

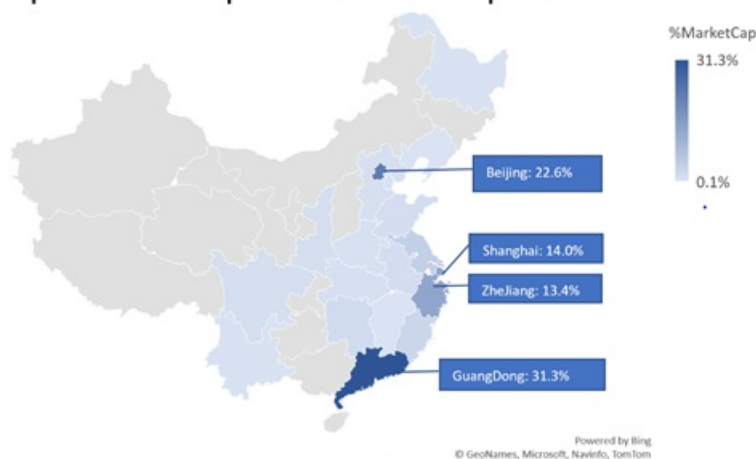
GEOGRAPHY OF CHINA'S GROWTH AND GOVERNANCE DISPARITY

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03/16/2021

For outsiders, it is common to view China as monolithic, with its central government dominating international news. When we map the [WisdomTree China ex-State-Owned Enterprises \(ex-SOE\) Index](#) weight onto each province where companies are headquartered, it shows more weight in China's southeastern region, which is generally believed to be more entrepreneur-oriented and better governed.

This geography concentration highlights the cultural element that comes from removing state-owned enterprises, which may lead to better corporate governance and a more interesting basket of companies than traditional [market cap-weighted](#) benchmarks¹.

WisdomTree ex-SOE China Index: % weight of companies headquartered in each province



Sources: WisdomTree, FactSet, as of 1/29/21. You cannot invest directly in an index.
Subject to change.

The WisdomTree China ex-SOE Index consists of companies headquartered in a few main growth centers in China:

- **Beijing**, with its dominance of the best education resources, is home to many SOE companies, but also tech firms like Baidu, JD and Meituan.
- **The Yangtze River** delta area and the **Shanghai and Pearl River** area next to **Hong Kong** are two other main areas of private company growth in China. Alibaba and Tencent are well-known representatives of these two regions.

China has a significant north-south divide in its economy and culture. This divide has been around for a while. Using data during the Qing Dynasty (1644–1911), historians collected the number of top-ranked students in national exams for counties within each province as a measure for human capital. The top provinces are either located near Beijing or in the Yangtze River delta area, with Jiangsu and ZheJiang provinces ranking consistently among the top five.

For historical reasons, the southeastern area is believed to be better governed, with more trust preserved in the community due to the common local languages and its own extended social network. Capital from Taiwan flowed

significantly to Zhejiang province after 1980 through these networks. Financial capital from Hong Kong flowed toward Guangdong province around that time.

The north-south divide is also reflected in an episode of China's own, "Do you trust Chinese data?" drama. As more high-frequency data becomes available, official Chinese [GDP](#) data has become a secondary source when gauging the Chinese economy.

- Around 2014, the central government was extremely concerned that several northern provinces' reported GDP numbers were overinflated by local officials. In 2016, the Liaoning province in the north was asked to reduce its reported GDP figure by 22.4%.
- In 2018, after the fourth national economic census, 12 out of 15 northern provinces' GDP estimates were adjusted lower, while 14 out of 16 southern provinces were adjusted higher. Jilin and Heilongjiang, both northern provinces, have respectively been adjusted down more than 20%.

These adjustments partly reflect a general impression that northern local governments are more bureaucratic, less transparent and slower moving to support private businesses.

We often hear questions about what ex-state-owned factor we are betting on. Clearly, compared to the SOE sector, it's a bet on [growth](#) and [quality](#) for the ex-SOE sector, with generally higher sales and revenue growth and higher [return on equity \(ROE\)](#).

We believe it is not just about growth and quality, but also other factors that are harder to measure but extremely important in emerging markets for private business success: relatively better governance, both within the company and within local governments and in their interactions with private businesses.

These cultural factors are one of the reasons we think the innovation and growth contained within the ex-SOE tilt will be long-lasting.

¹About 22 companies and 4.7% weight in WisdomTree's Index listed Hong Kong as their headquarters. It is well known many chose Hong Kong for listing and tax purposes, and some of these companies are relabeled to reflect the true company headquarter province when clear information dictates this change. There are 59 companies (9.3% weight within the [MSCI China Index](#)) in a similar situation that have been reclassified. Most Chinese companies are young and headquartered in the provinces where they were founded. So far, it is uncommon to move headquarters across provincial lines.

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You cannot invest directly in an index.

DEFINITIONS

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Gross domestic product (GDP) : The sum total of all goods and services produced across an economy.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

Quality : Characterized by higher efficiency and profitability. Typical measures include earnings, return on equity, return on assets, operating profitability as well as others. This term is also related to the Quality Factor, which associates these stock characteristics with excess returns vs the market over time.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

MSCI China Index : A free float-adjusted, market capitalization-weighted equity index designed to measure the performance of the Chinese equity market.