

JULY 2009

Distribution & Marketing

Drawing the Map

China's fund distribution and marketing structures are unlike any to be found in Asia or the rest of the world. Lessons learned elsewhere are, more often than not, a cause of problems rather than successes when foreign asset managers attempt to apply them on the Mainland. In this report, we first draw the map of the distribution system, ensuring readers can better exploit some fundamental truths:

- China's distribution architecture is almost perfectly open. In Z-Ben Advisors' view, **this increases the number of opportunities to get distribution wrong.**
- Banks are the cornerstones of the distribution system and sine qua non for successful fundraising but **they will offer fund managers almost no support post-launch.**
- Successful fund managers - domestic and foreign - manage strong relationships in **more than one sales channel.** Unsuccessful managers fail to break out from one channel.

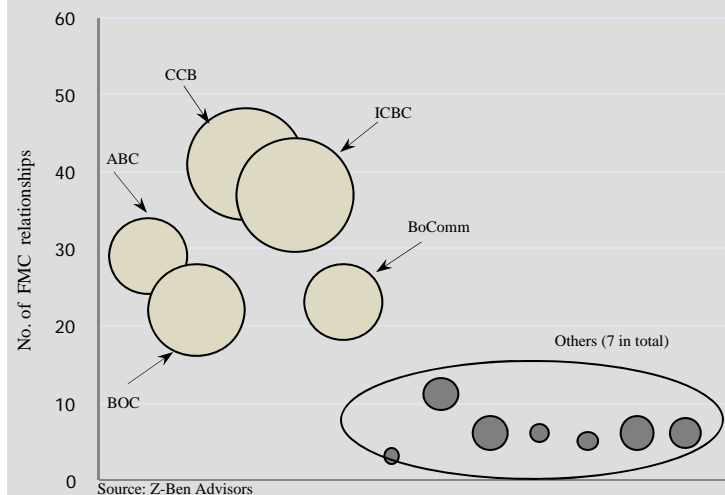
Next, we assess successful and unsuccessful strategies for marketing in China, using our extensive database of fundraising and asset retention results to give readers the best possible understanding of which marketing techniques work and which don't. Among the key lessons:

- **In China, funds are bought, not sold.** They are bought overwhelmingly at launch, at banks and banks have all of the power in determining which funds will be offered to their customers.
- NAV-based marketing - dividends, share splits and secondary offerings - **works better than any other kind of marketing, in every kind of market.**
- **Your global reputation means almost nothing in China.** Here, reputation = distribution = marketing strength. Failure to understand that will cripple your marketing efforts.

Using these distribution and marketing maps as our guide, we offer a critical assessment of current practice for each of four common channel construction models used by asset managers to access China - home office, Hong Kong/Singapore, strategic partner and representative office service - and give our advice on how to exploit each to better effect. For readers, **this report will make possible better strategic planning, better allocation of resources and better execution when funds are sold in China:** a must-read for all asset managers.

BIG BANKS DOMINATE DISTRIBUTION

Data point size = volume of funds under custody



REPORT HIGHLIGHTS

- Assessment system for identifying marketing and distribution power in China: what separates top-, middle- and bottom-tier fund managers, foreign and domestic
- Detailed positional analysis of China's 20 most important custodian/distributing banks and their key target markets
- Comprehensive appraisal of factors most likely to influence fundraising and how to manage them
- Post-sale asset retention and marketing: how to do the impossible in China
- Access model comparisons: which service models lead to growth, which to stagnation and why

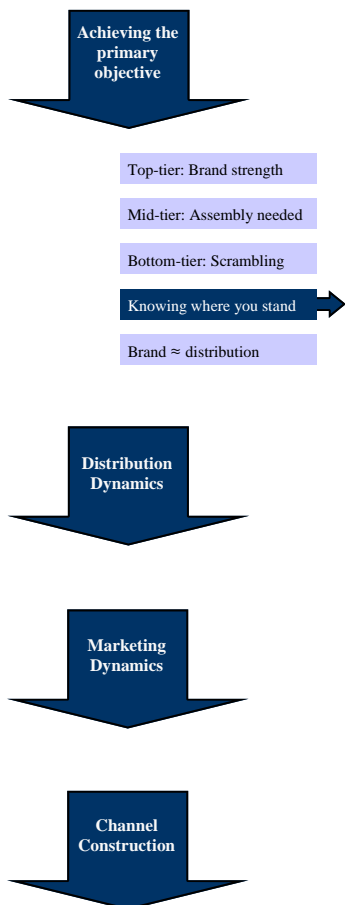
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Knowing where you stand



Which one of the preceding models best described your business in China? This is perhaps the most important question to be resolved before attempting to make sense of – or apply – the mass of data, research and advice contained in this report. In our five years of experience advising both foreign and domestic companies about how best to proceed in China, we have found that many companies have a fundamentally incorrect view of where they stand. A rare few underestimate their position; many more dramatically overestimate it, to their cost. In the Chinese market, if you don't know where you stand, it is all but impossible to make meaningful advances.

If you believe your firm to be top-tier, we would respectfully suggest taking a moment to reconsider. In Z-Ben Advisors' view, there are no more than 10 top-tier domestic fund management companies (FMCs), of which fewer than five are joint ventures. There are no more than six top tier foreign asset management companies (AMCs), none of which have spent less than five years establishing their positions. At a generous measure, there are another 25 FMCs making up the industry's mid-tier and perhaps 20 AMCs with a strong claim to have clawed their way off the bottom rung. Still certain of where you stand? If any doubt has crept into your self-assessment, we are encouraged.

Our primary purpose in constructing this report is to offer readers an understanding of marketing and distribution in China which they can immediately use to their benefit. How they can benefit depends, almost entirely, on which tier of the industry they occupy: no bottom-tier firm will enjoy any success employing mid-tier tactics; top-tier firms will develop faster by leaving some mid-tier necessities behind. Knowing – and accepting – where you stand is everything: the essential ingredient in constructing a successful development plan.

In the three paragraphs above, we have described the six audiences for whom we are writing: three tiers each of FMCs and AMCs. Our advice, where we offer it, is aimed squarely and solely at one audience at a time. What may work for a mid-tier FMC almost certainly won't for its larger and smaller rivals and will be wholly inapplicable for any AMC. We intend to make what helpful suggestions we can to every group, in as many different facets of China's distribution and marketing complex as we can. However, let us, one last time, reiterate our first message to readers: if you misidentify which tier you're in, nothing contained in this document will help you. Call us if you're in doubt. If you've already made the decision to purchase this report, chances are we know you and where you stand. If we don't know you, we'll have an answer for you by the end of a short call. Please, at a minimum, consider seriously our promise that such a

call may unlock more value from this document than any other effort.

For a number of our readers, what follows will require them to think within the two hats they habitually wear: as, say, an officer of a top-tier AMC and board member of a mid-tier FMC in which that AMC owns a minority stake. We sympathize. The organizational needs of one are unlikely to predict the needs of the other, nor is a marketing plan which works for the parent likely to aid the development of the JV. With luck, for you, this document will produce double the value.

Our second message to readers: China's marketing and distribution system is perhaps the most opaque of its kind in Asia. It responds, as we'll demonstrate, entirely differently to different tiers of participant. Most of it is resistant to generalization and particularly impervious to quantitative analysis beyond the least useful generalities. We believe we can see further into many black boxes than most observers but we have (and, we hope, know) our limits. There are counterexamples, outliers and non-conformers to almost every general statement expressed herein. Some of them, which we have taken pains to identify, have blazed trails that other, similarly-positioned firms may be able to follow. Others are accidents of history, market timing or pure, dumb luck.

Abstracting useable guidance and data from such a system requires both experience and a will to think qualitatively about trends and ingrained structures which resist formal measurement. We have the first. We've done the second. Much of what we will present in this document will directly contradict the assumptions underpinning a number of business plans we see being executed in China. We stand by our findings. A number of the business plans we see being executed have no meaningful chance of success. A greater number, in our view, mix correct and incorrect assumptions about what is possible, what is realistic and, at worst, what is plausible. This is, without doubt, a forgivable and natural sin. Typically, such business plans represent hard-earned knowledge of what has and has not worked in other markets. The fact that such lessons are only rarely useful in China is something that, until now, could only be learned on the ground. We hope this report can be the best possible substitute to that very bloody school of hard knocks.

The reasons it is so difficult to import lessons take us, however indirectly, to our third message to readers: unless you know us very, very well, this is unlikely to be the report you were expecting. As an example, we will devote a lavish proportion of this report to identifying, for FMCs, the myriad ways in which custodian banks impact sales, marketing, product design and post-sale

Chinese banks: Who's who

Achieving the primary objective

Distribution Dynamics

Assessing the role of banks

Fact - open architecture

Chinese banks: Who's who

Bank play differing roles

Picking the right partner

Bank QDII: Closed

Custody: competitive issues

Relationship webs

Accessing the client

After-sale servicing

Alternative structures

Marketing Dynamics

Channel Construction

Bank of China (中国银行)

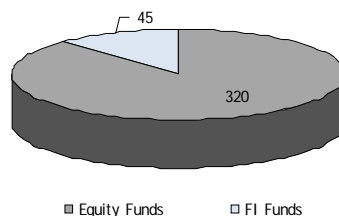
Network breadth

- Branches:	9,980
- Employees:	249,278
- Retail savings:	2,724bn
- Retail concentration:	53%

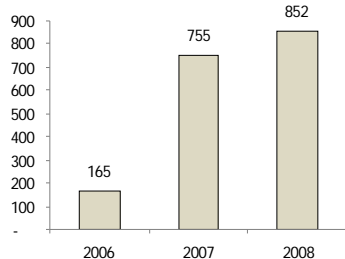
Network Depth

- Employees per branch:	25
- Retail savings per employee:	10.9bn
- Corp. savings per employee:	8.7bn

Funds under custody (Rmb bn)



Custody fee revenue (Rmb m)



Competitive positioning

Total product universe	463
No of product under custody	72
Market share	15.6%
Total custody market	2,220bn
Funds under custody	365bn
Market share	16.4%
Custody by branch	36.6bn
Custody by employee	1.47bn

Agriculture Bank of China (农业银行)

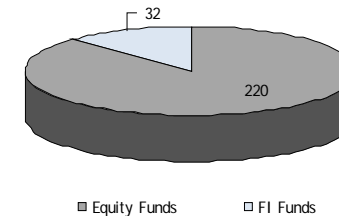
Network breadth

- Branches:	24,064
- Employees:	441,883
- Retail savings:	3,737bn
- Retail concentration:	61%

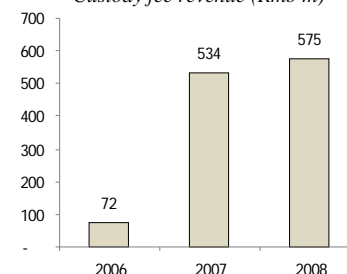
Network Depth

- Employees per branch:	18
- Retail savings per employee:	8.5bn
- Corp. savings per employee:	4.9bn

Funds under custody (Rmb bn)



Custody fee revenue (Rmb m)



Competitive positioning

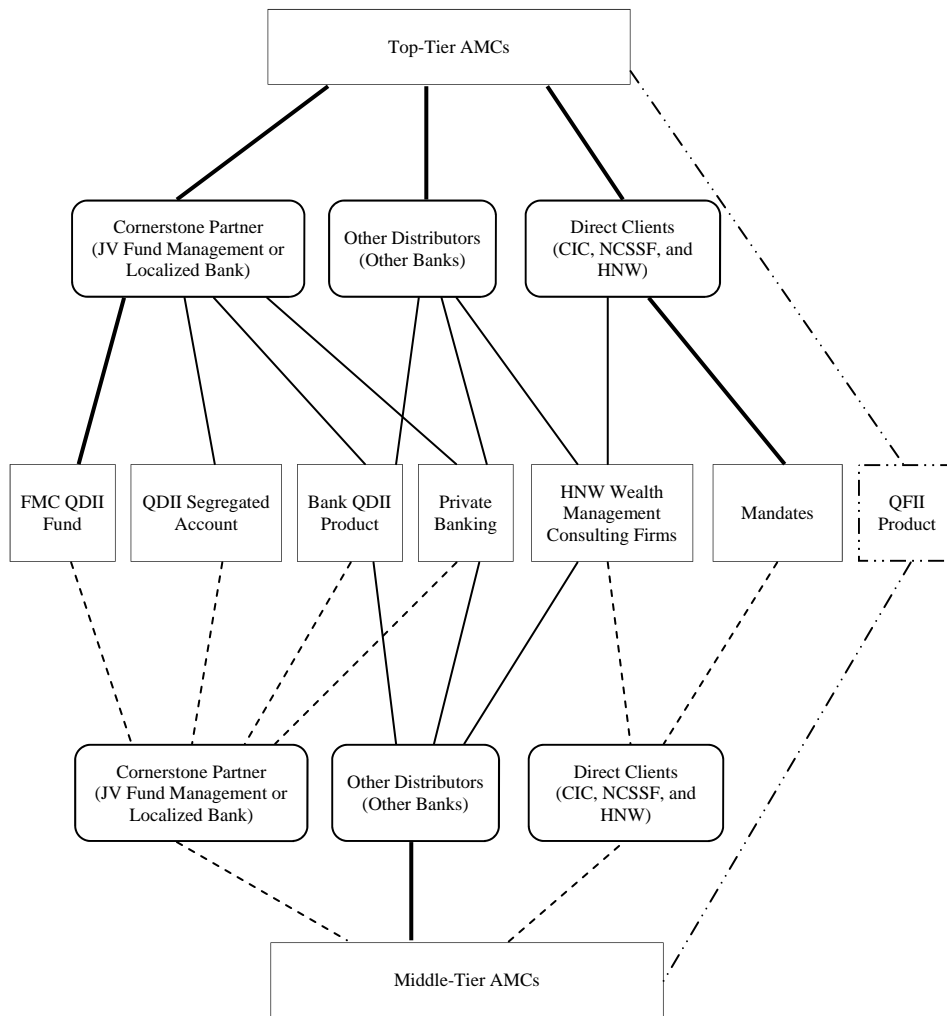
Total product universe	463
No of product under custody	59
Market share	12.7%
Total custody market	2,220bn
Funds under custody	252bn
Market share	11.4%
Custody by branch	10.5bn
Custody by employee	0.57bn

- Bank of China has retained a relatively high share of the domestic custodial business - typically 15% - despite a substantially smaller branch network employed by the bank's three primary competitors.
- Their success is a testament to the bank's strong reputation with customers and their consequent trust in its "to be sold" list. It is, however, also somewhat surprising as BoC takes a much greater interest in international than domestic investing. BoC, arguably the most global in outlook of any Chinese bank, is a powerhouse for QDII fundraising and the re-opening of this channel suggests the potential for strong growth in BoC's custodial business in coming years.

- Agricultural Bank of China has one of the most extensive branch networks in China - a clear advantage that is undercut by the fact that a high proportion of its branches are in low-income rural areas. In part because of this demographic disadvantage, the bank has had difficulty sustaining the market share of its custodial business and is now perhaps the least sought-after of the original custodian banks.
- ABC might also be considered the exception to the rule that banks give no particular priority to raising funds for their subsidiary FMCs. ABC raised eye-opening sums at launch for ABC-CA but has failed to match those totals for other FMCs' funds.

Accessing the client: AMC retail access

Exhibit 2.24: Wider relationships for top-tier AMCs
Retail access flowchart



- The model of graphical clarity to the left is intended to make one thing clear: **top-tier AMCs enjoy a multitude of profit generating relationships in China while mid-tier AMCs enjoy few.**
- A foreign AMC's JV FMC or its local retail bank can be regarded as cornerstone partners. **Middle-tier AMCs rarely have JV relationships or bank branches in China.**
- More typically, middle-tier AMCs sell their products through banks' QDII lists. **Bank QDII lists may carry the fewest reputational benefits to AMCs of any relationship in China.**
- Moreover, with bank QDII lists now the subject of significant restriction and scrutiny by CBRC, AMCs may find themselves being deleted from active lists at a time when the bank QDII range is narrowing. **If you can only have one storefront in China, don't pick a domestic bank's QDII list.**
- **SWF investment may be the best way to accelerate development of relationships in China as CIC or NCSSF investment is seen as a seal of approval for an AMC.** That said, a CIC or NCSSF mandate may be the most difficult piece of business to win in China.
- HNW wealth consulting firms are a relatively new development and the best and largest companies are typically run out of Hong Kong. They do not yet have much influence over asset flows or other distributors.
- QFII remains the one place where top- and middle-tier firms can play relatively equally. **Operating a QFII fund remains one of the best ways to form on-the-ground relationships with key distributors and possible cornerstone partners.**

Developing on- and offshore funds

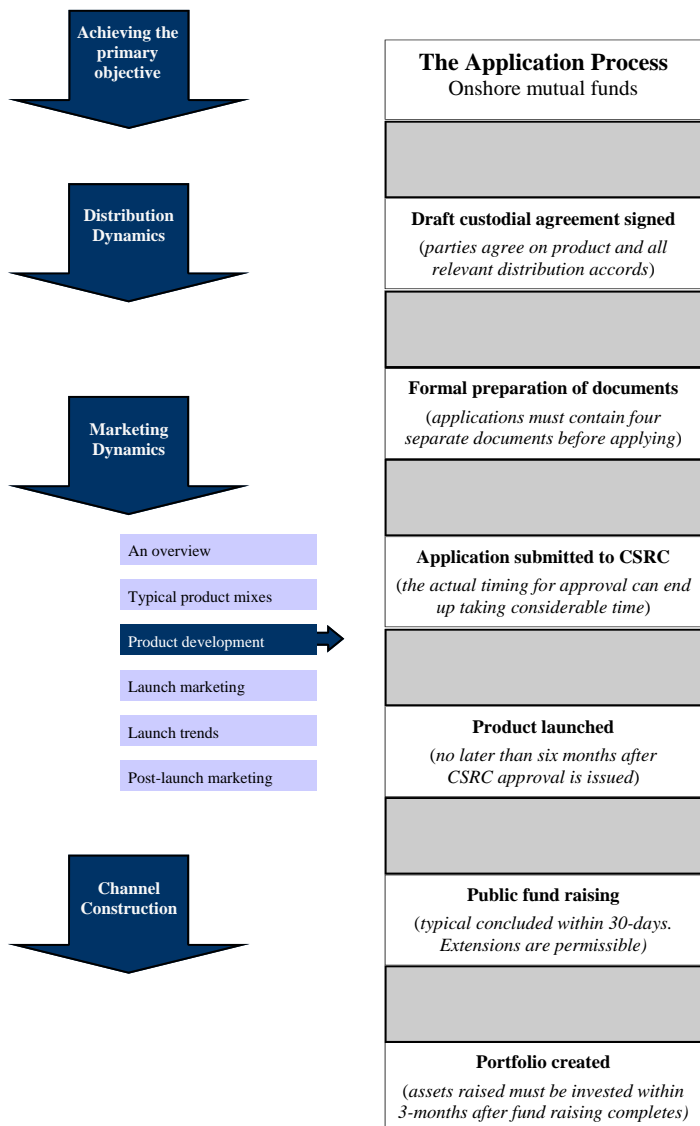
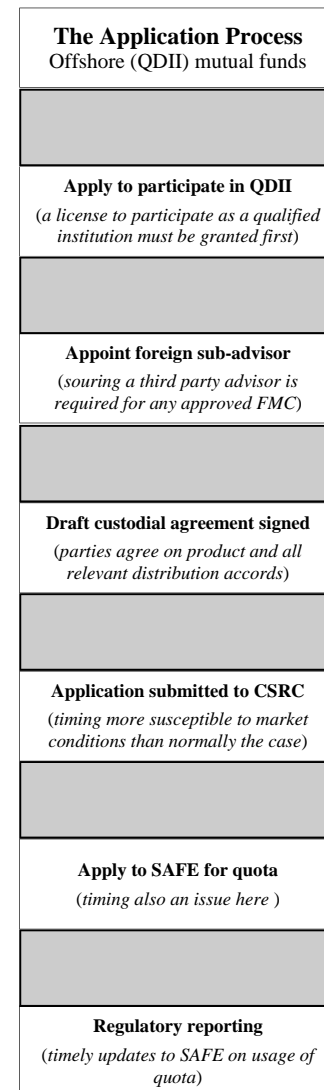


Exhibit 3.14: Looks easy, rarely is

FMCs users' guide for onshore and QDII mutual fund applications

Procedural issues to be mindful of

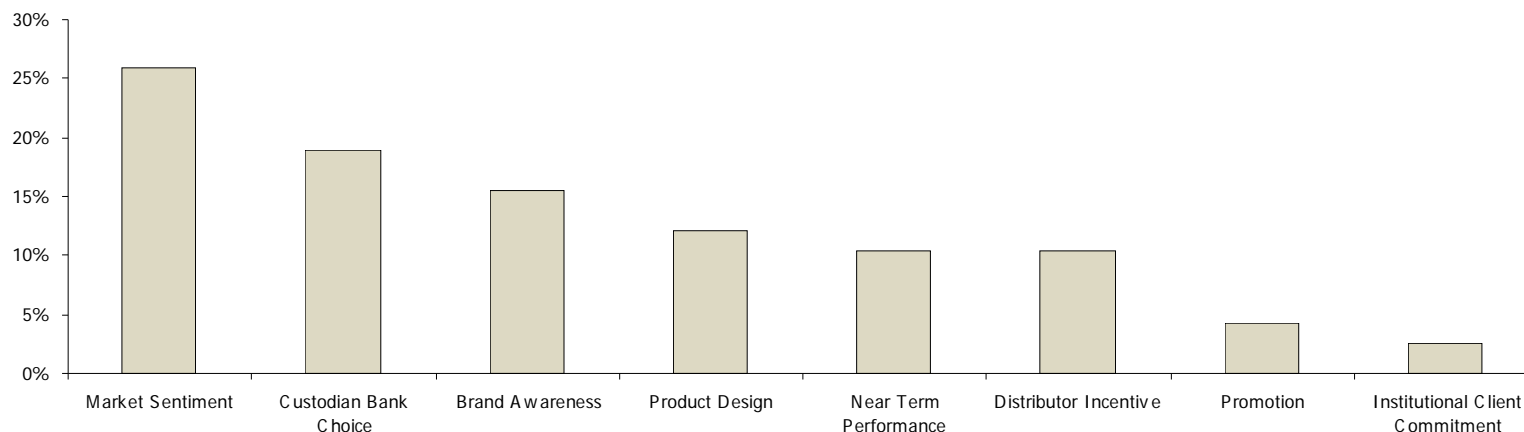
- FMCs attempting to gain regulatory approval for a new domestic product now have two routes to consider: **the traditional approval process and the newer “green channel”** which fast-tracks innovative funds to market and rewards successful applicants with a priority place in the traditional queue for a non-innovative fund.
- Regulatory channel management efforts must always be considered. For example, **CSRC declined all applications for new equity funds at the end of 2007**, in the belief that the stock market had become overvalued. By contrast, in the second half of 2008, CSRC allowed a record number of bond and money market funds to launch, in part to ensure FMCs could expand their product ranges.
- As important is the FMC’s standing with CSRC.** Bankrupt owners, foreign investors undergoing government bailouts or changes of control, serious disputes between shareholders: all these can and do prompt CSRC to withhold product approvals until the FMC’s share register meets spec.
- The process for launching QDII funds is significantly more complicated than that for domestic funds.** In essence, three approvals are necessary: one from CSRC to participate in the program, a second from CSRC for a product-specific proposal and a third, from SAFE, to receive the quota itself. Both regulators take an active stance: CSRC has taken several steps to promote greater heterogeneity in QDII fund designs in recent months, while SAFE balances the interests of FMCs against global market levels and China’s own foreign exchange position.
- A reputable overseas sub-advisor is essential for the QDII application success. The first to launch a QDII product was Hua’an, who cooperated with Lehman Brothers. **So far, all other FMCs which have launched QDII funds have aligned themselves with premier league overseas AMCs.** Quality of the advising AMC, today, is one aspect of the QDII application process likely to come under more CSRC scrutiny.



Launch marketing: Weighting the factors

Exhibit 3.20: Controlling your destiny isn't certain

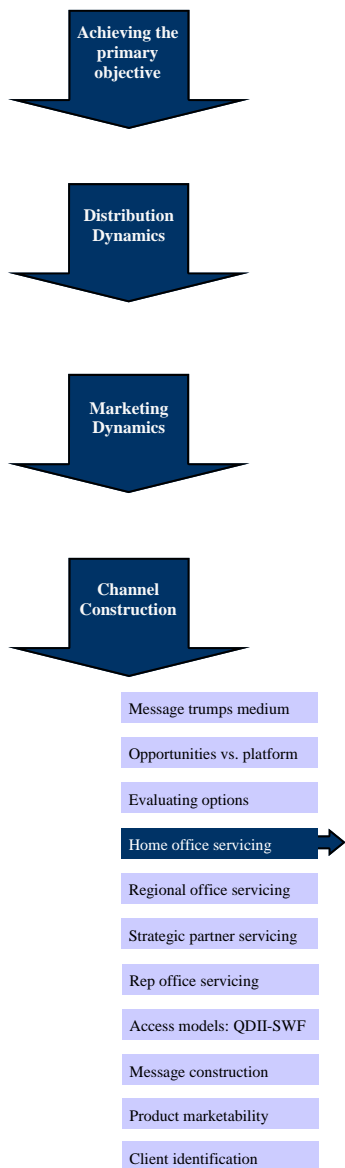
Factor weightings affecting launch results



- Fundraising results are closely related to stock market performance and show a conspicuous cyclicity. A fast-rising market can overcome practically any problems an FMC faces, including distributing bank goodwill, lack of size, lack of reputation and a confusing product structure.
- However, synchronizing a product launch with the market is all but impossible without collaboration from distributors. Having ICBC or CCB work as your main distributor almost always secures above-average fund raising results but these banks prefer top-tier FMCs which already enjoy strong brand awareness.
- Working with institutional clients before the launch officially kicks off can secure the minimum purchase amounts required by law but is unlikely to take bottom- and mid-tier FMCs much further. Also, institutional launch supporters have proven themselves to be very short-term investors and their departure can seriously damage performance in subsequent quarters.
- Good product design is always rewarded with larger AUM. Classified funds, innovative closed-end funds, and bond funds that purchase stocks at IPO are all good examples of this rule. However, trying to rely on product design for fund flows is risky: some laudable design efforts have simply confused buyers and scope to innovate remains low. All FMCs should consider the benefits of novel product designs alongside the risks novelty carries.
- The more positive factors that can be combined, the better. A common trick at launch is to build publicity for the near-term outperformance of a comparable in-house fund. Such publicity is often boosted by declaring dividends in as many funds as possible. The new product is not offered until retail investors are well aware of the FMC's performance and generous dividends.



Channel Construction: Home office servicing



Most AMCs attempting home office service find that their greatest difficulty is in targeting their efforts. While global brand name recognition can open some doors in China, such meetings are unlikely to produce a well-rounded view of either the Chinese opportunity set or the steps that will need to be taken to exploit it. In this exhibit, we contrast the typical state of play at an AMC attempting home office service with what we feel can be achieved by better targeting of time and resources.

<u>Current</u>	→	<u>Possible</u>
<p>On-demand/periodic China visits</p> <ul style="list-style-type: none"> • Fly in periodically to scan local environment • Limited understanding of regulators’ priorities, local demand dynamics • Difficulty achieving meetings with local firms and service providers 	→	<p>Develop comprehensive monitoring platform/capabilities</p> <ul style="list-style-type: none"> • Source/develop constant updates on China’s investing environment • Keep informed of regulatory environment/changes and the opportunities they create • Develop strong understanding of potential partners’ strategic vision
<p>Broad capability promotion</p> <ul style="list-style-type: none"> • Working with a general pitch book • Attempting to literally translate foreign “brand” in China • Limited exposure to local media and, therefore, investing public 	→	<p>Initiate comprehensive brand-building effort</p> <ul style="list-style-type: none"> • Develop a China-specific pitch book • Initiate early investor education and brand development with potential partners • Exploit credible local media as part of overall branding effort
<p>Waiting for leads to self-identify</p> <ul style="list-style-type: none"> • Limited understanding of local investing behavior • Attempting to sell global “best-selling” offshore products in China • Working with any available channels to distribute any house product 	→	<p>Identify markets and develop relevant products</p> <ul style="list-style-type: none"> • Identify, segment, and assess market opportunities • Promote products consistent with targeted segment’s demand • Begin relationships with appropriate distribution channels for each segment
<p>Chasing short-term opportunities</p> <ul style="list-style-type: none"> • Selling “popular” products as defined by local distributors • Listing offshore products on local shelves without comprehensive planning and adequate incentives • Focusing development efforts on channel with nearest-term ROI possibilities 	→	<p>Develop Strategic Relationships</p> <ul style="list-style-type: none"> • Work closely with regulators and outline general intention • Develop ties with FMCs, banks, and trust companies for access to retail market • Develop ties with insurance, SWFs, and pension providers for institutional market

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USD 8,800.⁰⁰