

# THE ESTABLISHMENT OF BERTELSMANN IN CHINA

by

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## **Abstract**

This report provides an overview of the development and expansion of Bertelsmann in China. It reviews and analyzes a number of Bertelsmann's strategic operations within the country. It also provides some information on how Bertelsmann has survived as a new foreign investor in Chinese book market, given policies governing the industry, the competitive environment, and public opinion. The report also describes how Bertelsmann's strategies direct its operations and how the firm has acclimatized itself to China's complicated market environment.

In focusing on Bertelsmann's experiences in China, this report is intended to be used solely as a collective reference, not as a guide to foreign investment. This report is based on media coverage and Bertelsmann's news releases over a span of eight years (1997-2005). The articles were provided partially by the Public Relationship Department of Bertelsmann China, when I was doing my internship at Bertelsmann Asia Publishing (from 2003/11/01 to 2004/03/01).

## Dedication

献给爸爸妈妈，他们给了我生命

献给奶奶，她的教诲照亮了我一生

献给姑姑，她指引我开始出版生涯

献给爱我的人.....

*To my mum and dad, they brought me to the world*

*To my grandma, her earnest instructions light my life*

*To my auntie, she led my career into publishing*

*To those who love me...*

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## **Introduction**

Bertelsmann AG is a multinational media conglomerate. It has operations in 63 countries, including China. Bertelsmann AG owns book clubs in 22 countries around the world under its division DirectGroup. In 1997 Bertelsmann entered China's book market by establishing a business named "Bertelsmann Book Club". In doing so, Bertelsmann took an initial step into a challenging industry – China's book industry.

China has long been isolated from global economy. It has only opened its market to the world in the past 20 years. Beginning in the 1980s, China shifted to a more market-oriented economy and it maintained this momentum. The business climate in the country continued to improve, particularly after China's accession to WTO in December 11, 2001. Nevertheless, foreign investors in the publishing industry, still face tight government regulations. An analysis and summary of how this sophisticated multinational's operations in China succeeded both in development and survival, under restricted policies, will benefit enterprises that have entered or plan to enter China's publishing market.

Bertelsmann is a participant and pioneer in the reform of China's publishing industry. Between 1995 and 2005, China's book market changed from a monopolized market to one shared by state-owned enterprises, private domestic enterprises and foreign companies like Bertelsmann. Each competes within the market; creating a tripartite market structure. That said, while regulations allow for participation in some sectors of the market, they still prohibit foreign-owned publishing houses.

In face of this prohibition, as a market competitor, Bertelsmann dedicated itself to building a powerful book distribution channel in China. And even though Bertelsmann entered the Chinese market early; before the market was formally opened to foreign investors, the company has had to work hard to establish the first foreign-owned book distribution company in China. For example, while it successfully established a book club business in China, the Bertelsmann Book Club, the Club faced numerous unfavourable factors in China, which include:

- The low purchasing power of Chinese readers. This results in low book prices. For example, *Harry Potter and the Half-Blood Prince* sells for about CNY 58 (about \$9 CND) in China, in contrast to \$41 CND in Canada. .
- Chinese readers prefer to buy after seeing the book. Bookstores allow the purchaser the option of looking through the book first, while a book club mail order system does not.
- For Book Club members, payment is quite tedious because credit cards and personal cheques are not widely used in China.
- Bertelsmann must rely on China Post<sup>1</sup> for book delivery in China. However, China Post's service can be unreliable because it is under development. And the service of China Post is often inefficiency.
- Establishing a countrywide retail network with Bertelsmann's Club Centre<sup>2</sup> is rather difficult because of China's vast territory—as large as Canada.

However, the biggest challenge for Bertelsmann Book Club is still China's restrictive policies on publishing industry. In spite of these unfavourable factors, by keeping its operating style of being firm, dovish, and effective, Bertelsmann has managed to gain a position in this potentially lucrative market. In China, Bertelsmann works legally and effectively within policy restrictions. Its endeavours have stimulated some welcomed changes in Chinese publishing industry. Furthermore, Bertelsmann has also set a new benchmark for its competitors in China, gaining the notice of both the publishing industry and the Chinese public.

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<sup>1</sup> China Post is a state-owned postal service provider of China. It is the only one that can provide postal services to the whole nation wide region.

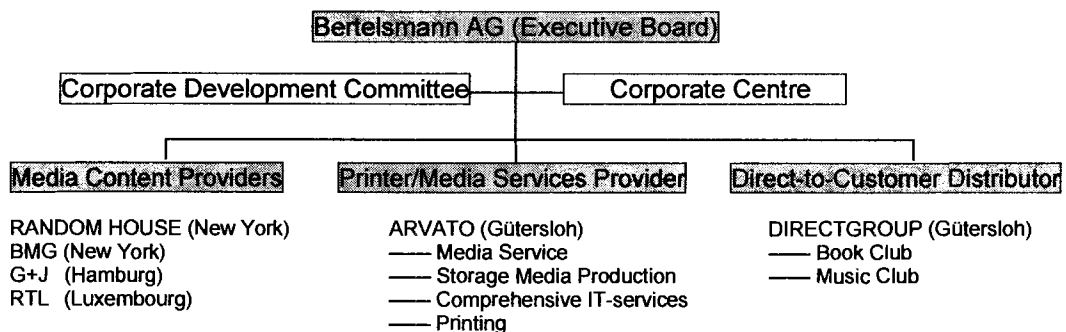
<sup>2</sup> See Chapter 2.5 for detail information.

# Bertelsmann AG and its Business Units in China

## 1.1 Bertelsmann AG

Bertelsmann AG is the international parent group with divisions around the world. Its core business is to produce, serve, and market media. The Bertelsmann family of companies includes renown book publishers, record labels, music and book clubs, newspaper and magazine publishers, television and radio stations, television production companies, media and print services providers. This wide scope of business allows Bertelsmann to offer comprehensive cultural media products. Its six divisions: RTL, Random House, Gruner + Jahr, BMG, DirectGroup and Arvato, offer different functions, namely in providing media content, media services and customer services. Chart 1 illustrates the organizational structure of these divisions.

Chart 1: The Structure of Bertelsmann AG



### 1.1.1 Media Content Provider

The German conglomerate includes in its media content provision the RTL Group, Europe's leading enterprise in television and radio broadcasting; Random House, the world's largest English-language general trade book-publisher, which consists of more than one hundred imprints; Gruner + Jahr, a leading European enterprise in magazine publishing; and BMG, the parent company of Sony BMG Music Entertainment and BMG Music Publishing.

### **1.1.2 Printer and Media Services Provider**

Arvato, one of the biggest international media service providers, offers a variety of services including conventional printing, supply chain solutions, fulfillment and distribution services, customer relationship management, media products replication, and financial services. Arvato Systems is one of the leading authorities on media information technology. Arvato Mobile, Europe's leading mobile entertainment provider, enables network operators, media companies and internet-portals to offer their customers first-rate mobile content and innovative applications.

### **1.1.3 Direct-to-Customer Distributor**

DirectGroup integrates Bertelsmann's global media direct-to-customer business. Roughly 32 million customers secure DirectGroup's competitive position among the largest enterprises in the media industry. The cornerstone of this success is the book and music clubs in 22 countries, which comprises strong brands like France Loisirs (France), Doubleday Book Club (USA and Canada), Der Club (Germany), and BeMusic (USA). Its online club stores are popular shopping destinations. DirectGroup's clubs and other strong brands such as CDNow make it a major player in direct-to-customer media e-commerce.

Bertelsmann AG is a non-public stock corporation. Its shareholders are the Bertelsmann Stiftung (57.6 percent), Groupe Bruxelles Lambert (25.1 percent) and the Mohn family (17.3 percent). Bertelsmann began with Carl Bertelsmann's creation of Bertelsmann Verlag in Gütersloh Germany. It was a small religious publishing company that evolved from a bookbindery to a printing house and finally a full-scale publishing house in 1835. The Hymnal Theomele was the company's first bestseller. Bertelsmann survived World War I, and was the largest publisher in Germany when World War II began. Reinhard Mohn, the fifth generation of the Bertelsmann family, rebuilt Bertelsmann after the war and laid the cornerstone for its development into a modern media company. Bertelsmann started Germany's first book club in 1951 to stimulate book sales. In 1962, Bertelsmann established the first book club outside Germany in Spain, marking the first venture into international territory. In 1971, Reinhard Mohn completed the transformation of the midsize family business into a modern, management-led media corporation by establishing Bertelsmann AG.

Bertelsmann then began to diversify into other forms of modern media by a series of international acquisitions. Over the next 30 years, the company grew at a tremendous rate. Along the way, Bertelsmann acquired newspapers, magazines, television, radio and book clubs throughout Spain, Eastern and Central Europe. During the 1980s, Bertelsmann acquired two major American publishing companies, Bantam Books and Doubleday, as well as the record companies Arista and RCA. After 1990 Bertelsmann continued its expansion in Eastern and Central Europe. In 1997 Bertelsmann reached further still to bring the first book club to China. Bertelsmann acquired Random House in 1998, a move that made the United States Bertelsmann's biggest market. Today, Bertelsmann AG has become one of the most prestigious multimedia groups in the world, with operations in 63 countries and 76,266 employees (as of December 31, 2004). In 2004, it reported revenue of €17 billion. Bertelsmann AG's current Chairman & CEO is Dr. Gunter Thielen.

## **1.2 Decentralization and Synergy**

Bertelsmann AG operates using a decentralized corporate structure. Reinhard Mohn first introduced the concept while Bertelsmann was recovering after World War II. Reinhard Mohn created an infrastructure for the growing company with decentralized profit centres. Executives in Bertelsmann subsidiaries were largely autonomous. The decentralized structure, with performance-based compensation, attracted entrepreneurial executives who came to be called "Bertelsmen". Bertelsmann AG's official website says: "Decentralization is a key factor in our success"<sup>3</sup>, which shows it is the foundation of Bertelsmann's management style. Meanwhile, within this framework of entrepreneurial autonomy, Bertelsmann's executives are responsible for effective cooperation. They must ensure that their activities serve the interests of Bertelsmann AG, as well as the interests of the joint venture partners. Synergies are sought within the corporate structure of the group. Bertelsmann sees decentralization, entrepreneurship and leadership through partnership as the basis for success. The Chairman & CEO of Bertelsmann AG, Gunter Thielen, has said:

"Bertelsmann is proud of the 'entrepreneurs in its enterprises.' Strong managing directors who cooperate with one another are the underwriters of our success. Synergies and cooperation have become part of our daily

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<sup>3</sup> Bertelsmann AG, 2005

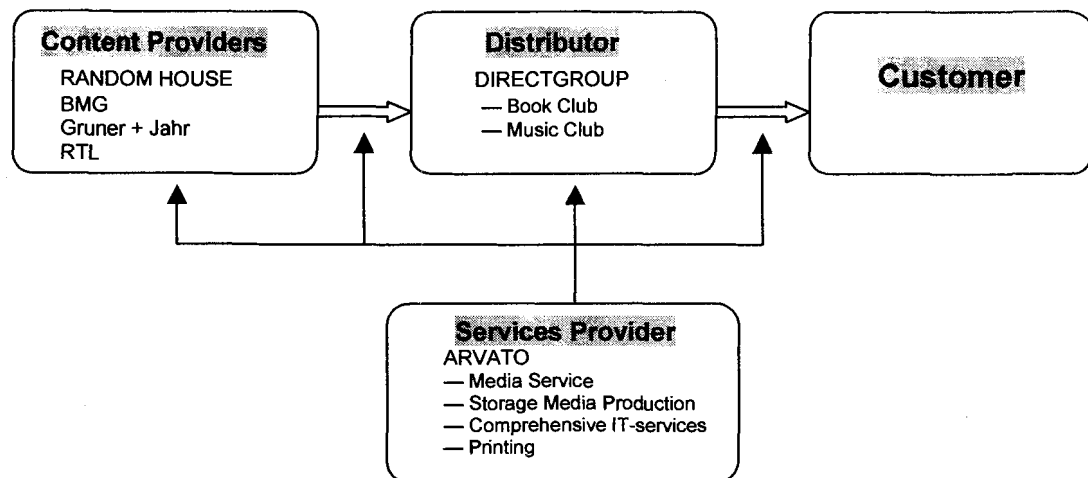
business,” “We exploited synergy potential and strengthened our market positions with outstanding creative achievements.”<sup>4</sup>

### 1.3 Bertelsmann’s Value Chain

Decentralization and synergy are the essential parts of the corporate strategy designed by Reinhard Mohn. Decentralization encourages and allows managers the freedom to make executive decisions and explore, grow and expand into the industry as they saw fit. Synergy brought this growth and expansion together allowing the company as a whole to increase its market development. The following process can summarize the synergy of Bertelsmann’s divisions.

First, content providers create content and turn it into media products with the help of service providers. Then the content providers transfer these products to the distributor. The distributor delivers those media products directly to the consumer. The content provider focuses upon the processes of creating attractive content. Correspondingly, the distributor focuses on building excellent channels that reach consumers directly and rapidly. Meanwhile, the service provider supports the content provider and distributor at every step of those aforementioned procedures. For example, service providers supply chain solutions, fulfillment and distribution services, as well as customer-relation management.

Chart 2: Bertelsmann’s Value Chain



<sup>4</sup> Bertelsmann AG, 2005

The synergies created by these divisions create a cost effective way of doing business by forming a value chain. The value chain is a means of analyzing an organization's strategically relevant activities in order to understand overall costs. Applying Michael E. Porter's<sup>5</sup> value chain concept, the Bertelsmann family of companies can be seen in Chart 2.

#### 1.4 Bertelsmann Business Units in China

Bertelsmann is proud of its successful global expansion into 63 countries and regions. Two-thirds of Bertelsmann's annual income is derived from territories outside Germany, earning it the title "multinational conglomerate". China, the most rapidly growing market, with a tremendous potential for profitability, has become a dream scenario for multinational media conglomerates like Bertelsmann. Bertelsmann entered China in 1995, and has achieved substantial business growth over the past decade. Up to September 2005, Bertelsmann has established numerous wholly-owned or joint venture companies in China. Table 1 describes those companies.

*Table 1: Bertelsmann Business Units in China*

<b>Time of Establishment</b>	<b>Name</b>	<b>Affiliation &amp; Function</b>	<b>Business</b>
February 1995	Shanghai Bertelsmann Culture Industry Company (Shanghai Bertelsmann)	The parent company of Bertelsmann Book Club. A joint venture between China Science & Technology Book Company (China Sci&Tech Book) and Bertelsmann AG. CSTBC is a Chinese state-owned book trading company under the Shanghai Press and Publications Bureau (SPPB). Its actual operations are all under its subsidiary – Bertelsmann Book Club.	Mail Order Company
January 1997	Bertelsmann Book Club	Bertelsmann's first foray into the Chinese economy. A catalogue-based book club which now has 1.5 million members. The first and, as of 2005, the only joint venture book club in China.	Book Club
February 1999	Bertelsmann Asia Publishing (BAP)	A book publishing company registered in Hong Kong with a liaison office in Shanghai. It works closely with the Book Club by providing worldwide copyright information to Chinese publishers.	Book Publishing

<sup>5</sup> Michael E. Porter is the Bishop William Lawrence University Professor. His research focuses on competitive strategy, international competitiveness, the relationship between competition and society, and the relationship between competitiveness and the natural environment. He received a B.S.E. in aerospace and mechanical engineering from Princeton University in 1969, and an M.B.A. from the Harvard Business School and a Ph.D. in Business Economics from Harvard University in 1973. (Harvard University, 2005)

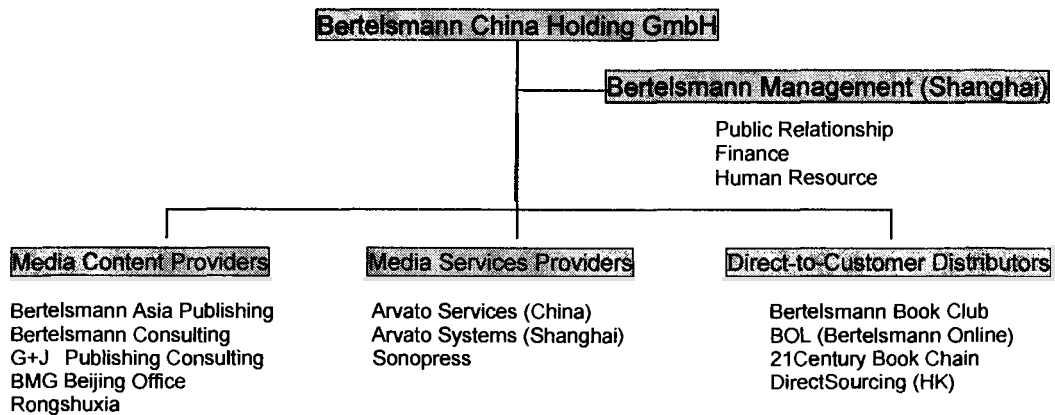


<b>Time of Establishment</b>	<b>Name</b>	<b>Affiliation &amp; Function</b>	<b>Business</b>
December 2000	BOL (Bertelsmann Online) China, www.bol.com.cn	Later in March 2003, BOL China merged with the Book Club's website. It is playing active roles in online retail of books and audio/video products in China.	Online Bookstore
February 2001	Bertelsmann Consulting (Shanghai) Co. Ltd	A consulting service provider in publishing. It works closely with its sister company BAP to provide services, such as, copyright arrangement, editing, and production to Chinese local publishers.	Publishing Consulting
February 2002	Shanghai Rongshuxia	A pioneer Chinese web-literature site. As the strategic partner of Bertelsmann in China, it aims at providing more cultural products to the Club members and Chinese readers.	Literary Forum
September 2003	21 <sup>st</sup> Century Book Chain Company	DirectGroup's Joint venture. Formerly a Chinese private book retail company under the same name. Being the first nationwide joint venture book chain in China, it creates book chains in the country based on the model of Bertelsmann Book Club Centre.	Book Chain
December 2003	DirectSourcing (HK) Co. Ltd	A trading company providing international clients with sourcing opportunities for gift and promotion products from China and other Asian regions.	Small Gift Trade
May 2005	Liaoning Bertelsmann Book Distribution Co., Ltd. (Liaoning Bertelsmann)	A joint venture between DirectGroup and one of the pioneers of Chinese publishing industry reform, Liaoning Publishing Group. Besides traditional bookstores, the joint venture will develop sales in supermarket and stationary stands. It is the first book distribution company co-founded by Chinese state-owned enterprise and foreign investor in China.	Book distribution
December 1999	Arvato Systems (Shanghai) Co., Ltd	Formerly Shanghai Bertelsmann Information Technology Co., Ltd. It focuses on offering tailored solutions to its external customers. The solutions include E-Business, CRM, SCM, and Content Management.	IT
September 2000	Sonopress (Shanghai) Multimedia Technology Co., Ltd	Sonopress provides Disc mastering and replication services and anti-piracy technology to Chinese clients.	Disc Duplicator
December 2000	Arvato Services (China) Co., Ltd	Formerly Shanghai Bertelsmann Commercial Service Co., Ltd. It offers a complete logistics service including supply chain management, customer relationship management and call centre management.	Logistics
September 2002	G+J-CLIP (Beijing) Publishing Consulting Co., Ltd	A consulting service provider in magazine publishing. It is Gruner + Jahr's joint venture with China Light Industry Press.	Consulting

Time of Establishment	Name	Affiliation & Function	Business
May 1996	BMG China Inc., Beijing Office	It provides media consulting services in the fields of music and entertainment to Chinese clients.	Consulting
October 2004	Bertelsmann Management (Shanghai) Co., Ltd.	It bears management functions in Human Resources, Finance, and Public Relations. It is also responsible for build-up of a positive corporate image as a cultural ambassador between China and Germany via various significant public activities, government and media relations.	Management

Bertelsmann's businesses in China can be sorted into three fields. The first being media products distribution, which includes books, magazines, audiovisual products, through offline and online channels, such as Bertelsmann Book Club and BOL China. The second is content provision, undertaken by such companies as BAP, Bertelsmann Consulting, G+J and BMG. The third is media services, including logistics and customer service, and information system service provided by the Arvato division.

*Chart 3: The Structure of Bertelsmann China*



## 1.5 The Core Business in China – Bertelsmann Book Club

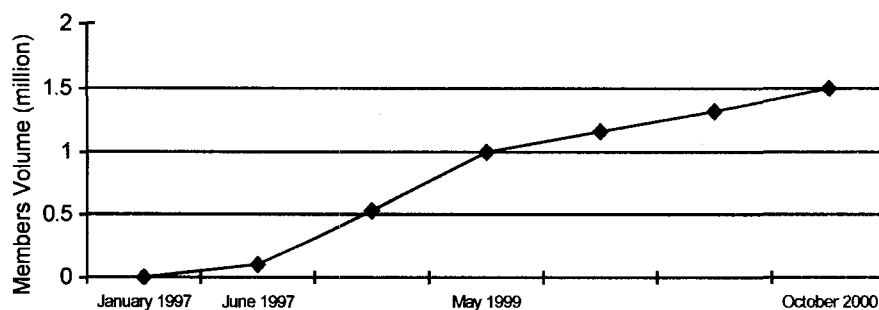
A book club is where people usually meet to discuss a book. Commercially, a book club is a method or a channel of publishing and selling books. Book club members agree to receive books by mail, and pay for them as they are received. The book club periodically sends book catalogue to the members. However, books are sent when the customer specifically orders

them.<sup>6</sup> The concept of a book club was put in practice in Germany by Reinhard Mohn, he established the first book club of Germany. At present, the book and music club is the main direct-to-customer business of DirectGroup and makes up a majority of its revenue. As the subsidiary group of Bertelsmann, DirectGroup contributes € 2.2 billion revenues to the whole group (2004 fiscal year).

The German company named its Chinese book club Bertelsmann Book Club (hereinafter referred to as the Book Club) to clearly demonstrate its origin. The Book Club purchases publications from Chinese domestic publishers. Club members can find their favourite items listed on the catalogue published by the Club or BOL's website and get them through mail order. In cities with Bertelsmann Club Centres, members can purchase books directly in the centre.

Bertelsmann Book Club is the subsidiary company of Bertelsmann AG's first joint venture Shanghai Bertelsmann. It is the exclusive business of the joint venture. Bertelsmann spent almost two years preparing its entry of China including market research and getting market entry permission from the government. Finally, the Book Club was officially launched in 1997. Since then, Chinese readers have embraced this new book-purchasing model. The reputation of the Book Club was quickly established and it experienced a rapid initial growth from 1997 to 2000. The following diagram shows the growth in the volume of Club member from 1997 to 2000.

*Chart 4: The Growth on Club Members (Before 2001)*



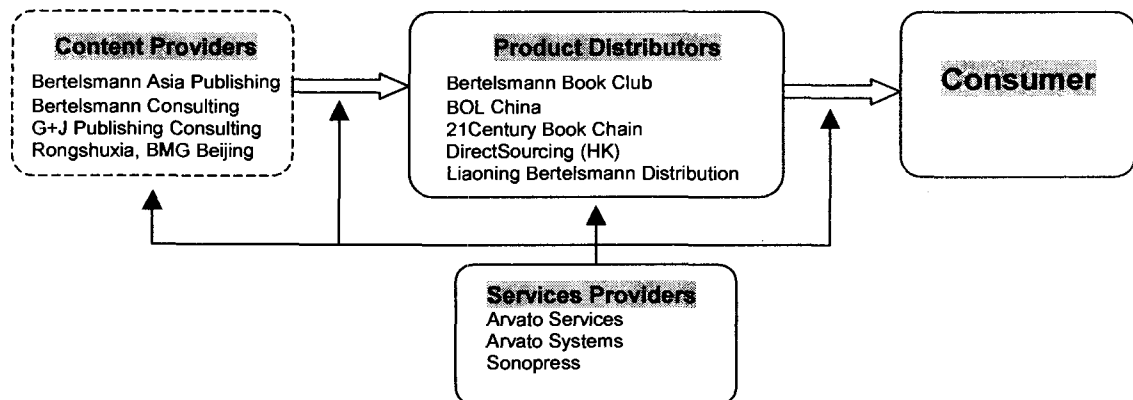
<sup>6</sup> This business may be done by means of negative option billing in which the customer receives an announcement of the book or books along with a form to notify the seller if the customer does not want the book. If the customer fails to return the form by a specified date, the seller will ship the book and expect the customer to pay for it. (Wikipedia, 2005)

Currently, DirectGroup represents Bertelsmann's core business in China – the Bertelsmann Book Club. DirectGroup has established subsidiaries and joint ventures to support the Book Club's operation and business expansion. This includes Bertelsmann Asia Publishing, Bertelsmann Consulting, and Rongshuxia all of which provide editorial content services for the Book Club; 21<sup>st</sup> Century is the retail channel of the Book Club, and Liaoning Bertelsmann is a book distributor; and the Book Club's online sales channel, BOL China, was integrated into DirectGroup's operation in March 2003. Bertelsmann's other business units in the country, for example, Arvato divisions, BMG and G+J-CLIP will not be referred to in the report. This report will focus mainly on the Book Club and the mentioned support companies.

## 1.6 Bertelsmann China's Value Chain

Bertelsmann established its value chain in China gradually. See Chart 5 for reference. Ten years ago, when Bertelsmann signed the first joint venture to participate in China's book market, it was not evident that Bertelsmann was creating a value chain. But when we compare Bertelsmann's operations in China with the value chain model introduced in Chapter 1.3, numerous similarities arise. It appears Bertelsmann has adopted this model into its business structure in China.

Chart 5: Bertelsmann China's Value Chain



Facing fierce competition in China and being a new entrant to the market, Bertelsmann clearly understands that a smooth and integrated value chain is crucial for facilitating cost-effectiveness. However, this value chain is just a frame, which needs further favourable policies from the Chinese government to complete Bertelsmann's intended business structure. As a result of policy restrictions, Bertelsmann's value chain is incomplete in

China. For example, as a foreign company, Bertelsmann cannot publish books in China. That is why the frame of “content providers” in Chart 5 is dotted. Those companies listed in the frame operate restrictively in the role of content providers<sup>7</sup>, while waiting for the opening of policies before they can fully assume the role. Once policy restrictions are lifted, all signs point to Bertelsmann completing the formation of its value chain with the companies it owns. This may happen through the purchase of existing Chinese publishers or through the formation of new publishing entities of its own. Since its initial expansion into China, Bertelsmann has never stopped seeking opportunities for its survival and development, meanwhile, constructing the value chain under the restricted policies. Five notable operations will be studied in Chapter 2. These operations are essential for the completion of the value chain.

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<sup>7</sup> See Chapter 2.2.

## Bertelsmann's Strategic Operations in China

The publishing industry is a special economic sector in China. After the establishment of the Communist Government<sup>8</sup>, there was a period of time when publishing was not considered a real business because it was not a profit centre. Publishing was considered the mouthpiece of the Chinese Communist Party<sup>9</sup> (hereafter referred to as “the Party”), and functioned as a tool of propaganda. Therefore, all publishing activities were kept under the control of the Party and the government. During the Cultural Revolution, this party control and propaganda function was absolutely maximized. Publishing activities were turned into political tools.

At present, this situation has changed, especially after the “reform and opening up”<sup>10</sup> of the country. In addition to propaganda, other functions of publishing such as education, communication, and culture dissemination regained recognition. Publishing became a channel for Chinese people to share their feelings and views. More and more people are thinking of making their works public.

At the same time, the government has cancelled the financial support of the publishing houses and has given them freedom to expand their business operations independently. None the less, the industry as a whole is still under the macro control system of the government by policy guidance and legislation regulations. Publishing companies in China remain state-owned, and publishing books is off-limits to private and foreign investors.<sup>11</sup>

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<sup>8</sup> The communist government of China was established in 1949, which is The People's Republic of China.

<sup>9</sup> The Chinese Communist Party is the ruling party of China.

<sup>10</sup> “Reform and opening up”, that is, reform of the economic system and opening to foreign trade. It refers to the economic reform program that Chinese Communist Party leaders decided to undertake for gradual but fundamental reform of the economic system in December 1978. The purpose of the reform program was not to abandon communism but to make it work better by substantially increasing the role of market mechanisms in the system and by reducing, not eliminating, government planning and direct control. (Wikipedia, 2005)

<sup>11</sup> The chief rules governing the industry, *the 1997 Regulations on Publication Management*, and *the 1997 Regulations on Electronic Publishing*, stipulates that only government-designated publishing organizations may engage in publishing. Thus no private individuals or foreign entities may engage directly in publishing in China. Chinese government controls its publishing sector through ISBN. A certain number of ISBNs are allotted to the publisher annually. This number is basically based on the size of the publisher. Since the ISBN is necessary for a book, only government-designated companies can engage in book publishing.

Furthermore, because publications potentially guide public opinion, editorial content faces the monitoring and censorship of the government.

As a foreign investor in China, Bertelsmann's business activities are under the supervision of the government. In addition to the monitoring and censorship on the editorial content, and the difficulties brought by a new market development, the multinational has faced market entry barriers formed by various restrictive policies. Facing such difficulties, Bertelsmann has adjusted its operating model to accommodate the government's regulations and policies as well as adapt to the Chinese market. Such adjustments have led to a Bertelsmann operating model with Chinese characteristics. In an effort to understand this new model, which guides Bertelsmann's operations in China, five remarkable strategic operations will be studied in this chapter.

## 2.1 Shanghai Bertelsmann

Shanghai Bertelsmann Culture Industry Company (Shanghai Bertelsmann) was the first Sino-foreign joint venture of China's book industry and the first entry of foreign investors to China's book retail and distribution market. Bertelsmann Book Club, Bertelsmann's major business in China, is the subsidiary company of Shanghai Bertelsmann.

Bertelsmann's first visit in China was as a member of a 1993 delegation led by German Chancellor Helmut Kohl<sup>12</sup>. During the visit, Bertelsmann negotiated a verbal approval with Central Government authorities concerning the possibility of cooperation in the areas of cultural and media industries with Chinese counterparts. The sophisticated multinational took the verbal approval as a "god-given" chance. Bertelsmann soon began negotiations with the municipal government of Shanghai<sup>13</sup> to turn the proposal into a reality. Following its pattern, which had been successful in 22 countries, Bertelsmann entered the market by rolling out its book club business. However, establishing a book club engaged in book retailing was, at the time, still off-limits to foreign investment in China. This prohibition remained in effect until

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<sup>12</sup> Dr. Helmut Kohl (full name Helmut Josef Michael Kohl) (born 3 April 1930) is a German conservative politician and statesman. He was Chancellor of Germany from 1982 to 1998 (West Germany between 1982 and 1990). (Wikipedia, 2005)

<sup>13</sup> Shanghai is one of four municipal cities of China. The four municipal cities, Beijing, Shanghai Tianjin and Chongqing, are directly under the administration of the central government, which possess a higher level of power in decision-making than other cities.

the third year after China's accession to the WTO in 2003, when the government opened its book retail sector to foreign investment.

The establishment of Shanghai Bertelsmann was a landmark of the German giant entering China's market. It also made a breakthrough on China's policy allowing foreign investors to be involved in the book retail segment, which had never happened in the history of the industry. It has proven to be a model case for foreign investors to study.

### **2.1.1 Joint Venture – The Unchanged Strategy**

For international investors interested in the Chinese book market, a joint venture is the most suitable method for entering the market. A joint venture between a state-owned company and a foreign investor is more likely to be approved by authorities than one between a private sector Chinese company and a foreign investor. The government believes that a joint venture will bring investments, advanced technologies and management methods to Chinese enterprises. On the other hand, since publishing is the mouthpiece of the Party, the government would like to partially keep control by being one of the shareholders. Secondly, because of insufficient regulations and policies on the publishing industry, foreign investors venturing into book distribution in China will need time to familiarize themselves with the market and policy environment. The best shortcut to the market is to find a reliable local partner with good contacts to reduce risks and make an early entry.

Bertelsmann AG chose China Sci&Tech Book, a state-owned book trading company as its first partner in China. This reliable local partner helped Bertelsmann to quickly familiarize itself with the local cultural environment, acclimatize to the local economic operational model, free it from the language obstacle, and helped Bertelsmann to understand market demand and consumer psychology. Holm Keller, the president of Bertelsmann Corporate Development Asia, acknowledged the value of joint ventures when he was interviewed about a recent Bertelsmann's joint venture in China – Liaoning Bertelsmann.

... Bertelsmann claims that ... it has no plans to operate independently in China, even if the country's regulations should change. "Bertelsmann, in any case, does not want to," says Holm Keller, the president of Bertelsmann Corporate Development Asia. "We're incapable of fully comprehending the opportunities and risks in the China market."<sup>14</sup>

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<sup>14</sup> Weinberg, 2005



### **2.1.2 A Mail Order Company**

Normally a book club is viewed as a business engaged in book retailing. However, the matter can be argued, or, at least, reconceived. To avoid conflicting with the regulations and policies, Bertelsmann registered Shanghai Bertelsmann as a mail order company instead of a book retailing company. This was a wise step for two reasons. First, a mail order enterprise is neither a publishing company nor a bookstore, thus it does not technically violate legislation. Therefore Shanghai Bertelsmann was approved to legally operate in China. Second, government regulation does not stipulate whether distributing books by mail order should be prohibited from foreign investment. By engaging in book distribution<sup>15</sup> to book club members Shanghai Bertelsmann is essentially engaged in book retail even though, formally it could claim that it was not.

On the other side of their activities, Bertelsmann was able to set a precedent in opening up foreign investment in the book industry of China. Because there is no clear prohibition of foreign ownership of book clubs within China, Shanghai Bertelsmann was able to establish itself and expand its business to include China's first joint Chinese-foreign book club – Bertelsmann Book Club. In short, rather than challenging or violating government policy barriers Bertelsmann discreetly worked around the presented obstacles.

### **2.1.3 Shanghai: Bertelsmann's Gateway to China**

As a company engaged in media and publishing in China, Bertelsmann's ideal headquarters should have been Beijing. Beijing is the capital city and the media and publishing centre of China<sup>16</sup>. However, Bertelsmann selected Shanghai for its first point of entry. The following reasons explain why Shanghai was chosen:

1. Beijing is where the Central Government is located. The Central Government prohibits foreign investment in the publishing industry. However all foreign investment projects less than 5 million CNY<sup>17</sup> can be independently authorized by municipal governments. Prior to Bertelsmann, no other foreign investor had tried to invest in the publishing industry, so the government had not realized this policy loophole.

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<sup>15</sup> The Book Club sells books, audiovisual products and small gifts to its members.

<sup>16</sup> According to GAPP (General Administration of Press and Publications) statistics, up to 2002, 236 out of 568 publishing houses in China were located in Beijing. They published 41 percent of the new released books in 2001. China. Beijing. (Committee of Chinese Political Consultative Conference, 2004)

<sup>17</sup> Yan, n.d.

2. Shanghai is the financial and trade centre of the county, which has a relatively loose and comfortable business environment for investment.
3. The Shanghai municipal government was willing to authorized Bertelsmann to operate in its city.

#### **2.1.4 GAPP Scrambles to Regulate Bertelsmann**

The Shanghai municipal government approved the establishment of Shanghai Bertelsmann without Beijing being aware of this foreign entrant. When the General Administration of Press and Publications (GAPP)<sup>18</sup> learned of the establishment of Shanghai Bertelsmann, the company was already in operation. GAPP made attempts to regulate this new foreign entrant with four governmental articles:

1. The Book Club can only serve its club members.
2. The books of the Club must be published by Chinese local publishers.
3. The Club Centre, which provides in-store, face-to-face services to the club members, can only be set up in Shanghai.<sup>19</sup>
4. Club members in places other than Shanghai must purchase books by mail order.

The Chinese government feared the impact this German giant could bring to the market, as much as the Chinese enterprises who saw Bertelsmann as a strong new competitor. The GAPP regulations imposed upon Bertelsmann both protected Chinese companies and restricted Bertelsmann's ability to operate throughout the country free from government control. For its part, Bertelsmann was willing to comply with these governmental articles and remained an operator in the Chinese market.

#### **2.1.5 Shanghai Bertelsmann Milestones**

Shanghai Bertelsmann was created to pave the way for Bertelsmann to establish its book club in China. To understand the early development of Shanghai Bertelsmann Table 2 offers a chronicle of its development. The chronicle details Shanghai Bertelsmann milestones up to its crowning achievement of establishing Bertelsmann Book Club.

As noted, Bertelsmann received the official approval for Shanghai Bertelsmann in July 1994. However, it took another 30 months before the company's goal was achieved. All the

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<sup>18</sup> General Administration of Press and Publications is the highest government administrative agency responsible for the publishing industry of China.

<sup>19</sup> The government cancelled this article by approving DirectGroup's joint venture with 21<sup>st</sup> Century Book Company in September 2003.

elements required to operate a book club in China was finally realized in 1997. Bertelsmann did not make public what strategic planning was conducted during those 30 months, nor how it overcame all the political obstacles, but the company did successfully obtain every license, approval and permission required to commence operations. The chronicle also offers a look into the tedious and complicated procedures needed to set up a publication retail business in China.

*Table 2: Chronicle of Shanghai Bertelsmann and the Book Club*

<b>Time</b>	<b>Milestones</b>
July 1994	The Shanghai Foreign Capital Committee approved the joint venture proposal of Bertelsmann AG and China Sci&Tech Book to co-found Shanghai Bertelsmann.
February 1995	Shanghai Bertelsmann was issued a business license by the Shanghai Industry and Commerce Administration.
March 1995	Shanghai Bertelsmann received permission for mail order book distribution issued by the Shanghai Press & Publication Administration.
February 1996	Shanghai Administration for Audiovisual products permits Shanghai Bertelsmann to distribute audiovisual product through the mail.
January 1997	Bertelsmann Book Club was officially established.

## **2.2 BAP and Bertelsmann Consulting**

In February 1999, Bertelsmann Asia Publishing Company Limited (BAP) was founded in Hong Kong. Two years later, in February 2001, Bertelsmann Consulting (Shanghai) Company Limited (Bertelsmann Consulting) was founded in Shanghai. The Establishment of BAP and Bertelsmann Consulting was to bring foreign titles into China, satisfying the first link of the value chain<sup>20</sup> – content provision. To fully realize Bertelsmann’s value chain, Bertelsmann Shanghai needed to establish a strong content provision company, which would support the development and growth of equally strong direct-to-consumer distribution channels. For Bertelsmann to achieve its goal of building a successful book club, it needed to be prepared to overcome the obstacles posed by restrictive policies. One of most significant

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<sup>20</sup> See chapter 1.6.

obstacles is the government regulation which required Bertelsmann Book Club to sell only books published by Chinese publishers.<sup>21</sup>

Recognizing this issue early on, Bertelsmann built BAP and Bertelsmann Consulting to surmount this obstacle. As a multinational media company, Bertelsmann is able to access numerous publishing resources in the world that Chinese publishers may not be able to obtain. Bertelsmann AG owns book clubs in 22 countries around the world. It also owns Random House and a variety of other imprints. Titles that are popular in its other book clubs (and perhaps its publishing arms) are examined for suitability and profitability in China. Once Bertelsmann has found a title it wants to introduce into the Chinese market, BAP and Bertelsmann Consulting, actively working with Chinese publishers, will arrange for its publishing in China.

### **2.2.1 Bertelsmann Asia Publishing Company Limited**

Hong Kong is a metropolitan city with an advantageous geographic location. It was the ideal place for BAP to radiate its influences to major cities in East Asian. Moreover, Hong Kong is the premier gateway for trade with and investment into and out of the Chinese Mainland. Even with such beneficial properties, BAP was mainly established in Hong Kong for other reasons.

Hong Kong is the Special Administrative Region of China, which maintained a free economy after its 1997 return to Chinese control. Only in Hong Kong could a non-state-owned Chinese publishing company be legally established. Bertelsmann took advantage of this to establish BAP, a foreign publishing company, in Hong Kong. However, BAP's target audience was the Book Club members in Mainland China, where publishing is limited to state-owned enterprises. Note that Hong Kong book publishers are treated as overseas companies in Mainland China because Hong Kong is a separate economic zone of China. So BAP cannot legally publish books in Mainland China. Therefore, a liaison office for the Hong Kong-based BAP was created. All BAP operations are conducted in Shanghai, through the BAP Shanghai liaison office. The liaison office of BAP in Shanghai carries more responsibilities than BAP's head office in Hong Kong. Hereafter all mentions of BAP will refer to the BAP Shanghai liaison office.

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<sup>21</sup> See chapter 2.1.4

### **2.2.2 Two Companies under One Management**

BAP Shanghai liaison office (BAP) and Bertelsmann Consulting work closely together. BAP's major function is to introduce overseas books to Chinese readers through trade in copyright. Bertelsmann Consulting provides consulting services mostly in editorial and production areas to Chinese book publishers. As sister companies, BAP and Bertelsmann Consulting share the same office space and work under the same management team. Ms. Yan Pan is the General Manager of both BAP and Bertelsmann Consulting.

### **2.2.3 Business Model**

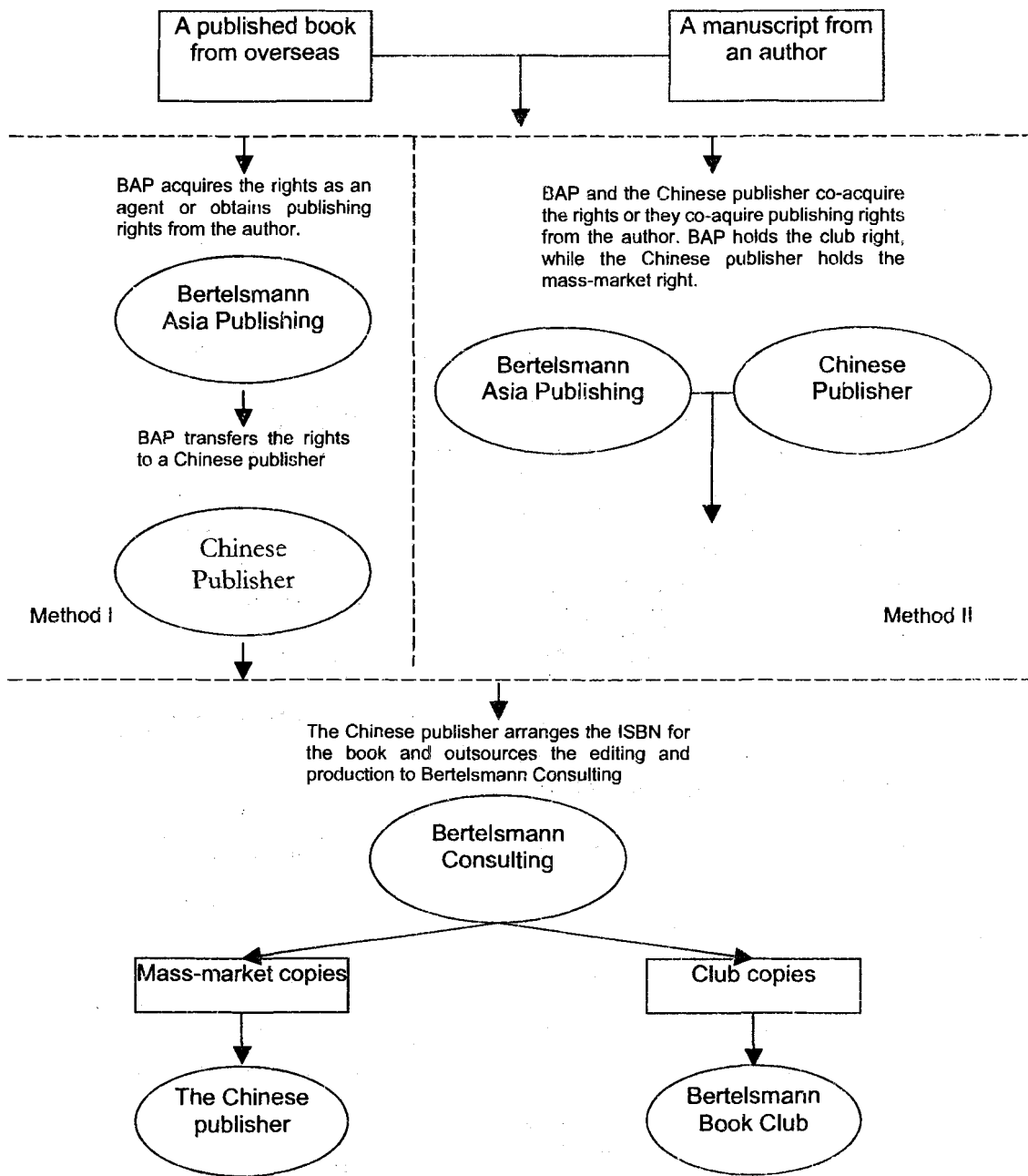
BAP and Bertelsmann Consulting arrange for their highest priority books to be published in China. To legally work under China's restrictive policies, BAP and Bertelsmann Consulting carefully designed their business to allow Bertelsmann to collaborate with Chinese publishers to bring variety to its Book Club members. This is accomplished first, by BAP locating overseas titles, then arranging reprint permissions in China and also locating a Chinese book publisher willing to publish the titles. Bertelsmann Consulting follows by providing services in editing and production for the Chinese publisher.

Chart 6 demonstrates the whole business model. When BAP discovers a book or a manuscript that it thinks will appeal to Book Club members, BAP can acquire the rights using one of two methods. Method I is to acquire the rights as an agent and then transfer it to a Chinese publisher for publishing in China. Method II is to co-acquire the rights with a Chinese publisher who will then publish the book in China. Whichever method BAP selects, it is able to secure three advantages for Bertelsmann:

1. Bertelsmann Book Club becomes the exclusive book club to distribute the title in China.
2. The copies sold by the Book Club (club copies) are purchased at a lower royalty than those sold by the Chinese publisher (mass-market copies).
3. Through negotiations, BAP is able to convince the Chinese publisher to outsource the editing and production to Bertelsmann Consulting.

Bertelsmann Consulting works closely with the Chinese publisher to produce the book. The Chinese publisher oversees and approves the text, illustrations, layout, and proofs. It also provides the ISBN, which is essential to legally publish in China.

Chart 6: Business Model detailing the Publishing Process of BAP



The success of this business model can be measured in two ways. First is by its ability to develop and grow Bertelsmann's distribution channels. While Bertelsmann realizes a satisfactory sales margin, due to the lower royalty received on club rights, this business model does not contribute a large marginal increase to the overall business conducted by Bertelsmann.

The other titles offered by the club are purchased from Chinese publishers. Although the purchasing discount for the Book Club, is much higher than what other Chinese booksellers can get<sup>22</sup>, the margin is still lower than what Bertelsmann obtains in other countries. The former president of DirectGroup Bertelsmann China has confirmed this situation:

President of DirectGroup Bertelsmann China Mr. Christian Unger<sup>23</sup> said his company would further develop the Chinese book market, where it is gaining a small margin. The margin is 10-20 percent lower than margins Bertelsmann recorded in other parts of the world, but he did not provide detailed figures. Unger said the key challenge Bertelsmann faces in China is that it buys books from local publishing houses at comparatively expensive prices.<sup>24</sup>

The second way in which this business model is successful is that it establishes all the foundations permitted in preparation for policy change that will allow Bertelsmann to publish in China. The moment the Chinese government relaxes its publishing policy, Bertelsmann will be able to function as it does in other countries.

Today, restrictive policies on editorial content and ISBN remain the last barrier before Bertelsmann can wholly engage in the publishing business in China. In the year 2005, BAP provides about 110 sets of rights to local publishers annually, and in doing so has established a rather significant influence in China's publishing circle. Meanwhile, BAP has built up cooperative relationships with a large number of publishers, and maintains contact with many famous Chinese writers. BAP and Bertelsmann Consulting are capable of fully functioning as a publishing company. Once the Chinese government releases publishing rights to foreign investors, Bertelsmann will surely transform BAP and Bertelsmann Consulting into a book publishing company in China.

### **2.3 Strategic Alliance with Rongshuxia**

“Rongshuxia”<sup>25</sup>, rongshuxia.com, is an in-vogue cultural web forum for Chinese youth to express their thoughts, emotions and reveal their innermost feelings. It is an original Chinese literature website that has a high-level of influence in Chinese speaking communities around the world. The volume of its registered users has reached 4.5 million at October 2005.

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<sup>22</sup> See chapter 3.2

<sup>23</sup> Christian Unger is the Former President of DirectGroup Bertelsmann China.

<sup>24</sup> Xinhua Financial Network News, 2003

<sup>25</sup> “Rongshuxia”, the English meaning of which is “Under the Banyan”, is a pioneer of Chinese web literature. It was created in Shanghai in 1997 by Will Zhu, an American-born Chinese.

Bertelsmann and Rongshuxia established a close relationship before their alliance in 2002. Bertelsmann had noticed the significant influence of Rongshuxia in the web literary followers and the excellent sale performance of its books in the mass market. The Club included some books written by Rongshuxia authors on its list. These books sold well in the Club. In August 2001, Bertelsmann exclusively sponsored the third year of the “Chinese Original Web Literature Award”. Industry watchers saw this sponsorship as a test leading to their alliance. Six months later, in February 2002, Bertelsmann announced a strategic alliance agreement with Rongshuxia. According to 2004 Annual Report of Bertelsmann AG, Bertelsmann holds 58.5% shares of Rongshuxia.

### **2.3.1 Chinese Web Literature**

The Internet became available in China in 1994. In the following year, some local literary websites appeared on the Internet and established the beginning of China’s “web literature”. The definition of web literature is rather vague in mainstream China, although there is a common understanding in Chinese culture and publishing circles. Web literary works are created by the author and published on the Internet. These authors are often called web writers. Literary works that have been previously published and then uploaded on to the Internet are not recognized as web literary works.

In 1997, Chinese web literature began to receive notice in the web world and attract the attention of editors in publishing houses. Some web literary works began to enter the traditional publishing world in the form of print publications. *“The First Intimate Contact”*, a milestone work of web literature, narrates a love story that occurred on the Internet. It was published in Mainland China at the end of 1999, and became the year’s bestseller. Since then, web literary works often appear on bestseller lists. The structure of Chinese literature has been affected by this situation. Although the prospect of the newborn literary sector is unclear, there are signs indicating that in some social groups, web pages are pushing aside book pages; screen reading is outpacing book reading; electronics and laser are replacing paper and pen. This cultural change cannot be ignored by publishing industry.



### 2.3.2 Rongshuxia in Chinese Web Literature

Rongshuxia is a website collecting web literary works. Its official name is “Rongshuxia – a global website of original creations of Chinese literature”. “Original creations” make Rongshuxia different from normal literary websites that only aim at spreading printed literary works. More and more literature enthusiasts choose Rongshuxia as the first place to publish their works. Of course, quite a lot of the authors of Rongshuxia had failed to publish their works in traditional forms, and choose Rongshuxia as an alternative option.

With an increasing number of people having gathered “under the banyan”, Rongshuxia has gradually developed into a literature website with significant influences in China. In 1999, “Rongshuxia” set up the “Chinese Original Web Literature Award”. It was a literary campaign. Participants publish their works on the website competing for the award. Rongshuxia invited Chinese literary celebrities to form a jury. This award attracted a large number of web literature enthusiasts to attend, catching the attention of both culture and publishing circles. Editors in publishing houses were able to find some potential authors through this campaign. Since then, more authors from Rongshuxia have been offered contracts with publishing houses. The influences of Rongshuxia was recognized in Chinese culture and publishing circles.

In May 2000, China Society Publishing House (CSPH) published a collection named “*My Life on the Web*”. Nine articles in this collection were from Rongshuxia. However, CSPH did not receive permission from Rongshuxia to publish these articles.<sup>26</sup> No solution could be reached through private negotiation between both sides. So in 2001, Rongshuxia filed a lawsuit against CSPH. This suit gained media attention and mass exposure by Chinese publishing and culture circles and web literature followers. The court adjudicated the infringement of CSPH was tenable. CSPH was required to stop publishing the book, submit a written apology and compensate Rongshuxia a total of 10,001 CNY (USD \$1538). The ruling marked the victory of web literature writers in protecting their legal rights and intellectual property. As well, Rongshuxia earned a “hero” prestige among web literature fans. This marks the solidification of web literature as part of China’s cultural consumer market.

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<sup>26</sup> The author has licensed the copyrights to Rongshuxia when publishing the article on the website. See Chapter 2.3.

### 2.3.3 Rongshuxia's Business Model in Publishing Practise

As a web forum, Rongshuxia's initial income was from advertisements. However, it soon realized the potential commercial value of the literary works posted by the web writers on its website. This realization stimulated efforts to gain income from these literary works. First Rongshuxia obtained a copyright license from the web writers for their literary works. The following sentence can be found behind the end of every article by the web writers in Rongshuxia.

Author announcement: I (the author) herein guarantee that I am the copyright holder of the work, which is published in "Rongshuxia" for the first time. It was agreed to appoint "Rongshuxia" to be the exclusive agency of the copyright of the said works, without repealing of the appointment, the said works will not be submitted to any other media. The publishing, assignment and any other affairs concerned with this works are entrusted to "Rongshuxia" with full responsibility. Without authorization of "Rongshuxia", any republishing in any other media is prohibited.<sup>27</sup>

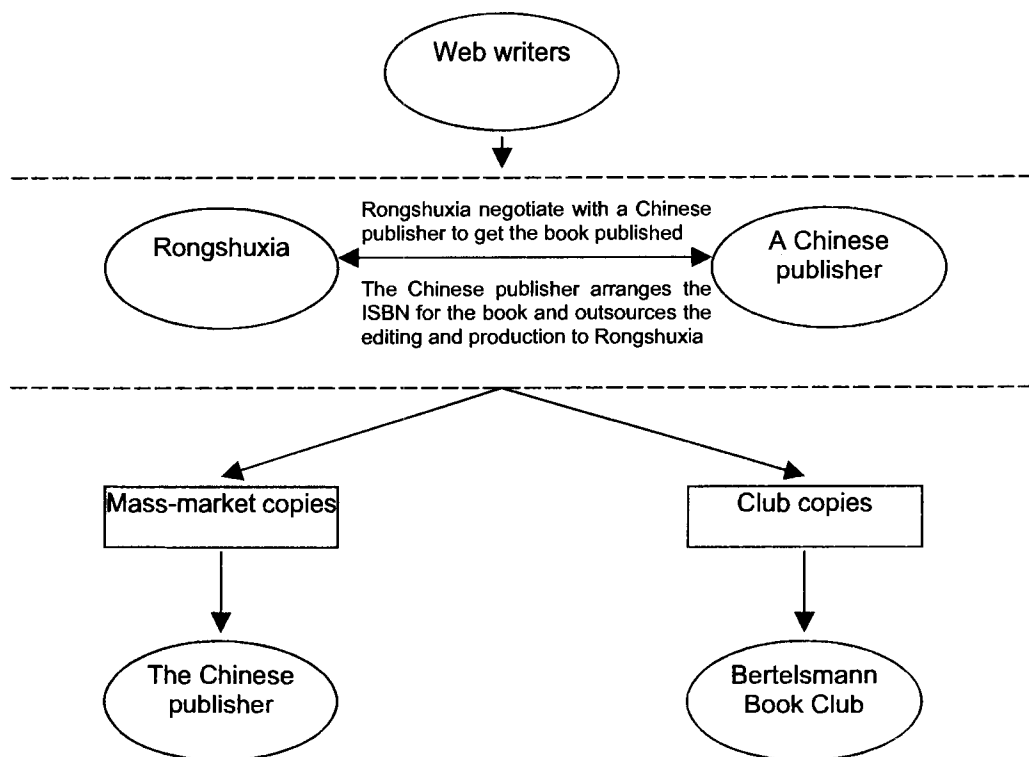
Every web writer had to post and accept this announcement before they up-loaded their works on Rongshuxia. This announcement ensures that Rongshuxia is the exclusive rights agent of the works on its website. Thereby, Rongshuxia can legally publish these works.

In actual practice, Rongshuxia's editors collect works from the website, elaborate them into a manuscript, and then negotiate with a book publisher for publishing. Rongshuxia also contracts authors (they are mostly from the web community) to get the manuscript and then negotiate with publishers for publishing. In the deal between the Chinese publisher and Rongshuxia, the former usually outsources the editing and production job to the later. So, Rongshuxia acts like a book packager, produces and delivers finished books to both Chinese publishers and Bertelsmann Book Club. A quantity of the printed copies are delivered to the Book Club. Chinese publishers distribute the other copies in the mass market. Chart 7 illustrates the business model of Rongshuxia's publishing practice.

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<sup>27</sup> Shanghai Rongshuxia Computer Company, 2005

Chart 7: The Business Model Detailing the Publishing Practice of Rongshuxia



### 2.3.4 Give and Take: Rongshuxia to Bertelsmann

The web company Rongshuxia is not a licensed book publisher in China. It does not possess the resources that Bertelsmann needs to overcome the policy barriers. So what benefit does Bertelsmann reap in such an alliance? Essentially, it is the access to a large population of registered users as well as ready access to new literary works. Rongshuxia had about 1.6 million registered users before its alliance with Bertelsmann, which benefits Bertelsmann in three aspects:

1. Bertelsmann controls the most important resources for a publisher – the authors of Rongshuxia. Among the registered users are many web writers, from where Bertelsmann can find its would-be authors.
2. Rongshuxia registered users are mainly Chinese youth. Coincidentally, The Book Club demographic is made up of members between 16 to 25 years old. Since Rongshuxia and Bertelsmann both share a similar target demographic, Rongshuxia’s users are potential Club Members.
3. On the other side, the Book Club can use Rongshuxia as a test forum for new authors as well as a place to pre-screen works before mass production. One of the reports from *Financial Times* writes,

When his editors suggested they push international bestseller *The Da Vinci Code* in China, Mr. Unger was sceptical, worrying that customers would be put off by its references to Catholic Church history and other wrinkles of western culture. But trial postings of *The Da Vinci Code* extracts on Rongshuxia's website showed otherwise. "I was completely wrong... It was a big success," says Mr Unger. "When Chinese readers didn't know about something, they searched for background information on the web."<sup>28</sup>

However, these are not the only benefits Bertelsmann obtains from Rongshuxia. The official website of Bertelsmann China has revealed Rongshuxia's resources as the following,

Rongshuxia's rich content blesses the company with a strong competitive edge on the country's media market. Across China the company has 685 contracted imprint media, 30 publishing houses, and 40 radio stations as its partners in content syndication. 847 Chinese authors are registered as "Contracted Rongshuxia Writers," among whom all of China's first-tier authors of Internet Literature are in close working relationship with the company.<sup>29</sup>

## **2.4 The Integration of BOL China and BBC.com.cn**

BOL China was launched in December 2000 with the web name [www.bolchina.com](http://www.bolchina.com). The company is an online mega store for media products. This extension of BOL in China offers more than 160,000 different book titles, as well as 3,000 audio/video products and 1,000 game software products to Chinese customers. Before BOL launched BOL China, another website was running under Bertelsmann in China. It was the website of the Book Club, [www.bbc.com.cn](http://www.bbc.com.cn), which was established in 1998. Its main function is to provide an online platform for new member recruitment, customer retention, and to create an additional marketing and sales channel. March 2003, BOL China was restructured and incorporated into local book club business, and became the only BOL, which is still in operation among the entire group worldwide.

### **2.4.1 Bertelsmann's Online Outlet: BOL**

As a media conglomerate, Bertelsmann was caught up with the internet hype of the late 90s. In 1995, American Online (AOL) and Bertelsmann co-founded AOL Europe, marking Bertelsmann's entrance into online commerce. Showing its optimism for e-commerce,

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<sup>28</sup> Dickie, 2004

<sup>29</sup> Bertelsmann AG China, 2005

Bertelsmann bought 50 percent of barnesandnoble.com<sup>30</sup> in 1998 for \$200 million and invested millions more into developing it over the next few years. Apparently, this deal was not just an investment in stock market. Bertelsmann wanted to establish additional online sales outlet in the major American book market.<sup>31</sup>

To establish its online outlet outside North America, the company began in Europe, another major market of Bertelsmann, with Bertelsmann Online, BOL. The initial idea of BOL was to offer Bertelsmann's 35 million book and music club members an added service. They were able to select and order from the entire range of books available on the open market, in addition to the attractively priced products that have been especially chosen for them by its book and music clubs. In 1999, Bertelsmann launched BOL with operations in Germany, the Netherlands, Great Britain and Switzerland, soon after Italy was added. In 2000, BOL expanded its offerings into China.

#### **2.4.2 The Decline of Internet Economy and Opportunities in China**

BOL was Bertelsmann's expansion in e-commerce during the Internet economic bubble. In 2000, the Internet economy began declining throughout Europe and North America. This decline persisted in the following years and Bertelsmann's e-business quickly entered a gloomy period. The former CEO of Bertelsmann AG, Dr. Thomas Middelhoff, admitted that he had overestimated e-commerce growth.<sup>32</sup> He was replaced by Gunter Thielen in August 2002. Thielen began steering the company's worldwide businesses guided by its new strategic priorities and "concentrating on core businesses". As part of its strategic reprioritization, Direct Group divested from pure-play e-commerce companies like BOL in order to focus on its media clubs.

The international BOL ventures currently account for less than four percent of DirectGroup's total turnover. After its dovetailing with local club operations, synergetic effects overall lagged behind expectations. BOL is growing, but

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<sup>30</sup> The US-based bookstore chain Barnes and Noble's online operation. Barnesandnoble.com is one of the largest online bookstores in the world. It has been a strong competitor to Amazon.com for years.

<sup>31</sup> Bertelsmann sold its interest in barnesandnoble.com in 2003. Bookspan is Bertelsmann's current major outlet in the US. In 2001 Bertelsmann merged its book clubs with those of Time Warner to form Bookspan, a jointly owned company that includes the Book-of-the-Month Club and the Literary Guild. (Barker, 2003)

<sup>32</sup> Cox, 2002.

being a start-up venture it is not yet profitable. As a retail enterprise, BOL will not be able to meet Bertelsmann's return targets in the coming years.<sup>33</sup>

In contrast to the rest of the world, the Internet was booming in China during the early 2000s. According to statistical records of the China Internet Network Information Centre, between 2000 and 2002, Chinese Internet subscribers grew from 7 million to 50 million. This Centre also noted that by the end of 2002, China had more than 6 million Internet users who had shopped for books and other products online.<sup>34</sup> Meanwhile, China's publishing industry entered a flourishing period. In line with the introduction of e-commerce in China, online bookshops arose. Meanwhile, the membership of the Book Club had reached to 1.5 million. At that time, B2C<sup>35</sup> had just emerged in China. A few new companies were engaged in this business model. BOL's biggest competitors Amazon were far away from China. It was the right moment for BOL to enter China. BOL's future looked bright in the country.

### **2.4.3 The Need for Integration**

BOL was a stand-alone division of Direct Group. BOL China's operation was independent of the Book Club. As the official website of the Club, [BBC.com.cn](http://BBC.com.cn) solely served Book Club members, while BOL China as an online retail platform served general Chinese customers. The two sites were two online sales channels serving partially overlapping target markets. Two websites under the same Bertelsmann brand created confusion and inconveniences as listed below.

1. Club members had to make two separate orders, if they found books they wished to purchase from [BBC.com.cn](http://BBC.com.cn), and BOL China.
2. Some Club members did not understand that the two websites operate independently, and presumed that what was offered on one website applied to the other. When they discovered their error, many felt frustrated and chose not to buy from Bertelsmann.
3. Chinese publishers were confused when receiving two individual orders from Bertelsmann. They had to send books to two separate locations, one to the Book Club, one to BOL.

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<sup>33</sup> Bertelsmann AG, 2002

<sup>34</sup> China Internet Network Information Center, 2003, 2001.

<sup>35</sup> Business-to-Consumer (B2C) is a form of commerce in which products or services are sold from a firm to a consumer.

More importantly, both websites operated separately and independently, which increased the cost of operation and management. For example, advertisements of BBC and BOL appeared on linking pages of a magazine. The IT, human resource and financial teams also had to double their work. Their logistical systems, including order handling, distribution, fulfillment, payment management, and call-order services, also overlapped. Ekkehard Rathgeber, former President of DirectGroup China, remarked, “What is the point in overlapping two similar businesses? I think these two sites must be integrated, not in the sense of individuality or brand, but in operation and staff.”<sup>36</sup>

September 2002, Direct Group phased out its BOL businesses in Germany, Switzerland, the Netherlands and Sweden. Adapting to the development of China’s Internet economy and Bertelsmann’s situation in the country, Direct Group decided to hold on to BOL China by integrating BOL’s business into the Book Club. The two websites, www.bolchina.com and www.bbc.com.cn, were merged to form a new website, www.bol.com.cn in March 2003.

Rathgeber said, “The integration of www.bbc.com.cn and BOLchina.com only takes place in China. In other countries, due to the early development of e-commerce and fierce competition, BOL is not the leading player in the market. Therefore with the realignment of the group strategies, they were either sold or closed down. But in China, BOL takes the lead in the market with good growth momentum.”<sup>37</sup>

Unger prospected BOL China’s future by saying, “The Club members will be treated as BOL’s VIP customers, as a special community enjoying further benefits. This will greatly enhance the attractiveness of the club. Meanwhile, BOL could share the member with the Book Club or absorb the potential members who join in the club, so as to share the customer resource, and finally strengthen our comprehensive capacity in media product distribution area.”<sup>38</sup>

“We will prove that Bertelsmann can guide its customers to all its product and service platforms in a most direct way by the complementary competences of the traditional book club and online shops of media products in the Chinese market.”<sup>39</sup>

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<sup>36</sup> Zheng, 2003

<sup>37</sup> Chen, 2003

<sup>38</sup> Tang, 2003

<sup>39</sup> Ge, 2004

The key strategy of the new BOL China is to build up a far-reaching platform based on both the traditional sources and digital technologies, and to provide customers with more direct and convenient access to all the media products and services of the Club. The reorganization trimmed costs by slashing overlapping administrative and marketing operations and without causing layoffs. BOL China is an important sales channel of the Book Club, and also used for new member recruitment, customer retention, and as an additional marketing channel.

## **2.5 21<sup>st</sup> Century Book Chain**

21<sup>st</sup> Century Book Chain (hereinafter 21<sup>st</sup> Century) is a joint venture of Bertelsmann with Beijing 21<sup>st</sup> Century Book Chain Co., Ltd <sup>40</sup> (hereinafter Beijing 21<sup>st</sup> Century, referring to the enterprise before the joint venture with Bertelsmann). 21<sup>st</sup> Century had the responsibility to roll out chain bookstores in China based on the featured business model of Bertelsmann Book Club Centre. A Club Centre of Bertelsmann is a special kind of medium-sized bookstore (around 150-200 m<sup>2</sup> in space) built in a neighbourhood in which many club members reside. It is a face-to-face channel for the Book Club to provide comprehensive services, including new member recruitment, customer retention and book sales. Available books in the Club's catalogue are displayed here so club members can buy their favourite books by visiting the Club Centre. The Club Centre model was successful in Shanghai. Benefiting from the concessionary articles from the relevant authority<sup>41</sup>, Bertelsmann established six Club Centres in Shanghai before 21<sup>st</sup> Century joint venture was approved. In 2003, the salesrooms of these six Club Centres accounted for 40 percent of total sales of the Book Club in Shanghai.<sup>42</sup>

### **2.5.1 China Changed its Policies**

The joint venture, 21<sup>st</sup> Century, was made possible because China changed its publishing industry policy. As one of its commitments to the World Trade Organization (WTO), China partially opened its book, magazine and newspaper wholesale and retail market

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<sup>40</sup> The Beijing 21<sup>st</sup> Century Book Chain was the first officially approved private book chain enterprise in China that was endorsed by a national book chain license. It was founded by Reiren Luo in 2000, when he was teaching in the Business School of Renmin University of China. Luo now is the Chairman of the DirectGroup joint venture.

<sup>41</sup> See chapter 2.1.4

<sup>42</sup> Shi, 2003



(hereafter jointly referred to as “publication distribution”, and separately as “publication wholesale” and “publication retail”) to foreign investors. According to *the Schedule of Specific Commitments on Services of The People's Republic of China to WTO* (hereinafter The Schedule), one year after the date of China’s accession to WTO, foreign service suppliers were able to engage in publication retail business in the form of a joint venture in five Special Economic Zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) and eight cities (Beijing, Shanghai, Tianjin, Guangzhou, Zhengzhou, Wuhan, Dalian and Qingdao). Two years after accession, controlling stakes by foreign investors in publication retail enterprises were allowed in all provincial capitals, as well as in Chongqing and Ningbo. Three years after WTO membership, foreign investors were permitted to engage in publication wholesale; and restrictions on the location, production, equity ratio and form of establishment were lifted. However, within five years after China’s accession, foreign majority ownership is still not permitted in publication retail chain operations with over 30 branches.

On May 1<sup>st</sup>, 2003, *Management Regulations of Foreign Investors in Distributing Books, Newspapers and Periodicals* (hereafter called “the New Regulation”) were put into effect. It was promulgated on March 17, 2003 jointly by the GAPP and the Ministry of Commerce (the former Ministry of Foreign Trade and Economic Cooperation). By putting the New Regulation into effect, China opened its book distribution market ahead of the time period stipulated on The Schedule. Therefore, Bertelsmann did not have any policy barriers in rolling out its Club Centres in China.

### **2.5.2 The Road to Happiness Full of Hardships**

Bertelsmann started negotiation for the cooperation with Beijing 21<sup>st</sup> Century in the beginning of 2002 and was finally able to establish the joint venture officially almost two years later at the end of 2003. In the meantime, 21<sup>st</sup> Century opened a medium-sized bookstore in Beijing at the end of 2002. The bookstore was a copy of Bertelsmann Book Club Centre’s model. According to the existing restrictive policies, Bertelsmann was not permitted to set up its Club Centre in the cities other than Shanghai. A Bertelsmann’s Club Centre emerged outside Shanghai, where staffs are recruiting members for the Book Club, which immediately attracted the attention of the Chinese publishing industry. Government authorities soon questioned Bertelsmann about this defiance and asked for an explanation. Bertelsmann and

Beijing 21<sup>st</sup> Century replied as follows. The bookstore in Beijing does not belong to Bertelsmann but Beijing 21<sup>st</sup> Century. That was why government approval was not needed. The bookstore was under the cooperative agreement between Bertelsmann and Beijing 21<sup>st</sup> Century in which Bertelsmann provided supply of goods and consulting service, for example, on store design, employee training, logistic system, and book layout and display. Beijing 21<sup>st</sup> Century was an agency of Bertelsmann in Beijing with the responsibilities of club member recruitment that used the established business model of Bertelsmann book Club Centre. The Beijing Club Centre was wholly owned and operated by Beijing 21<sup>st</sup> Century.

Although government authorities ceased to pursue any further investigation of Bertelsmann and 21<sup>st</sup> Century, people should not be misled to believe the Chinese government fully accepted such an explanation. The Chinese government has always been strict in its control of its publishing sector, and the explanation given was not enough to deflect government investigation. One can only speculate the real reason for the lack of further investigation was that the New Regulation was soon to be promulgated and the Chinese government was planning to open its publication distribution market to foreign investors. Whatever motivated the government, Bertelsmann took advantage of the planned change and found a loophole in the restrictive policies of China. It is obvious that Bertelsmann understands Chinese publishing policy and grasps its trends. Publishing industry watchers regarded this operation as an experiment of Bertelsmann to test government reaction and to explore opportunities for further development outside Shanghai.

On May 1<sup>st</sup>, 2003, the New Regulation was put into effect. Bertelsmann and 21<sup>st</sup> Century immediately handed in their joint venture proposal for government approval. September 2003, the GAPP and the Ministry of Commerce officially approved the joint venture between DirectGroup Bertelsmann and Beijing 21<sup>st</sup> Century Book Chain Company Limited. It was the first foreign capital acquisition in China's book chain sector and gained the title of the first foreign joint venture nationwide book chain of China.

### **2.5.3 How Does the Joint Venture Benefit Bertelsmann**

By establishing the joint venture with Beijing 21<sup>st</sup> Century, Bertelsmann obtained a national book chain license, which was previously held by Beijing 21<sup>st</sup> Century. This license was much desired by Bertelsmann, because in holding it, Bertelsmann is able to engage in book

retailing in the whole nation. The operations of Bertelsmann were restricted in China by the government in three aspects before it was granted the license. Firstly, Shanghai Bertelsmann was a mail order enterprise; it was unable to engage in retail business. Secondly, Bertelsmann was restricted to a defined business area for its Club Centre, and was prevented from setting up its Club Centres outside Shanghai. Thirdly, Bertelsmann's target consumers were limited to its club members. By obtaining the national book chain license through the joint venture with Beijing 21<sup>st</sup> Century, Bertelsmann overcame all these restrictions, which is demonstrated in Table 2.

*Table 3: Comparisons Before and After the Joint Venture with Beijing 21<sup>st</sup> Century*

	<b>Before</b>	<b>After</b>
<b>Operating Regions</b>	Shanghai	Whole Nation
<b>Sales Channel</b>	Mail order and Online Sales	Mail order, Online Sales and Retail
<b>Target Customers</b>	Club Members	General Customers <sup>43</sup>

However, this license does not merely benefit Bertelsmann in the ways mentioned above. To open a bookstore in China requires the approvals from several administrative departments of the local government. Investors have to go through a complicated application procedure, which includes registration and examination. Sometimes, new market entrants face protectionism from local authorities. Holding this national book chain license endorsed by GAPP, Bertelsmann needed only to file its operations with the local government when planning a Club Centre in any city of China. All other procedures are unnecessary. Given Bertelsmann's accomplishment of having set up 51 Club Centres in 14 cities of China<sup>44</sup>, a national book chain license saves it considerable time and energy. To the end of 2005, Bertelsmann is the only foreign enterprise that holds a national book chain license, an advantageous position for Bertelsmann with respect to other international competitors.

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<sup>43</sup> Unger confirmed, "... The license we have just got in China allows the centres to be opened to members as well as non-members. We have just started the practice to allow non-members to buy books in our centres. ..." (21cn Business Herald, 2003)

<sup>44</sup> See Footnote 45.

#### 2.5.4 A Selection Fitting China's Conditions

Compared with the postal systems that Bertelsmann relies in China, the Club Centre organization can be more reliable because it is a system that Bertelsmann has built by itself and for which it holds complete control. However, Bertelsmann has not built Club Centres in every country. For example, Bertelsmann has Club Centres in France and Germany, but its biggest club, "Bookspan" in the US, does not have any Club Centres.

A Club Centre is not simply a retail bookstore. It is a complete sales and distribution channel, which relies a powerful logistical system to ensure that books are delivered to club members rapidly and with complete accuracy. Most European countries are small in territory. It is relatively easy to build up a logistical system covering the whole country. Therefore Club Centres are popular and quite successful there and have become another major sales channel of Bertelsmann for book delivery in Europe. But in the US, the vast territory and the large number of the club members make it difficult to construct a logistical and distribution system to cover the whole country. Even though it can be set up, the cost would be extremely high. So Bertelsmann relies on the stable postal system of the US.

China also has a large territory. The establishment of Club Centres around the country would face the same difficulties as in the US. Nevertheless, Bertelsmann's German Headquarter soon approved the proposal. The following factors contributed to this decision. The development of China's economy is quite unbalanced. Currently, the recruitment of Club members focuses on the eastern-coastal regions of China.<sup>45</sup> These regions are more economically developed and the population makes up a majority of the existing club members. Thus Bertelsmann does not need to build up a logistical system covering the whole country at this current stage of China's development. Meanwhile, because most Chinese do not have alternative access to Bertelsmann Book Club titles and because procedures of payment and delivery are relatively complicated, many Chinese readers prefer to visit to the Club Centres, see the books and then pay less<sup>46</sup> by cash.

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<sup>45</sup> Up to September 2005, 21<sup>st</sup> Century has built 51 Club Centres in 14 cities of China. Most of them are located in eastern-coastal regions.

<sup>46</sup> Because they do not need to pay for the delivery fee.

### **2.5.5 Bertelsmann is Leading its Competitors**

Besides Bertelsmann, six other foreign publishing companies submitted applications for retail licenses right after the New Regulation was issued - Germany Books Centre, Pearson Education, McGraw-Hill, Hakuyosha of Japan, Cambridge University Press, and Pan Pacific Singapore. The seven applicants were among dozens of companies who had been in consultation with the press and publication bureaux in Beijing, Shanghai and Guangzhou. Apparently, these foreign companies had been keeping a close eye on the China market for years, waiting for opportunities to get a piece of the action. However they were deterred from entering the market by the likelihood that Chinese authorities would favour companies from Hong Kong, Macao and Taiwan. Chinese officials specifically granted approval in 2002 to a small number of Hong Kong background joint ventures to enter the publications retail market ahead of the legislation schedule. After the New Regulation was promulgated in May 2003, the GAPP approved eleven publication retail joint ventures. These chosen investors are from Mainland China, Hong Kong and Taiwan. Up to now, Bertelsmann is the only approved company from overseas. It may take some time before overseas companies enter the market in strength, meanwhile, Bertelsmann has taken the lead position among its international competitors in China's book market.

In overview, the strategic purposes of these five remarkable operations of Bertelsmann in China could be sorted into two areas of activity: one is content provision, the other is provision of a sales channel. These two aspects are two crucial links between production and sales of the value chain. They are the lifelines of book industry. These well run operations of Bertelsmann in the two areas of activity have resulted in its successful and steady growth in China, and they appear to be successful strategies in far-reaching development and provide an excellent operational foundation for Bertelsmann's commanding position in the market.

## Bertelsmann's Effects on China's Publishing Industry

In China's publishing industry, Bertelsmann is often considered a foreign invader. Some refer to "the impacts of Bertelsmann" in a negative manner. However there is an alternative view, which sees that Bertelsmann has had positive effects on China's publishing industry. Bertelsmann's investment in China is not a large one. China has a \$5.5 billion USD gross book retail market<sup>47</sup> is unlikely to be affected by Bertelsmann's current estimated sales income of about 14 to 15 million USD<sup>48</sup> in China. Bertelsmann is facing stiff competition in this market and is positioned as an ordinary competitor in China.<sup>49</sup> However, by introducing a unique commercial model into the country, this ordinary competitor has caused far-reaching influences on China's publishing industry. This chapter will discuss the following:

1. The Chinese book market reorganization and the new sales channel Bertelsmann has brought to it.
2. The competitiveness of Bertelsmann's sales channel in China and the impact on Chinese book publishers.
3. The setting of a new distribution price for the book publishers in China by Bertelsmann, which has challenged the profitability of Chinese publishers.
4. The positive changes introduced to the static publishing industry.

### 3.1 China's Book Retail Channel Reorganization

During the planned economic period of China from 1953 to 1979<sup>50</sup>, the book retail channel was controlled by the Xinhua<sup>51</sup> Bookstore, a state-owned enterprise (SOE) and

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<sup>47</sup> General Administration of Press and Publication (GAPP), 2003

<sup>48</sup> Bertelsmann Shanghai is not required to publicize its annual same income. In the article "Middelhoff's Resignation Leads to Changes of Bertelsmann's Strategies in China" by Shan, Shen published in *The Economic Observer*, August 12, 2002, Page B8, the correspondent reported the estimated sales income of Bertelsmann Book Club in China.

<sup>49</sup> Ekkehard Rathgeber said, "Chinese market will not be carved up freely. Bertelsmann is a common competitor, what we want to do is to make this market growing together with Chinese counterparts." (Fan, 2001)

<sup>50</sup> The planned economic period of China refers to the years 1953 to 1979. During this period, China implemented a planned economy, and the government took over all means of production. The state outlined how the economy was to be developed through a plan which detailed how investment funding, production materials, and other resources were to be allocated. (Microsoft Corporation, 2005)

<sup>51</sup> The English meaning is "New China".

newspaper and magazine distribution was monopolized by China Post. Since China's economic "reform and opening up", private investors were permitted to enter the book retail market, weakening the monopoly of Xinhua Bookstore. The rise of private bookstores<sup>52</sup> in the mid-1990s formed an additional sales channel. Industry workers refer to Xinhua bookstores and China Post as the Primary Channel and all private bookstores as the Secondary Channel<sup>53</sup>. In 1997, Bertelsmann introduced book clubs into China. This brand new book sales model was soon copied by many domestic investors. Meanwhile, with the flourishing of the IT industry, online bookstores were successful in occupying a segment of the book retail market. In 1999, Joyo and Dangdang, the main online bookstores in China were established. Bertelsmann Online (BOL) also launched in China during the same period.

Another book retail channel that cannot be ignored is the super bookstores<sup>54</sup>. From the mid-1990s on, some provincial Xinhua Bookstores began to build large-scale super bookstores in large cities to satisfy the growing demand and consumption of books. Meanwhile, private investors and some SOEs from non-publishing industries saw the growth of the book retail market and decided to create additional market competition by also building super bookstores in large cities throughout China<sup>55</sup>. By 2005, 23 super bookstores were built in China.<sup>56</sup> Super bookstores provide comprehensive services and extensive varieties of available books, all in a comfortable buying environment. They have become an important outlet for readers to get their favourite books. Super bookstores stand out, because most deal directly with the publisher, cutting out book wholesalers and other middlemen. China's book market has experienced a changing period from a monopolized market by the Xinhua Bookstore to a diversified, multi-channel, shared market. As a result of these changes, there are now five major book retail channels: Xinhua Bookstore, private retail bookstores, super bookstores,

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<sup>52</sup> It includes private book retailers, wholesalers and distributors.

<sup>53</sup> Secondary Channel is an industry appellation for the private ownership of the bookstore. It refers to the private book sales forces including, private book retailers (independent, chain and super bookstores), wholesalers and distributors. Primary Channel and Secondary Channel are not official terms, but are approved appellations in publishing circles, although they do not appear in any official documents by the government. GAPP has allowed private bookstores to distribute books throughout the whole nation by promulgating the *New Publication Market Regulation* in September 2003. This regulation has granted private bookstore the right to compete directly with Xinhua Bookstore and China Post.

<sup>54</sup> In Chinese publishing industry, the super bookstore normally refers to a bookstore possessing over 10,000m<sup>2</sup> operation area and carrying over 100,000 varieties of titles.

<sup>55</sup> For example, Chongqing Modern Book Centre is a super bookstore wholly invested by a state-owned energy company in Guangdong Province, China Guangdong Nuclear Power Holding Co. Ltd. It has an operation space of 24,000 m<sup>2</sup> and located in the down town area of Chongqing.

<sup>56</sup> Li, 2005

book clubs and online bookstores. Table 3 details the different retail channels, their ownership and the source of each channel's stock.

*Table 4: Five Retail Channels of China's Book Market*

<b>Retail Channels</b>	<b>Ownership</b>	<b>Vendors</b>
Xinhua Bookstore Book retail outlets	Xinhua Bookstore	Provincial Xinhua Bookstore Wholesale Centres
Private Book Retailers	Private	Provincial Xinhua Bookstore Wholesale Centres and private book wholesalers
Super Bookstores	Private and SOE (including Xinhua Bookstore)	Book Publishers, Xinhua Bookstore (Wholesale) and private book wholesalers
Book Clubs	Private, SOE and Foreign Invested	Book Publishers, Xinhua Bookstore (Wholesale) and private book wholesalers
Online Bookstores	Private, SOE and Foreign Invested	Book Publishers, Xinhua Bookstore (Wholesale) and private book wholesalers

Among these five channels, the book clubs and online bookstores are the newest retail models in China's book market. Bertelsmann has made a remarkable contribution to the building of these two channels in China, especially the book club model. It is a type of sales channel and communication hub, which connects readers and publishers. When Bertelsmann first introduced book clubs in China most Chinese readers were not familiar with how a book club could service them. Readers had a habit of going to a bookstore to purchase books. As the pioneer of the book club concept, Bertelsmann offered readers an alternative channel to obtain books, thereby adding another sales channel for Chinese publishers.

### **3.2 Competitive Book Sales Channels that China Needs**

For book publishers, sales channels get books to the readers and are therefore an essential tool for profit-making. Since its official launch in China, Bertelsmann has made great progress in the introduction and development of its sales channel through its four joint-venture and subsidiary companies in China, (see table 4). Each of these four channels has its own strengths. Club Centres offer service to readers living in large developed cities with a high population. Online orders through BOL offer service to readers in most cities where



network construction has been completed. As for catalogue mail order, with the use of China Post, service can be offered to the whole country including the remote countryside. Book distributor, Liaoning Bertelsmann will help book retailers accessing books that Bertelsmann Book Club introduces to the readers. It will develop sales not only through traditional bookstores, but also through other sales channels like supermarket and stationary stands. In China's book industry, Bertelsmann is the only enterprise that offers comprehensive sales channels (see table 5) that can cover all regions throughout China.

*Table 5: Bertelsmann's Multi Sales Channel in China*

<b>Companies</b>	<b>Sales Channels</b>
Bertelsmann Book Club	Catalogue Mail order
BOL China	Online Bookstore
21 <sup>st</sup> Century Book Chain	Retail Bookstore
Liaoning Bertelsmann	Book Distributor

China has made great efforts to guide the publishing industry to build up a health book circulation environment which is supported by the five book retail channels (see chapter 3.1). However, these channels are unbalanced countrywide, because book distributors and retailers often place their efforts in economically developed regions, neglecting remote areas.<sup>57</sup> People in remote areas tend to go to the cities to buy the books they need. Meanwhile, even though the larger cities have well established book sales channels with more bookstores in the market, books do not stay on the shelf for long. Due to the increasing number of newly released books, often books placed on the newly released book display are replaced with newer titles before they catch the eyes of the consumer. A shortened shelf life of the book is resulting in a shorter sales life of a book. This results in a higher return rate and large overstock for book publishers. Recent statistics on China's book industry show that the annual published titles and total print run increase, but the average sales volume rises at a lower rate<sup>58</sup>. These data can be interpreted as meaning that while Chinese book publishers are incurring an increasing return rate.

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<sup>57</sup> Zeng & Zhao, 2004

<sup>58</sup> General Administration of Press and Publications, 1999, 2000, 2001, 2002, 2003

Ruiren Luo, the founder of Beijing 21<sup>st</sup> Century and the current chairman of the joint venture 21<sup>st</sup> Century has a “shelves theory” that is a commentary on the results of too many books chasing too little bookstores shelf space. He has said,

“The loading capacity of the bookshelves in a bookstore is limited. Let’s assume that in a large-sized super bookstore, there are usually about 30,000 types of books on displaying. Among them, 18,000 to 20,000 titles are always on the shelves. But in our country, about 180,000 books are released every year. Therefore, the future trend will certainly be that the publishers will pay for their new book being put on shelves. As long as we construct and maintain good channels, the future profit will be huge.”<sup>59</sup>

China’s traditional book retail channels seem not able to deal with the increasing return rate effectively. However, Bertelsmann’s featured book club sales model can contribute to building up a healthy book circulation environment. A Book Club membership benefits the readers by informing them about the books in an informed and timely fashion. Such services facilitate club members making a buying decision. In addition, by clearly understanding the taste of the members, Bertelsmann can forecast potential demand and make more accurate orders from the book publishers. Bertelsmann Book Club is proud of its no return guarantee to Chinese publishers. Its high sales and wide distribution channels offer Chinese book publishers the ability to reach large audiences. Meanwhile, Bertelsmann’s Book Club is looked upon as a sales performance gauge. If the Book Club orders a specific title, Chinese book publishers are more likely to put that title into mass production. In addition, Bertelsmann’s book clubs have already been proven successful in the international book market. Such a tested sales model will not only benefit the book distribution channel construction, but also set a valuable example from which Bertelsmann’s Chinese competitors can learn.

### **3.3 Surprising Competitiveness of the Club Centre**

Given the lack of statistical information regarding the competitiveness of the catalogue-based mail order system, the online bookstore and the book distributor channels, the only reliable proof of Bertelsmann’s competitiveness is the performance of the retail book channel. One of the tools used by the Chinese book retail industry to measure the retail book channel is the Area Annual Sales Income (AASI) which clearly shows Bertelsmann is more profitable than its competitors.

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<sup>59</sup> Kang & Zhang, 2003

The Area Annual Sales Income (AASI) is an important index of retail bookstore sales performance. Bertelsmann's Club Centres have been in Shanghai for many years. For example the Xujiahui Club Centre's (XCC) operating space is 150m<sup>2</sup>. Its daily average sales income reached 18,000 CNY in 2002. Thus its AASI is approximately 43,800 CNY (18,000×365/150), that is 6.5 million/150m<sup>2</sup>. Comparatively, the Beijing Book Building, which is one of the biggest super bookstores noted for its high sale performance in China, possesses 16,000m<sup>2</sup> operation space. Its sales income in 2002 was 320 million CNY. The AASI per m<sup>2</sup> is about 20,000 CNY (320,000,000/16,000), less than half as much as that of the XCC. Comparatively, the annual sales income of competing bookstores having a similar operation space and location as the XCC rarely exceeds one million CNY or 6,667 CNY/m<sup>2</sup>.<sup>60</sup>

Bertelsmann achieves this extra profitability over its competitors in the following ways. In addition to its low retail price, Bertelsmann uses excellent marketing and promotion strategies, which attribute the Club Centre's competitiveness. However, Bertelsmann's competitiveness in the book retail market originates from the following three factors. First, the Book Club sells the most popular books in the market. Bertelsmann's acquisition editors carefully select approximately 1,500 titles annually from over 110,000 newly released titles in China<sup>61</sup> and recommend them to Book Club members. Most of these books have a proven sales performance in the mass market, which potentially offers high sales for the Book Club. Second, although Xinhua Bookstores occupy a comprehensive range of customers by distributing most of the newly released titles in China, Bertelsmann aims to promote popular books to young readers. Popular books sell more quickly than other titles and therefore, Bertelsmann can gain quick returns on capital. Third, Bertelsmann has a much more specific target market relative to its competitors. Bertelsmann aims its Chinese Book Club at recruiting and sustaining members in the younger demographic. By selecting a specific market, it is able to tailor their product and their services to be a leader to this target market. Once they accomplish this, efforts are being placed to sustain them as the readers mature.

An investigative report from the Chinese Institute of Publishing Science<sup>62</sup> shows that young Chinese readers think reading is critical for self-development and it has secured a more important role in their lives than in the past. The survey shows that a large number of

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<sup>60</sup> Li, 2003

<sup>61</sup> General Administration of Press and Publications, 2003

<sup>62</sup> Chinese Institute of Publishing Science, 2004

respondents chose “having difficulty in choosing a book” for the reason why they do not read. The report concludes that the market does not offer adequate book recommendations (note that Bertelsmann is the only enterprise offering book recommendations). There is reason to think young readers could be enticed to buy even more books if Bertelsmann’s editors could improve their recommendations to this target market.

### **3.4 Setting a New Distribution Price for Chinese Book Market**

For many years, Chinese book publishers customarily sold their books to bookstores at 60 to 68 percent of the list price.<sup>63</sup> However, current Chinese publishers sell their books to book clubs and online bookstores at 40 percent of the list price. This unprecedented price was set by Bertelsmann when the Book Club began its operation in 1997. This price scheme caused quite a reaction in the industry. The sales director, Chunyan Li, from Liaoning Science and Technology Publishing House, summed it up best, “The price demanded is too harsh but the large volume ordered is hard to refuse”. Her sentiment was echoed by many others. She retold her encounter with Bertelsmann in an informal interview I conducted in 2000. The Book Club selected one of her back-list books for the Book Club. The book was near the end of its sales life, with only weak market sales. When the Book Club requested 20,000 copies as the first order demanding a low purchasing price of 40 percent, she decided to reprint the book to fill the order. However, once the publisher agrees upon this below-industry average price, it is pegged as the price for all future orders. This made matters difficult for publishers.

On the other hand, Bertelsmann employees also experience difficulty when attempting to make deals with Chinese publishers. Jian Ye, an acquisition editor of BAP, recalls his experience when the Book Club was just setting up. He carried a case full of cash to purchase books all around the country. At that time, even using cash payment, many publishers were still unwilling to sell books at 40 percent the list price – Bertelsmann’s expected purchasing price. Now, with Bertelsmann’s efforts, Chinese publishers have accepted this new distribution price and do not feel reluctant to sell books to book clubs and online bookstores. This new relationship enables supplies to meet demands. All of these are helpful for the growth of these new book sale channels in China.

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<sup>63</sup> On individual titles the price can go as low as 50 percent of the listed price.

### 3.5 Stimulating Industrial Reform and Restructure

As a mature and powerful enterprise, Bertelsmann is a tough competitor. Not only does it introduce new book distribution channels to China, it also contributes positively to the publishing industry. The publishing industry, as a special sector, not only has enjoyed the protection through government policies but also has developed at a steady pace<sup>64</sup> under the protection of the traditional planned economy. In the past 20 years, Chinese publishing enterprises flourished easily when the government built a “greenhouse” by allowing them free market development opportunities in combination with governmental protection policies<sup>65</sup>. In this environment, Chinese publishing enterprises, especially SOE publishing houses and Xinhua Bookstores, had a strong hold on the market.

However, their long-term development was hampered by the distinctive features of the planned economy. Such features included industry monopolies, governmental interventions and regional blockades. The industry’s steady development left it relatively uncompetitive and unprepared for any drastic market changes of the future. The government recognizes the need for reform and restructuring of the industry to promote future growth. Therefore the industry is undergoing reform and restructuring required by the government. However, SOE publishing houses and Xinhua Bookstores have not increased the competitiveness to their operations sufficiently. Bertelsmann’s success and the new competition to the market have made their competitors realize that they are no longer able to benefit from a protected economy. To keep competitive against foreign investors, changes need to be made from within, so that they can be competitive when the policies allow foreign investors into the whole publishing market. In sum, it is not the government mandate that stimulates reform, but the threat of foreign competition that effectively awakes the industry.

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<sup>64</sup> It refers to the structure of publishing houses in each province of China. Chinese publishing houses are responsible for specific categories. For example some specialize in social science, education, natural science and technology, children, literature, nationality and religion, or fine arts. There is one publishing house for every category in each province. Titles that do not fit in these government-selected categories are not approved for publishing.

<sup>65</sup> In 1982, the Chinese government started reforming its economic system, changing to a market oriented one. Chinese publishers are allowed to develop the market freely. Meanwhile, the industry maintained its state-owned monopoly status. See chapters 4.1.2 for reference.

## Bertelsmann's Competitors in China

Bertelsmann has built up its sales channels in China, covering a comprehensive range of book distributing channels, online and catalogue mail order, book retail and distribution. Bertelsmann's catalogue mail order business has not met much competition in China. During the year 2000, state-owned China Book Import & Export Company (CBIEC) tried to build up a nationwide book club. However, its effort has not been successful. Other state-owned book clubs are mostly established by the publishers, and they focus on distribution of their own books. In China, private book clubs often belong to a local book retailer, functioning mainly as a marketing tool to add sales. Few book clubs, state-owned or private, in China have successfully established a mail-order system with the same coverage as Bertelsmann. Bertelsmann covers a wide territory with as many as 1.5 million club members.

In terms of online competitors, BOL's main competitors are Joyo and Dangdang. They have been the adversaries of BOL for many years in China. Bertelsmann's fiercest competitor in its book retail and distribution business is the state-owned Xinhua Bookstore, although many private bookstores<sup>66</sup> also pose as competitions in the market. In the following three sections of this chapter, basic information about Xinhua Bookstore, Joyo, Dangdang, and private bookstores will be introduced in an attempt to understand some of these competitor's weaknesses and strengths. The aim is to offer a general sense of Bertelsmann's competitive environment in China.

### 4.1 Xinhua Bookstore: The Giant State-Owned Enterprise

Xinhua Bookstore<sup>67</sup> is China's biggest book distributor, wholesaler and retailer, with sixty-six years in operation. As the "primary channel" of the book distribution, the nationwide Xinhua Bookstore System possesses over 12,000<sup>68</sup> outlets and most of the large-scale super

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<sup>66</sup> It refers to private book retailer, wholesaler and distributor.

<sup>67</sup> Xinhua Bookstore, or the Xinhua Bookstore System, refers to the state-owned book distribution system under the brand name of Xinhua Bookstore. To be explained in chapter 4.1.2.

<sup>68</sup> General Administration of Press and Publications, 2003

bookstores in China. Having been long established in the country, Xinhua Bookstores often occupy prime locations. As well, every provincial Xinhua bookstore acts as the central distributor in the province. They have huge warehouses and well-equipped distribution centres. So far, Xinhua Bookstore is the only bookstore system that can stock all annually published books. Other bookstores must stock fewer titles because of limited shelf space. In addition, Xinhua Bookstore has established long-term business relationships with Chinese publishers. These strong relationships enable Xinhua Bookstore to operate easily and efficiently throughout the supply chain. Xinhua Bookstore is a well-known and popular brand in China enjoying the reputation of a business which carries only authentic copies of books, a feat in a country riddled with pirated copies of books in stores. These traditional superiorities are longstanding and cannot be achieved by new entrants like Bertelsmann in a short time. Table 6 outlines basic statistics on Xinhua Bookstore.

*Table 6: 2003 Basic Numbers of Xinhua Bookstore*

<b>Branch Stores</b>		2,692
<b>Bookstalls</b>		9974
<b>Employees</b>		149,140
<b>Annual Sales</b>	Copy	11.934 Billion
	Amount	69.595 Billion CNY (10.7 Billion USD)
<b>Annual Sales in the Whole Industry</b>	Copy	75.75 percent
	Amount	65.03 percent

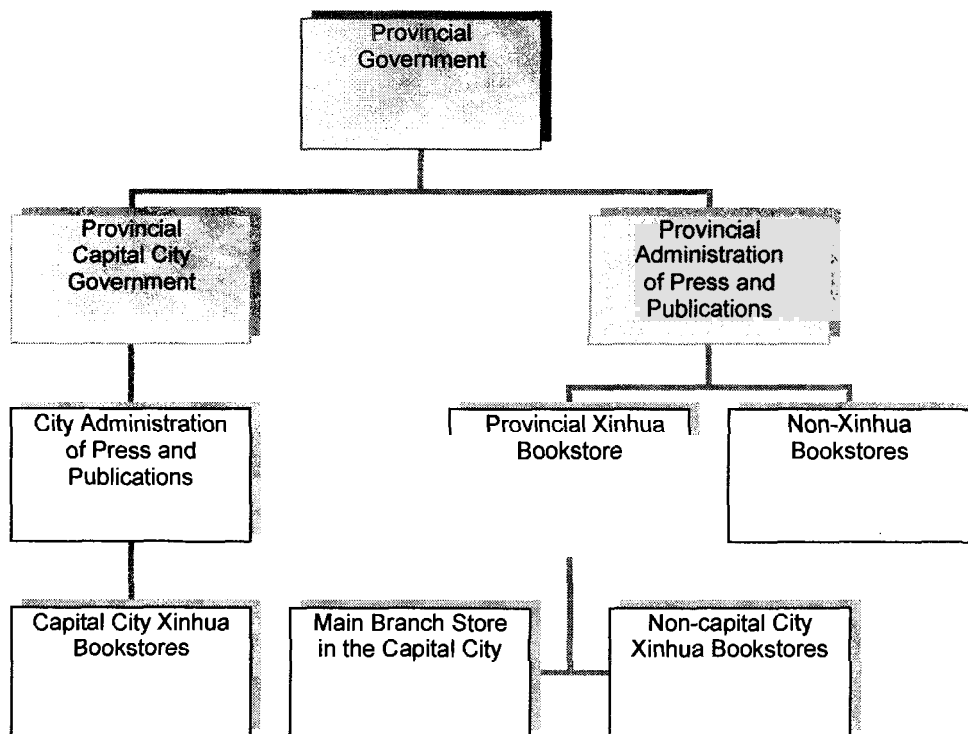
#### **4.1.1 Xinhua Bookstore is not a National Book Chain**

The Xinhua Bookstore used to operate as branches with a centralized administration structure. During the planned economic period of China, Xinhua Bookstore's head office in Beijing was the sole sourcing distributor to branches in the country. With no sales team, all publishers sent their catalogues to Xinhua Bookstore's head office. Xinhua Bookstore's head office publicized the titles to its provincial subsidiaries and collected the orders from

them. Informed about the orders by Xinhua Bookstore's head office, the publisher distributed their books to provincial Xinhua Bookstores. Every provincial Xinhua Bookstore had the responsibility of sending these publications to its branch stores and retail outlets throughout the province.

This situation has changed since the late 1980s, when Chinese book publishers were allowed to distribute their own books<sup>69</sup>. Since the publishers' sales teams distribute their books directly to provincial Xinhua Bookstores<sup>70</sup>, Xinhua Bookstore's head office (which was overseen by the Central Chinese Government) no longer acted as the head administrator for Xinhua Bookstores. Instead it became a new independent company with the name, Xinhua Bookstore Head Office. This is a confusing issue in that it inherited the name Xinhua Bookstore Head Office, but it no longer operates as a head office for Xinhua Bookstore branches and it remains under the Central Government.

*Chart 8: The Provincial Hierarchy of Xinhua Bookstore's Administration*



<sup>69</sup> *Temporary Provisions on the Sales Activities of Publishing Houses*, co-promulgated by GAPP and SAIC (State Administration for Industry and Commerce) on August 12, 1991, and was implemented from the same day.

<sup>70</sup> When Xinhua Bookstore is pluralized, it refers to the bookstores in the Xinhua Bookstore System.



The administration of provincial Xinhua Bookstores was transferred to local provincial governments. However, provincial Xinhua Bookstores do not oversee all the Xinhua Bookstores in the province, because the Xinhua Bookstore in the capital city reports to the government of the capital city. The provincial Xinhua Bookstore oversees its main branch store in the capital city and subsidiary Xinhua Bookstores in non-capital cities. Chart 8 is a simple illustration of the provincial hierarchy of Xinhua Bookstore's administration. It is beyond the scope of this paper to attempt to draw out the complete provincial structure, but chart 8 does show the general competition between Xinhua bookstores throughout the province, especially in the capital city. The capital city of the province is where provincial Xinhua Bookstore's head office is located and where its main retail store operates. So in the capital city, both the capital city Xinhua Bookstores and the provincially run main branch store compete with each other. From a holistic point of view, Xinhua Bookstores compete within a province, and operate independently from other provinces. Few provincial Xinhua Bookstores have even considered competing outside of their own province.<sup>71</sup> In sum, Xinhua Bookstore is not a book chain covering the whole country but rather is a brand name being used by the state-owned bookstores in every province of Mainland China.

#### **4.1.2 Xinhua Bookstore Has Lost Half of the Mass Market**

Under the provincial hierarchy of Xinhua Bookstore (see Chart 8), some odd things have occurred. As mentioned, in provincial capital cities, the main branch store of the provincial Xinhua Bookstores competes with the capital city Xinhua Bookstores. This often leads to price wars between Xinhua Bookstores. Not being in a book chain operation, Xinhua Bookstores operate independently and lack coordination. Moreover, due to their long-standing monopoly, Xinhua Bookstores have been plagued by high costs, low efficiency and poor service. Their business activities are inflexible to the changing nature of the market. This slow adjustment to change allows other book sales forces, especially private bookstores, to compete directly and effectively against Xinhua Bookstores.

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<sup>71</sup> The government has never issued any policy to limit provincial Xinhua Bookstore's business activity within the province. However, no other Xinhua Bookstore has ever tried to do business outside of its own province; that is before Zhejiang Provincial Xinhua Bookstore (see Chapter 4.1.4 for details). The reason for this phenomenon is complex. It could be local protectionism, the shortage of funds or because each Xinhua Bookstore carries its provincial name in the prefix and would seem out of place in another province.

The above-mentioned issues have resulted in a mass-market share loss for the state-owned giant. Xinhua Bookstore's government sponsored advantage is the exclusive right to undertake textbook distribution in China. The following analysis is based on the *2003 Statistics on Publishing Industry of China* by GAPP. It tells us that Xinhua Bookstore only makes up 50 percent of the non-textbook market, namely the mass book consuming or trade book market. Officially released numbers by GAPP show that 2003 sales in the publishing industry totaled 15.754 billion copies, which generated a sales income of 107.02 billion CNY. Xinhua Bookstores contributed 11.934 billion copies and 69.595 billion CNY to those amounts. Meanwhile, 2003 sales of textbooks totaled 8.302 billion copies with a sales income of 42.239 billion CNY. According to these numbers, China's 2003 mass-market book sales totaled the difference, that is 64.781 billion CNY (107.02 – 69.595) with 7.452 billion (15.754 – 8.302) copies sold. Deducting the sales income and copies contributed by the textbooks, Xinhua Bookstore's mass-market sales income was 27.356 billion CNY (69.595 – 42.239) generated by 3.632 billion (11.934 – 8.302) copies sold in the market. Therefore, Xinhua Bookstore's share in the mass book consuming market in 2003 was 48.7 percent (3.632/7.452) in copy and 42.2 percent (27.356/64.781) in total sales income.

#### **4.1.3 Xinhua Bookstore's Reform and Restructure**

Since China allowed private sector companies into the industry, Xinhua Bookstores have experienced a huge and continuous decline in market share. The reduction from 100 percent of the market to less than 50 percent of the mass market is dramatic. The breakdown of Xinhua Bookstore's monopoly reflects China's economic reform and the impact of change from governmental planning to a more market oriented system. Surely the purpose of China's economic reform is economic development by building a fair market environment founded on competition. SOE companies like Xinhua Bookstore are expected to become powerful contributors to market competition upon completing the reform and restructuring guided by the changes in government policies. The following examples in Zhejiang, Liaoning and Beijing show that Xinhua Bookstores are actively seeking new methods to reform and develop so that they can deal with the pressures of competitors like Bertelsmann.

Since the end of the 90s, some provincial Xinhua Bookstores (as mentioned this is the body that controls Xinhua Bookstores in non-capital cities and the main branch store in the

capital city) have been planning on developing distribution systems in their own provinces, with chain operations and modern logistics services. One example is the Zhejiang<sup>72</sup> Provincial Xinhua Bookstore. This bookstore stands out because it has broken through the local protectionism by establishing the first trans-provincial chain store in the Xinhua Bookstore system. In November 2003, Zhejiang Xinhua Bookstore's subsidiary, BooKoo Book City, established a super bookstore with an operation space of 5,000m<sup>2</sup> in Xuzhou, a city in its neighbouring province, Jiangsu. In October 2004, Jiangsu Xinhua Bookstore responded by opening a super bookstore through its subsidiary WanJuan in Ningbo, Zhejiang Province.

Chinese publishing authorities are happy to see these business phenomena because carving up the operation area according to administrative boundaries were a mark of planned economy. There are no policies or government regulations restricting provincial Xinhua Bookstores' operation to their own province any more. However, due to the protectionism brought by the long-term planned economy, not many provincial Xinhua Bookstores have expanded their business to other provinces in China.

Another example is in the Liaoning Province, in northeast China. The distinction of Liaoning from Zhejiang is that Liaoning crossed the provincial boundary as a state-owned book distributor rather than a book retailer. North Publication Distribution Centre (NPDC), formerly the Liaoning Xinhua Bookstore Distribution Centre, also the subsidiary of Liaoning Publishing Group, had signed a contract with the Xinhua Bookstore of Inner Mongolia Municipality to build a distribution system covering eastern Inner Mongolia in April 2003. According to this contract, NPDC would provide services to the Xinhua Bookstore branches in eastern Inner Mongolia. Most of these branches are in remote rural areas.

Beside these powerful provincial Xinhua Bookstores, Xinhua Bookstore Head Office has also started its reform and restructuring, hoping to maintain its dominating market position. On April 25, 2005, Xinhua Publications Circulation and Distribution Co., Ltd. (Xinhua C&D) was officially established. It is a joint venture of Xinhua Bookstore Head Office and other private and foreign investment firms. Xinhua Bookstore Head Office is the largest shareholder. *China Daily* reported this collaboration:

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<sup>72</sup> Zhejiang is located in the Yangtze River Delta Region (YRD). YRD includes Shanghai, Jiangsu and Zhejiang, which is economically one of the most prosperous and vibrant regions in China. YRD is also expected to become China's second largest publishing centre after Beijing. The economic foundation, population and cultural and educational levels of this area provide favourable conditions for the rapid development of the publishing industry.

The new company will take over the core distribution business of Xinhua Bookstore Head Office ... and be devoted to establishing a nationwide circulation network and optimized regional distribution networks, to consolidate the leading position among publication wholesalers.<sup>73</sup>

#### 4.1.4 Government Interferences

Foreign investors should understand that as a SOE company, Xinhua Bookstore inevitably uses the government's preferential policies during its marketing campaign. The most beneficial policy utilized by Xinhua Bookstores is the 'exclusive textbook distributor' regulation. Moreover, administrative powers have also been used by some provincial governments to assist Xinhua Bookstore's expansion in the province. A typical example is again in Zhejiang. Zhejiang Province has written Xinhua Bookstore construction into government document, such as *"The Notice to Strengthen the Construction of Xinhua Bookstore Retail Outlets"*<sup>74</sup>. This notice is co-issued in January 21, 2002 by Zhejiang Provincial Administration of Press and Publication and other governmental institutions regarding provincial development and planning, land and resources, finance, taxation and construction. The notice stated that governmental institutions are required to support Xinhua Bookstore development in the province. For example, the notice highlighted the following points that institutions are required to implement:

- Xinhua Bookstores are considered an enterprise which contributes as a Chinese Public Welfare enterprise and is therefore given priority in land assignment and benefits as a public welfare enterprise.
- Space for Xinhua Bookstore retail outlets must be included in all construction plans of towns and cities and Xinhua Bookstore outlets must be included in residential areas. The construction of Xinhua Bookstore retail outlets should be planned, coordinated and managed by related governmental departments, for examples, local Press and Publication Administrations, Urban Planning Department and Construction Administrations.
- For the operation space in cities such as Hangzhou, Ningbo and Wenzhou Xinhua Bookstores are built according to population with each m<sup>2</sup> serving 100-150 people. Centre towns listed in Provincial developing plan must have at least one Xinhua Bookstore branch with an operation space larger than 200-400m<sup>2</sup>

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<sup>73</sup> Zhang, 2005

<sup>74</sup> Retrieved November 16, 2005, from the Official website of Zhejiang Provincial Archives, [http://www.zjda.gov.cn/show\\_hdr.php?xname=CP0GHU0&dname=Q3QNHU0&xpos=3](http://www.zjda.gov.cn/show_hdr.php?xname=CP0GHU0&dname=Q3QNHU0&xpos=3)

- Outlets could be owned by the state-owned or state-holding Xinhua Bookstores in partnership or collaboration with other ownership (private or foreign invested) companies, taking part in Xinhua Bookstore's operation.

Zhejiang Provincial Xinhua Bookstore has received absolute support from the provincial government. Meanwhile, according to this document, private and foreign invested companies have been allowed partnership with Xinhua Bookstore chain operations.<sup>75</sup> However, this government activity in Zhejiang has caused many controversies and it has been deemed unjust by some industry watchers, private and foreign investors. Government interference like this will create an even more complicated market environment for competitors like Bertelsmann.

## 4.2 A New Rising Force – Private Book Companies

After years of struggling for survival, the ever-growing private book companies have become another rising force in the industry that should not be neglected. The analysis in 4.1.3 shows that non-SOE companies share 51.3 percent of the mass book consuming market (in terms of copies) and 57.8 percent in sales. While foreign-owned companies account for a minority of book sales, when added to the private sector's market share, both together lay claim to more than half of China's general book retail market. Up to 2003, China had 34,384 private book companies. This number is 51.04 percent of the total book sale outlets in China.<sup>76</sup> Currently, there are private book companies in the retail, wholesale, book packaging and distribution business.

### 4.2.1 Private Book Retailers

Book retailing is the most common business for private book companies entering the market. *The Report on China's Media Industry* in May 2004 revealed that more than 90 percent of private book companies are book retailers. Private book retailers in China vary in their operations, as they exist in the market as independent bookstores, super bookstores, book chains, online bookstores and book clubs.

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<sup>75</sup> Xinhua Bookstore has undergone ownership transformation in the last few years. Private and foreign investments are allowed in Xinhua Bookstore. Xinhua Bookstore Head Office and Zhejiang Xinhua Bookstore are two examples. However, Xinhua Bookstore is required by the government to keep the leading shareholder position in the joint venture.

<sup>76</sup> This official number is released by GAPP in its *2003 Basic Statistics on the Publishing Industry of China*. Non-official statistics estimates a much higher number, with as many as 78,000 Chinese private book companies (Liu, 2003)

#### **4.2.1.1 Independent Bookstores**

Most private companies are small or medium-sized independent bookstores. Operating with relatively small sales volumes, most independent bookstores buy books from wholesalers (private wholesalers or the SOE Xinhua Bookstore). Independent bookstores are usually located in densely populated regions near schools or in a large community. It is noticeable that some independent bookstores tend to cluster near colleges and universities. A number of them have gradually gained a considerable market share in the big cities where there are many colleges and universities. Private independent bookstores are usually flexible in giving discounts to the readers. Most of them have a good reputation in the neighbourhood and serve loyal customers.

If an independent bookstore is located in a residential community, often with an elementary or a middle school around, it usually carries popular books (mainly bestsellers), reference books and children's books. Those that are located near college and universities will carry a different selection of books. They often carry select titles for categories such as the arts, music, literature, social science, architecture, computer science, medicine, economy and law. These bookstores are for target customers and can easily establish customer loyalties. Once they are recognized by customers and established a good reputation in the region, they are not easily displaced by competitors. Book publishers, mainly of scientific and technological books, often support some competitive local bookstores by making them exclusive regional retailers of their books. Thereby, some independent book retailers, which are strong in the market, are often a wholesaler at the same time.

#### **4.2.1.2 Super Bookstores**

There are few private super bookstores in China. Those in operation emerged in big cities in the late 90s. Most of them are owned by other industries rather than the publishing industry.<sup>77</sup> Shenyang DongYu Bookstore in Liaoning and Popular Book Mall in Jiangsu are two typical examples of private super bookstores in China. Owing to their high volume of sales,

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<sup>77</sup> The publishing industry used to be monopolized by SOE companies. Private book companies encountered many policy barriers and discriminations, so few had large enough capital to open a super bookstore. During the end of 1990s, when the policy barriers had been lifted by the government, investors from other industries, seeing the lucrative profit in China's book retail business, entered the market. However, investors from other industries often lack experience and the necessary networking to succeed in the industry. Running a book wholesale business is difficult for them, so they often choose book retailing to start their business.

private super bookstores have established themselves in the market and they can get books directly from the publisher. Of course, they also buy books from local private wholesales or even Xinhua Bookstores.

DongYu Bookstore is a subsidiary company of DongYu Group. DongYu Group is an enterprise group engaging in IT, medicine, international trade, book retail and real estate, with total assets of 2.35 billion CNY (360 million USD). DongYu Bookstore initially was a small book retailer and book wholesaler established by DongYu Group in 1993. Now, Dongyu Bookstore has established two retail chain stores in Shenyang, the capital city of Liaoning province. Its main book retail store has an operation space of 4000 m<sup>2</sup>. The annual revenue of DongYu Bookstore has exceeded 100 million CNY (15.4 million USD) in 2002<sup>78</sup>. The Popular Book Mall was open in January 2003. It is owned by private Nanjing HongGuo Group. HongGuo Group began as a footwear company and has expanded to diverse business areas of department store, foot wear, luggage, book distribution, real estate, financial investment and international trade. The Popular Book Mall is located in the busy town centre with an operational space near 15,000 m<sup>2</sup>.<sup>79</sup>

#### **4.2.1.3 Book Chains**

After 2000, along with Xinhua Bookstore's progress in book chain operations, some private bookstores started their expansion with the book chain model. In Beijing, Shanghai, Shenyang, Hainan, Hunan, and Inner Mongolia, private book companies with several chain stores emerged. Among them, the largest two are 21<sup>st</sup> Century Book Chain and Xishu Book House. Steered by its CEO and finance master Ruiren Luo, 21<sup>st</sup> Century Book Chain has established a joint venture with Bertelsmann (see 2.5 for details). Meanwhile, Xishu Book House has found another way to expand its chain operation in China.

Xishu Book House (Xishu) is named after its founder, Mr. Shu Xi, one of the famous pioneers in the private book chain industry of China. Xishu established its first bookstore in Beijing in 1996. After nine years in operation, Xishu's network covers 30 provinces of the country. It has established more than 600 outlets in over 400 cities. Over 80 percent of its stores are in small and medium-sized cities, making it easier for readers living in remote areas

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<sup>78</sup> Dongyu Group, 2004

<sup>79</sup> Hongguo Group, 2004

to buy books. After fulfilling its strategy of capturing the small and medium-sized cities, Xishu's next step was to take on the big cities, while continuing its expansion in residential communities. Most of the numerous bookstores established under its name are franchise stores. Due to the lack of funds, Xishu has not been able to build up a logistics system to support its large-scale expansion. Most of its franchise stores have to buy books from local wholesalers and are unable to respond rapidly to changes in market demand.

Most Chinese book chains operate within their own provincial boundaries. Even the powerful Zhejiang Xinhua Bookstore can only expand its chain stores into neighbouring provinces. Bertelsmann's joint venture 21<sup>st</sup> Century has the potential to be the first real nationwide book chain operation.

#### **4.2.1.4 Online Bookstore and Book Club**

Besides competition among foreign, private and SOEs in the traditional book retailing business, online bookstores and book clubs add another dimension. Private online bookstores and book clubs are usually established by private book retailers, and basically serve local customers where the book retailer is located. When book retailers have realized large-scale sales in the retail market, they often begin to develop more sales online by establishing their online bookstore. Online bookstores are attractive as they offer publications cheaper than those bought over the counter at a traditional bookstore. Some private book retailers also establish book clubs to build customer loyalty. However, these book clubs are different from Bertelsmann's, because their main function is not book sales but customer loyalty maintenance. The real sales are from their retail stores.

The aforementioned, Dongyu Bookstore has established an online bookstore and book club. Xishu also established its "Xishu Good Book Club" in July 1997, followed by its online bookstore, [www.jingqi.com](http://www.jingqi.com), in March 2003. Private companies Joyo and Dangdang are the leading two online bookstores in the market. Different from the private book retailers mentioned above, online sales are Joyo and Dangdang's major business. Joyo and Dangdang were established by private investors with the help of foreign investments. Joyo was founded in Beijing in January 2000 by two Chinese leading IT companies, Lenovo and Kingsoft. Amazon acquired Joyo for 70 million USD in August 2004. Now Joyo is the seventh global website of



Amazon.com. Joyo established its reader's club in October 2001.<sup>80</sup> Dangdang is known as the biggest Chinese online bookstore, providing 90 percent of the available books in Mainland China. It was established in November 1999. The shareholders of DangDang are IDG, Matthews Pacific Tiger Fund, Luxembourg Cambridge Holding Group, Softbank, Beijing S&C Books Information Technology Co., Ltd. Dangdang offers over 300,000 products including books, audio-visual products software and games. 200 new titles are added to Dangdang's selections every day.<sup>81</sup>

The number of private online bookstores and book clubs in China has yet to be official documented.<sup>82</sup> However, *The Report on China's Media Industry* in May 2004 says private online bookstores account for the main body of Chinese online book distribution. SOE companies have lagged behind the development of private companies in this area.

#### **4.2.2 Private Book Wholesalers**

Chinese private book wholesalers utilize a unique business model. A typical private book wholesaler often acts as the wholesale agent for one or two or even several book publishers in the local market. Private book wholesaler's main customers are private book retailers. Of course, it often happens that when some Xinhua Bookstore branches are out of stock, they also go to private wholesalers for replenishment. Unfortunately all private wholesalers are small and are unlikely to become dominant wholesalers in the province, let alone the whole country. Therefore, the government has built indoor markets, referred to as publication wholesale markets, for private book wholesalers to come together and sell their products to retailers. Most publication wholesale markets are built and operated by the government, but in August 2003 the first private investors' publication wholesale market (Capital City Book Wholesale Market) was built in Beijing.

There is at least one private book wholesale market in the central cities of most provinces. Take for example, the government-built Beijing Book Wholesale Trade Market, opened in 1993, which has an operating space of 13,000m<sup>2</sup>. Currently, there are about 180 private book wholesalers operating in this publication wholesale market. Annually, about 2

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<sup>80</sup> Joyo.com Ltd., 2005

<sup>81</sup> Dangdang.com, 2005

<sup>82</sup> A speech by Guang Wei Xin, an officer from GAPP in 2000 revealed that there are more than 700 online bookstores in China. However, this number includes SOE online bookstores mainly established by publishers and Xinhua Bookstore.

billion CNY (308 million CND, by list price) worth of books are traded in the publication wholesale market.<sup>83</sup> Although, private book wholesalers are not able to impact the book market individually, these publication wholesale markets allow private book wholesalers to collectively compete with state-owned book wholesaler Xinhua Bookstore.

#### **4.2.3 Private Book Packagers**

Private book companies cannot publish books in China. However, some private book companies who are strong content providers often package books for state-owned book publishers. They usually specialize in one or two categories, for example, computers, children's books, business and finance, health, or fiction. Private book packagers are based mainly in Beijing, Shenzhen, Chengdu and Guangzhou. The May 2004 *Report on China's Media Industry* estimates that of the hundreds of book packagers in Beijing, more than 40 percent of them exceed an annual revenue of 10 million CNY (about 1.54 million CND) by list price, and more than 10 percent of them exceed 30 million CNY (about 4.62 million CND ) by list price in annual revenue. The private book packagers, who have established a sales channel in addition to their packaging services, can also act as private book distributors. The following section offers a brief understanding of private book distributors.

#### **4.2.4 Private Book Distributors**

On September 1, 2003, the Chinese government granted private book companies the right to function as private book distributors when qualified private book companies (GAPP will evaluate their qualification) were allowed to distribute books countrywide. A year later, 11 private book companies have been licensed by GAPP.<sup>84</sup> Private book distributors in China are book companies who package books for state-owned publishers and then exclusively distribute these books in the market. Since private book distributors provide both editorial content and distribution of the books, they are conducting business activities very similar to a book publisher. When dealing with book publishers, state-owned publishers will license the ISBN to private book distributors. This kind of business phenomenon existed prior to

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<sup>83</sup> China Economic Information Network, State Information Centre, May 2004

<sup>84</sup> This does not mean that only eleven private book companies are engaged in the book distribution business in China. Due to weak governmental supervision, the actual number of private book companies engaging in book packaging and distribution (be it licensed or not) is far higher than reported by GAPP. Some book distributors are private book packagers holding wholesale licenses.

September 2003, but the Chinese government had not acknowledged this type of business until then. Their book packaging and distribution activities should not be confused with publishing because the Chinese government has still not issued any official policy allowing private book publishers to operate in China. This remains the last road block to fully opening the industry to private enterprise.

King & Key Education Group is one of the largest private book distributors in China. Its subsidiary Shandong ShijiTianhong Book Co., Ltd is the first licensed nationwide private book distributor. *The Report on China's Media Industry* released in May 2004 estimated that King & Key has an annual sales scale of 500 million CNY (77 million USD) by list price. This report also estimated that more than 20 private book distributors in China have exceeded 100 million CNY (15.4 million USD) in their annual sales by list price.

Although, there are a few powerful players like King & Key and Xishu in the market, private book companies are generally small or medium-sized businesses. Private book companies often deal with capital shortage, low public and media recognition<sup>85</sup>, and market discriminations<sup>86</sup>. However, private book companies have clear-cut property rights. Compared with SOE companies, private companies are more flexible in management and more market-oriented in operations. Meanwhile, since they often pay up front to the publisher, private book companies can get better discounts than their state-owned counterparts. Some private book companies believe they can be competitive in the market with their flexible management and efficient operations. Industry administrators have recognized the positive effects brought by private book companies to the publishing market, and are attempting to guide them to the path of healthy growth and high-speed development. Now private book companies have encountered an unprecedented opportunity for their development and are expected to experience a rapid growth in the market.

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<sup>85</sup> For example, private bookstores are considered a place where people can find pirated copies, while Xinhua Bookstore has a reputation of carrying only authentic copies in their store.

<sup>86</sup> For example, private book companies often have to pay up front to the books from the publisher. However, Xinhua Bookstore could buy on credit, holding payment for 90 to 120, or even 180 days on account to the publisher.

## **Bertelsmann's Strategies in China**

China's publishing industry had been controlled by the government ever since the establishment of the People's Republic Government (1949 – present). During government control, the publication market was monopolized by state-owned enterprise SOE publishers and Xinhua Bookstore. For foreign investors, the publishing industry of China is low in operation transparency, high in policy barriers, strict in censorship, and the relationship networks are complicated. Foreign investors conducting business in China must learn about the Chinese culture, especially Chinese business practices. Successful foreign enterprises pay attention to how relationships are built in China and show their commitment to the country. Foreign investors must also recognize the changes China is undergoing in its economic reform and restructuring. Institutions are evolving and there are more changes to come as the economy opens to allow more foreign investment.

Bertelsmann, a multinational operating in China for over ten years, clearly understands that it is facing a market with a different cultural background. Bertelsmann distributes cultural products in China. Although Bertelsmann would like to be directly in the publishing industry, it is only allowed to provide the sales channels utilized by the industry. Realizing that the industry is under special restrictions and supervision from the government, it has made every effort to succeed in this difficult environment. Bertelsmann strategically applies the successful experiences from other countries in China and has succeeded in establishing several successful operating strategies to guide its business practices in the country.

### **5.1 Localization**

Localization is an important aspect of Bertelsmann's strategies for integration into new markets. As stated in their employee recruitment materials, "We strive to establish an organization highly respecting local culture with the responsibilities of promoting social

development and cultural exchange.”<sup>87</sup> Bryan Ellis, General Manager of Bertelsmann Book Club has said:

“Our competitiveness comes not only from internationalization, but also from localization. Bertelsmann is a media group carrying out localization strategy. Localization is the essential element of Bertelsmann’s success around the world.”<sup>88</sup>

Bertelsmann’s localization strategy is reflected in two aspects. First, Bertelsmann contributes to Chinese cultural accessibility by organizing or sponsoring public activities and events.<sup>89</sup> Bertelsmann’s business model of selling books through mail order asks customers to pay before they get the book, which is different from the traditional way of buying books in person. To be successful in introducing this new method of book purchasing, it would require Bertelsmann to establish a good reputation and be a credible merchant in the market. As part of Bertelsmann’s strategies, the sponsorship of public activities have benefited Bertelsmann by establishing the reputation and creditability needed during the market cultivating stage. Ekkehard Rathgeber, former President of DirectGroup China, said: “As a media company, our business is disseminating culture products. If we cannot show our contributions to Chinese culture, we would not establish market foundation in China.”<sup>90</sup> As a multinational media company, Bertelsmann values and respects the culture, ethic and the tradition of the local nation. In China, Bertelsmann serves 150 million Chinese customers, and has become one of the most important channels for Chinese consumers to acquire high quality cultural products. Bertelsmann understands that, as a foreign company, it must build a foundation in respect of the Chinese culture, base itself on the Chinese social and economic background, and follow the rules of the industry. Now, Bertelsmann has created a point of access to the market through cultural understanding, and in turn has found a way to work with, and at times, around the policy barriers. Through these efforts, Bertelsmann has demonstrated a driving force for expansion in China.

The second aspect reflecting Bertelsmann’s localization strategy is that it relies upon local business partners and staff for its operations and expansion in China. Up to now, Bertelsmann has established three joint ventures within China. It benefits Bertelsmann to have

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<sup>87</sup> 21<sup>st</sup> Century Book Chain Company, 2004

<sup>88</sup> Wang, August 15, 2005

<sup>89</sup> See the list of Bertelsmann sponsored public activities at <http://www.bertelsmann.com.cn/index.htm>

<sup>90</sup> Beijing Representative Office, Bertelsmann China Holding GmbH, April 6, 2001

reliable Chinese partners<sup>91</sup>. Bertelsmann's achievements over this last decade in China are proof of the effectiveness of the localization strategy in place. The first joint venture with China Sci&Tech Book made Bertelsmann the first foreign investor in China's book industry. Its joint venture with privately-owned 21<sup>st</sup> Century let Bertelsmann become the first foreign company to obtain a book retail chain license in China. The latest joint venture, Liaoning Bertelsmann, with Liaoning Publishing Group, has helped Bertelsmann obtain a national publication distribution license.

Bertelsmann highly recognizes the contribution of the local Chinese staff in the company and recognizes the importance of local employee recruitment and training.

Yan Pan said: "the recruitment, training and acquisition of excellent local employees are challenges that Bertelsmann faces daily since we started business in China. ...The company is more like a training school. We find qualified jobseekers and train them from the beginning."<sup>92</sup>

Now, Chinese employees are the main body of Bertelsmann's staff in China. Yan Pan herself is a typical example of Bertelsmann's local Chinese staff. Pan has been working for Bertelsmann for ten years. She was one of the first three people working for Bertelsmann's first joint venture, SBCIC, in China.<sup>93</sup> Now, she runs Bertelsmann's two subsidiaries, Bertelsmann (Shanghai) Consulting and BAP, and the Liaoning Bertelsmann joint venture.

## 5.2 Adapting a Proactive Approach to Business

Bertelsmann takes a proactive approach to business. It pays close attention to the progress of the Chinese government in regards to industry policies. It prepares ahead of the government's promulgated schedule, taking action at the earliest time. The joint ventures with Beijing 21<sup>st</sup> Century and Liaoning Publishing Group are two examples. Bertelsmann started the negotiation with Beijing 21<sup>st</sup> Century on its retail joint venture at the beginning of 2001. One year later the test store of Bertelsmann's Club Centre opened in Beijing<sup>94</sup>. Another year later on May 1, 2003, China opened its publication retail market to foreign investors. And as

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<sup>91</sup> See chapter 2.1.1

<sup>92</sup> Chen, September 7, 2005

<sup>93</sup> The other two employees were Ekkehard Rathgeber and Qihua Zhang. In 1993, Rathgeber was sent to China by Bertelsmann to initial a business operation. He resigned from at the position of President of Bertelsmann Asia Region in 2003. As for Qihua Zhang, he represents Chinese shareholder (China Sci/Tech Book) in Shanghai Bertelsmann. Now he is the Deputy General Manager of Bertelsmann Book Club.

<sup>94</sup> See chapter 2.5.2

early as 2002, Bertelsmann had started to get in touch with some Chinese book publishers for the possibility of cooperation in book distribution and even in book publishing. On December 1, 2004, China lifted the restrictions on foreign investment in publication distribution. Five months later, May 2005, Liaoning Bertelsmann was established in Shenyang. Because of its early planning and efforts, Bertelsmann was the first licensed foreign investor in the Chinese book chain industry. Liaoning Bertelsmann became the first book distribution company co-founded by a Chinese state-owned enterprise and a foreign investor.

China's economic reform and opening up creates more business opportunities for international investors, especially those in monopolized industries such as publishing. The ability to understand the industry policy and its development trends enables Bertelsmann to apply foresight to its planning. As a sophisticated multinational with over ten years of operation in China, Bertelsmann has gained an early advantage and occupies an offensive position over its international competitors. Bryan Ellis sums it up best:

We respect local laws and regulations. Meanwhile, we pay close attention to the changes of the government on the industry policy. Once there is a favorable policy, we will grasp the opportunity and try to bring more advantageous products and services to the Chinese market. Regarding the opening of China's book market, we have done some preparation work. As many German companies do, we act before we speak, rather than speak before we act.<sup>95</sup>

### **5.3 Adding Value to Service**

The book club is a direct sales channel. Within the value model, the book club is but one part of the sales avenues. Direct sales is a targeted method of selling compared to traditional retail. Bertelsmann always tries to utilize the advantage of direct sales to provide added-value services to the Club members. Bertelsmann has established a large database that records detailed information about the club members, for example, their age and gender, education background, occupation, income, buying habits, reading hobbies, even their favorite contact method. Analysis of the information enables Bertelsmann to understand the needs of the target customer, so as to provide better services to them. Although, Bertelsmann's Book Club offers discount to members, Bertelsmann believes price wars are not the way through which it can gain dominance in the market. Bertelsmann's competitiveness comes from the service it provides to the consumer.

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<sup>95</sup> Wang, August 15, 2005

Yan Pan said: “What we think now is how to best use our current resources to develop book sales channel that can provide more convenient services to our members. The more channels we provide, the more convenient the members feel. ... The key point of our competition in the book market is our added value services. The biggest challenge for direct sale is the Customer Relationship Management (CRM). We can open 200 retail stores shortly in the country, but we cannot lag behind in service quality.”<sup>96</sup>

To add more value for consumers, Bertelsmann keeps expanding upon and investing in building its direct sales channel<sup>97</sup>. Now members of Bertelsmann Book Club can enjoy many conveniences in buying books that match their tastes through its online and offline services. Besides continually reinforcing its mail order and online sales channels, Bertelsmann is building club centres around China. Bertelsmann has established 53 club centres in 13 cities throughout China. Meanwhile, Bertelsmann is planning on delivering its books to thousand of supermarkets through its new joint venture book distributor, Liaoning Bertelsmann. Moreover, Bertelsmann has also categorized their members as to better target their personal needs. The Book Club divides its members into four groups, Student Club (for students under 22), Charming (for adults older than 22), Beauty Mum (for kids under 6 and their mothers), and Be-Styleish (for small gift lovers). Catalogues are published individually for each of the groups. They are designed in different styles, not only in cover and layout but also in literature. Through these catalogues, Bertelsmann provides personalized services and products to the different group members, offering books that meet the needs of members in different life stages.

## 5.4 Low Profile

“The wolf is coming” is a phrase often used in China’s publishing circles to describe Bertelsmann entering the Chinese market. This phrase was made popular during the first few years after Bertelsmann starting its operations in China. It reflected the complex feeling of some Chinese companies in the publishing industry as they watched their monopolies fall victim to an intruding foreign company. Although the government was planning to open the market to foreign investors, Chinese enterprises were not happy to see their market being carved up by a new foreign entrant. Even with numerous obstacles addressed, such as the

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<sup>96</sup> Chen, September 7, 2005

<sup>97</sup> See chapter 3.3



endorsement of the government with a business licence, the ability to provide added-value services to their customers, and the hard work of local employees and partners bridging the cultural gap obstructing the market; Bertelsmann would not be able to operate in China if Chinese competitors and counterparts had boycotted Bertelsmann.

Bertelsmann understands that public opinion is crucial for its survival, especially during the initial stage in its development in China. Keeping a low profile is the strategy Bertelsmann is using to avoid arousing industry players and is its main public relations strategy in China. In the eyes of the Chinese media and its counterparts in the publishing industry, Bertelsmann is a low profile and modest operation. Seldom is Bertelsmann's strategic operation in China unveiled before its due time, allowing Bertelsmann the luxury of executing its plans without interference. When the correspondent from *China Reader's Weekly* asked Pan about Bertelsmann's next strategic move in China, Pan showed Bertelsmann's low profile style by answering:

“Our strategy is to do better on the jobs on hand. As regards what we will do in the future, it depends on the operating space created by the market, government policy and industry environment, which are the company should refer to before making strategic decision.”<sup>98</sup>

Bertelsmann's low profile strategy has reduced the chance of some non-market interferences during the embryo stage of its new business operation. The business environment is complex in China. Although some countries view China as a communist country without any signs of democracy; on the contrary, public opinion can inspire government interference. An example would be Bertelsmann's cooperation with Rongshuxia, an all-Chinese original literary forum<sup>99</sup>. Bertelsmann applied its low profile strategy when obtaining control of the Rongshuxia website. By describing its relationship with Rongshuxia as a strategic alliance rather than an outright purchase, Bertelsmann probably minimized feelings of cultural invasion. Bertelsmann understands that it has given the Chinese people an impression of a wolf-like invader. Therefore, keeping a low profile and conveying a modest tone is necessary to succeed in developing Bertelsmann's operations. Pan talked about Bertelsmann's low profile strategy when answer the correspondent from *China Reader's Weekly*.

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<sup>98</sup> Chen, September 7, 2005

<sup>99</sup> See chapter 2.3.

China Reader's Weekly: Why did Bertelsmann keep such a low profile when it entered China? It neither bought nor merged with other companies. And there were no large employee recruitment which other multinationals often do in China? For example, as it was reported, tom.com had rapidly expanded in China by buying, merging and recruiting. So, what was Bertelsmann's strategy at that time?

Yan Pan: Bertelsmann entered China's book market very early. In retrospect, the market environment in regards to industry policy, government regulation, public opinion and customer foundation, indicated that people were taking a wait-and-see attitude on our accession to China. We were in an initial stage. We needed time to understand the market and acclimatize ourselves to it. (Bertelsmann is a media company). We are different from the top 500 manufacturing or commodity companies. We wanted to be low profile back then.<sup>100</sup>

Bertelsmann has been successful in developing a strong reputation among the public. A harmonious business environment aided its survival and development in the country. Although some people in the publishing circle find foreign investors like Bertelsmann a threat, most have expressed minimal concern. There is no discussion in Chinese media on the issue of whether foreign capital should or should not enter China's publishing industry. Discussions focus upon what attitudes should be adopted by the enterprises in the publishing industry and how to sustain and develop within competition. Now Chinese publishing circles have accepted Bertelsmann as a competitor rather than a wolf-like invader.

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<sup>100</sup> Chen, September 7, 2005

## Conclusion

In China, the demand and consumption of books is understandably large. Given the size of its population, there is still much room for market expansion as cultural and living standards adjust in the wake of China's WTO accession and economic progress. In order to maximize the margin, state-owned, private and foreign-owned companies have to strengthen the construction of the sales channel and expand their own channels to the areas that have not been reached by others. This situation will definitely benefit the publishing industry by increasing the size of the book market. Yet such expansion is not possible without first mastering survival in China's Byzantine publishing industry.

The publishing industry has a complicated market environment. The market can be better understood by grouping environmental factors into two categories: macro environment and micro environment of the market. The macro environment refers to elements other than the market itself. For example, the Chinese culture, Chinese customs, business practices, industry regulations and policies are all part of the macro environment. The micro environment refers to the market itself, built by Bertelsmann's counterparts in the industry and the media who is watching the industry. Bertelsmann's operating strategies for China focus upon four essential factors contributing to building a healthy market environment for business success. The following is a list of these factors:

1. **Socio-cultural Factors:** This deals with cultural accessibility, reputation building and human resource helping Bertelsmann to fundamentally establish itself in the market.
2. **Political Factors:** This deals with governmental regulation, barriers to entry, and censorship.
3. **Customer Recognition:** This refers to the satisfaction of consumer needs, wants and demands in addition to identifying and serving a targeted market.
4. **Public Opinion:** This refers to public relations, media, suppliers, competitors and industry counterparts.

The first two factors belong to the macro-environment of the market. Socio-cultural and political factors influence Bertelsmann's operation, but are out of its direct control.

Bertelsmann understands that it needs to be flexible to adapt to the continual changes of the market's macro-environment. Bertelsmann has successfully acclimatized itself to China's complicated publishing industry. This success can be attributed to successful cooperation with business partners in China and the building of a strong local operating team. Such cooperation and local staff allow Bertelsmann to bridge the cultural gap, and in turn succeed in both obtaining the necessary licenses and developing a smart business model for market entry.

The last two factors belong to the micro-environment of the market.

Micro-environmental factors influence the company directly and can be impacted by strategic planning and execution. In this area, Bertelsmann has stood out as a wise foreign company capable of contributing in a harmonious manner to the market by serving its customers well, in addition to treating the media and its business counterparts with credibility and trust.

Ting Yao, the Senior Supervisor of Public Relations from Shanghai Bertelsmann Management summed it up best: "Bertelsmann China is a tree bedded by Germans and grows in China"<sup>101</sup>. This excellent metaphor describes the relationship between Bertelsmann and China. If Bertelsmann China is a tree, Chinese culture is the soil, water and sunshine. The fertilizer is the experience, technology and management that Bertelsmann has brought to China.

Some say Bertelsmann opened the door to the publishing industry of China. However, I prefer to say Bertelsmann knocked on the door, stimulating some welcomed changes by the government for its publishing industry. We cannot attribute the changes to Bertelsmann, but as a pioneer of China's publishing industry reform, Bertelsmann has indeed contributed to the progress of these changes.

The future is positive for Bertelsmann. Bertelsmann is optimistic about China's book market and has gained momentum in market development in China. It cooperates well with the Chinese partners and counterparts. The Chinese government has also expressed a welcoming attitude towards Bertelsmann. Bertelsmann will continually and actively participate in cultivating the Chinese book market.

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<sup>101</sup> Lan, October 20, 2004

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