The Economist

## Legend Holdings

# A torch-bearer for Chinese capitalism

**The conglomerate built by Liu Chuanzhi is closer to its American and European counterparts than to Asian business groups**

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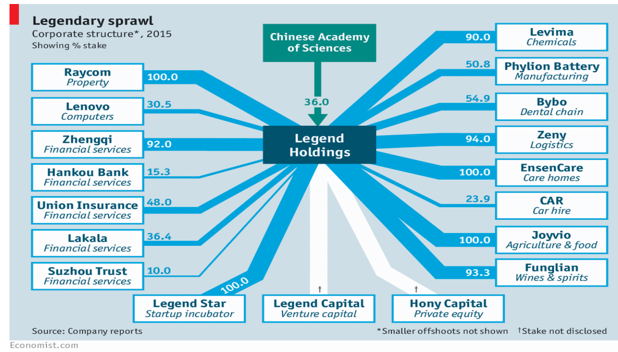
THREE years ago one of the many companies started by Liu Chuanzhi, the chairman of Legend Holdings, held its annual meeting in a city in the Chinese interior. As is usual, the conglomerate invited various officials to the opening banquet. But when people went to pay their respects to the most important figures in the room, it was Mr Liu, rather than the local Communist Party chief, who had the biggest queue of people wanting to speak to him.

That is because Mr Liu is the leading light of Chinese entrepreneurial capitalism. Legend is best known for spawning Lenovo, now the world's biggest maker of personal computers, in which it still holds a big stake. But Legend has a range of other business interests, from agriculture to car hire to dentistry (see diagram), and fingers in all sorts of other pies through its private-equity arm, Hony Capital.

Lenovo has been listed in Hong Kong since 1994 but now Legend itself is going for an initial public offering there. This week it released its prospectus, and Mr Liu and other executives went on an extensive road show. It expects to raise over $2 billion in the flotation, with nearly half of that sum already said to have been snatched up by strategic investors, putting a valuation of around $13 billion on the group.




The emergence of Legend into the global spotlight raises a few questions. First, who is Mr Liu and how did he rise to such prominence inside China? Second, what exactly are investors getting if they decide to buy shares? Most important, does Legend have a coherent strategy?

Mr Liu was born into a wealthy mainland family, but experienced severe deprivation during Chairman Mao's rule. Such memories drove him to be frugal and to persevere—two qualities that are essential for entrepreneurs everywhere but especially in China. His father was an ardent Communist who became one of China's top patent lawyers. He made a deep impression on his son, whose career has been devoted to creating a Chinese equivalent to the West's great corporations, through the embrace of modern business practices—including respect for intellectual-property rights. That is why Lenovo's smartphones are now sold around the world. Xiaomi, an upstart Chinese rival that is more relaxed about copying, is sure to attract lawsuits if ever it tries to sell its handsets in America.

The legend of Legend began in 1984 when the Chinese Academy of Sciences (CAS) loaned Mr Liu and a few associates $25,000 to help commercialise government-funded technologies. Frustrated by bureaucracy and eager to capitalise on nascent economic reforms, Mr Liu pushed Legend (and later Lenovo) to be market-oriented. CAS still owns 36% of Legend, but it is far from the typical state-owned enterprise. Liang Neng of the China Europe International Business School (CEIBS) in Shanghai insists, "It really behaves very much like a private firm in the market."

Thus far, Lenovo, of which Legend owns just less than a third, provides two-thirds of the group's profits. The computer-maker is doing well. In the year to March Lenovo's revenues rose by 20% to $46 billion and its gross profits increased by nearly a third, to $6.7 billion. But some of Legend's other businesses have also turned into profit, and look set to make a growing contribution to the group.

The group's sprawl reflects Mr Liu's bets on China's successive waves of growth and liberalisation. In the mid-1980s he saw opportunities for Chinese firms in the global rise in demand for computer hardware. At the turn of the century his firm bet on urbanisation and the need for non-bank financing. In this decade, it is betting that rapidly rising affluence will spur demand for safer food and for services ranging from health care to personal finance.

Given its many tentacles, it is tempting to see Legend as a Chinese incarnation of a South Korean *chaebol* or a Japanese *keiretsu*. Gordon Orr of McKinsey, a consulting firm, says that although there are some passing similarities, Legend does not have the web of crossshareholdings, and the incestuous supplier relationships among group members, that are seen in the archetypal East Asian conglomerate. He thinks a better comparison would be with European holding companies such as Investor, run by the Wallenberg family of Sweden, which is into everything from domestic appliances to hotels. In both cases, “They have listed and unlisted entities, they have private equity, they do startups,” notes Mr Orr.

Peter Williamson of Cambridge University’s Judge Business School notes that, somewhat like a *chaebol*, Legend’s business model is about allocating capital between businesses in a place where capital markets are inefficient. “But unlike the *chaebol*, I think Legend is more about leveraging expertise and international experience than pools of capital.”

Given his long-term outlook, and indeed his cultish following, does it make sense to think of Mr Liu as China’s Warren Buffett? Again, the shoe does not quite fit. Zhang Tao was Mr Liu’s assistant for eight years and recently published a book about his former boss. He thinks Mr Liu is more like General Electric’s former boss, Jack Welch. Mr Buffett is as proud of Berkshire Hathaway’s sprawl as Mr Liu seems to be of Legend’s; but Berkshire is not particularly known for developing managers or nurturing small firms in the way Legend seems to be doing. GE, in contrast, is a world leader in training managers. And as its current boss, Jeff Immelt, likes to say, the American firm is not so good at startups but it is great at scaling up small businesses into billion-dollar enterprises.

Mr Liu himself has said that a two-week visit to GE’s management-training centre in America, long ago, inspired him to build a world-class conglomerate in his native land. These are the lessons he took away: “Diversification will work when...every subsidiary is focused on its own field while the holding company serves as an investor and a driving force. To make a well-arranged ownership structure, we need the right leaders.”

Mr Liu has been adept at navigating the shoals of China’s state-led model of capitalism. He also deserves credit for professionalising management practice in China, says Edward Tse of Gao Feng, another consulting outfit. Mr Liang of CEIBS says Mr Liu’s strategy has been widely studied by younger Chinese businesspeople: “Build a strong top team, focus on long-term strategy and nurture a capable and dedicated workforce.”

For all his success so far, Mr Liu should look again at his erstwhile mentors at GE. Under pressure from regulators and investors, the American giant is now simplifying its business model, in particular by dismantling its huge financial division. As a private firm, Legend has so far not had to answer hard questions about its strategy. That is about to change: investors in publicly traded firms the world over dislike complex, murky conglomerates. Even one led by a figure as admired as Mr Liu will not have it easy.

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