

# **CSR and the Supply Chain in Changyu Pioneer Wine Co. Ltd**

Case Study:  
China

**China**

Written by

**Niu Zhiqiang**

Researcher, Global Business Institute  
China Enterprise Confederation

The case was developed with the cooperation of Changyu Pioneer Wine Co. Ltd solely for educational purposes as a contribution to the Project entitled “New Corporate Procurement Strategy on Trade in Goods and Services in APEC Region - Supply-chain options with CSR perspective -” conducted under the auspices of the Asia Pacific Economic Cooperation (APEC). The case is neither designed nor intended to illustrate the correct or incorrect management of the situation or issues contained in the case. No part of this case can be reproduced, stored or used without the written permission of the author and the Asia Pacific Economic Cooperation.

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## Executive Summary

The concept of Corporate Social Responsibility (CSR) is just unfolding in China. Enterprises are at different stages of understanding and implementation of CSR. Some have been releasing their CSR reports annually, though many still have misunderstanding about CSR due to various reasons. In this case study, Changyu Pioneer Wine Co. Ltd is an enterprise with a well-established brand in the domestic and international markets. The company is now at the stage of rapid growth and emerging as a leading player in the wine industry in China. In Changyu's whole supply chain, vintage grape planters, sales agencies, foreign importers and exporters constitute the critical parts. Hence, Changyu faces key challenges in its relationship with these stakeholders as the company implements its corporate social responsibility initiatives.

Understanding the critical importance of these relationships, Changyu formulated its internationalization strategy and adopted measures to guarantee vintage grape planters' benefits, which included providing free technical support of experts and entering into purchasing contracts with vintage grape planters. These measures not only protected the planters' benefits but also secured the supply of quality vintage grapes to the company.

Changyu likewise organized its whole production process in accordance with international practices and commonly accepted regulations (e.g. SA8000). The benefits of suppliers, agencies, customers, local community and environment were taken into consideration in everything, from the purchase of raw materials to production and from packaging to selling. With the establishment and operation of its four brand chateaus, Changyu completed its strategic layout for internationalization and gained increasing recognition at home and abroad.

The implementation of CSR helped Changyu generate not only economic but also social benefits both domestically and internationally.

## Introduction

As an enterprise with more than a hundred years of history, Changyu Pioneer Wine Co. Ltd is now the number one company in the wine industry in China. With sales income of US \$475 million in 2006, the company also ranked 14<sup>th</sup> in the world.<sup>1</sup> Throughout Changyu's history, the company has encountered various hardships and opportunities such as several changes in ownership and reforms of shareholders.

In all of these changes, Changyu has assumed its social responsibilities and has established favorable relationships with its suppliers, customers, the local community and government. One of the critical factors and biggest challenge for the success of the company is establishing and maintaining good relationship with its domestic and foreign suppliers. This is where the vintage planters and foreign importers and exporters play the key role. With economic globalization, domestic enterprises are facing competition both at home and abroad. For companies which do business globally, CSR implementation is becoming more and more important.

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<sup>1</sup> Interview with Mr Zhou Hongjiang, General Manager of Changyu Pioneer Wine Co. Ltd

## Overview of CSR in China

At present, Chinese enterprises, especially non-state-owned enterprises, are generally at the preliminary stage of growth and do not have a profound recognition of the concept of CSR and its importance. Under this scenario, it takes a long time for Chinese enterprises to incorporate CSR into the management of their businesses. Some enterprises which have no CSR mechanism in place focus on quick successes and instant benefits and in the process, exploit resources excessively, pollute the environment, evade taxes, cheat in financial affairs, default on wages and ignore security.

Problems concerning CSR in some labor-intensive enterprises are even more remarkable. Some employers do not sign employment contracts with employees which makes the fundamental rights of employees insecure. Some provide very poor working conditions and no safety measures, which sometimes cause the poisoning or even the death of employees. Many force their employees to work overtime with little or no extra pay in violation of the labor law. These kinds of behavior really harm the harmony between employers and employees, enterprises and consumers, enterprises and investors, and enterprises and the natural environment.

The problems of these enterprises in carrying out their social responsibilities brought not only social problems but also posed challenges from international competition. This is because with economic globalization, the concept of CSR has become very popular in Europe and North America. Hence, the enterprises most affected by the problem of CSR in China are those engaged in international businesses. Some enterprises which did not meet the requirements of SA8000 failed in their bid to become suppliers to the international market. Thus, CSR has directly influenced business opportunities for Chinese enterprises.

The China Enterprise Confederation, the only organization representing Chinese employers, has advocated that enterprises join the United Nations Global Compact and make an effort to become good corporate citizens. A consensus has emerged that in order to realize the goal of a harmonious society, it is now time for China to establish a system of incentives and penalties that would encourage enterprises to implement their social responsibilities with government guidance, legal guarantee, social supervision and self-regulation.

The manner and extent by which enterprises implement their CSR will vary for different enterprises with different resources and going through different stages of enterprise growth. In the **stage of gestation** and struggle for subsistence when enterprises have limited resources, enterprises should begin building up the ideals of CSR and abiding by the legal regulations. In the **stage of rapid growth** when enterprises greatly increase their strength, they should take CSR into consideration from the strategic perspective of the enterprise and take care of the benefits of all stakeholders. In the **mature stage** when they have accumulated substantial resources and capacity, enterprises should assume their social responsibilities more actively, not only from the legal perspective but also from the moral perspective, including resource saving, community responsibilities, public welfare and beneficence.

In general, the evaluation on CSR is done from two levels. The basic level CSR requires compliance with law and international labor regulations; the higher level CSR includes moral responsibilities. Although implementing CSR can mean additional cost for the enterprise, it however helps establish the enterprise's social image, improve the credibility of its products and services, and in the final analysis, bring higher rewards to the enterprise.

## Reasons for the Lack of CSR in Chinese Enterprises

In China, enterprises fail to assume their corporate social responsibilities because of the following reasons:

1. **Focusing on the short-term profits and ignoring long-term social responsibilities.** In the transformation process of the Chinese economy, enterprises have likewise been transformed into independent economic entities. Under the pressure of severe domestic and international competition, enterprises have to make themselves stronger and bigger first and enhance their capacity to manage risk in order not to be eliminated. This inevitably leads to the enterprise's ignorance of their social responsibilities such that some enterprises even build up themselves at the cost of these responsibilities. At the same time, although government no longer interferes with their business operations, enterprises still have the burden of providing some public services—a condition that is a carryover from a long history of planned economy. Thus the reluctance and passivity of enterprises in providing those services, together with the lack of regular government administration, also resulted in the lack of CSR among some enterprises.
2. **No rigid restriction on enterprises' lack of CSR.** With the reform and opening policy, China has made great achievement in reforming the economic and political systems but still has to complete and strengthen the legal system. The penalty imposed on enterprises for not fulfilling their CSR is not heavy enough to serve as a warning and restriction. This encourages enterprises to focus only on the maximum profits at the cost of stakeholders since the profits they gain from bad business practices is far bigger than the penalty that might be imposed on them. This causes a strong sense of unfairness among the “good” enterprises, and discourages them from sustaining their social responsibilities.
3. **Lack of supervision and restriction within enterprise.** The economic reforms in China have brought about profound changes in enterprise ownership. Except for a small number of very large companies, most enterprises have been transformed into non-state-owned companies where the status of employees has been weakened and the gap between employees and the management team has become increasingly bigger. The Workers Union does not have much say in protecting workers benefits. This encourages many company owners and managers to ignore the rights and benefits of employees in their desire to maximize company profits. The implementation of CSR is also not supervised by any organization.
4. **Lack of impetus in implementing CSR.** China's reform and opening policy started at a low economic level. At the level of both the economy and enterprise, the focus was primarily on economic benefits which had indeed contributed to the economic development at that time. However this has also formed the mechanism for an inefficient pattern of economic development that emphasizes immediate benefits and misleads people's concept of development. For instance, the quantity was given priority over the quality of economic increase, economic increase was regarded as equal to the increase in wealth, more emphasis was placed on economic development than on social development, and natural resources were exploited. All these concepts have deeply influenced enterprises and resulted in their lack of motivation to fulfill their social responsibilities.

## Importance of CSR and the Case Study

From the global perspective, the CSR movement is a general trend that nothing can impede. In the long run, the fulfillment of CSR is not only beneficial to an economy and society as a whole but also to an enterprise. CSR helps enterprises establish people-centered concepts and encourages them to care about public services and environmental protection for enterprise sustainability. It helps enterprises to transform themselves from low labor-cost competitive advantage to brand competitiveness both in the domestic and international markets. It also helps an enterprise to win more loyal customers with its good image, to retain intellectuals and avoid lawsuits with better working environment, and to improve the management of the enterprise and gain more opportunities in the global market.

The case study helps identify the enterprises that best fulfill their social responsibilities while earning profits and set good examples for others to follow. In 2006, China Central Television (CCTV) held the first session of Social Responsibility Investigation of the Enterprises in China after completing telephone interviews with 980 enterprises and collecting data on 500 enterprises. As a result, 20 were chosen as the best enterprises in fulfilling their social responsibilities. This study has made us understand Chinese enterprises' level of awareness and contributions to CSR and the problems that they faced in fulfilling their social responsibilities. The results of the study motivated more enterprises to actively assume their social responsibilities and contribute more to the creation of a harmonious society.

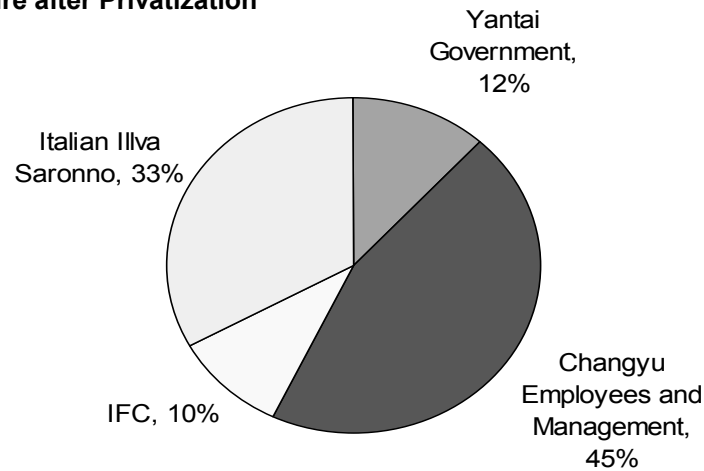
## Yantai Changyu Group Company Limited

Yantai Changyu Group Company Limited is a major corporation operating a wide variety of business interests. It currently has major holdings in a public company and a subsidiary, and owns four wholly-invested subsidiaries and its own branch. Initially focused on the production of wine and related products, the company has vigorously expanded into other areas including the development of health care wines and Chinese herbs, the processing of liquor and alcohol, import and export, packaging, machinery and manufacturing of glass products.

Although the history of grape planting and wine making in China dates back to the Han Dynasty (206 BC-220 AD), the industrialized production of wine was started by Changyu. Due to the foresight and wisdom of its founder, Mr Chang Bishi, a patriotic overseas Chinese, the development of China's national wine industry over the past century has been recorded for posterity.

Changyu Group (holding) was historically 100% owned by the Yantai government after 1949. It was privatized via a two stage process in 2004 through an Employee and Management Buyout (EMBO) of 45% of the Group and the sale of an additional 43% stake in the Group to foreign investors, in two separate tranches of 33% and 10% each. The shareholding structure of Changyu Group after privatization is illustrated in **Figure 1**.

**Figure 1:**  
**Shareholding Structure after Privatization**



Source: Report of Shareholder Changing of Changyu, 2005<sup>2</sup>

At the beginning of the 21st century, Changyu was China's leading winery and Asia's largest wine operation, with an annual production of 120,000 tons,<sup>3</sup> and a well-established domestic market. Throughout that century, generations of Changyu employees labored with painstaking devotion to produce wine products that were immensely popular both at home and abroad.

In recognition of its great contribution to the development of global wine-making, Yantai City where Changyu's wine originated, is the only city in China to be honored with the title, "International Vine and Wine City." This honor comes from the painstaking endeavor of generations of Changyu employees, using elaborate yet intricate methods that ensure Changyu wine products are enjoyed throughout the world.

In cultivating premium wine, the Changyu people are also cultivating their own unique wine culture. "Loyalty, devotion, quality and performance" is regarded as the spirit behind Changyu. This unified spirit is the driving force behind Changyu's unswerving and persistent progress. Changyu epitomizes the maxim that companies do not make people, people make companies.

Despite their sharp competitive edge, the people of Changyu never allow complacency to creep into their work ethic. The new millennium presents not only wide opportunities but also new challenges for the company as it continues to strive to create the best products in the world and achieve progress.

### *Products and Services of Changyu*

In the domestic wine industry, Changyu ranks first in all major economic indexes. Changyu's goal is to become one of the top ten in the international wine industry by 2008. In August 2006, *Newsweek* and *Interbrand* jointly appraised the "top 20 Chinese brands" and Changyu ranked the sixteenth. In October 2006 *Forbes* (Asia Edition) appraised 200 best enterprises with global sales of not more than US\$1 billion, and Changyu made it to the list because of the vigor and reputation of its brand, steadily increasing profit modes, excellent management team and capacity in expanding its global market.

In 2007, China had over 500 wineries in operation, with the top 10 producing around 10-12 million liters of wine annually. Cabernet Sauvignon was the most popular grape wine accounting for 40% of

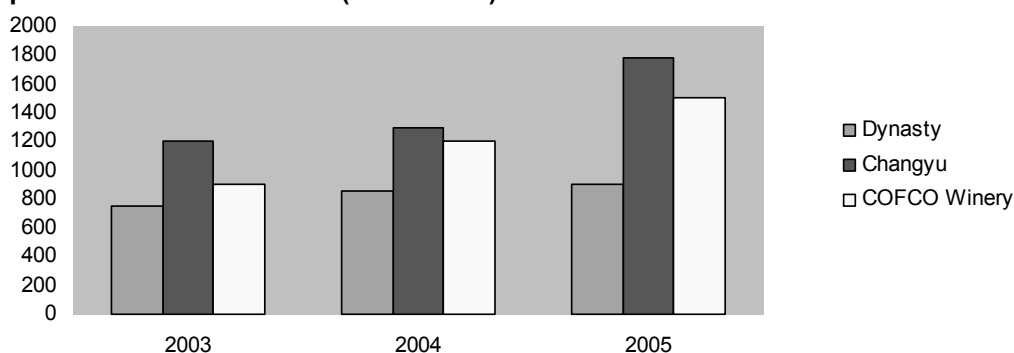
<sup>2</sup> Report of Shareholders Changing of Changyu 2005.

<sup>3</sup> 2006 Changyu's Annual Report.

the market in 2003. Merlot and Cabernet Franc each shared around 10% of the market. The low-end, middle-end and high-end wine segments made up respective market shares of 50%, 40% and 10%. The profit margin of low and middle end wine segments stood at only 11% while that of high end wine ranged from 30% to 50%.

According to the China Alcoholic Drinks Industry Association, four domestic wineries represented 51.49% of total Chinese wine production in 2006. The top three were Changyu, Great Wall, and Dynasty (**Figure 2**).

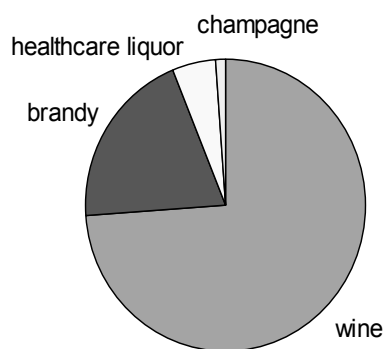
**Figure 2:**  
Comparison of Sales Revenue (In RMB mn)



Source: Sinolink Securities, Dec. 2006

Changyu’s product structure (**Figure 3**) and revenues indicate that wine is the company’s main product and the biggest source of its revenues (**Table 1**).

**Figure 3:**  
Changyu’s Product Structure



Source: Sionlink Securities, Dec. 2006

**Table 1:**  
Revenue by Product Category (2004-2006, in RMB mn)

	2004	2005	2006
<b>Wine</b>	923.97	1,340.21	1,631.07
<b>Brandy</b>	300.90	363.42	395.17
<b>Health Liquor</b>	98.09	80.78	97.54
<b>Champagne</b>	15.47	19.98	21.47

Source: Changyu’s Financial Report (2004-2006)



As a wine company with a hundred years of history Changyu assumes the responsibility of promoting and popularizing wine culture in China. In 2002, Changyu pioneered the establishment of the first domestic tourist destination in the wine industry which can receive 300,000 tourists a year. It is the only 4-A rated tourist spot in the country.

Changyu has over 30 subsidiaries around China and every year, a group of consumer opinion leaders are chosen to experience the wine culture tour of Changyu. Consumers who attended the first wine culture tour at Castle Chateau in Yantai found everything new and fresh and their experience strengthened their loyalty to Changyu. Later, the company organized the visit of consumer media representatives to the ice wine base in Liaoning, where they could observe how the ice grapes were picked, compressed and processed. All these activities intended to increase consumer awareness of Changyu wine which could lead to an increase in sales by millions Yuan.

Ordering wines in barrels is an individualized service Changyu provides. In the Chinese wine market, the level of competition is increasing and the consumption is becoming more individualized. While Changyu provides personalized services for consumers, it also promotes the consumption of wine in traditional channels like restaurants. Changyu established a top-class membership club and catered to orders by barrels. Shortly after taking this measure, Changyu received orders for over 1000 barrels of wine from many famous individuals and organizations such as CCTV, which contributed a lot to the brand image and marketing of Changyu's wine products.

Based on the analysis of different income levels, cultural background and preferences of consumers, Changyu further differentiated the wine market for high-class consumers and put more effort on increasing buyer's value. This helped Changyu avoid price competition.

In their product series Changyu increased individualized services. Changyu also formed partnerships with famous domestic brands, such as People's Great Hall and Diaoyutai, which took full advantage of the "wine for national banquet" channel and thus strengthened Changyu's image as a top wine brand.

### *International Strategic Cooperation of Changyu*

Changyu faces global competition even without going abroad because of the increasing globalization which made possible the entry of various kinds of foreign wine in China. For any industry or enterprise, China deserves careful study because of its huge market potential. As part of an international supply chain Changyu has to actively participate in the competition in the international market. In carrying out its internationalization strategy Changyu has undertaken the following:

**1. Internationalization of ownership system and capital investment.** In the current share structure of Changyu, Italian Illva Saronno Corporation holds 33%, International Finance Corporation 10%, Yantai SASAC and Yuhua Corporation composed of Changyu employees holds 45%. This kind of ownership structure greatly motivated all parties and brought together the shareholders' vast experience in operating the brand and managing its capital in the international market. With 400 years of history, Illva has a sales network in 150 economies and abundant international marketing experience. International Finance Corporation of World Bank also holds shares in over 60 private enterprises and has very rich experience in international management of capitals.

**2. Internationalization of talents.** In recent years, Changyu has been involved in running schools together with Tongji University and Jiangnan University, and also sent its vintage engineers and other technicians to study abroad. Changyu has a national technical center, the only one in the industry, which has an R&D team of over 100 people.

Changyu also had regular communication with first-class wine companies abroad. They invited vintage experts and grape planting experts from many European and American economies such as Australia, France, and Italy. At the beginning of 2006, Changyu met the international standard for classifying the quality of wines, which is based not only on production year of grape, place of production and age of grape trees, but also on other aspects such as techniques of vintage production, oak barrel storage and technical level of vintage engineers.

Apart from training the technical staff, Changyu also emphasized the training and recruitment of marketing talent. It enrolled some local staff in overseas economies, and thereby increased its international market share by making full use of the staff's understanding of the local market. The company retained Australian wine experts as senior advisors and conducted over 300 sessions of training in wine culture and knowledge for leading consumers in China. In 2006 Changyu invited Mr Kelly, school director of the University of Pennsylvania, as its senior advisor for international marketing. This greatly helped Changyu's global marketing efforts.

**3. Improvement of Changyu's marketing network in three aspects.** The first aspect is addressing the China market. A precondition for Changyu's globalization was to do well in the domestic market, and this required high-quality products, a strong core business model and a solid market position. In the domestic market, Changyu had 1500 marketing personnel and about 3000 agents who were all well-educated and responsible for both marketing and management. Changyu began marketing its wine abroad and at the same time introducing foreign wine to meet the needs of China's consumers through Pioneer International Wine Corporation which was established to sell wines from around the world.

The second aspect of the strategy was expanding exports. Changyu chose and developed the best agents in order to increase export sales. In 2006, exports reached RMB30 million, which though relatively small, was an encouraging trend. TXB Corporation of Germany, one of the largest wine agents in Europe ordered 240,000 bottles of Changyu Cabernet wine- the biggest order of Chinese wine exported to Europe in recent years.

**4. Establishment of four professional wine chateaus.** The Castle Chateau built in Yantai a few years ago is the first professional wine chateau in China. Its wine products have been warmly welcomed since they first appeared in the market.

Chateau Changyu Afip Global is jointly invested by investors from America, China, Italy, France and Portugal. It is a wine chateau integrating vintage, tourism, entertainment and training on wine knowledge which was opened for business in June 2007. The chateau is positioned as the new leader of international wine chateaus and it is technically supported by OIV (*Organizacion Internationale de la Vigne et du Vin*). It is positioned for top political and business activities with Beijing as the focus of marketing. The Olympic Games in Beijing in 2008 will be a good opportunity for the entry of Changyu's products in the international market.

Changyu cooperated with Canadian Aurose in setting up the world's largest ice wine base in Liaoning, which released new products in December 2006. They organized local and foreign wine experts for wine tasting of the new products side by side with foreign ice wine. The experts found Changyu's ice wine to be of high quality.

Currently the combined annual output of ice wine from Austria, Canada and Germany totals 1000 tons. The same volume can be produced by Changyu alone; hence the ice wine of Changyu will create a great impact on the world's ice wine market. China will become the major supplier of ice wine in the world market together with Canada and Germany. Ice wine will be one of the key products of Changyu to expand its world market for wine.

Changyu also jointly built wine castles in distinguished foreign vintage grape planting area. It built Changyu Kely Chateau in New Zealand which marketed its products to Oceania and China. The two kinds of products sold domestically are positioned particularly for golf clubs with over one million high-income members.

Changyu's internationalization strategy follows two principles. The first is keeping its own brand. It maintains both an independent brand and jointly-owned brand. Its independent brand of Changyu Cabernet has successfully entered the European and American markets. Its jointly-owned brand, Changyu-Kely, serves the Oceania market with New Zealand as the center. Through cooperation with these strategic partners, Changyu has improved the quality of its products, increased the influence of its brand in the world and met the requirements of CSR according to international standards.

## **Key Challenges Concerning CSR and the Supply Chain in Changyu**

Changyu recognizes that CSR is a voluntary activity that a company has to undertake to have sustainable growth, and that CSR covers compliance, consumer protection, environmental preservation, labor, human rights, contribution to community and local development - all of which go beyond pure financial performance measures. The current high level of attention to CSR is mainly attributed to the globalization of business and the occurrence of company bankruptcies due to unethical practices. The company anticipated that the social requirements placed on business enterprises would increase further due to various large-scale changes in the business environment.

The objective of Changyu's CSR activities is for the company to carry out business activities and at the same time fulfill its responsibility to contribute to the sustainable development of society. The company believes that CSR activities will help raise its corporate value and will ultimately support the sustainable mutual growth of its suppliers and its own business. The company's resolve to adhere to CSR is faced with a number of challenges:

- 1. Challenge of keeping good relationship with the company's suppliers.** As a wine producer, Changyu must ensure the quality of the raw materials, particularly grapes. Therefore, Changyu established four chateaus in different cities in China, which provide good quality raw materials for the production of wine and job opportunities for the local labor. It is very important that Changyu maintains good relations with the local government and communities. Changyu adopts the policy of being open, fair, honest to its sales agencies and customers so that they can all contribute to Changyu's good image and by so doing, gain benefits from their efforts.

The special feature of wine demands high quality vintage grapes which can only be ensured through the proper mode of planting and growing. There is a surplus production of vintage grape in China but high-quality grapes are in short supply. This is because China produces

about 300,000 tons of wine a year. Since 1.5 mu\* of vintage grape can produce one ton of wine, it would need a maximum of 600,000 mu to provide the vintage grape materials needed for the total wine output of 300,000 tons. However the area planted to vintage grape has now exceeded 750,000 mu, implying that there will be a large surplus of vintage grapes under normal climatic conditions. Such situation will undoubtedly affect the vintage grape planters.

When natural disasters, plant diseases and insect infestation strike however, vintage grape will be in short supply. To address this potential situation, Changyu developed a grape planting base and invested a large sum of money in developing the Shelongzhu base which put 80,000 mu under cultivation.

Changyu also imported oak barrels, mainly from France, for storage to maintain the high quality of wine. High quality oak barrels are usually sourced abroad. Without the support of these foreign oak barrel suppliers, it would be difficult for the company to keep their products in good storage and maintain their high quality.

- 2. Challenge of maintaining good relationships with the company's sales agencies.** The products of the company are mainly sold through its China-wide network of sales agencies and foreign agencies. For domestic selling, Changyu must provide the right product to the sales agencies according to the market segments served, help sales agencies increase investment in advertisement, and encourage sales agencies by giving more favorable contract terms. For overseas sales, apart from maintaining the high quality of the products, the company must meet the needs of the international market to satisfy some commonly accepted standards, for example those of SA8000, which has had a great impact on many enterprises in China. SA8000 is used by purchasers worldwide to measure how well a supplier has implemented its CSR. It has consequently become a new standard to measure a supplier's credibility and reliability.

## Efforts of Changyu in Fulfilling CSR

Changyu's efforts in developing relationships with its suppliers and customers to enhance brand recognition and quality image need to be seen in the context of the company's overall commitment to CSR. Changyu earns customer satisfaction and confidence by developing and offering beneficial and reliable products and services and by paying careful attention to safety. It supplies products and services of value, based on an understanding of customer needs and expectations so that it will be highly regarded by society. The company also maintains and improves the quality and safety of products and services to win customer satisfaction and confidence, and responds and provides adequate information to customers with sincerity.

Changyu strives to develop creative technologies and works actively to break ground in new business areas for the future prosperity of society. It maximizes customer satisfaction and develops unique technologies that contribute to the enjoyment of high-quality life. Changyu promotes fair, transparent, and free competition among corporations and ensures that its relationships and dealings with government agencies and political bodies are of a normal and proper nature. It enhances general awareness of the observance of related laws within the company. It builds and maintains control systems for proper entertainment and gift-giving.

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\* Mu is the Chinese unit of area. It is equivalent to one-sixth of an acre.

Changyu delivers accurate and sufficient corporate information in a timely, clear, and appropriate manner while enhancing the transparency of its corporate activities. It discloses adequate and timely information to stakeholders and promotes two-way communication with them. Changyu respects the customs and cultures of all regions and economies and manages its activities in a way that contributes to community development. It promotes corporate activities based on respect for local cultures and mutual trust. It continues to be interested in the activities of local business partners to fulfill their CSR and support their efforts to improve. As a good corporate citizen, it fully recognizes that it is a key member of society and actively engages in philanthropy and other activities of social benefits. Changyu promotes social contributions that respect the interests and support the progress of all stakeholders, including local communities.

Changyu respects human rights in workplaces and promotes respect for human rights and equal opportunities among all business partners, including those overseas. It respects each employee's individuality and creates work environments where all its employees can fully demonstrate their abilities and carry out their jobs with enthusiasm. It supports employee's efforts to plan and prepare for their future and develop their skills. It endeavors to create an equitable work environment for a variety of talents to be fully demonstrated.

Changyu also continuously strives to innovate and generate superior products of high quality through improvements made in its supply chain:

#### *Huge Investments in Developing Grape Planting Base*

Huge investment has been made in developing grape planting base to satisfy the demand for raw materials in the production of high quality wine. In the last few years, the sales of Changyu Cabernet has skyrocketed to several hundred million RMB from about RMB50 million, and it is estimated that the sales of Changyu castle wine will increase steadily in the next 12 years.

The market demand for such high-quality vintage grape as Shelongzhu will greatly increase with the increase in sales of Changyu Cabernet wine and Changyu chateau wine. In 2004, Changyu declared that RMB300 million would be invested in three years, of which RMB5 million would go to breed selection and technical development; RMB5 million to improving technical skills of grape planters; and RMB20 million to increasing the scale of Shelongzhu grape planting in Yantai. At present, the planting of Shelongzhu grape accounts for about 70% of the total production in China. With the RMB30 million input, Shelongzhu grape planting will be further expanded and thus satisfy the increasing demand for Cabernet wine from high-quality vintage grape.

According to experts, the increase in Shelongzhu grape planting by Changyu can give the company a competitive edge upstream, and at the same time support the brand recognition and quality reputation of Changyu Cabernet. In the "fighting for cabernet" in 2005, Changyu gained the support of academic and major media sectors although some competitors imitated Cabernet by taking advantage of legal flaws. Instead of taking legal measures, Changyu strengthened its market position by ensuring the high quality of raw materials with better results.

#### *Provision of Technical Support and Formation of Close Relationships with Grape Planters*

Changyu has 80,000 mu of vintage grape planting base composed of 200 units with thousands of planters and workers. Changyu has taken various measures to guarantee grape planters benefits.

- 1. Protection agreements were signed with planters to ensure planters' profits.** Changyu signed contracts with all planters in the grape base and promised "protection price for general grape and higher price for high-quality grape." Protection price means that planters' profits from planting grapes are 1.5 times more than the profits they can gain if they grow grains. High-quality grapes are examined by professionals and are priced higher. This makes the planters confident to plant high-quality grapes without worrying about marketing their grapes and earning profits. In 2005, the average income from planting grapes in Yantai reached RMB8000 per mu.

The mode of "base plus planter" followed quality-oriented production policy. Changyu purchases grapes from these planters at a price not lower than protection price and higher than the market price, and pays planters by Spring Festival every year. This forms a relatively close, steady supply circle.

- 2. Grape planting bases are classified into different classes and the top classes are awarded prizes.** Besides a good sum of prize money, planters receive materials on the latest planting techniques and protection against plant diseases and insect pests. Every planter has been given a brochure on *Principles of Assessment of Planting Base* and the Standards for Classification, which assesses each plant according to its geographical position, scale, breed of the grape and planting management.

Because of its many years of experience in the construction and management of planting base, the quality of grapes in Changyu's planting base has been improving. For example, in early 2005 when there was more rain than normal, Changyu still managed to produce high quality grapes in increased volume.

- 3. The technicians from Changyu grape planting base complied with the company's requirement on the management of vintage grape with no public hazard.** The technicians tracked the planting in all aspects throughout the process from growing to fertilizing, from output control to pesticide usage. They were always ready to help whenever problems occurred in planting. In order to improve planters' working efficiency, Changyu asked farming machine experts to design small machines appropriate for planting use. Hence, weeds-cutting, fertilizing and pesticides spraying have been mechanized.
- 4. Each technician is allocated an area within the 80,000mu planting base which he has to manage.** The technician needs to choose over 10 grape gardens to manage for the supply of high-quality grapes. The assessment of the technician's performance is directly related to the quality of vintage grape, its output, average sugar rate and volume of rotten grapes in his area of assignment. A meeting is held every Monday so that technicians can review the previous week's operations, find solutions to difficult problems and plan the work for the following week. Every technician must work with planters four days a week and planters have to certify to the work that the technicians have done for the week.

#### *Establishment of Other Grape Planting Bases in China and Outside of China as a Supplement to Yantai Base*

The world demand for vintage grape is steadily increasing. In order to produce high-quality wine of various tastes and flavors, Changyu established its own wine companies or partnered with foreign companies in Hebei, Shanxi and Beijing. In central and western China, Changyu partnered with local farmers to establish 20,000 mu of grape planting base.

Changyu's increasing Yantai vintage base can hardly meet the needs of the market. As a corporation which aims to be among the top 20 wine producers in the world, Changyu believes that its growth relies heavily on the performance of its vintage grape base and that the planters are just as important as the company's market share. Throughout the process of grape planting and harvesting, executive directors of Changyu often visit the planters to listen to their ideas, plans, complaints and suggestions about vintage planting. Changyu's No.1 workshop was directly connected with the vintage grape base. Most of the technicians in Changyu provide free technical assistance to the planters from time to time.

The development of vintage grape base has made a large group of planters prosperous, especially those in central and western part of China, and has increased the pace of local economic development as well. Planters not only earned profits but also improved their technical skills which contributed to Changyu's competitiveness.

In 2006, Changyu's products accounted for 20% of the wine market in China and Changyu became the number one brand in the wine industry. Since 2002, Changyu had experienced high growth rate in sales, profits and taxes. In 2003, it had sales income of RMB2 billion and profits of RMB430 million or an increase of about 15% compared with 2002. In 2004 the two economic indexes further increased by 20%.

According to the strategic plan, Changyu will increase its sale of wine to over 100,000 tons in two or three years with sales income of RMB5 billion and profits of RMB1 billion. To make Changyu a world-class brand has always been the dream of all employees but this also signifies greater responsibility for all people of Changyu. With the expanding scale of operations, the vintage grape base has become one of the critical factors in realizing their dream. The technicians are exploiting new methods of planting grapes and improving the mode of "base plus planters." This has helped build a closer and more solid relationship between planters and the corporation. Planters gained more profits, the local economy improved and Changyu guaranteed its supply of high-quality vintage grapes.

#### *Setting of High Requirement for its Suppliers of Barrels, Bottles, Packaging and Other Materials*

Exporters of oak barrel and building materials must meet the CSR requirements according to international standard before they can be suppliers to Changyu. The manufacturers of wine bottles and package must implement their social responsibilities before they can be considered as suppliers by Changyu. They must have a good reputation in the marketplace; they must manufacture their products in resources-saving and environment-friendly way; and they must be just to their own suppliers. The final selection of suppliers is made through open, fair and just public bidding process.

#### *Integration of CSR into Changyu's Cultural Construction*

Since 1997, Changyu has been conducting a tour exhibition of one hundred years of wine culture in the major cities in China which includes a review of the history of wine industry in China, the present situation and prospects of the wine industry, and relevant information on wine. This was done through a combination of exhibits, special topic forum on TV, and articles in newspapers and magazines.

Changyu put up a wine museum, opened its historical wine cellar to the public, and displayed Changyu's particular culture through famous paintings and archive materials of historical importance. The company built wine castles by integrating grape planting, vintage, entertainment and tourism,

which added new dimensions to Changyu wine culture. They pushed the globalization of the corporation by participating in various domestic and international conferences on wine and consulting foreign experts, thus providing Changyu the most advanced technology and concept in vintage wine production and marketing in the world.

They also sacrificed a lot to foster the domestic market for wine, signifying its corporate culture as the leader in the industry. Although it takes time and means cost, it benefits the healthy development of the industry as a whole.

Changyu has institutionalized CSR in its relationship with its employees, suppliers, sales agencies and other stakeholders. The top management team puts more emphasis on CSR and attaches strategic importance to CSR. The company combines CSR with its internal management system and makes it a compulsory part of the company's achievement when the final assessment is carried out.

The company maintains good relationships with suppliers, sales agencies, customers, local governments and communities. Taking into consideration the nature of Chinese enterprises. Changyu develops its own evaluation system for CSR implementation.

Changyu hires and retains the most suitable employees at the lowest cost and best efficiency, including not only highly technical talents but also skilled workers. By increasing the power of the workers union, consumers association and other NGOs, the company promotes CSR not only within the company but also in the whole society.

Finally, the company increases its investment in environmental protection and voluntarily accepts the supervision of mass media and other concerned government organizations.

## **Conclusion**

The Changyu case leads to a number of important conclusions about the concept and current stage of development of CSR in China. It also illustrates some important examples of the benefits of good CSR practices.

1. In the short term, the implementation of CSR may increase the running cost of a company as it strives to meet higher standards concerning labor, environment and other production aspects. Thus it may reduce a company's competitiveness for a period of time. As such, CSR can also be regarded as a non-tariff barrier by some exporting enterprises. This helps explain the lack of attention given to CSR by some enterprises (including Changyu before the restructuring was conducted in the company) in China.
2. In the long term however, the implementation of CSR brings both economic and social benefits to an enterprise. It helps an enterprise improve its brand image thus gaining more trade partners and giving the company more chances to succeed. It can help an enterprise attract and retain talent and consequently increase its competitiveness. It promotes sustainable development of society as a whole, which benefits the healthy development of the enterprise itself. This may well explain Changyu's achievements.
3. Problems created from the lack of socially responsible practices, external requirements and worldwide efforts to promote CSR are pressing Chinese corporations to place more emphasis and invest more resources in their social responsibilities. As a global company, Changyu has



recognized the importance of CSR and has met the key challenges throughout its supply chain by maintaining harmonious relationships with the vintage grape planters and its sales agencies at home and abroad. In assuming its social responsibilities, Changyu has made great achievement both socially and economically. Best practices concerning CSR in a company and the development of the company can form a virtuous cycle which mutually benefits each other. This is the most valuable learning about the Changyu case which can be shared with other companies.

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