spark radio network, they delivered our 4G mobile network, and more recently our expansion into 4.5G. Right now we are working with them on our 5G trial in Wellington and a showcase planned in Auckland next month."

China Business

Unlocking SME growth potential

China Business
Michael Barnett

The dilemma you have as a small-medium business in New Zealand that is succeeding is to identify "where to next".

From one perspective we are told that businesses in New Zealand will not get rich selling to themselves and from another we know that, while the greatest opportunity may appear to be China, a New Zealand SME will have significant barriers to overcome in order to succeed.

Can I suggest our SMEs should take advantage of the situation where we have many of our larger corporates doing well in the China market — and most of them have learnt very public lessons that the SME sector should not ignore.

The other benefit of having many of our larger businesses doing well is that freight and distribution networks into China, along with the associated documentation and administration, are well-established and offer the SME a proven platform for exporting goods and services.

We also know the Chinese Government acknowledges the important role of their small business sector and is trying hard to make it easier for them to do business in their home and export markets.

To complement this we need a system that accelerates the access of our SME into the China market, not frustrates it.

When I look at the obvious resource to assist access, this has to be New Zealand Trade and Enterprise (NZTE). In my opinion they are well resourced and do a great job, but are more focused and adept at supporting the larger entities in New Zealand not the SME.

The question becomes, what can we do to provide a resource to support and accelerate SME access into the opportunity the China market provides?

I am reminded that when you look at the start-up and SME market in New Zealand, there are multiple organisations and resources providing support for the SME.

These range from Chambers of Commerce to EMA, Business New Zealand and the many Economic Development Agencies funded by ratepayers' money.

The support on offer is huge, yet complicated to access, and could be simplified by a co-operative response by all the agencies rather than a competitive one.

My recommendation for SME access into China would be for government and the private sector to form a partnership and consolidate the support which they could all promote to SMEs.

Imagine combining that with a platform, like Trade Me, that provided a digital portal where all New Zealand businesses could register product and services for China in a way that these could be viewed by companies in China and introductions between buyer and seller could be made.

Provision could also be made so Chinese companies could do the same with products and services that New Zealand may have an interest in.

The creation of this would have a cost, but the platform could be used for China and any other market, and costs recovered on a user-pays basis over time.

Alongside such a platform the SME in New Zealand would need to follow some basic steps that their international competition also face — these would include;

- Undertake research to clearly identify that the product that has succeeded in New Zealand, will be as good in a foreign market as it has been at home. This will carry a cost, but done well is better than the future cost of failing.

> Imagine combining with a platform, like Trade Me, that provided a digital portal where all New Zealand businesses could register product and services for China in a way that these could be viewed by companies in China and introductions between buyer and seller could be made.

- Understand that China is huge (1.4 billion population and growing), so choosing a region is likely to be the smart way to go.

Many of our New Zealand cities already have sister city or trade relationships, so leverage off those.

- You will probably need a partner to help you, so understand the risks this might impose on your IP and access to a market. Appreciate that you are dealing with a different culture. Observe the behaviour of Chinese in the New Zealand market, note the ways business is conducted differently and ensure there is an alignment of values and expectations with potential business partners.

The challenge for all relationships is how you approach this critical value. Should you trust, until you know you shouldn't, or don't trust until you know you should? For business this is a part of the risk in doing business anywhere in the world, including China.

- Have a very good understanding of China's social media platforms and how important they are to doing business in China.
- Yes the market is big, but you will probably be too small to commoditise your product into this market, and probably would not want to, so be like the elephant and the mouse and bite off one small mouthful at a time.

The opportunity is there and we can, as SMEs, succeed — but we need to create a purpose-built platform and appreciate that our plan and this platform is competing with the world.

- *Michael Barnett is CEO of the Auckland Chamber of Commerce.*

Air NZ has cachet with Chinese flyers

Scott Cara took up the role of Air New Zealand's Regional General Manager Asia in April 2016.

Shanghai-based Cara has global experience including Japan, New Zealand, Australia, United States, the United Kingdom and Europe. But despite that he says his current role in China is the most competitive market he has ever worked in.

"The aviation market in China has seen enormous growth in recent years. Particularly in the last 18-24 months, we're seeing quite a number of new carriers entering second tier cities, second tier carriers, that kind of thing" he says.

"Not everyone is focused on short to medium term EBIT. Some are in it with a long-term strategy, and others are just opportunistic cash flow searching. It's a really interesting, challenging environment."

Cara says the volume of the marketplace in China can seduce companies into losing sight of brand value and quality.

But he adds that New Zealand is a destination that carries a cachet with Chinese consumers, which has helped Air New Zealand position itself into a higher yielding market segment.

"From an Air New Zealand perspective, and indeed from a New Zealand country perspective, I think we've always got to maintain our focus on the value for money proposition rather than the pricing proposition," he says.

"Air New Zealand is the only airline that can say: your holiday starts the moment you get on board."

Handing out lollies is popular everywhere. Chinese celebrity Nicky Wu makes friends with Pete the kiwi.

> The way that people consume media in China has helped us . . . in terms of generating a positive brand impression.
>
> Scott Cara

Marketing and social media

In order to create a strong brand impression in the minds of Chinese consumers and drive awareness and preference for the airline, Air New Zealand has deployed highly effective brand and social media marketing campaigns.

The airline now has nearly 260,000 followers on its various social media channels in China including WeChat and Weibo.

In November Air New Zealand launched its "A Better Way to Fly global brand campaign in China. The hero video — featuring Pete the Kiwi — has achieved over 14 million views in China and has helped highlight some of the unique product and personality differences Air New Zealand offers its customers.

Last month, Air New Zealand released it's "World's Coolest Safety Video" set in Antarctica, which has already achieved nearly 8 million views.

"The digital online environment and the way that people consume media in China has helped us have a huge uptake in terms of video views and in terms of generating a positive brand impression," says Cara.

Cargo

Air New Zealand has seen double digit growth in cargo from both the New Zealand and China ends of the market.

Cargo into China from New Zealand is typically fresh seafood, dairy, produce and meat. Fresh seafood and stonefruit have had strong growth in the last year, with some fresh fish shipments increasing by 87 per cent on Air New Zealand's services.

"Chinese consumers put a premium on freshness and safety.

"New Zealand's reputation and quality of products means that to the Chinese consumer our export products are in high demand and maintain a premium price in the market," says Cara.

"As new products are signed off and listed in the FTA we see strong growth for that product. Demand for fresh milk is continually growing."

Out of China, cargo tends to be high-end electronics, with significant bumps in demand during new phone or electronics launches.

"Cargo tends to be a bit of a lead indicator for us at times, so we look at the growth in that side of our business as being a good indicator for our future in the market," says Cara.

CHINESE TOURISM — VISITOR ARRIVALS

- Year end February 2018 at 436,000 and growth of 8 per cent for the year
- February month numbers more than doubled last year, as a result of Chinese New Year timing, to nearly 69,000 being the largest month on record.
- Total for January-February period (i.e. covering the Chinese New Year period for both years) was up more than 18,000 visitors (+21 per cent)
- Provisional numbers for March suggest continuing growth — in the high single figures.

Air New Zealand

- First carrier to fly non-stop between mainland China and New Zealand with launch of Shanghai services in 2006 (12 years of operation)
- Daily 302 seater 787-900 operates all year on the Shanghai-Auckland route
- Additional 3x weekly 787-900 service (making 10x weekly in total) over the key 7-8 week Chinese New Year period.
- 120 staff based in Shanghai including c.80 cabin crew

A gateway for global

Tim McCready spoke to Stephen Phillips, Director General at InvestHK about Hong Kong's role in attracting foreign direct investment into Asia.

When asked what makes Hong Kong the best place in the world to invest, Director General at Invest Hong Kong (InvestHK) Stephen Phillips points to its geographic positioning in the heart of Asia, the fusion of Eastern and Western culture, the melting pot of highly educated talent, and its proximity and connection to Mainland China.

The investment promotion agency of the Hong Kong Special Administrative Region (HKSAR) has been headed by Phillips for the past nine months — one of the highest positions in the Hong Kong Government that is open to expatriates.

Phillips has worked in Hong Kong on and off since 1989 — initially with Barclays Merchant Bank (now Barclays Investment Bank) in aircraft financing and structured project financing. Since then, he has had stints at Deutsche Bank, co-founded a tech startup in Hong Kong, worked for the UK government and the China-Britain Business Council. He's also an avid fan of scuba diving in the tropics (he says his reluctance to cold water rules New Zealand out).

Phillips says the most notable change he has witnessed in Asia over past decades is the rise of China and the growth in other countries. But he says China is still not well understood by the rest of the world.

"The level of sophistication many of the businesses in China have is much higher than international

Stephen Phillips

counterparts recognise. It continues to transform at a very fast pace," he says.

"There are also other economies in the region that have grown strongly. The Philippines is one example that has had robust growth for quite a period of time. There are lots of bright patches across the region."

Hong Kong — which is part of China under the "one country, two systems" principle — has distinct advantages for attracting investment, including operating with a very strong rule of law based on English common law, independence of the judiciary, a simple tax system, and world-class intellectual property protection.

"This can't necessarily be said of the other cities in the region," says Phillips. "It's the certainty that Hong Kong offers business that I think sets it apart from other cities across Asia — not just China."

That said, Hong Kong is navigating its own challenges. Recent data from the United Nations Conference on Trade and Development shows the flow of foreign investment into Hong Kong has fallen over the past few years — from US$174b in 2015 to US$108b in 2016, which analysts attribute to the obstacles presented by crippling property prices, a constrained domestic market, and a lack of competition in some sectors.

But Phillips points out that the number of international and Mainland companies investing in Hong Kong continues to track upwards, and that capital flows can be misleading.

"At a fundamental level, from what we see, investment going into Hong Kong — where people are doing business and generating jobs — continues to track upwards. Tracking capital figures on a year-on-year basis can look a bit bumpy," he says.

The transformation and growth in cities across China is remarkable on a global scale, and in recent years Shenzhen, Shanghai, Beijing and Chengdu have taken much of the limelight away from Hong Kong. But Phillips says the big difference between the fast-growing cities on the Mainland and Hong Kong, is that cities in China are still very focused on the domestic market and the surrounding hinterland, whereas Hong Kong remains one of the most international-focused cities in Asia.

"If companies are looking at a particular geographic market within China, then establishing a base in one of those cities might make sense," says Phillips.

"But if they're looking at a much bigger picture — at the whole Asian landscape — then Hong Kong is a great entry point to not only China but also the countries in Southeast Asia, Japan, Korea, and beyond."

Hong Kong's historic role as an intermediary for inbound investment into China from around the world continues to be important. In addition to this, the growth in the Mainland's economy has seen Hong Kong's role as an outward stepping stone for Chinese companies to access a global market become increasingly important for InvestHK.

China's answer to Silicon Valley

The ambitious Greater Bay Area initiative has been put in place by the Chinese Government, aiming to link Hong Kong, Macau, and nine cities in Guangdong Province in an integrated economic and business cluster.

The 11 cities in the region have a combined population of close to 68 million people — greater than the world's largest city cluster of 44 million in Tokyo — and a GDP of around US$1.4 trillion.

All cities in the Greater Bay will be within one hour's travel of each other, with transport infrastructure under way including a 55km Hong Kong-Zhuhai-Macau bridge-tunnel system opening this year that will cut drive times from up to three hours to just 30 minutes, and a Guangzhou-Shenzhen-Hong Kong express rail link.

"The Greater Bay offers a very dense patch of the world with some of the highest GDP per capita in China — it is very attractive commercially, and this connectivity will help ease the way to do business," says Phillips.

"The Greater Bay will allow companies to tap into the depth of financial and professional services, the innovation taking place, and the intellectual property environment in Hong Kong — and combine that with the scale of manufacturing and

International dispute resolution centre

In April 2017, delegates from New Zealand's Ministry of Foreign Affairs & Trade concluded preliminary negotiations in Beijing for the planned upgrade of the 2008 Free Trade Agreement ("the New Zealand-China FTA").

The upgrade aims to raise bilateral trade to NZ$30 billion by 2020 while removing tariffs from New Zealand's most popular exports (eg fresh dairy products) by 2024.

It is the latest initiative by both countries to strengthen trade relations that generated NZ$23b in 2016 — a quarter of which was the result of foreign direct investment.

Given the strong investment and trade ties, it is important for New Zealand and Chinese partners to agree on an effective method and venue for resolving disputes.

In this respect, Hong Kong is key.

After more than 150 years of colonial rule under the British, Hong Kong reverted to Chinese sovereignty in 1997 under the "one country two systems" doctrine. As a Special Administrative Region, Hong Kong enjoys a high degree of autonomy and retains a separate legal system from that of Mainland China.

Like New Zealand, Hong Kong's legal system is based on English common law. Hong Kong has a long tradition of upholding the rule of law and judicial independence; two key foundations for the city's success as a global dispute resolution centre. Hong Kong has been ranked the most

China Business
Sarah Grimmer

judicially independent jurisdiction in Asia by the World Economic Forum's Global Competitiveness Report over the past 10 years. Hong Kong's highest court, the Court of Final Appeal (HKCFA), whose power of final adjudication is constitutionally entrenched, regularly includes judges from other common law jurisdictions, including New Zealand. The most recent appointee from New Zealand was Sir Thomas Gault, former justice of the New Zealand Supreme Court, who served from 2006-2015.

The most effective means of dispute resolution for cross-border transactions, including between New Zealand and Chinese parties, is arbitration. In arbitration, disputing parties select the individuals who decide their dispute as well as the applicable law. In many disputes between Chinese and non-Chinese parties, Hong Kong is selected as the dispute resolution venue and Hong Kong law as the applicable law (and as is it based on English common law, it has a large degree of commonality with New Zealand law).

The final decision of an arbitration, known as an award (equivalent by analogy to a judgment in a court case), is legally binding.

Under international law, a party from one country can have an award in its favour enforced against a party from another country. If, for example, in an arbitration between a New Zealand party and a Chinese party, the New Zealand party obtains an award finding that the Chinese party owes it monetary sums, the New Zealand party can attach the Chinese parties' assets in China (or wherever they are, in over 150 other countries in the world).

The same is true if the Chinese party obtains an award in its favour against a New Zealand party. It is the binding nature of arbitration that makes it the international dispute resolution method of choice. Unlike arbitral awards, it is very difficult to enforce national court judgments against foreign parties in foreign countries.

Hong Kong is a sophisticated and mature jurisdiction when it comes to arbitration.

It is one of the most preferred venues for international arbitration and enjoys particular advantages in relation to arbitrations between Chinese and non-Chinese parties. Chinese parties choose Hong Kong because it is part of China; foreign parties choose Hong Kong because of its independent legal system based on common law, and its independent judiciary.

The Hong Kong Government and judiciary, and many Hong Kong legal professionals and industry experts, are able to practise and conduct business in both English and Chinese.

All Hong Kong legislation and regulations are enacted in both languages. In 2011, Hong Kong was the first major Asian jurisdiction to enact the model law for arbitration promulgated by the UN. Since that time, legal reform has kept apace with, and often led, international arbitral practice.

The Hong Kong courts are predictable when it comes to arbitration, and consistently adopts a pro-arbitration approach. Hong Kong is also home to one the world's leading international arbitration institutions: the Hong Kong International Arbitration Centre (HKIAC).

HKIAC has extensive experience handling disputes involving parties from mainland China: of 260 arbitrations filed with the Centre in 2017, approximately 28 per cent involved mainland Chinese parties.

Also, 80 per cent of HKIAC's caseload in 2017 involved parties from the Asia-Pacific.

HKIAC's secretariat is staffed by multilingual and international experts in the field; in 2016, a New Zealander was appointed as the Secretary-General of HKIAC.

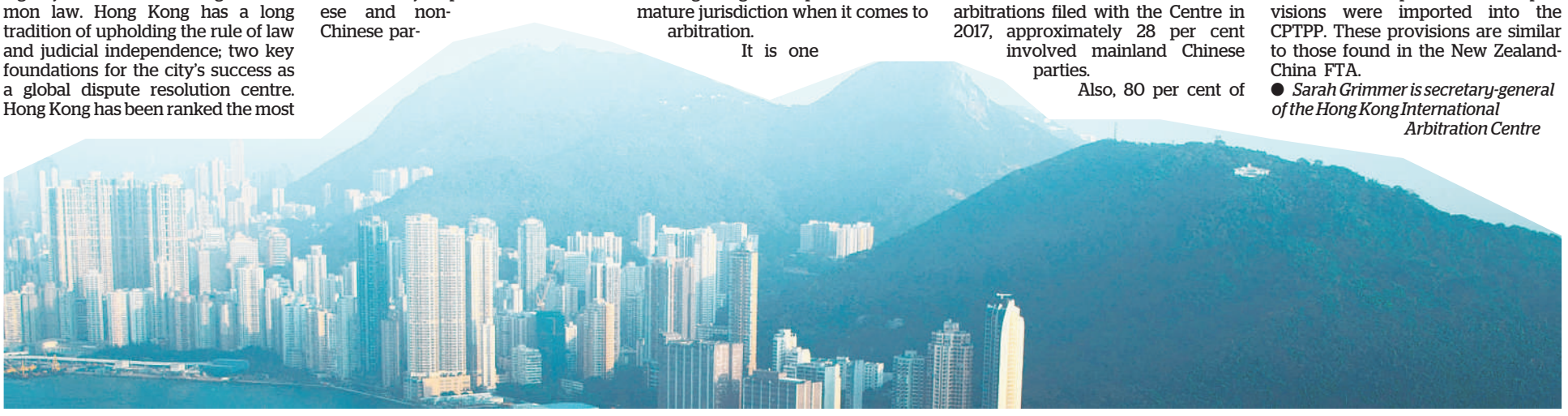
Various sources of international law, both in force and proposed, contain dispute resolution provisions applicable to New-Zealand China cross border investment. The New Zealand-China FTA provides for arbitration under arbitration rules promulgated by the United Nations. HKIAC has experience in administering arbitrations under these rules since 1986.

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) also encourages the use of arbitration by private parties between whom international commercial disputes have arisen in relation to the CPTPP free trade area.

New Zealand investment capacity in Southeast Asia is likely to expand once the CPTPP enters into force: of 11 countries who are party to the agreement, four are also members of the Asean 4 bloc.

Despite stagnation of the original TPP — incited by the withdrawal of the US — its dispute resolution provisions were imported into the CPTPP. These provisions are similar to those found in the New Zealand-China FTA.

● *Sarah Grimmer is secretary-general of the Hong Kong International Arbitration Centre*



investors

innovation within Guangdong.

"You can do R&D in Hong Kong, prototype in Shenzhen, and then take things to market very quickly as well. We will see this part of the world develop into a major financial and innovation centre."

However, there is still a lot to work to do. Wang Rong — a top Guangdong official — was this month unusually critical of his exchanges with Hong Kong counterparts about the Greater Bay Area plan. He says the initiative involved more talk than action and noted that greater co-ordination across the region, policy reform, social support, as well as improvement in transport networks and public services is needed.

"Guangdong, Hong Kong, and Macau come under one country, two systems, and three custom zones," he says.

"There [are] often many meetings, dialogues, and complicated etiquettes, but little strength in pushing things forward pragmatically, or systems in consolidation."

Another grand project from the Chinese Government is the "One Belt, One Road" initiative (OBOR), linking China to the economies along the Silk Road Economic Belt and the 21st Century Maritime Silk Road — and cementing China's position into the future as an economic powerhouse.

Hong Kong's key role in OBOR will be the connectivity it provides.

It has the ability to bring together Chinese and international investors under joint ventures, for projects that will take place in other countries.

"These joint ventures will be tapping into the debt and equity capital markets in Hong Kong, the structuring expertise and so forth, and take advantage of Hong Kong being an acceptable jurisdiction both to Chinese and international players," says Phillips.

The near-term opportunities will continue to be around infrastructure. According to the Asian Development Bank, developing the "belt" and "road" along the maritime and land routes will require US$1.7 trillion per year until 2030, including investment in power, telecommunications, and water.

Longer-term, Phillips suggests OBOR will rapidly provide more and more opportunities. As the economic levels of countries along the belt and road increase, there will be demands for world-class healthcare, education, and other social services.

"A lot of the focus at the moment is on airports, rail, bridges ... but companies need really to be thinking about what will be on that mid-term horizon — maybe three or five years hence," says Phillips.

"You need to position yourself now for the future, because if you're not in at the ground level yet, the chances are that you won't ever get the business. I encourage companies to watch very carefully what is happening already."

A FOCUS ON INNOVATION

Hong Kong's support for incubators, accelerators and funding initiatives over the past few years has seen the startup ecosystem skyrocket. Between 2015 and 2016 the number of startups grew 24 per cent, and the number of staff working in startups ballooned 41 per cent.

InvestHK's latest survey shows that 35 per cent of founders have come from overseas or Mainland China, and recent policy changes from the Government demonstrate Hong Kong's commitment to continue to attract the best global talent, businesses, and academics in key sectors.

In particular, areas of high priority for Hong Kong include:

- **AI and robotics:** building a centre of excellence by attracting leading universities and academics to do fundamental R&D that could then have commercial applications.
- **Fintech:** attracting the very best wealth management, insuretech, payments, and blockchain companies to use Hong Kong to advance their globalisation journey. Hong Kong is assisting by providing an environment where fintech firms can experiment and prove their business model in collaboration with regulators, rather than being tied up in knots by regulations.
- **Smart cities:** Hong Kong's population density makes it an attractive location from a commercial point of view. This makes smart technologies in areas such as transportation, green buildings and smart buildings economically cost effective.
- **Healthy ageing:** Hong Kong's rapidly ageing demographic is providing an impetus to seek companies and technologies that can take pressure off the hospital system and shift care into the community and the home environment. As demographics in Hong Kong are similar to the Mainland, it is expected there will be transferrable innovation developed that will be well suited for scale-up.

While InvestHK continues to service Hong Kong's historic investment links with the US, Canada, the UK and Europe, Phillips stresses that its focus isn't on where companies come from, but rather on attracting the best from around the world.

"It isn't about geography, but about the nature of the business. We want the best companies to be investing in Hong Kong either because they have good product or because they're bringing new innovation and skills into the economy," he says.

"When we look at New Zealand, we think of some of the fast-growing tech companies here, and the world-class food and drink companies."

Opportunities in the Greater Bay

Glen Murphy

Imagine if you found an export market that had a GDP the size of Australia and was expected to grow to three times that size in the next decade. A market with an increasingly wealthy middle-class who travel frequently and are developing a taste for international products. A market with some of the best logistics capabilities in the world and where recent infrastructure investment will further improve the flow of goods and the flow of the over 70 million people that live there.

That'd be a pretty attractive market, right?

Welcome to the Greater Bay Area in southern China.

Previously known as the Pearl River Delta, the Greater Bay Area is more than a simple re-branding exercise. Under the umbrella of the Belt and Road Initiative the region is focused on being a world leader in a number of sectors including: technology and innovation, new industry development, tourism and international co-operation.

Including cities like the technology, financial services and logistics centres of Hong Kong and Shenzhen, the advanced manufacturing mega-city of Guangzhou and lesser-known outposts like Dongguan, Foshan and Zhuhai — plus China's casino capital of Macau — the region is already an economic powerhouse. However, with significant infrastructure developments about to come online along with large-scale investment in areas like robotics and artificial intelligence further rapid growth is expected.

This year the opening of the new express train between the mega-cities of Hong Kong and Guangzhou will cut travel time to a meagre 50 minutes. Around the same time the engineering feat that is the Hong Kong-Macau-Zhuhai bridge will mean those cities will also be a one-hour commute from each other. For New Zealand the opening of an increasing number of direct flight links to Guangzhou, Shenzhen and Hong Kong has made the region increasingly accessible in the past two years, giving no excuse to fly over the region on the way to the brighter lights of cities like Shanghai.

It's been pleasing to see a number of New Zealand companies taking advantage of this connectivity and bringing further weight to the existing presence of companies like Mainfreight, Gallagher Security and Comvita who already have their Greater China headquarters in the Greater Bay Area.

It won't all be smooth sailing to get the region more integrated. There are big questions over how the three quite distinct administrative and legal systems of Hong Kong, Macau and mainland China will work together and significant questions about what the mainland government will do with regard to restrictions on capital flow. However, with the growth expectation for the region we do see more New Zealand companies looking at the region as a serious option for expansion and even a city like Hong Kong, that is generally well-known to New Zealand business, is getting a fresh look.

As the home to over 142,000 high-net-worth-individuals and with over 40 million visitors from the mainland each year Hong Kong is already an attractive city-market in its own right and the additional connectivity is bound to make it even more attractive. And that's just one of three mega-cities in the Greater Bay Area.

● *Glen Murphy is the Regional Director for Greater China for NZ Trade & Enterprise (NZTE)*

WITH THANKS TO OUR SPONSORS

HUAWEI
AUCKLAND BUSINESS CHAMBER
ANZ
Fonterra Dairy for life
ICBC
AIR NEW ZEALAND

China's history is marked by thousands of years of world-changing innovations: from the compass and gunpowder to acupuncture and the printing press. No one should be surprised that China has re-emerged as an economic superpower

GARY LOCKE

AVAILABLE ON 13TH OF APRIL

HUAWEI P20 Series

CO-ENGINEERED WITH Leica

Master Photography Powered by AI

#SEEMORE

consumer.huawei.com/nz

Product colour, shape, interface and functions for reference only. The actual product may vary.