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# Learning to do Business in China:

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## the Evolution of BAT's Cigarette Distribution Network, 1902-41

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### Abstract

This article traces the development of BAT's cigarette distribution network in China. It demonstrates that BAT utilised the connections that expatriate managing agencies had developed with Chinese merchants in the treaty port economy of Shanghai during the late nineteenth century, and shows how these linkages were subsequently developed into a distribution network to serve the whole of China. The keys to the success of BAT's selling organisation in China lay in two main areas of competence: first, the company's ability to develop accounting and credit control systems that both monitored its cigarettes and minimised the risk of bad debts; and, secondly, in its ability to foster competition within its own sales teams by creating parallel distribution mechanisms throughout much of China, in particular through the creation of a joint venture with the Chinese-run Wing Tai Vo Corporation. By the 1930s BAT's products were widely available in China, despite the upheavals that acted to undermine the development of a national market there.

# **Learning to do Business in China: the Evolution of BAT's Cigarette Distribution Network, 1902-41**

**Howard Cox**

In the era spanning the two world wars, few companies managed to achieve greater progress in foreign markets than the British-American Tobacco Company (BAT Co.). With operations embracing more than forty national markets, in most cases utilising local production facilities, BAT Co. could realistically claim by 1939 to have evolved into the world's most geographically-extensive manufacturing-based multinational enterprise.<sup>1</sup> At the heart of this commercial empire, however, lay its operations in a single market; between 1921 and 1941, of the 2,000 billion cigarettes manufactured and sold by the company world-wide, practically 40 per cent were consumed purely within the Republic of China (see Figure 1).

The purpose of the present paper is to study the process by which, essentially during the first quarter of the twentieth century, BAT Co.'s management created a sales distribution network that served a substantial part of this vast Chinese market. Much important work on this subject has already been developed through the detailed research of Sherman Cochran.<sup>2</sup> The present paper attempts to build on this work in a number of ways. Firstly, by considering the company's operations in China in the context of the development of the BAT's commercial and strategic development as a whole; secondly, by examining in more detail the role played by BAT's predecessors in the cigarette market in China; thirdly, by identifying the specific managerial tools that the Western business enterprise used to regulate its sales operations across China; and fourthly, by assessing the ability of BAT, not simply to deal

with competition from rival firms, but to inculcate competitive rivalry among different parts of its own sales organisation.<sup>3</sup>

Placing the focus of attention on BAT's formidable distribution network, as this paper does, should not be allowed to obscure the other factors which helped to account for the company's success in China before the Second World War. A full assessment of BAT's performance in that market needs to acknowledge the state-of-the-art production facilities which they constructed,<sup>4</sup> the sophisticated marketing techniques which they utilised, and the role that their encouragement of locally produced bright leaf tobacco played in maintaining their cost-effectiveness.<sup>5</sup> Such an assessment also needs to recognise the political influence which the company was able to exert within China. Ultimately underpinning all these facets of their performance lay the tremendous financial resources which the company was able to call upon. In the final analysis, however, it was BAT's ability to place their products within the easy reach of large numbers of Chinese consumers, to monitor and control the flow of these stocks, and to secure the revenues which these millions of small transactions generated, that effectively delivered the company's profits in China.<sup>6</sup>

Two particular aspects of BAT's sales operations in China will be considered here. The first issue concerns the process of market entry used by the company as it set about creating its sales network. In doing this, the paper considers the operations of Western business enterprises that preceded BAT Co. in the Chinese cigarette market. The second issue relates to the different ways in which BAT Co. integrated Chinese distributors into its marketing operation. Enlisting and supervising the participation of Chinese businessmen as BAT cigarette merchants was of vital importance to the company as they set about expanding the market for their tobacco goods in the volatile terrain of twentieth century China.

The first question, that of market entry, touches upon an issue which has received a good deal of attention from business historians recently, stimulated by research undertaken by Stanley Chapman, Mira Wilkins and Charles Jones.<sup>7</sup> What their work has demonstrated is that modern multinational enterprises - the vanguard institutions of foreign investment and

international business co-ordination during the twentieth century - were preceded in this function during the nineteenth century by the international operations of a variety of business institutions. Organisations such as trading houses, investment groups, managing agencies and free-standing companies evolved over the course of the nineteenth century into complex international networks which assumed the tasks of developing foreign markets for industrial goods and managing foreign investments, well before American-inspired multinational corporations (like BAT Co.) took root.

Although these international business networks have tended to be studied independently of conventional multinational enterprises, as alternative systems of international business management, it is clear that the success of BAT Co. in China cannot be properly appreciated without reference to the pioneering role played by the more trade-oriented organisations which preceded it. The operations of agencies such as Mustard & Co. and Rex & Co., that had acted as distributors for the products of BAT Co.'s founder companies, were fundamental in developing linkages with Chinese traders that BAT later skilfully exploited, and upon which so much of their eventual success was based. In addition, the earliest attempt to utilise the most modern cigarette manufacturing technology within China involved a collaboration between mercantile elements in Shanghai and an American-based industrial enterprise, intermediated by an American trading organisation. Such complex networks were an important and necessary feature of foreign direct investment and technology transfer in the era preceding the development of modern multinational corporations.<sup>8</sup>

Even after BAT had established themselves as the leading enterprise dealing in manufactured cigarettes in China, the company's managers still found themselves facing a steep learning curve. Before they were able to effectively deal with the problems involved in marketing a foreign product in the Chinese economy - particularly in those regions which lay beyond the treaty ports<sup>9</sup> - the company was forced to experiment with various strategies. Not surprisingly, BAT's initial approach was centred on an effort to replicate the type of

distribution mechanism which its main parent company, the American Tobacco Co. (ATC), had utilised in the United States. Given the problems faced by foreign firms operating in those parts of China where the legal provisions of the treaty ports were not valid, however, such a strategy was fraught with difficulties. As political conditions became still more problematic in China following the revolution of 1911, it became apparent to BAT that the creation of a truly national sales network for their products would require the involvement of Chinese merchants at a high level of responsibility, and that the key to financial success would be the creation of mechanisms through which these merchants' activities could be effectively managed.

## II

In common with many other staple consumer goods, the processing of tobacco was radically transformed during the late nineteenth century by the introduction of mechanised production. The branch of the industry where the greatest change occurred was in cigarette-making, an activity which traditionally had been a semi-skilled task practised by hand. As the market for cigarettes in America and Britain grew during the 1880s, a number of cigarette-making machines were designed. The most efficient of these proved to be a model developed by an American inventor, James A. Bonsack. In 1883 Bonsack had exhibited his machine in Paris, hoping to interest the French state tobacco monopoly in his invention. Whilst on display there, it attracted the attention of a major British cigarette manufacturer, the Bristol firm of W.D. & H.O. Wills, who were sufficiently impressed to carry out tests of the machine at their own factory. Wills' directors quickly concluded that the machine was the best currently on offer and purchased Bonsack's patent for use in Britain. The decision proved to be instrumental in enabling Wills to emerge as Britain's leading cigarette manufacturer in the years before 1900.<sup>10</sup> In America, where Bonsack's early efforts to find a buyer for his machine had been frustrated, the first manufacturer who was willing to adopt it seriously, W.

Duke Sons & Co., was able to negotiate a much more favourable rate for its use than any of its American rivals. By pressing home this cost advantage Duke's company forced its way into a position of leadership in cigarette-manufacturing and by 1890 Duke had been able to browbeat his four main competitors into an amalgamation. With James B. Duke installed as its President, the newly-created American Tobacco Company (ATC) commenced its commercial life with a virtual monopoly over mechanised cigarette production in America.<sup>11</sup>

The profitable exploitation of Bonsack's invention required a high volume of output and sales, and thus was dependent upon generating rapid growth in the demand for machine-made cigarettes. During the 1890s, both ATC in America and Wills in Britain introduced marketing innovations which persuaded numerous consumers to adopt this new tobacco product.<sup>12</sup> In addition, both firms began to explore outlets abroad for their cigarettes and, as the new century approached, the two found themselves competing in a number of countries, most notably in the British colonies of Australia and South Africa, and in the Far Eastern markets of Japan and China. The two firms also clashed in Britain, where Duke's firm had developed an export trade during the mid 1880s. Higher duties on manufactured tobacco imports, compared with the raw leaf, meant that domestic firms such as Wills enjoyed a significant degree of effective protection against imported American cigarettes, and the adoption of mechanised cigarette production by other British firms severely squeezed the market share of imported cigarettes.<sup>13</sup> Duke, however, was unwilling to be edged out of the British market. Having enormously expanded ATC's capital base during the 1890s by extending the firm's control into other segments of the American tobacco market, Duke used his financial resources to acquire control of the Liverpool-based Ogden Tobacco Company in 1901. Ogden's had emerged as a major rival to Wills in the British market and the Bristol firm responded to Duke's assault by forming an alliance with twelve of the major tobacco producers in the United Kingdom, creating a gigantic national enterprise under the banner of the Imperial Tobacco Company (of Great Britain and Ireland) Ltd. These manoeuvres by Duke and Wills during the closing months of 1901 began the "Tobacco War" of 1901/02.<sup>14</sup>

For a period of twelve months, ATC and the constituent firms of the Imperial company, particularly Wills, found themselves engaged in commercial warfare both in Britain, and in the various foreign markets where the British and American firms competed for customers. One especially significant act in this year-long drama was played out in the potentially huge market of China.

Duke's first attempt to popularise his firm's cigarettes in China had been undertaken during the late 1880s,<sup>15</sup> ultimately teaming up there with the American trading firm of Mustard & Co. This latter organisation had been active in Shanghai since at least the 1870s<sup>16</sup> when a certain Lauritz Andersen joined the firm<sup>17</sup> and, around 1890, Mustard & Co. began to import into China the machine-made "Pin Head" brand of cigarettes produced at Duke's factories in Durham and New York.<sup>18</sup> After Duke's firm had spearheaded the formation of the ATC, Mustard & Co. were appointed as exclusive agents for all ATC's brands in China. By establishing a sales outlet in China through the Mustard agency, Duke's firm had quickly sought to exploit the vast potential offered by the Chinese market for this new type of mass-produced tobacco product.

The possibility of building on this initiative by setting up production facilities directly within China, however, remained conditional upon acquiring the Bonsack patent rights for that region and, much to Duke's frustration, the Bonsack company had already allocated the sole agency for its machine in China to Richard H. Wright in 1888. Wright had earlier been a partner of the Dukes, joining them in 1880 and travelling extensively abroad to promote the firm's foreign sales, but after returning to Durham in 1884 he and the Dukes fell out and Wright divested his share in W. Duke Sons & Co. in order to purchase an interest in a rival tobacco manufacturing concern, the Lone Jack Company. Unable to make much headway in the domestic cigarette market, Wright once again turned his attention abroad and in 1888 he began working for the Bonsack Machine Company, purchasing a substantial interest in the stock of that concern.<sup>19</sup>

Within China itself, the earliest attempt to produce machine-made cigarettes seems to have been made by Lauritz Anderson, the principal of Duke's Shanghai sales agency Mustard & Co.<sup>20</sup> However, a more serious undertaking was put in hand by a long-standing American merchant of Shanghai, Mr E. Jenner Hogg,<sup>21</sup> who around 1890 formed a company under the title of the American Cigarette Co. and established a factory in the Pudong [Pootung] district of Shanghai.<sup>22</sup> Hogg's concern made only limited progress and towards the end of 1898, in an effort to compete more effectively with ATC's imported products, the American Cigarette Co. signed a contract with Richard Wright to purchase ten Bonsacks on the understanding that the deal would also grant them Wright's patent rights to the machine for China as a whole.<sup>23</sup> Sensing an opportunity to reap substantial profits, as well as the chance to frustrate his bitter rival James Duke, Wright acquired an interest in the American Cigarette Co. as it expanded its share capital to finance the Bonsack purchases.

Wright's efforts to exert an influence over his Chinese investment from North Carolina, however, proved little short of futile. Despite having his own representative, a Mr Collins, in Shanghai to assemble the machines when they arrived and to provide technical advice to the American Cigarette Co., Wright soon discovered that the operation of the new technology was not running smoothly.<sup>24</sup> Moreover, as an experienced dealer in leaf tobacco, Wright became concerned that the company was sending to the United States an unqualified tobacco buyer, who was purchasing entirely the wrong type of American leaf for the product.<sup>25</sup> It thus rapidly became apparent that the American Cigarette Co.'s attempt to profitably expand the market for manufactured cigarettes in China would prove to be an elusive goal, and by 1902 the day-to-day management of the company's affairs had been placed in the hands of Fearon, Daniel & Co., one of the American-run Shanghai managing agencies.<sup>26</sup> Notwithstanding its limited commercial success, the American Cigarette Co.'s control of the Bonsack patent for China meant that the firm soon became a target for more ambitious cigarette manufacturers.



One such manufacturer was the British concern of W.D. & H.O. Wills which, like Duke's ATC, had begun to look towards the Chinese market as a source of future sales. In 1899 Wills' directors had lavishly entertained a visiting Chinese government official who was touring Britain, and at the following month's Board meeting it had been noted that "our trade in North China, where enormous quantities of cigarettes are being sold, is increasing satisfactorily."<sup>27</sup> Wills' export business in Shanghai was managed by Rex & Co., a general commission merchant with no special connection to the tobacco trade. Rex had distributed Wills' high class products directly to retailers in Shanghai, but had also successfully utilised a group of Cantonese tobacco merchants named Wing Tai Vo<sup>28</sup> to distribute the company's cheaper brands of "Pirate" and "Ruby Queen", much to the Bristol firm's satisfaction.<sup>29</sup>

By the time of Duke's invasion of the British market in 1901, therefore, Wills had already established a significant market presence in Shanghai. As the rivalry between the two firms spread from Britain to other markets of the world, Rex & Co. made it known to Wills that ATC was on the point of buying out the American Cigarette Co. An agreement had been drawn up on 14 May 1902 between E. Jenner Hogg and Harold Roberts, the Export Manager of the ATC, by which Duke's company had agreed to purchase the Pudong factory, together with the Bonsack contract, for the sum of 102,500 Taels.<sup>30</sup> Before the deal could be concluded, however, Wills instructed Rex & Co. to offer the Shanghai managing agents Fearon, Daniel & Co. a higher bid of 110,000 Taels for the company's assets, with all other conditions maintained. Wills' counter-offer gained immediate approval among the directors of the American Cigarette Co., before being duly accepted at a hastily convened Extraordinary General Meeting of the company's shareholders on 24 July 1902.<sup>31</sup>

Wills' acquisition of the factory in Shanghai, with its control of the Bonsack patent, was a serious blow to Duke's international plans and may, indeed, have been a significant factor influencing the outcome of the conflict then taking place in Britain.<sup>32</sup> Certainly, a mere two months after Wills' successful Shanghai gambit, ATC reached an agreement with the Imperial Tobacco Company precipitating the American firm's withdrawal from Britain.

It was this agreement that created BAT Co. as a jointly (but not equally) owned subsidiary of ATC and Imperial, and it specified that the new joint venture would take possession of the two firms' overseas operations. To this end, the agreement explicitly allocated to BAT Co. "the interest of the Imperial Company in a factory in Shanghai recently purchased by it and/or in the American Cigarette Company of Shanghai."<sup>33</sup> Hence, the American Cigarette Co. became BAT Co.'s first operating identity in China.

### III

The agreement signed by ATC and Imperial in September 1902, as well as transferring all the export and overseas facilities of those two companies into the control of BAT Co., also gave the newly created joint venture exclusive rights to use trademarks of the two companies in all overseas markets outside of the United Kingdom and the United States (including its foreign dependencies).<sup>34</sup> Of the eighteen places on the Board of Directors, seven were filled by ATC executives, including James Duke as Chairman, and five by directors of the Ogden company. The remaining six were allocated to directors of Imperial, in line with their allocation of one third of BAT Co.'s share capital. BAT Co.'s registered headquarters were established in London, at Cecil Chambers in the Strand, well away from the reach of America's anti-trust authorities. The Board of Directors located there, comprising initially of the Imperial and Ogden members, oversaw the export trade of the British factories. The American directors, meanwhile, formed a separate Committee of Directors in New York to supervise the American-based export trade.<sup>35</sup> In the case of its manufacturing subsidiaries located abroad - notably in Australia, South Africa, Canada, Germany and Japan - suitably qualified executives were dispatched to manage BAT Co.'s interests.

The manufacturing operations inherited from Wills in Shanghai were quickly consolidated under the control of a general manager drafted in from Liverpool, Henry A. Keily.<sup>36</sup> The original American Cigarette Co. was liquidated and a new company of the same name was incorporated under the Hong Kong Ordinances in July 1903.<sup>37</sup> This was now a wholly-owned subsidiary of BAT Co. and acted in the capacity of BAT's manufacturing arm in China. During 1904, BAT also sent out two of their senior members of staff, the company's Secretary Hugo Cunliffe-Owen and its Chief Accountant, William R. Harris, to help consolidate its operations there. Although the China business as a whole was formally designated as a branch of the London head office, in practice the operations in North China, centred on Shanghai, were supervised during the early years by Duke from New York.

Operations in South China, focused on the Hong Kong depot, were in contrast supervised directly from London until 1917.<sup>38</sup> During 1905, when Duke handed over the Chairmanship of BAT to W.R. Harris, liaison with Shanghai seems to have been conducted by Duke's right-hand man in New York, George G. Allen. At the same time a trusted Duke employee, James A. Thomas, was sent to Shanghai and placed in overall control of BAT's affairs in North China.<sup>39</sup> Also in 1905, A.G. Jeffress became the first American director to be appointed to the BAT Co. London Board of Directors and seems to have been given special responsibility for relations between Shanghai and the London office.

In terms of distribution arrangements, both Mustard & Co. and Rex & Co. initially acted as sales agents, with the two firms maintaining their existing responsibilities for American and British cigarette imports respectively. This dual arrangement was clearly considered to be unnecessary in the longer term, however, being quickly revised in favour of ATC's former agency. In 1903 BAT Co. bought the controlling interest in Mustard & Co., and Lauritz Andersen became part-owner of the reconstituted firm with 10 per cent of the authorised share capital.<sup>40</sup> Soon after this, it was decided to completely dispense with the services of Rex & Co. During 1904, as Hugo Cunliffe-Owen briefly took charge of the company's affairs in China, Alfred Rex agreed to comply with BAT's wish to discontinue his firm's agency, in return for an immediate payment of £750, followed by further annual remittances of £500 over a five-year period. For its part, Rex & Co. covenanted not to undertake operations in the tobacco business in China for a period of fifteen years. Significantly, Alfred Rex was required by the agreement terminating his agency to use his influence with the Wing Tai Vo Company to induce them to obtain their tobacco products from Mustard & Co.<sup>41</sup> Following Rex's withdrawal, the agency for the British brands was turned over to Mustard & Co., who thus became BAT Co.'s sole distributors within Shanghai and for a distance of 100 miles around the city.<sup>42</sup>

During its early years, when the preponderant share of BAT's Chinese sales and all of its small amount of local manufacturing were focused on Shanghai, Mustard & Co. used its

links with the local Chinese merchants to create a selling agency known as the Shanghai Tobacco Guild. Initially, six wholesale merchant firms were appointed to undertake the main task of distribution through the framework of the Guild, one of which was Wing Tai Vo.<sup>43</sup> Mustard's control of this Guild, which had expanded to embrace twenty Chinese firms by 1916, provided BAT with an effective sales network in Shanghai; the merchants traded only in BAT products and formed exclusive deals with local retailers which acted as a barrier to the products of rival domestic cigarette manufacturers.<sup>44</sup>

BAT's early dominance of the cigarette market in Shanghai threatened to be seriously disrupted when a widespread campaign to boycott American products erupted in the middle of 1905.<sup>45</sup> The boycott presented small-scale Chinese tobacco manufacturers with an opportunity to gain access to BAT's Shanghai market, and it was during this campaign that the Wing Tai Vo organisation made a strong impression on BAT's Western managers, particularly through the actions of one of the partners, Zheng Bo Zhao [Cheang Park Chew]. Zheng was able to prevent the boycott from leading to a substantial fall in his sales by emphasising the British origins of the Wills' brands of cigarettes that his firm distributed, and by arranging for stocks of the American-manufactured "Ruby Queen" brand to be relabelled as "Britannia" cigarettes. (BAT's managers in Shanghai also responded to the hostility towards Americans by re-registering their American Cigarette Co. manufacturing subsidiary as the British Cigarette Co. in September 1905). Zheng's subterfuge was successful, and both during and after the boycott the Wing Tai Vo sales network expanded rapidly.<sup>46</sup>

The treaty port agreements of the nineteenth century, which governed economic relations between the Qing government in Beijing and the Western Powers, limited foreign economic involvement in China to the purposes of mercantile trade. At the conclusion of the Sino-Japanese War of 1894-95, however, the Chinese authorities had been obliged by the terms of the peace treaty signed at Shimonoseki to allow the commencement of foreign investment in the treaty ports.<sup>47</sup> After the boycotts of 1905 it became apparent to BAT's top managers that the company would need use this newly-gained concession to expand their manufacturing capacity in China and reduce their dependence on relatively high-cost imported cigarettes.<sup>48</sup> Manufacturing cigarettes directly within the treaty ports would enable the firm to compete effectively with low-cost native cigarette producers, and to develop the market for their cigarettes beyond Shanghai. With this latter aim in mind, it was also clear that commercial expansion in China would require the formation of a distribution network under the company's control which was capable of channelling cigarettes beyond the treaty ports to those consumers located within the interior.

The individual charged with the responsibility of developing BAT's operations in China beyond the limits of the treaty port economies, James Thomas, had already gained experience of working in the tobacco markets of the Far East before joining ATC in 1899. He had been seconded to BAT Co. on its formation by James Duke, who placed him in control of the company's operations in India.<sup>49</sup> On his transfer to Shanghai in 1905, therefore, Thomas was able to bring to the post both the knowledge he had gained from his experience abroad, and an appreciation of the workings of Duke's ATC organisation in America. The former experience convinced Thomas of the importance of adhering to the local trading infrastructure and customs, and of the need to market cigarettes at a price denominated in an appropriate local coin. The latter experience provided the basic blueprint for the production and distribution structure that he set about creating in China.

In his capacity as managing director of the American (later British) Cigarette Co., and also as a director of Mustard & Co., Thomas controlled BAT's operations in Shanghai for ten years. During this time Thomas promoted a vast expansion in the number of cigarettes distributed by BAT in China which were manufactured directly by the factories of the British Cigarette Co. In 1906, the Pudong factory in Shanghai was extended to enable a total of 8 million cigarettes per day to be produced. Also during that year a factory was begun in Hankou of Wuhan [Hankow], to which a second was added in 1911, giving the British Cigarette Co. a production capacity in Hankou of 10 million cigarettes per day. In 1908 a cigarette factory was built in Manchuria, at Shenyang [Mukden], capable of producing another 2 million sticks daily.<sup>50</sup> By 1912, therefore, these three British Cigarette Co. production sites were capable of supplying the company's distribution networks with around 70 per cent of their total sales - a level of output in excess of 5 billion cigarettes (100,000 cases) per annum (see Tables 1 and 2).<sup>51</sup>

The influence of Duke's ATC organisation on Thomas' strategy in China is revealed by reference to the managerial structure adopted by the British Cigarette Co. As he set about the task of establishing BAT as the leading supplier of cigarettes across the whole of the Chinese Empire, Thomas adopted the centrally co-ordinated organisational management structure of the ATC. From his headquarters at 22 Museum Road in Shanghai, Thomas exerted authority over a small group of executives whose departments were responsible for carrying out the functions of purchasing, manufacturing, and marketing.<sup>52</sup> BAT's long-term strategy in China, implemented by Thomas, focused on building a nationwide distribution structure which was under the company's control and which could be co-ordinated with the output of a small number of high-volume factories located directly within China. The strategy was clearly inspired by the experience of the tobacco industry in America, where the rapid growth of cigarette sales during the 1880s had encouraged the largest manufacturers to take a more active role in the distribution process.

Traditionally, American tobacco manufacturers had merely employed a few travelling salesmen to make contact with local jobbers and retailers, while the bulk of the trade remained in the hands of independent wholesalers who supplied small retailers with a variety of goods, of which tobacco was only one. However, during the mid-1880s the largest cigarette manufacturers began to set up their own warehouses to serve dealers in the largest cities. The effect of this was to eliminate many commission merchants and some of the largest urban jobbers from the distribution system for cigarettes in the United States.<sup>53</sup>

In America, therefore, by creating their own regional distribution centres, the cigarette manufacturers had introduced a measure of forward integration into the tobacco industry. In China, James Thomas attempted to replicate this policy, as far as was practicable, by developing a distribution system which divided the Chinese market beyond the Shanghai area into a series of regional sales territories, each of which was placed under the control of a Territory Manager, supervised by the Sales Department of the Shanghai headquarters. Two strategies were then employed to manage this China-wide territorial distribution system. Firstly, a number of foreign salesmen were recruited by BAT whose task it was to supervise these territories and to promote the company's goods in collaboration with Chinese sales teams. These foreigners were supported by Chinese interpreters (compradors) a number of whom ultimately took on direct management roles within the BAT sales organisation.<sup>54</sup> Secondly, a series of warehouses were created in the main towns of China to receive and distribute the products manufactured in the company's factories. Where these warehouses were located outside the jurisdiction of the treaty ports, native Chinese were employed as depot-keepers to manage the stocks. Thomas' principal achievement in China was his creation of a management system capable of administering these two elements of the distribution process.

The foreign salesmen recruited by Thomas were mainly young Americans, drawn primarily from the tobacco-growing areas of North Carolina and Virginia. The standard contract of employment for these young men involved a continuous period of four years



abroad, followed by four months home leave.<sup>55</sup> A bonus was awarded to those who learned sufficient Chinese to pass the company's examination.<sup>56</sup> One such employee, James Hutchison, began working in China during 1911 as a travelling salesman around Beijing [Peking] before graduating into the role of a Territory Manager two years later.<sup>57</sup> His early work included tours of local towns accompanied by a Chinese sales crew armed with advertising material (posters and handbills) and samples of the products.<sup>58</sup>

One of the tasks of these travelling BAT salesmen was to monitor the market conditions in the different parts of the country to which they travelled. This was undertaken through the completion of Form 163, a survey of market conditions which had been designed by Thomas during his early excursions into the field. The form was completed monthly by all of the company's travelling representatives as they visited dealers, before being returned to the company's headquarters in Shanghai. It set out the prevailing conditions for each town in terms of population, dealers operating, depot facilities available, stock levels by brand, the local currency exchange rate and the general income levels of the inhabitants.<sup>59</sup> Duke had understood well the importance of accurate information of this kind, and his chief accountant in New York, W.R. Harris, created an accounting system for the American organisation, based around daily reports on brand sales by town, in order to keep stocks flowing smoothly.<sup>60</sup> Thomas adapted this procedure to the needs of the China market, in particular to pricing cigarettes at an appropriate level in the local currency.<sup>61</sup> During its first ten years in operation, the distribution system created by Thomas and managed by his American sales team continued to evolve. As the geographical scope of the sales network expanded, individual territories would be grouped together to form small Sales Divisions. The three main focal points of this network emerged as the treaty ports of Shanghai, Tianjin [Tientsin] in the north, and Hankou [Hankow] situated inland from Shanghai along the Yangtze basin, although important adjuncts were the operations in Manchuria, centred in Shenyang [Mukden], and Hong Kong, the latter at this point still controlled directly from London.

Important as the American and other foreign salesmen were to the company's early growth in China, the expansion of BAT's distribution system also necessitated the increasing participation of Chinese merchants. One reason for this lay in the provisions of the trade treaties themselves which prevented foreigners from owning land outside of the treaty ports and thus presented BAT with severe problems in terms of expanding their network of warehouse provision. To overcome this it was necessary to develop a system of warehouses which were under the ownership of Chinese nationals. In addition, BAT needed to tap into the well-established Chinese trading networks that already delivered goods extensively within China.<sup>62</sup> This required a system of dealers to be developed using contract arrangements which, as far as possible, ensured the security of BAT's goods as they passed through a complex Chinese distribution mechanism towards the ultimate retailers and hawkers.

The means by which the company expanded their distribution system to incorporate Chinese dealers was through the development of two legally-binding contracts, Forms 15A and 16A, which, like Form 163, were introduced by Thomas. The Form 15A was designed to enable BAT to appoint independent Chinese merchants as godown (depot) managers for their stocks. The agreement permitted BAT to furnish large-scale depots with adequate stocks by retaining ownership of the goods until such time as they were released to the dealers.<sup>63</sup> Thus, although the 15A depots were independent concerns, in contrast to the company's own depots located within the treaty ports, the 15A agreement enabled BAT to transfer stocks to them without foregoing their right of title to such goods until they actually left the depot. This arrangement was supported by the Form 16A, which was a Guarantee Bond signed by all of BAT's appointed dealers. Before a Chinese merchant was appointed to deal in the company's goods, he needed several tens of thousands of Yuan as capital and a permanent premises for dealing exclusively with BAT's goods. Additionally, in order to receive goods on credit, a distributor needed to be able to offer BAT two guarantors each of which constituted a firm with a permanent place of business.<sup>64</sup> The role of the 16A Guarantee Bond was to act as a security against stocks held by the dealer. By signing the 16A agreement, each dealer pledged

a fixed amount of compensation to the company, calculated by taking the credit limit allowed to the dealer in question and adding a 25 per cent margin, as guarantee against the loss of stocks held by him.

These arrangements provided BAT with the security they needed to extend credit to their dealers, who were then allocated goods on a consignment basis of no more than 30 days after they had been drawn from the depot. In areas too remote for the company to set up depot facilities, the main Association dealers were permitted to draw stocks on behalf of Sub-dealers, under similar guarantee arrangements, thus effectively performing the wholesaling function.<sup>65</sup> The flows of stocks were monitored by both the Territorial Managers in the field and the Accounting Department in Shanghai which controlled all the financial transactions across the entire Chinese market.

## V

The development of BAT's operations in China, and indeed the evolution of the company as a whole, was materially affected by two political events that occurred almost simultaneously towards the end of 1911. On 16 November, a four-year process of prosecution by the anti-trust authorities in America culminated in the Supreme Court ordering the dissolution of Duke's ATC by formal decree. One month earlier, on 10 October, the discredited Qing government was forced to yield its political authority, and a Republican government was formally instituted under the provisional Presidency of Sun Yatsen on 1 January 1912.

The main implication for BAT Co. of the dissolution decree arose from the Supreme Court's ruling that ATC should relinquish its institutional shareholding in the joint venture with Imperial. This decision led to two thirds of the company's stock passing into the hands of private shareholders and left Imperial, who held the remaining one third of BAT Co.'s shares, as the main single shareholder. In April 1912, in an effort to ensure its managerial autonomy, an Extraordinary General Meeting of BAT Co. agreed to issue 500,000 new

ordinary shares and offer them to the existing directors at 30 shillings each. These shares, which had a market value of around £5, were available for purchase over a period of four years on condition that the directors did not act in a similar capacity for any other tobacco company. A total of 280,228 of these shares were allocated to James Duke alone.<sup>66</sup> Having masterminded the dissolution of his American tobacco empire following the Supreme Court judgement, Duke therefore declined to assume control of any of the successor companies, electing instead to resume the Chairmanship of BAT Co. that he had passed to Harris in 1905. Thus, during 1912, London became both Duke's temporary home and the undisputed managerial apex of the BAT organisation. To mark the shift in authority, an impressive new headquarters was built by the company in Westminster opposite the Houses of Parliament.

The impact of the second political development, the Republican revolution, on Thomas' strategy in China seems to have been twofold. Firstly, the failure of Sun Yatsen's regime and its successors to prevent political fragmentation in China encouraged Thomas to delegate more authority to regional managers in BAT's Chinese operation. Beginning in 1914, therefore, Thomas began the process of formally regionalising the company's sales management structure, placing it on a path which, by the 1920s, effectively saw the company operating five relatively autonomous departments across the main macro regions of China. Secondly, the growing popular antipathy towards foreigners which had helped to destabilise the Qing regime caused Thomas to experiment with the creation of a sales network which was managed directly by Chinese merchants rather than by Western salesmen.

In 1912, two of the company's most trusted Chinese servants, Zheng Bo Zhao (by now the manager of the Wing Tai Vo distribution agency) and Wu Ting Sheng (a BAT employee), accompanied Thomas on a visit to London for a meeting with BAT's top management.<sup>67</sup> Following their return to China, Zheng Bo Zhao became the first Chinese agent to be allocated sole agency for a BAT brand, "Ruby Queen", across the whole of China, rather than just in the Shanghai region. Meanwhile, with a similar aim in mind, Wu Ting Sheng was co-opted into a new initiative.

Wu had first been hired by Thomas as his interpreter at the age of twenty, and had been instrumental in helping the Western tobacco merchant to establish the Shanghai Tobacco Trade Guild.<sup>68</sup> Thomas had been impressed by Wu's command of English, his ambitious attitude and his skilful dealings with influential Chinese gentlemen and merchants. Unlike Zheng Bo Zhao, who was part of the mercantile class that had benefited from the rapidly expanding treaty port trade, Wu was a member of the urban gentry whose political influence in China had expanded as the ruling Qing regime in Beijing disintegrated. Wu had already displayed his loyalty to the Western firm publicly when, at the height of anti-American sentiment in 1905, he spoke out in support of BAT at a meeting called to announce the boycott American goods at the Shanghai Chamber of Commerce.<sup>69</sup>

Thus convinced of Wu's loyalty, and mindful of his growing political influence, on returning from London Thomas engaged Wu in a joint venture. In July 1912 a new company, wholly owned by BAT Co., was created in London called the Enterprise Tobacco Co. and this had taken control of certain BAT trademarks.<sup>70</sup> Shortly afterwards, in November, a company was incorporated in Shanghai under the title of the Union Trading Co. and was immediately appointed as an agent of the Enterprise Tobacco Co., by whom it was exclusively allocated within China the brands "Purple Mountain" and "New York".<sup>71</sup> The Union Trading Company,<sup>72</sup> in which Wu Ting Sheng now became a shareholder, was designed to develop a distribution network for BAT's cigarettes that would cover the whole of China, and which appeared, to outside observers, to be operated by a high profile member of the Chinese urban gentry. Significantly, it was also expressly designed "for the purpose of creating competition among the salesmen in China."<sup>73</sup>

As a subsidiary company, BAT allowed Union much more generous credit arrangements than their existing Chinese agencies and hence the organisation was able to deal in much greater volumes of cigarettes. Using this advantage, Union rapidly expanded sales of the company's products as Wu, applying his influence and offering incentives to dealers, made early progress.<sup>74</sup> These initial successes of the Union Trading Company

proved impossible to sustain, however, and towards the end of the decade the enterprise began to run into serious financial difficulties. For all his political influence, Wu did not have sufficiently deep roots in the mercantile community and was unable to maintain the company's growth.<sup>75</sup> In 1919, the Union company went into liquidation and the Enterprise Tobacco Company was reconstituted to form BAT's operating arm in Hong Kong. This initial attempt to formally integrate traditional Chinese business networks into BAT's corporate structure in China therefore ended in failure principally, it would seem, as a result of Wu Ting Sheng's limited mercantile links. In June 1920, six months after his mentor James Thomas went on leave from BAT Co., Wu resigned from BAT and took up employment with their principal Chinese rivals, the Nanyang Brothers Tobacco Co.<sup>76</sup>

The second plank of Thomas' strategy, regionalisation of BAT's Chinese sales organisation began with the creation of three huge Sales Divisions covering the whole of China other than Manchuria and the Southern Provinces. Under these new arrangements, individual Territory Managers reported to newly-created Division Managers, who then reported to the Shanghai headquarters. Thus another tier of management was added to help streamline communication within the organisation and improve territorial supervision. The three core sales areas, with their divisional headquarters in Shanghai, Tianjin [Tientsin] and Hankou [Hankow], now emerged as Southern, Northern and Central Divisions respectively. Sales in the south of China, co-ordinated from Hong Kong, remained autonomous.

In 1915 a fourth sales division was set up in Manchuria, with its headquarters based in Shenyang [Mukden]. In this part of China, especially around Harbin in the north, Russian cigarette manufacturers had been operating since the turn of the century, popularising their own type of tobacco product featuring a mouthpiece, and BAT's main rival in Manchuria was the Russian firm of A. Lopato & Sons that had been founded at Harbin, Northern Manchuria, in 1898. In 1913, BAT gained a financial interest in the Lopato factory in Harbin, possibly expanding the capacity of the factory to produce some of BAT's brands, although the Lopato concern continued to operate an independent sales team.<sup>77</sup>

Notwithstanding the development of the company's own Manchurian Sales Division, relations with the Lopato concern were further extended in 1918 when, following a surge in demand for Russian-type cigarettes caused by an influx of Russian refugees into Manchuria seeking sanctuary from the Bolshevik revolution, and probably also as a response to an intensification of competition in Manchuria from the Japanese State Tobacco Monopoly,<sup>78</sup> BAT and Lopato set up the Alliance Tobacco Co. with a registered office in Shenyang [Mukden] and with E.A. Lopato as Chairman.<sup>79</sup> Although BAT held a majority interest in this company, Alliance's Board of Directors and their exclusively-Chinese sales team again seems to have operated independently of BAT's own Manchurian Sales Division. The Alliance initiative seems to have represented another attempt by the company to retain control of productive capacity but to facilitate competition between sales teams.<sup>80</sup> This particular arrangement struck problems during the early 1920s, however, when the products of the Lopato company developed a price advantage over BAT's brands in the markets of northern China outside Manchuria, and a degree of rationalisation was necessary.<sup>81</sup>

## VI

The boost given to the authority of the London office of BAT Co. by the Supreme Court's ruling in 1911 was partly reversed by the outbreak of the war in Europe in 1914. On hearing the news, Duke returned permanently to New York and continued his (now largely nominal) Chairmanship of BAT Co. from there. In London, meanwhile, a group of five Vice Chairmen assumed control of the company's affairs at the newly-built Westminster House headquarters. During 1916, the production of cigarette exports destined for the Chinese market, which before the war had become increasingly concentrated in BAT Co.'s British factories, was transferred back to America as British output shifted towards supplying War Office requisitions.<sup>82</sup> However, this loosening of London's control over the company's sales in China was compensated for by the transfer of James Thomas to Westminster House in

1916 as director responsible for China, being replaced in Shanghai by his American assistant, Thomas F. Cobbs. Soon after the end of the war, in February 1919, the London management restructured its operations in China by creating a new holding company, BAT Co. (China) Ltd., registered in Shanghai, which acquired the assets of both the British Cigarette Co. and Mustard & Co. Although the Board of Directors of BAT Co. (China) initially included many members of BAT's management in China, in 1920, due to the stipulation of the British authorities over the nationality of directors of British China companies, most of these directors were instructed to stand down. The changes acted to give the London Board a much stronger hand over the management of the China subsidiary during the inter-war years.

Towards the end of 1919 a newly formed enterprise called the Chinese-American Bank of Commerce offered Thomas the opportunity to return to China in the capacity of managing director, and he successfully applied for leave of absence from BAT to take up this role.<sup>83</sup> Shortly before his departure from London, Thomas had persuaded his successor in Shanghai, Thomas Cobbs, to further develop the relationship between BAT and Zheng Bo Zhao's Wing Tai Vo organisation. In 1912, when BAT had first franchised the "Ruby Queen" brand of cigarettes to Wing Tai Vo for the Chinese market as a whole, it had simply sold the cigarettes to them at a standard price, allowing Zheng to add on whatever profit margin he felt appropriate. Later, in November 1917, a more formal arrangement had been agreed upon by which BAT paid all expenses in connection with the distribution of "Ruby Queen" and paid Wing Tai Vo a fixed commission of 2 per cent on each case sold.<sup>84</sup> Now, Zheng was instructed by Cobbs to set up a sales network of distributors which exactly paralleled BAT's China-wide depot system. Zheng's own distributors were to be paid a commission of 1 per cent in addition to the 2 per cent commission payable to Zheng himself. These distributors were given exclusive rights to deal in the brands of "Ruby Queen" and "Vanity Fair" (a lower grade brand) within the limits of each specified Sales Division, and were themselves to appoint Association dealers and Sub-dealers in each of the villages, towns and districts served by the sub-depot within their designated division.<sup>85</sup> Thus BAT now



operated two independent sales organisations, acting in competition with each other, across the entire Chinese market.

During 1920, two further developments acted to strengthen still further Wing Tai Vo's position within the BAT organisation. Firstly, in June, Wu Ting Sheng's defection to the Nanyang Brothers Tobacco Co. led Zheng Bo Zhao to be awarded his franchised brands to distribute within the Shanghai area.<sup>86</sup> Two months later Thomas informed Jeffress, who had once again assumed overall responsibility for the China market at BAT's London headquarters, that a representative of the Liggett & Myers Tobacco Co. had arrived in China from the United States with the intention of setting up a rival selling organisation for that firm.<sup>87</sup> Shortly afterwards, when Liggett & Myers did begin to compete in Shanghai with a brand of cigarettes called "Red House", BAT countered the move by franchising to Wing Tai Vo a brand named "Victory". The combination of Zheng's sales network and BAT's competitive strength meant that the "Red House" threat was quickly nullified.<sup>88</sup>

The key to Zheng's ability to rapidly expand BAT's sales lay in his willingness to offer generous credit terms to his dealers. Whereas BAT had been obliged to place stringent conditions on its Chinese distributors in terms of guarantees, in order to safeguard itself, the regional solidarity which characterised Zheng's network of Cantonese merchants allowed him to adopt much less restrictive conditions.<sup>89</sup> Zheng required much less in terms of the capital value of distributors, he extended credit on the strength of only one guarantor and on a much more lenient basis, and he even paid interest on money that was lodged with him as security. As a result, Wing Tai Vo was able to rapidly expand its network of distributors.<sup>90</sup> By September 1920, sales of "Ruby Queen" had set a new monthly record for the company in China of 11,462 cases and the company found it necessary to resume production of cigarettes for China, which had been transferred to America in 1916, at their factory in Liverpool.<sup>91</sup>

The success of Zheng's Wing Tai Vo Company also made it a threat to BAT. Clearly, BAT's ownership of trademarks and their high profile marketing support provided a strong incentive for Zheng to retain his position as a BAT dealer, but the fact that Wing Tai Vo now

controlled a significant proportion of the company's sales gave him the necessary bargaining strength to draw BAT into a compromise arrangement, which allowed Zheng a high degree of autonomy within the BAT organisation. In October 1921, Zheng and his two main business partners, Zheng Gong Xia his eldest son, and Huang Yi Cong his brother-in-law, joined with BAT to form the Wing Tai Vo Tobacco Corporation.<sup>92</sup> Using capital resources derived from sales commissions, Zheng and his partners were able to put up 49 per cent of the agreed capital of the new corporation of 1 million Yuan, with BAT providing the remaining 51 per cent. In order to maintain financial control of the Wing Tai Vo Corporation, BAT required that all dealers settled accounts through payment to the parent company's banks. Wing Tai Vo had no independent accounting records; the sales generated were recorded by the Accounting Division of the parent company and all accounts were receivable by that company. Commission was then paid to Wing Tai Vo in due course on the value of cigarettes that were sold through its distribution mechanism. In addition Wing Tai Vo received an annual bonus of 20,000 Yuan and, of course, 49 per cent of the profits generated by the Wing Tai Vo Corporation were paid to Zheng and his relatives on the Board of Directors. Thus through their links with the Wing Tai Vo Corporation, BAT had grafted on to its own sales organisation in China a parallel organisation which was entirely Chinese-run, and which accounted for approximately one third of all BAT's sales there between the wars (see Figure 2).

What are the implications of the preceding discussion for this paper's two main points of concern? Firstly, what was the significance of the trade agencies, who first opened a market for cigarettes in China, for the subsequent development of BAT there? Secondly, how should the integration of Chinese business organisations and personnel into BAT's distribution system in China be evaluated? These two issues will be considered in turn.

The question of BAT's precursors in China is of interest because it presents a coming together of two different forms of international business enterprise. As agency houses, both the American Mustard & Co. and the British Rex & Co. represent traditional nineteenth century commission agencies who provided the links between the industrialised world and the pre-industrialised, frequently colonial, parts of the globe. The commercial value of these institutions - the source of their competitive advantage - lay in the locality-specific knowledge which they had acquired, combined with the established linkages they held back in their country of origin. Both Mustard and Rex had utilised these sources of advantage in pursuing their agency work for the cigarette manufacturers Duke (later ATC) and Wills. In particular, Wills' agent, Alfred Rex, had demonstrated the value of his local connections by thwarting Duke's attempt to enter the Chinese market directly through the acquisition of the American Cigarette Co. in 1902.

The complementary nature of the location-specific knowledge, which these agencies possessed, and the process- and product-specific knowledge of the cigarette manufacturers, encouraged the development of a partnership between them. For such a partnership to be successful, however, it was necessary for the transfer of process- and product-specific knowledge to involve more than the simple transplantation of machinery. In addition, an important element of tacit knowledge was required in order for the manufacturing process to be adjusted appropriately to local conditions. The failure of the American Cigarette Co.'s attempt to exploit control of the Bonsack patent within China provides an example of the

difficulties involved in transferring technological blueprints without the complementary expertise embodied in human capital.

Even after taking control of the Pudong factory, and hence of the Bonsack rights for China, BAT's principal objective was to put in place a distribution mechanism covering the market in Shanghai, whilst relying principally on imported cigarettes. Before engaging in a substantial burst of investment in plant and machinery, BAT took steps to acquire the necessary location-specific knowledge by purchasing control of the Mustard agency, thus bringing into their employ Lauritz Andersen, and induced Rex & Co. to withdraw from the market for cigarettes whilst passing on to Mustard their links with the influential merchants Wing Tai Vo. Only after these connections with local actors had been secured did BAT Co. step up their direct investment in China. The importance of these foundations for BAT's subsequent success in China can clearly be illustrated, both by the fact that Andersen remained a director of Mustard & Co. throughout the two decades that it operated as BAT's main distribution arm in Shanghai, and by reference to the central role that the Wing Tai Vo organisation came to play in the development of BAT's distribution mechanism for cigarettes in China.

Forging links with expatriate agency houses such as Mustard and Rex constituted the cigarette manufacturers' first step in creating a distribution system to serve their needs in China.<sup>93</sup> One major drawback of these institutions, however, was that their direct area of influence in China rarely extended beyond the treaty ports of Shanghai and Hong Kong.<sup>94</sup> Rex & Co.'s links with Wing Tai Vo were therefore especially valuable because they provided BAT with access to one of the traditional trading associations whose networks, founded upon the strength of regional collegiality, extended deeply into the Chinese economy.<sup>95</sup> In contrast to Mustard and Rex, BAT's objectives in China were far more ambitious than simply providing cigarettes within the treaty port economies. Under the managerial guidance of James Thomas, BAT soon began to look beyond those limited horizons.

On assuming control in Shanghai, therefore, Thomas began to step up local production facilities and recruited an expatriate sales team who, supported by salaried Chinese interpreters, could take these low-priced cigarettes "up-country" and establish relations with the traditional Chinese merchant houses that managed China's internal trade. During the ten years in which Thomas was in control of BAT's operations in Shanghai, the company established an extensive network of Chinese dealers who conducted warehousing arrangements for them beyond the treaty ports, and who took responsibility for the distribution of their products to the final consumer. So effective did these links with Chinese merchants become, that, by the latter part of the 1920s, the need for Western salesmen to engage in travelling had more or less ceased.<sup>96</sup>

This reliance on Chinese merchant groups has led Cochran to dispute the originality of BAT's distribution system, and to question whether BAT's entry into China actually led to the creation of something which, in economic terms, could be considered as novel.<sup>97</sup> Certainly, as time passed, it was increasingly the Chinese merchants who managed the physical process of distributing BAT's cigarettes to the consumers. In addition, there can be little doubt that BAT's Western salesmen would have found it extremely difficult to operate without the support of their Chinese interpreters/compradors, to whom they were thus obligated. However, these marketing activities represented only the physical manifestation of the distribution system that BAT created in China. Supporting this field organisation was a system of management accounting, implemented by Thomas through his Accounting Department in Shanghai, which monitored its operation. This system ensured that the dealers obtained those supplies that their customers required, that the company's warehouses and dealers were not overstocked, that the credit allowed to dealers was kept to the minimum level commensurate with their needs, and that the revenues generated by the operation as a whole were properly accounted for and received by the company. These systems of market intelligence, of dealer guarantees, and of financial accounting procedures, were the products

of Western business expertise that BAT's management introduced into early twentieth century China.

Managing a distribution mechanism comprising almost entirely of Chinese dealers was a key to BAT's success in China. Beyond this, however, it is important to recognise that the company also maintained a competitive edge by creating rivalry between different parts of its own sales organisation. This is evidenced by the schemes with Wu Ting Sheng and the Lopato family and, most successfully, with Zheng Bo Zhao's Wing Tai Vo operation. James Duke himself had come to appreciate in the United States that the benefits of large scale production could easily be dissipated by the dulling effect that a monopoly position could have on sales performance.<sup>98</sup> A striving to maintain rivalry within the sales operation, whilst gaining the maximum economies of scale in production, thus emerges as a continuous thread in the competitive strategy implemented by BAT's management in China during this period.

BAT's crowning achievement within China was to oversee a distribution network that transcended in scope any of the individual Chinese trading associations which had hitherto carried out China's internal trade. It did this ultimately, not by creating a fully-blown distribution mechanism of its own making, but by instituting an administrative framework that brought within its organisational compass a great many of the established trading firms that were already serving the traditional Chinese economy and by allowing certain of the elements within this distribution mechanism to compete against one another.

BAT's long-term success in China lay less in their ability to protect the concentrated urban markets of the cities against competitors, than in their ability to provide cigarettes to customers in the furthest reaches of China. As Table 3 illustrates, in 1931 (the first year for which a regional breakdown of sales is available), at a time when BAT and Wing Tai Vo together accounted for 60 per cent of cigarette sales in China, their combined market share in the Shanghai Sales Department - a market they had earlier dominated through the operations of the Shanghai Tobacco Guild - was just under 50 per cent. Their sales in Hong Kong, Guangzhou [Canton] and South China (which included treaty ports such as Shantou

[Swatow], Xiamen [Amoy] and Fuzhou [Foochow]) were relatively weak. Again, in Northern China, their market share was relatively weaker in the city of Beijing [Peking], and in the Northern Division, which included the major commercial city of Tianjin [Tientsin], than in the more remote parts of the region. It was thus the extensive nature of BAT's sales network, its ability to propel its goods towards the more sparsely populated regions of China, and its ability to generate rapid growth of sales in these areas, rather than a monopoly control of the large urban markets, which accounted increasingly for its continued growth in sales and its strong national market share.

Individually, the scope of the indigenous trading networks was relatively limited. Even the Wing Tai Vo organisation, which controlled an extensive, traditional Chinese place-of-origin distribution network, had little representation in Manchuria or the South of China. Practically 50 per cent of Wing Tai Vo's sales were still concentrated in the Shanghai Sales Department by 1931. Only by linking together these networks through the medium of a comparatively sophisticated management accounting framework, could a genuinely national distribution mechanism be created in Republican China. Moreover - and an observation that constitutes another indicator of BAT's success in Chinese business - Zheng Bo Zhao himself willingly adopted the business systems introduced by BAT, creating forty sales territories across China headed by Territory Managers, and utilising the same system of 15A warehouses pioneered by the Western company. As Wing Tai Vo developed its business, it did so increasingly along Western lines.<sup>99</sup>

Thus BAT were able to develop a thriving business enterprise in China because they were willing and able to adapt the expertise which they had already mastered, in the production and distribution of cigarettes, to the conditions that prevailed within China. On arriving in the Far East, BAT, and James Thomas in particular, were prepared to continue the process of learning. It was this willingness to learn and adapt that makes an analysis of BAT's operations in China between 1902 and 1941 so fruitful an example of the potentially successful marriage which could be made between Western business methods and the

traditional mercantile institutions of China.



TABLE 1: CIGARETTE SALES IN CHINA (BAT v. RIVAL FIRMS)  
1902-41 (various years) (50,000 cartons)

Year	BAT Sales	(%)	Rival Sales	(%)
1902	12,682	-	n.a.	-
1909	80,353	-	n.a.	-
1910	105,548	-	n.a.	-
1911	129,933	-	n.a.	-
1912	142,933	-	n.a.	-
1914	187,969	-	n.a.	-
1915	179,127	-	n.a.	-
1916	192,975	-	n.a.	-
1918	267,202	-	n.a.	-
1919	309,028	-	n.a.	-
1920	340,419	-	n.a.	-
1921	355,610	-	n.a.	-
1922	405,707	-	n.a.	-
1923	509,478	(79.3)	132,643	(20.7)
1924	634,624	(82.1)	138,704	(17.9)
1925	587,950	(77.1)	174,886	(22.9)
1926	580,413	(70.4)	244,032	(29.6)
1927	562,690	(67.7)	268,497	(32.3)
1928	516,419	(61.1)	328,439	(38.9)
1929	820,431	(68.4)	379,027	(31.6)
1930	877,905	(65.3)	466,813	(34.7)
1931	823,764	(60.1)	545,962	(39.9)
1932	797,146	(62.3)	482,811	(37.7)
1933	791,953	(59.9)	529,844	(40.1)
1934	708,162	(54.9)	581,212	(45.1)
1935	752,777	(56.9)	569,464	(43.1)
1936	877,376	(63.3)	509,558	(36.7)
1937	1,118,616	(67.2)	546,471	(32.8)
1938	901,939	(73.0)	333,819	(27.0)
1939	871,943	(64.1)	487,943	(35.9)
1940	885,518	(58.5)	627,005	(41.5)
1941	894,909	(59.8)	602,725	(40.2)

Source: Shanghai (ed.), *Ying-Mei*, pp.512,733. Note: BAT sales include those of Wing Tai Vo; see Table 4 for breakdown between BAT and WTV from 1923 onwards.

TABLE 2: OUTPUT OF MANUFACTURED CIGARETTES BY BAT IN CHINA BY FACTORY LOCATION 1912-25; 1931-32; 1936-41 (50,000 cartons)

Year	Shang-hai	Hankow	Tien-tsin	Tsing-tao	Mukden	Hong Kong	Total
1912	57,700	38,480			6,520		102,700
1913	65,180	40,160			9,120		114,460
1914	56,360	15,400			5,860		77,620
1915	66,520	25,580			-		92,100
1916	75,220	34,040			-		109,260
1917	83,120	31,900			-		115,020
1918	122,820	28,600			2,300		153,720
1919	183,220	47,720			9,500		240,440
1920	188,800	55,120			23,400		267,320
1921	185,320	64,920			27,700		277,940
1922	183,040	62,420	23,720		38,700		307,880
1923	212,680	70,760	57,360		59,080		398,880
1924	285,460	116,020	99,720	2,000	54,440		557,640
1925	187,120	105,060	119,820	16,000	61,160		489,160
1931	252,011	114,779	131,653	98,698	58,132	5,808	661,081
1932	306,526	658	120,652	78,966	45,107	8,778	560,687
1936	329,503	144,560	123,769	95,120	191,424	11,380	895,756
1937	368,995	190,733	177,434	134,716	232,337	20,339	1,124,554
1938	229,887	150,425	140,060	87,397	214,323	36,431	858,523
1939	357,037	16,262	132,749	121,638	199,667	29,944	857,297
1940	344,932	37,131	143,742	118,695	185,700	38,965	869,165
1941	362,871	35,500	160,765	131,038	164,476	65,203	919,853

Source: As for Table 2, pp.1635-6, Table 4.

Note: Output figures do not include production at Lopato's factory in Harbin.

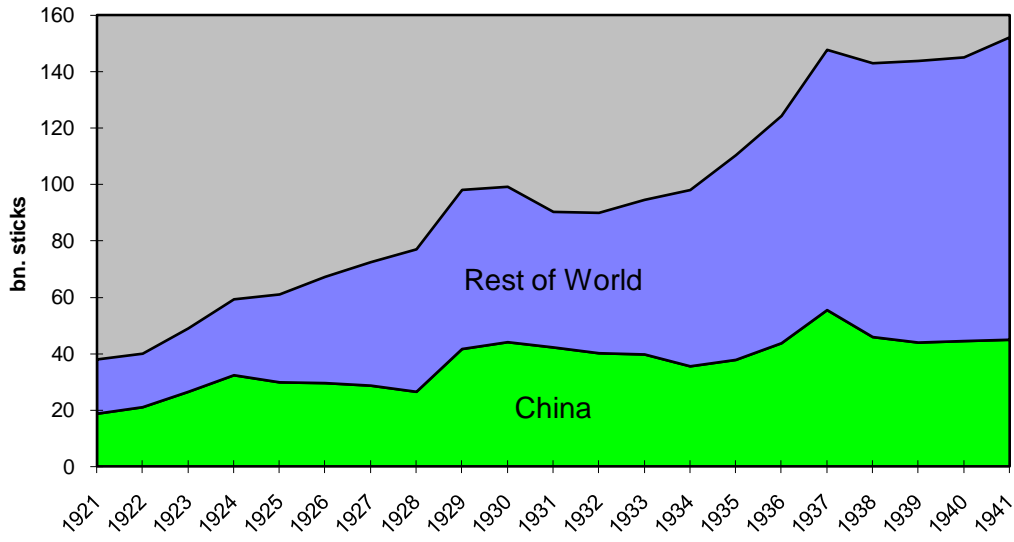
TABLE 3: BREAKDOWN OF CIGARETTE SALES IN CHINA BY REGION, 1931

Dept./ Division	BAT Brands			WTV Brands			Rival Brands		
	Sales (%)	Sales in Cartons	Mkt Sh.	Sales (%)	Sales in Cartons	Mkt Sh.	Sales (%)	Sales in Cartons	Mkt Sh.
Manchurian Dept	19.4	118,639	77%	0.5	1,052	1%	6.3	34,217	22%
Tientsin Dept									
<i>Frontier Div</i>	1.9	11,452	73%	1.3	2,854	18%	0.2	1,321	8%
<i>Northern Div</i>	6.1	37,029	62%	4.8	10,770	18%	2.2	12,094	20%
<i>Luhan Div</i>	9.0	54,969	74%	4.1	9,350	13%	1.7	9,519	13%
<i>Peking City</i>	2.4	14,954	59%	2.3	5,100	20%	0.9	5,088	20%
<i>Shantung Div</i>	13.9	84,908	64%	13.2	29,854	22%	3.4	18,659	14%
Hankow Dept									
<i>Honan Div</i>	5.0	30,329	60%	6.3	14,294	28%	1.1	5,783	11%
<i>Hupeh Div</i>	10.9	66,735	61%	11.8	26,515	24%	3.0	16,554	15%
<i>Hunan Div</i>	2.5	15,353	60%	0.5	1,121	4%	1.7	9,323	36%
<i>Kiangsi Div</i>	1.3	7,767	32%	2.2	4,998	20%	2.1	11,714	48%
<i>Szechuen Div</i>	1.5	9,424	57%	2.5	5,615	34%	0.3	1,418	9%
Shanghai Dept									
<i>Shanghai City</i>	1.4	8,591	7%	22.9	51,774	42%	11.5	62,591	51%
<i>Eastern Div</i>	8.4	51,216	25%	18.6	42,045	20%	21.2	115,617	55%
<i>Nanking Div</i>	9.6	58,652	31%	8.3	18,656	10%	20.5	112,038	59%
Hong Kong Dept									
<i>Hong Kong</i>	1.7	10,346	37%	0.0	0	0%	3.2	17,481	63%
<i>Canton City</i>	1.1	6,420	8%	0.0	0	0%	13.2	72,005	92%
<i>South China Div</i>	3.6	21,957	37%	0.0	23	0%	6.9	37,878	63%
<i>Yunnan Div</i>	0.4	2,288	39%	0.7	1,600	27%	0.4	1,959	34%
<i>Kwangsi Div*</i>	0.0	0	0%	0.0	0	0%	0.0	0	0%
TOTAL	100.0	611,029	44%	100.0	225,621	16%	100.0	545,259	39%

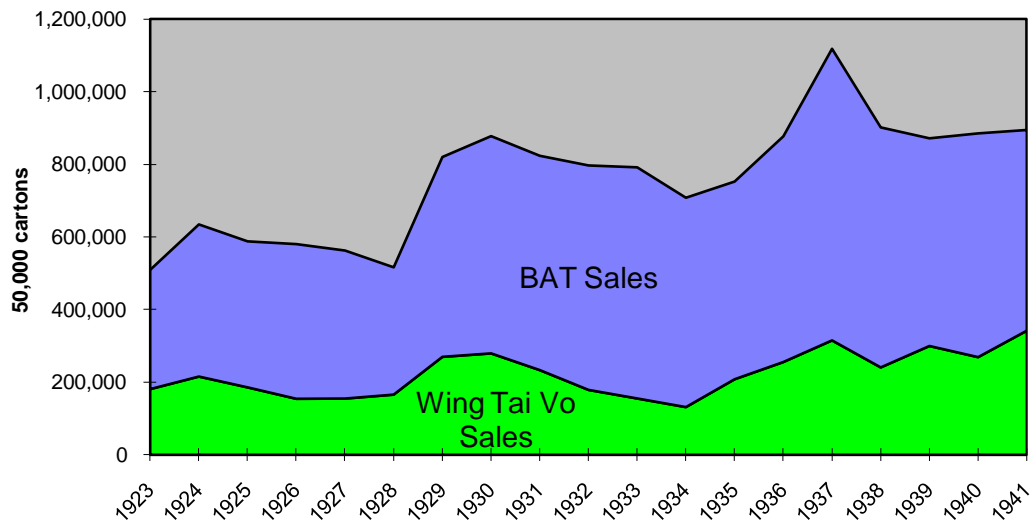
Source: Shanghai (ed.), *Ying-Mei*, pp.734-46.

\* Note: No separate sales figures are given for the Kwangsi Division of the Hong Kong Department until 1938. At that time BAT are credited with a 52 per cent market share, the remainder held by rivals.

Figure 1: BAT Co. Cigarette Sales (China v. Worldwide), 1921-41



**Figure 2: Sales of Manufactured Cigarettes in China (BAT v. Wing Tai Vo), 1923-41**



## NOTES

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<sup>1</sup> For a review of the early international growth of BAT Co. as a whole, see H. Cox, "Growth and Ownership in the International Tobacco Industry: BAT 1902-27", Business History, Vol.31, No.1 (1989), pp.44-67.

<sup>2</sup> S. Cochran, Big Business in China: Sino-Foreign Rivalry in the Cigarette Industry, 1890-1939, (Cambridge, MA, 1980); idem, "Economic Institutions in China's Inter-regional Trade: Tobacco Products and Cotton Textiles, 1850-1980", Conference on Spatial and Temporal Trends and Cycles in Chinese Economic History, 980-1980, Bellagio, Italy (1984); idem, "Commercial Penetration and Economic Imperialism in China: An American Cigarette Company's Entrance into the Market", in E.R. May and J.K. Fairbank (eds.) America's China Trade in Historical Perspective: the Chinese and American Performance, (Cambridge, MA, 1986), pp.151-203. Expanding on these findings has been possible due, in part, to the access granted by the company to various sources of information, most particularly at the company's library in Southampton. In addition, access has been gained to materials which the company was forced to abandon when they finally withdrew from China in the early 1950s. These papers are held at the Centre for Chinese Business History at the Shanghai Academy of Social Science; hereinafter referred to as BAT Archive (SASS). A four-volume account of BAT's activities in China based on these papers has been published in Chinese: Shanghai shehui kexueyuan jingji yangjiusuo [Economic Research Institute at the Shanghai Academy of Social Science] (ed.), Ying Mei Yan Gongsi zai Hua qiye ziliao huibian [Documents on the Enterprises of BAT in China], (Beijing, 1983); hereinafter referred to as Shanghai (ed.), Ying Mei.

<sup>3</sup> Cochran's main study of BAT in China, Big Business in China (see note 2 above), is concerned primarily with a detailed assessment of BAT's competition with their main Chinese rival cigarette manufacturer, the Nanyang Brothers Tobacco Co.

<sup>4</sup> The production machinery that BAT brought into their China factories was leading edge technology and their engineering workshop in Shanghai was a centre of excellence and innovation within the organisation. See for example, BAT Archive (SASS), Document Nos. 12-C-106 to 107. For the best attempt to assess the various aspects of BAT's performance in China see Cochran, "Commercial Penetration".

<sup>5</sup> Backward integration into the provision of support for farmers engaged in leaf production began to take shape after 1913 when agricultural support and advice was provided to encourage farmers in Shandong [Shantung] and Hubei [Hupeh] provinces to grow tobacco suitable for use in cigarettes. The difficulties involved in buying land in rural China, on which to build reception stations for the leaf for example, was overcome through the creation of the Hong An

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Real Estate Company, a Chinese-registered company under the nominal ownership of nine of BAT Co.'s Chinese agents.

<sup>6</sup> According to a Chinese source, BAT's reported profits from its China for the period 1902-41 amounted to approximately £50 million. However, it suggests that, taking into account such things as inflated raw material imports, excessively high salaries paid to the Western managers, unrealistically high depreciation, and the reserves retained as cash, the actual level of profit amounted to something more in the region of £82.5 million for the period. Shanghai (ed.) Ying Mei, p.1536. What is not in dispute is that BAT's operations in China provided a mainstay of the company's income, particularly after the first ten years. Duke himself is reported by the trade press in 1915 as stating that, "It has taken many years to build up our business in China. It is only now being put on a paying basis. We were willing to take a loss there for ten years because we saw great possibilities in the country." Tobacco, No. 410, (February 1915), p.37. Of course, his reported losses are likely to be partly designed to deter rival tobacco firms in the U.S.A., who had gained their independence following the dissolution of the American Tobacco Company a little over two years earlier, from emulating BAT's strategy in China.

<sup>7</sup> S.D. Chapman, "British-based Investment Groups before 1914", Economic History Review, 2nd Series, Vol.38, No.2, (1985), pp.230-51; idem, Merchant Enterprise in Britain: From the Industrial Revolution to World War I, (Cambridge, 1992); C. Jones, International Business in the Nineteenth Century: The Rise and Fall of a Cosmopolitan Bourgeoisie, (Brighton, 1987); M. Wilkins, "The Free-Standing Company, 1870-1914: An Important Type of British Foreign Direct Investment", Economic History Review, 2nd Series, Vol.41, No.2 (1988), pp.259-82.

<sup>8</sup> For a review of British business enterprises that operated in China during the nineteenth century see J. Osterhammel, "British Business in China, 1860s to 1950s" in R.P.T. Davenport-Hines and G. Jones (eds.) British Business in Asia since 1860, (Cambridge, 1989), pp.189-216. In the case of American firms, see M. Wilkins, "The Impacts of American Multinational Enterprise on American-Chinese Economic Relations, 1786-1949, in May and Fairbank, America's China Trade, pp.259-92.

<sup>9</sup> For a discussion of the extent to which British firms, including BAT Co., conducted business in China beyond the treaty ports, see J. Osterhammel, "Imperialism in Transition: British Business and the Chinese Authorities, 1931-37", China Quarterly, Vol.98, (June 1984), pp.260-86.

<sup>10</sup> B.W.E. Alford, W.D. & H.O. Wills and the Development of the U.K. Tobacco Industry, 1786-1965, (London, 1973), pp.139-57.

<sup>11</sup> The story of James Duke's creation of the American Tobacco combine has been recounted on numerous occasions, most recently by R. Kluger, Ashes to Ashes: America's Hundred-Year Cigarette War, the Public Health, and the Unabashed Triumph of Philip Morris, (New York, 1996), pp.20-6. Other academic accounts are P.G. Porter, "Origins of the American Tobacco Co.", Business History Review, Vol.43, No.1 (1969), pp.59-76, and R.F. Durden, The Duke's of Durham, 1865-1929, (Durham, NC, 1975), pp. 26-55.

<sup>12</sup> On the strategies employed by Duke's firm see P.G. Porter, "Advertising in the Early Cigarette Industry: W. Duke, Sons & Company of Durham", The North Carolina Historical Review, Vol. 48, No.1 (1971), pp.31-43; on Wills see B.W.E. Alford, "Penny Cigarettes, Oligopoly, and Entrepreneurship in the U.K. Tobacco Industry in the Late Nineteenth Century", in B. Supple (ed.) Essays in British Business History, (Oxford, 1977), pp.49-68.

<sup>13</sup> By 1900, ATC's London depot was actually beginning to incur losses for the American firm. See Bureau of Corporations, Report of the Commissioner of Corporations on the Tobacco Industry, Part I, (Washington, 1909), p.166.

<sup>14</sup> M. Corina, Trust in Tobacco: the Anglo-American Struggle for Power, (London, 1975), pp.65-108.

<sup>15</sup> A number of American firms had developed a significant export trade in hand-rolled cigarettes from the beginning of the 1880s. Duke's company followed these pioneers a little later and a contemporary report in the tobacco trade press indicated that in 1886 Duke's firm already claimed to possess a large trade for their still mainly hand-rolled cigarettes in China. Tobacco, Vol. 6, No.67 (July 1886), p.156.

<sup>16</sup> The origins of Mustard & Co. can be dated back to at least the early 1870s. An obituary of Mr Yao Ching Yung in the BAT house journal in 1925 indicates that the deceased had been hired by Mustard and Co. in 1871 as assistant storekeeper and, as a result of his longevity, had become something of a celebrity within the BAT organisation. BAT Bulletin, Vol.17, No.73 (1926), p.95.

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<sup>17</sup> Ying Mei Yien Kung Ssu Yueh Pao [British American Tobacco Co. Monthly Journal] (Sept. 1923), p.2. The Yueh Pao, was BAT Co.'s House Journal in China. The edition of September 1923 was a special commemoration number produced to celebrate the twenty-first anniversary of BAT's formation. The publication gives synoptic outlines of many of BAT's Chinese dealers, as well as the most important "foreigners", i.e. Westerners, employed by BAT in China.

<sup>18</sup> According to the Yueh Pao account, Pin Head were the first machine-made cigarettes to be sold in Shanghai. Pin Head were the first cigarettes to be manufactured mechanically by Duke's company, in 1885, but the brand did not become very popular in the United States; see B.W.C. Roberts and R.F. Knapp, "Paving the Way for the Tobacco Trust: From Hand Rolling to Mechanized Cigarette Production by W. Duke, Sons and Company", The North Carolina Historical Review, Vol.69, No.3 (1992), pp.256-81.

<sup>19</sup> For a brief summary of Wright's career see W.S. Powell (ed) Dictionary of North Carolina Biography, Vol.6, (Chapel Hill, NC,1996), p.279. His relationship with the Dukes is discussed in Durden, Duke's of Durham, pp.19, 28-35, 39-43 and passim.

<sup>20</sup> According to the account in the BAT house journal, Andersen had been the first to manufacture cigarettes in Shanghai using a plant that was driven by a small gas engine. BAT Bulletin, Vol.17, No.73 (1926), pp.30-1.

<sup>21</sup> A brief obituary of E. Jenner Hogg indicates that he had settled in Shanghai in 1857 at the age of 20 and lived there continuously until his death in 1920 at age 83. It does not mention his involvement with the American Cigarette Co. See F.L. Hawks Pott, A Short History of Shanghai, (Shanghai, 1928), pp.246-7. See also E.O. Hauser, Shanghai, City for Sale", New York, 1940, pp.99-100.

<sup>22</sup> BAT's own account of the development of the China market indicates that the American Cigarette Co. had also used the Mustard agency to market its products. BAT Archive (SASS), Documents 2-C-39 and 2-C-58.

<sup>23</sup> Letter from R.H. Wright to the American Trading Company, Shanghai, 5 December 1898, in the Richard H. Wright Papers, Special Collections Department, William R. Perkins Library, Duke University (hereinafter Wright Papers).

<sup>24</sup> In response to a letter from Collins complaining that the cigarettes produced on the machines were developing a yellow stain, Wright wrote to suggest that either the company was using an inferior glycerine, accusing the firm of changing to different suppliers in order to save money, or that they were incorrectly processing the tobacco and not taking into account the affect of the local climatic conditions. See letter dated 2 January 1899 from Wright to the American Trading Company, Shanghai, Wright Papers. The American Trading Company seems to have played an important role as intermediary for U.S. tobacco firms in the Far East generally.

<sup>25</sup> Wright to the American Trading Company, Shanghai, 5 December 1898, Wright Papers.

<sup>26</sup> The BAT house journal states that the factory in Pudong was "not a success, and was shut for some time prior to Messrs W.D. & H.O. Wills acquiring same in 1901." BAT Bulletin, Vol.17, No.73 (1926), p.31. In fact, Wills did not acquire the factory until 1902. The agreement for the sale of the premises to Wills includes provision for various supplies on order, suggesting that it was certainly in operation at that time. BAT Archive (SASS), Document 13-C-177.

<sup>27</sup> Cited in Alford, W.D. & H.O. Wills, pp.218-9.

<sup>28</sup> The transliteration of this firm's name using the conventional pinyin system is Yong Tai He. However, in order to maintain consistency with archival references, the old transliteration of the Cantonese name is utilised in the text.

<sup>29</sup> The Wing Tai Vo warehouse in Shanghai had been set up to import and distribute cigars from the Philippines. Chen Ren Jie, "Ying Mei yan gong si mai ban Zhen Bo Zhao" [The Comprador of the BAT Co.: Zheng Bo Zhao], Wenshi ziliao xuanji [Selection of material relating to culture and history] Zhong guo renmin zhengzhi xieshang huiyi (ed.) [Consultative Political Conference of the Chinese People] (Shanghai, 1978), pp.157-77; BAT Archive (SASS), Document 13-C-188.

<sup>30</sup> BAT Archive (SASS), Documents 13-C-176 to 178.

<sup>31</sup> H. Roberts to C.E. Roach, 14 May 1902; Agreement between E. Jenner Hogg and H. Roberts dated 14 May 1902; Rex & Co. to J.S. Fearon, 9 July 1902; J. Taylor (Inspectorate General of Customs, Shanghai) to A. Rex, 10 July 1902; Notice of Extraordinary General Meeting of the American Cigarette Co., posted by C.E. Roach by Order of the Board, dated 11 July 1902; Rex to Fearon, 11 July 1902; Fearon to Rex, 11 July 1902. BAT Archive (SASS), Documents 13-



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C-174 to 181. The American Cigarette Co. was formally transferred to Wills on 13 August 1902. BAT Archive (SASS), Document 2-C-58.

<sup>32</sup> Wright, as a shareholder in the American Cigarette Co., is likely to have been very supportive of the decision to sell the Bonsack patent to Wills rather than his old rival Duke. Wright had already engaged in discussions with the Wills company in 1898, when it appeared that Duke's firm might invade the British market. See Wright to Hugo Cunliffe-Owen, London, 3 December 1898, Wright Papers.

<sup>33</sup> Companies Registration Office, Document No. 74974/14, Agreement between the Imperial Tobacco Company and others dated 27 September 1902.

<sup>34</sup> For the purposes of the Agreement, the term "United States" was taken to include Cuba, Puerto Rico, the Hawaiian Islands and the Philippine Islands.

<sup>35</sup> It should be noted also that Hugo Cunliffe-Owen, BAT Co.'s Secretary, worked in both London and New York and thus provided an important link between the two groupings of directors before the First World War.

<sup>36</sup> Although Cochran suggests that BAT Co. inherited Mustard & Co.'s old factory, as well as the American Cigarette Co.'s Pudong plant, the company's own Chinese in-house magazine indicates that during the company's first five years in Shanghai its actual operations there consisted only of "a small factory at Pootung employing a few hundred Chinese." Cochran, Big Business, p.14; Yeuh Pao, p.18. On Keily see idem, p.8.

<sup>37</sup> BAT Archive (SASS), Document 3-A-5.

<sup>38</sup> Yeuh Pao, p.100.

<sup>39</sup> It is clear from the writings of James Thomas that Duke continued to take a close interest in BAT's development in China even after handing over control to Harris. See J.A. Thomas, A Pioneer Tobacco Merchant in the Orient, (Durham, NC, 1928), pp.38-63.

<sup>40</sup> BAT Archive (SASS), Documents 2-E-56 to 59.

<sup>41</sup> H. Cunliffe-Owen to Rex & Co., 21 June 1904; A. Rex to H. Cunliffe-Owen, 22 June 1904; Mustard & Co. to A. Rex, 23 June 1904; A. Rex to Mustard & Co., 23 June 1904; Cunliffe-Owen to Rex, 28 June 1904; Cunliffe-Owen to BAT Co., London, 28 June 1904. BAT Archive (SASS), Documents 13-C-182 to 195.

<sup>42</sup> This was formally agreed on 28 June 1905, less than one month after Thomas' arrival in Shanghai. BAT Archive (SASS), Document 2-C-59; Yeuh Pao, p.10.

<sup>43</sup> The other five were Fu He, Qian Kun He, Ye De Xing, Yong Shen Chang and Shun Xia Yuan. See Chen Ren Jie, "Ying Mei", p.157.

<sup>44</sup> Cochran mentions the work of the Shanghai Tobacco Guild in various places, cf. Cochran, Big Business, pp.29-33; idem, "Commercial Penetration", p.171. See also idem, "Economic Institutions", p.10.

<sup>45</sup> M.-C. Bergère, The Golden Age of the Chinese Bourgeoisie, 1911-1937, (Cambridge, 1989), pp.50-1, notes that the campaign of May 1905 was the first occasion in which boycotting had been used for explicitly political purposes and that it spread to all the merchant communities of the treaty ports.

<sup>46</sup> Chen Ren Jie, "Ying Mei", p.157; Cochran, Big Business, pp.45-53, notes that around twenty new Chinese-owned cigarette companies were formed during this time, but that few survived much beyond the duration of the boycott. For an example of such a rival concern, the Pei-yang Tobacco Company, see W.K.K. Chan, Merchants, Mandarins, and Modern Enterprise in Late Ch'ing China, (Cambridge, MA, 1987), pp.104-6.

<sup>47</sup> The factory built by the American Cigarette Co. before 1895 was therefore strictly illegal under the terms of the treaty port agreements. It may be for this reason that the factory was constructed outside of the treaty port territory of Shanghai, on the east bank of the Huang Pu river in Pudong.

<sup>48</sup> It is clear that the question of stepping up local production in China was raised with Duke by Harris when he visited Shanghai in 1904. Duke cabled to him, "If cigarettes can be made properly and more cheaply in China they should be

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made there.” Coded telegram, J.B. Duke to Harris, dated 17 April 1904, papers of James B. Duke, Special Collections Department, William R. Perkins Library, Duke University (hereinafter J.B. Duke Business Papers).

<sup>49</sup> J.K. Winkler, Tobacco Tycoon: The Story of James Buchanan Duke, (New York, 1942), pp.150-2. Thomas had first gone abroad in 1888 whilst working for the tobacco firm of Motley & Wright. On Thomas' early travels see his own account, J.A. Thomas, Trailing Trade a Million Miles, (Durham, NC, 1931). Between 1897 and 1899 Thomas worked in the Far East, including China, for the Liggett & Myers Co. When ATC bought out Liggett & Myers, in 1899, Thomas worked for Duke's firm in India, Singapore and the Straits Settlements before the move to China, see Thomas, Pioneer Tobacco Merchant, pp.23-4.

<sup>50</sup> BAT Archive (SASS), Document Nos. 2-G-1 to 13.

<sup>51</sup> This process of expanding local production in China was disrupted by the outbreak of the war in Europe, when the traffic in machines to the new overseas factories was brought to a halt. L.A. Batchelor-Smith, Loom of Memories: A History of Southampton Branch of British-American Tobacco Co., Ltd., (Southampton, 1969), pp.6-7.

<sup>52</sup> Cochran, Big Business, p.15. By 1923, these specialised departments at the Shanghai headquarters comprised Sales, Manufacturing, Leaf, Printing, Engineering, Supply, Accounting, Advertising, Traffic, Insurance, Legal and Order Departments. Yeuh Pao, pp.30-6.

<sup>53</sup> G. Porter and H.C. Livesay, Merchants and Manufacturers: Studies in the Changing Structure of Nineteenth Century Marketing, (Baltimore, 1971), p.205.

<sup>54</sup> A good example is the career of Yuan Yu Shu who was first employed by BAT as an interpreter in 1908. He was appointed as a District manager in 1916, an assistant Territory manager in 1917 and was appointed Territory manager for Tsingkiangpu [Zhenjiang] in Kiangsu [Jiangsu] Province in 1920. Yueh Pao, p.95.

<sup>55</sup> Thomas, Pioneer Tobacco Merchant, pp.85-6.

<sup>56</sup> According to Thomas, "We paid a bonus of \$1,000 to every American who learned to speak commercial Chinese in four years, and we held examinations every six months to check up on progress. Three out of five of the men that we brought out to China learned to speak fluent Chinese, and four out of every five held their jobs..." J.A. Thomas, "Selling and Civilization: Some Principles of an Open Sesame to Big Business Success in the East", Asia, Vol.23, No.12 (1923), pp.896-9 and 948-50 (quotation from p.949).

<sup>57</sup> J.L. Hutchison, China Hand, (Boston, 1936), pp.53, 101-2, 153-5, 171, 177.

<sup>58</sup> Similar tours of Chinese towns are described by another early BAT recruit from North Carolina, Lee Parker, who began his first tour of duty in Manchuria in 1909. L. Parker and R.D. Jones, China and the Golden Weed, (North Carolina, 1976), pp.20-6.

<sup>59</sup> According to Thomas' own recollections, "This form [163] was made out in Singapore in 1899 by myself, in pencil, and sent to New York Office to Mr. W.R. Harris, who instantly saw the usefulness of it and had a form printed, which is still in use with the necessary changes made to keep it up to date or in other words adapting the form to local conditions." Letter Thomas to C.S. Wolsiffer, Shanghai, 22 April 1923, papers of James Augustus Thomas, Special Collections Department, William R. Perkins Library, Duke University (hereinafter Thomas Papers). An example of a completed Form 163, returned from the Luhan Division by Mr W.T. Smith in November 1918, is given in Shanghai (ed.), Ying Mei, p.544.

<sup>60</sup> J.W. Jenkins, James B. Duke: Master Builder, (New York, 1927), pp.168-9.

<sup>61</sup> When visiting a town in China for the first time, Thomas' "first move was to make a study of the currency and to find the coin of low denomination generally current. Then I could give a man a good smoke for a price that would not necessitate the clumsy making of change." See Thomas, "Selling and Civilization", p.897.

<sup>62</sup> For a detailed analysis of the traditional trading networks that operated within China, see G.W. Skinner, "Marketing and Social Structure in Rural China", Journal of Asian Studies, Vol.24, No.1 (1964), pp.3-43.

<sup>63</sup> A history of the Chinese company states; "The original method of distribution from depots established by the Company in various parts of China, to which cigarettes were transported and from which they were distributed to purchasers was not affected by the arrangement with firms known as "distributors" [i.e. independent wholesalers] since

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in all cases, whether the distribution was handled by distributors or by the Company's branches and sub-branches direct, the property of the goods remained in the Company until sales to dealers were effected." History of YTTC, BAT Archive (SASS), Document Nos. 13-D-1 to 2. YTTC [Yee Tsoong Tobacco Co.] was an identity adopted by BAT Co. in China after 1934.

<sup>64</sup> Chen Ren Jie, "Ying Mei", p.159.

<sup>65</sup> The system operated by BAT is described in detail in an internal "Memorandum on Consignment Delivery System" in the BAT Archive (SASS), Document Nos. 13-D-21 to 25. The system of 15A godowns was also applied to South East Asia and India. See C. Basu, Challenge and Change: The ITC Story, 1910-1985, (Calcutta, 1988), pp.151-2.

<sup>66</sup> Letter Joseph Hood to J.B. Duke dated 11 April 1912, J.B. Duke Business Papers.

<sup>67</sup> Chen Ren Jie, "Ying Mei" pp.157-8.

<sup>68</sup> On Wu's relationship with BAT, see an account written by his son, Wu Sing Pang, in BAT News, (Spring 1988), pp.10-13. See also Cochran, "Economic Institutions", pp.170-1.

<sup>69</sup> Cochran, Big Business, pp.28-9, 46.

<sup>70</sup> BAT Archive (SASS), Document No. 2-E-77.

<sup>71</sup> Chen Ren Jie, "Ying Mei", p.159; summary of legal agreements undertaken by BAT Co. in China, 1902-1924, BAT Archive (SASS), Document Nos. 3-A-5 to 8.

<sup>72</sup> The title of the company was changed the following year to the Union Commercial Company.

<sup>73</sup> This statement is taken from a note prepared by R.J.E. Price, a BAT executive in China, written in 1936. See BAT Archive (SASS), Document No. 2-C-60.

<sup>74</sup> In February 1916, Thomas cabled Wu from the company's New York office, offering his congratulation for selling 446 cases of "Purple Mountain" the previous month. A few days later, he wrote to Cobbs, his successor in Shanghai, "The feeling here is that we should push "New York" cigarettes and enthuse Wu Ting Seng and his people to push "Purple Mountain" all they can now that this brand is made in Pootung." Thomas to Wu Ting Seng, Shanghai, 4 February 1916 and Thomas to T.F. Cobbs, Shanghai, 10 February 1916, Thomas Papers.

<sup>75</sup> Chen Ren Jie, "Ying Mei", p.159.

<sup>76</sup> During 1914, Wu had been used by BAT's management to engage in discussion with Nanyang on the possibility of a merger. Later, in 1917, soon after Nanyang had begun to build a factory in Shanghai and shift their operational base from Guangzhou [Canton], Thomas initiated another unsuccessful attempt to buy out the Nanyang concern in which Wu was again involved. See Cochran, Big Business, pp.28, 84-96, 157-63.

<sup>77</sup> Yueh Pao, pp.30, 121.

<sup>78</sup> The firm granted the right to manufacture and distribute the products of the Japanese Government Tobacco Monopoly in China was the Toa Tabako Kabushiki Kaisha, which seems to have been registered as the East Asia Tobacco Co. Ltd. See Rea's Far Eastern Manual, (2nd Edition), (Shanghai, 1924), p.316.

<sup>79</sup> The Alliance Tobacco Co. was registered in Shanghai on 28 April 1919 and the majority of the shares were taken up by the British Cigarette Co. BAT Archive (SASS), Document Nos. 2-C-169 to 170. Lopato's role as Chairman is corroborated by a report on the tobacco industry in China given by Rea's Manual, (see preceding note) p.315.

<sup>80</sup> An item on the Alliance Tobacco Co. in the BAT House Journal, under the sub-heading "Associated Companies", states that, "The Alliance Tobacco Company of China Ltd. has its Head Office at Moukden [Shenyang] and is controlled by a Board of Directors there who are entirely independent of the B.A.T... [This] will help the Reader to understand why it is that sometimes he finds the Alliance Company doing things differently to the way in which the B.A.T. does them, and why it is that their policy sometimes appears to be directly in opposition. Please remember that competition is a good thing for us all...", Yueh Pao, p.30. In fact, the degree of independence of the Board of Directors seems to have been rather more limited than this account gives credit. Certainly a plan adopted by Lopato to franchise

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brands to a local Chinese dealer on an exclusive basis met with Thomas' opposition in 1919. See letter Millard, Shanghai, to Thomas dated 13 October 1919, Thomas Papers.

<sup>81</sup> The problem arose due to depreciation of the local copper currency in North China which forced BAT to raise the price of their cigarettes from five to six coppers to retain their profit margin. The Russian manufacturers, on the other hand, were able to maintain the price of their similar quality cigarettes at the lower value, presumably because its prices were a function of the Rouble exchange rate which had been less badly affected.<sup>81</sup> The products of the Alliance company flooded into the markets of northern China and, because they passed through different channels to those used by BAT, many of the latter firm's dealers found their sales collapsing. BAT therefore reached an agreement with the directors of Alliance whereby the Anglo-American concern would take over the marketing of all the Alliance Company's brands outside of Manchuria. Minutes of Meeting of Board of Directors of Alliance Tobacco Co. of China, Ltd., 20 September 1922, BAT Archive (SASS), Document Nos. 13-C-51 to 54.

<sup>82</sup> The proportion of BAT's exports to China from the companies factories in Britain had steadily grown during the company's first decade in operation, possibly because of the convenience of the bonded factories which British legislation made available. In 1913, a new factory came into operation in Liverpool which began production of Chinese brands such as "Ruby Queen" and "Pirate". J. Jones, Cigarettes - Liverpool 5; the story of the Liverpool Branch of British-American Tobacco Company Ltd., (Liverpool, n.d.), p.11.

<sup>83</sup> In December 1920, following a number of requests by the company for him to return to his post in London, Thomas was formally requested by Hugo Cunliffe-Owen to resign from the BAT Co. Board. See correspondence A.G. Jeffress, London, to Thomas dated 23 June 1920, Thomas to H. Cunliffe-Owen, London, 3 November 1920, Thomas Papers. On Thomas' work for the bank, see N.H. Pugach, "Keeping an Idea Alive: the Establishment of a Sino-American Bank, 1910-1920", Business History Review, Vol.56, No.2 (1982), pp.265-93.

<sup>84</sup> BAT Archive (SASS), Document No. 2-E-32.

<sup>85</sup> Agreement between Mr Cheang Park Chew [Zheng Bo Zhao] and BAT Co. (China) Ltd., dated 16 May 1919, Thomas Papers.

<sup>86</sup> Letter H.C. Tan, BAT Co. (China), Shanghai, to Thomas dated 10 June 1920, Thomas Papers.

<sup>87</sup> Letter Thomas to A.G. Jeffress, London, dated 24 August 1920, Thomas Papers.

<sup>88</sup> On Wing Tai Vo's competition with Liggett and Myers, see Chen Ren Jie, "Ying Mei", p.158. Liggett and Myers had been acquired by ATC in 1899, during the so-called "Plug War", but had become an independent entity again following the dissolution in 1911. On Liggett and Myers' role in the plug war, see M.R. Burns "Outside Intervention in Monopolistic Price Warfare: the case of the "Plug War" and the Union Tobacco Company", Business History Review, Vol.56, No.1 (1982), pp.33-53. BAT bought out Liggett and Myers interests in China in 1927. See BAT Archive (SASS), Document Nos. 2-E-71 to 73.

<sup>89</sup> The regional links which were so important to the success of Wing Tai Vo were a characteristic feature of the capitalist bourgeoisie that had emerged in Republican China at that time. These groups, including Zheng Bo Zhao are discussed by Bergère, Golden Age, Chapter 4, espec. pp.141-52.

<sup>90</sup> Chen Ren Jie, "Ying Mei", pp.160-1.

<sup>91</sup> The cigarettes in question were Wills' "Pirate", brand. Letter C.W. Pettitt, BAT Co.'s China Department, London, to Thomas dated 5 October 1920, Thomas Papers.

<sup>92</sup> BAT Archive (SASS), Document Nos. 2-E-32 to 43.

<sup>93</sup> Wills and ATC were not the only cigarette manufacturers who attempted to develop a market for their products in China before 1900. The American firm of Cameron and Cameron, part of long-established group of family firms, began to export cigarettes to China in 1898 using the agency of Messrs. Sylva & Co. who, like Rex & Co., had established a link with Wing Tai Vo. This initiative seems to have foundered following the death of the senior partner of Sylva & Co. the following year. See letters Cameron & Cameron to Messrs H. Sylva & Co., Shanghai, dated 20 October 1898 and 24 October 1899, and to Alfred I. Hart dated 18 November 1899 in the papers of the British-American Tobacco Co., Ltd., Petersburg, Virginia, Special Collections Department, William R. Perkins Library, Duke University.

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<sup>94</sup> Osterhammel remarks that of the 400 or so British firms which operated in the treaty ports, no more than a handful extended their activities beyond Shanghai and Hong Kong. Osterhammel, "British Business in China", p.192.

<sup>95</sup> For an assessment of these trading networks see G.G. Hamilton, "The Organisational Foundations of Western and Chinese Commerce: an Historical and Comparative Analysis", in G.G. Hamilton (ed.) Business Networks and Economic Development in East and South East Asia, (Hong Kong, 1991), pp.48-65.

<sup>96</sup> On returning to China in 1929, James Hutchison had noted that, "The foreign sales staff was less than half of what it was fifteen years ago and, I soon learned, the men had practically given up travelling. Most of their work now consisted of checking, reading and writing reports and letters. The Chinese staff, mostly clerks, had increased ten times over." Hutchison, China Hand, p.281.

<sup>97</sup> Cochran, "Commercial Penetration", pp.172-6.

<sup>98</sup> In his testimony to the Circuit Court in the case of United States v. American Tobacco Co. et al, 25 February 1908, Duke stated that "...one of the mistakes the ATC made in the beginning [was] that we didn't keep up a separate organisation for all the principal businesses we bought...we would have got better service and better management; we would have had competition and would have built and extended the business. Q. You mean competition between those various branches of the ATC? A. Yes, sir." J.B. Duke Business Papers.

<sup>99</sup> This westernisation included Zheng Bo Zhao's use of BAT as a supplement to his own patriarchal authority to maintain control of his network of dealers. Chen Ren Jie, "Ying Mei", pp.163-4.