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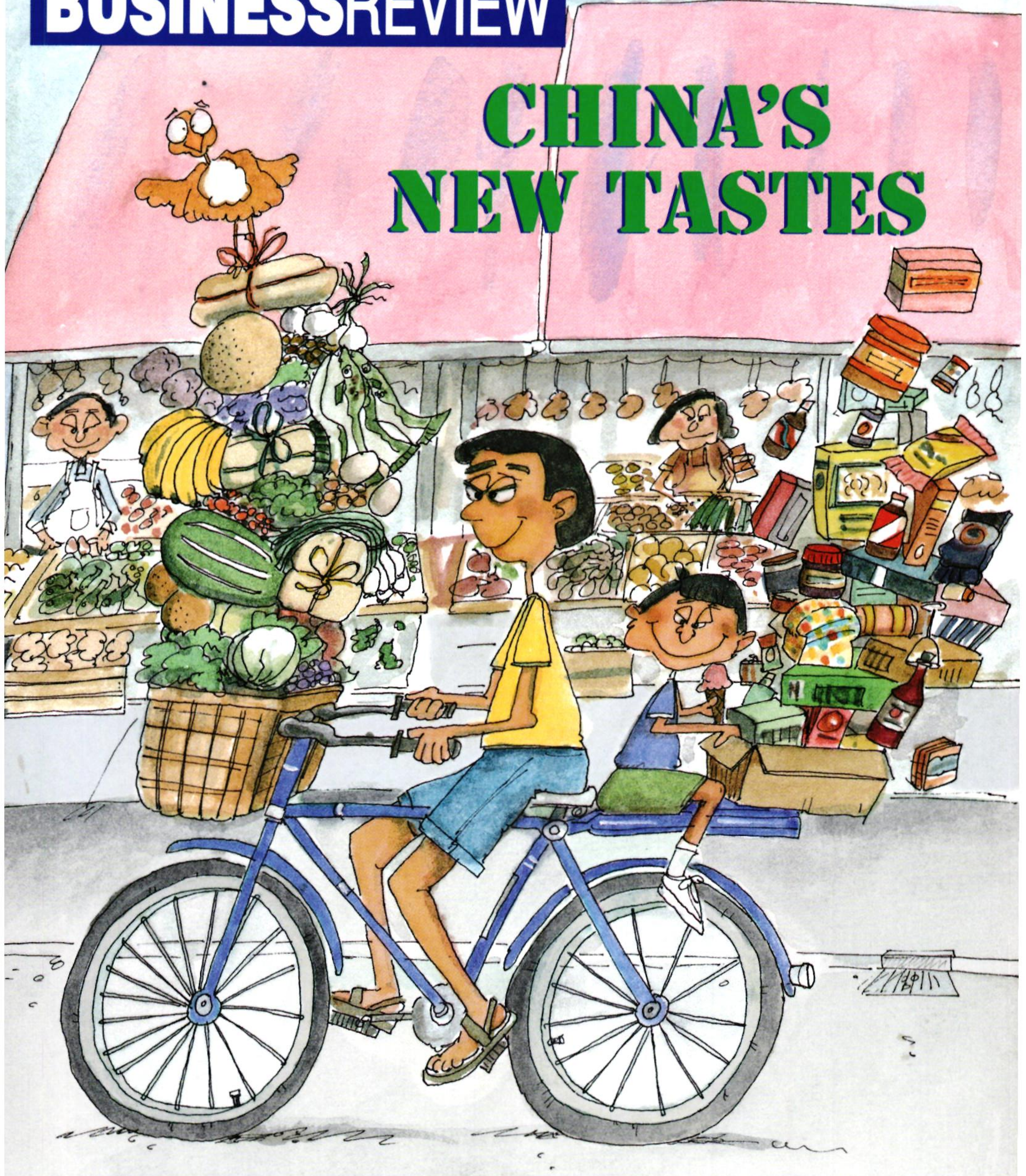
CHINA'S NEW TASTES



FOOD BRANDS IN CHINA

An analysis of China's food market by region, product and brand

SEYMOUR·COOKE
FOOD RESEARCH INTERNATIONAL

Key Features of the Report

- An analysis of over 1,000 leading food brands including market size, market shares, and price comparisons
- The brands apply to 34 food categories and are analysed both nationally and by region
- Competitive analysis is given for all processed food sectors including the positioning of international versus local brands, and of imported versus domestically produced brands
- Research supported by retail surveys across China's six regional centres
- Profiles of China's largest food groups, plus unique data on foreign activity in the food industry

The Authors of 'Food Brands in China'

Xiaohong Wu is Seymour Cooke's research manager for China. The senior consultant was Zhilin Gan, President of the Chinese Association for Food Science and Technology. Miki Ito provided a perspective on China from Japan.

TABLE OF CONTENTS - 330 PAGES, 8 CHAPTERS

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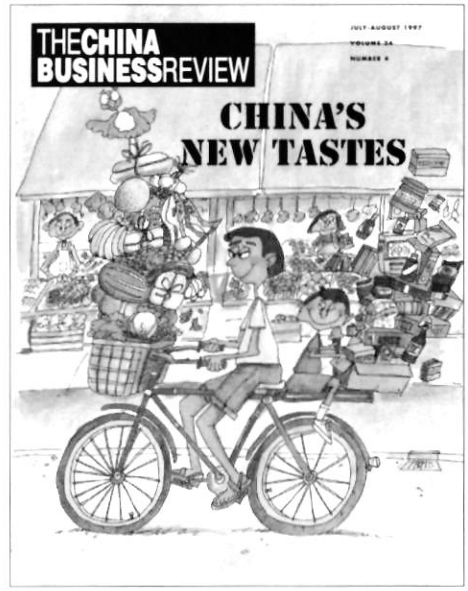
1997 JULY AUGUST



Cover illustration by Jim Paterson

CONTENTS

美中商贸评论

Making a Difference

Heart to Heart International, sponsor of 16 international airlifts, broke new ground in April when the organization joined hands with Federal Express Corp. (FedEx) to launch a multimillion-dollar medical airlift to southwestern China. After 10 months of working with PRC government officials to obtain approval for the project, on April 14 Heart to Heart proudly watched a FedEx DC-10, loaded with 36 tons of pharmaceuticals and medical supplies valued at more than $6 million, land in Chengdu, Sichuan Province. A delegation of medical professionals, volunteers, corporate sponsors, and Heart to Heart staff members were on hand in Chengdu to distribute the donated medicines and supplies and to provide training and updated pharmaceutical information to area hospitals and health care institutions.

The airlift was aimed at alleviating some of the suffering in China's poorer western provinces, which have failed to reach the levels of prosperity found in China's coastal areas, said Heart to Heart Chairman Gary Morsch. The airlift targeted facilities in or near Chengdu, the provincial capital. Four area hospitals—Sichuan Provincial People's Hospital, Number One People's Hospital of Zigong Municipality, Guangan District People's Hospital, and Central Hospital of Nanchong Municipality—received most of the supplies. Michael L. Ducker, senior vice president for FedEx's Asia Pacific division, called the airlift "a tangible gesture of friendship to the people of China as the doors of trade open wider with other members of the global community."

In addition to FedEx, a number of Council member firms either participated in or sponsored Heart to Heart's China mission, including Black & Veatch, Chrysler Corp., The Coastal Corp., Eli Lilly and Co., FMC Corp., General Electric Co., General Motors Corp., Holiday Inn Worldwide, McDonnell Douglas Corp., New York Life Worldwide Holding, Inc., and Praxair, Inc. Pamela Baldinger, director of the US-China Business Council's Hong Kong office, also participated in the airlift.

Based in Olathe, Kansas, Heart to Heart was founded in 1992 to provide worldwide medical relief to regions sorely in need of assistance. The airlift to China raised the organization's total global medical aid distributions to over $100 million. Heart to Heart is also considering a second airlift to China in the spring of 1998 focusing on Chongqing municipality.

—Ann M. Weeks

China's Capital Inflows to Ease

A number of economic institutions are predicting that China's capital inflows will see slower growth in the future. According to the World Bank's *Global Development Finance Report* released in June 1997, the pace of foreign direct investment (FDI) in China is expected to slow soon. Sharp declines in capital round-tripping—Chinese investment channeled through a third country (principally Hong Kong) for re-investment in the mainland as foreign capital—is cited as a primary reason for the slowdown. Concerned that significant amounts of PRC capital were re-entering China in this manner, Beijing clamped down on illegal capital outflows, while also tightening up the approval process for new foreign-invested enterprises (FIEs).

At the same time, Beijing is phasing out many FIE tax incentives (*see The CBR*, May-June 1997, p.10). While the changes should help discourage investment round-tripping, they could prompt foreign investors to seek more favorable investment conditions elsewhere in the world. Nevertheless, the World Bank believes that China's FDI inflows could surge as investors hurry to take advantage of incentives before they expire.

Though China's capital inflows are slowing, capital outflows are on the rise. According to *Global Development Finance*, China is one of a number of developing countries that is generating substantial capital outflows partially in response to a search for raw materials and the increasing international competitiveness of domestic firms. As PRC firms become globally competitive, many are establishing overseas operations, and taking Chinese capital with them.

Findings related to the sustainability of China's dynamic FDI inflows were reported in the United Nations' *World Investment Report 1996* and appear to support the World Bank's prediction, though UN analysts emphasize that China will remain one of the world's top FDI destinations. The UN report concludes that despite the slower capital inflows, China's solid economic growth and the diversification of FDI source countries will ensure that China remains a leading destination for foreign investment.

—Ann M. Weeks

Short TAKES

SAR Passport

Hong Kong residents traveling to the United States can breathe a sigh of relief. The US State Department recently announced that the new Hong Kong Special Administrative Region (SAR) travel document meets the US Immigration and Nationality Act's definition of a passport. State Department approval of the SAR passport means that the United States will continue the current practice of issuing maximum validity visas (10 years for multiple entries for temporary business/tourism visits) to all eligible holders of the SAR passport, provided that Hong Kong maintains its present visa and entry terms for US citizens.

Handover Coin Set

The Shanghai Mint of China has developed a limited edition, commemorative silver and gold coin set honoring the July 1, 1997, reunification of Hong Kong and mainland China. Among the available coin designs are the Hong Kong skyline, the logo of the People's Liberation Army, and scenes of the handover ceremony. A set with one gold coin and three silver coins retails for HK$2,580 ($333.34).

Letter from the Editor

As we wrap up this issue, Hong Kong is on the eve of its return to Chinese sovereignty, while the US Congress stands ready to decide the fate of normal US-China trade relations—once again (*see* p.6). Rest assured that we'll be tracking the full implications of the Hong Kong reversion in upcoming issues, with the goal of covering any political, legal, or financial changes likely to have an impact on foreign firms with Hong Kong operations.

In this issue, we tackle a topic of great interest to all of our readers: what drives Chinese consumer purchases. In our focus on China's changing food tastes, we investigate the development of national food brands in the PRC, taking special note of the types of foods where foreign firms have had phenomenal success building a market for their products. We also look at a number of changes afoot in China, including new demands on the country's cold storage chain, the advertising imagery that's likely to help sell products in the PRC in the 1990s, and a different way to categorize—and quantify—the Chinese consumer. Finally, for those who'd like to wash all this down with a good Cabernet, we offer a taste of the small but growing wine industry in China.

On a personal note, it is with regret that I announce some transitions within our own staff here at *The CBR*. After seven years at the magazine, I'll be heading home this week to await the arrival of my second child, a brother or sister to young David. I leave the magazine in the very capable hands of Kirsten Sylvester, who I know will welcome your comments and article ideas. I thank all of our readers for the many suggestions I've received over the years, and look forward to seeing *The China Business Review* sail into its 25th year of providing the reliable, accurate business analysis you've come to rely on for your China work.

Best regards, and 再見,

Vanessa Lide Whitcomb

Vanessa Lide Whitcomb

Gearing Up for Summer with New Internet Sites

Those seeking timely information on China-related topics will find many new Internet sites this summer.

http://www.hk97.com—*The Corner City Guide* and *Reuters* present the Hong Kong '97 Return to China website. Packed with breaking news on handover-related events, a hyperlink timeline, profiles of past and present political figures, and image tours of Hong Kong, this website is a valuable resource for those seeking a comprehensive orientation to Hong Kong's reversion to Chinese rule.

http://www.nychinatrade.org—*New York for US-China Trade*, a coalition of New York State companies, trade associations, and individuals, has launched its own website. The policy forum section of the site is loaded with US-China trade-related newspaper and journal clips that are ideal for decisionmakers and people seeking to better understand US-China trade.

http://www.eiu.com—*The Economist Intelligence Unit (EIU)* just announced the launch of its new service geared to global companies seeking to access international business intelligence. Subscribers can select from a number of EIU's regular updates on country-specific political and economic conditions, industrial trends, market outlooks, regulatory changes, and corporate strategies. The minimum annual package costs $7,500 and can be customized.

http://www.prnewswire.com—*PR Newswire* presents Asia Pulse Pte. Ltd., a joint venture involving leading news and information companies in Asia, including China's Xinhua News Agency. Asia Pulse is a "one-stop" source for Asian market intelligence providing daily news briefs of projects/tenders, commentaries, industry profiles, and business developments. A free 30-day trial period is available; a monthly subscription costs $325.

—*Ann M. Weeks*

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

美中商贸评论

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Robert A. Kapp

The Meaning of the 1997 MFN Victory

The broadening of this year's debate brought unexpected dividends

The June 24 decision by the US House of Representatives to maintain normal trade relations between the United States and China by refusing to abolish Most Favored Nation (MFN) tariffs on Chinese imports, although the eighth consecutive case of MFN preservation, must not be regarded as "business as usual." It was the result of a remarkable amount of very hard work, not only by the community of American international businesses and key national organizations like the US-China Business Council, but also by a new and impressive array of smaller businesses and non-business organizations that expressed for the first time the full breadth of US national support for a decent and civil relationship with China.

The extent and the ferocity of this spring's assault on MFN, and on normal US-China relations, deepened the discussion of US-China relations throughout American society. No one can say that the opponents of MFN and those dedicated to downgrading US-China relations did not have their chance to speak this year. They threw everything they had into their attack, including massive media efforts, virulently inflammatory language, shaky numbers, misleading statements, and plenty of bitter assaults on the integrity of MFN's supporters.

At first, Congress reeled backward under this onslaught from a well-organized, media-savvy campaign that seemed to be as heavily dedicated to scoring domestic political points as to changing US China policy.

In the dark days of February and March, when the full fury of the anti-MFN storm began to burst forth, many in the business community, too, were shocked by the intensity and animosity of the attack. The persistent, unelaborated allegations of PRC involvement in US campaign finance irregularities fueled an underlying flame that illuminated the political dangers facing elected officials dedicated to the preservation of normal US-China relations.

The blunt political insistence on defining MFN as a moral-religious issue seemed for a time likely to turn MFN into a visceral, media-magical drama of Foreign Treachery and Domestic Villainy. As the spring progressed, the intricate complexities of American domestic politics produced an ominous rumble of shifting positions among some prominent figures. For a time, it seemed that, in the House at least, MFN was headed for defeat.

Then, something remarkable happened.

From the countryside, from small towns and cities across the country came a growing chorus of alarm that killing MFN would be not only economically disastrous, but morally counterproductive. Members of Congress began to hear, from members of the religious community who actually work with the Chinese in the PRC, a gentle but urgent message of concern over the damage that a comprehensive degradation of US-China relations would wreak on their work and the welfare of their friends within China. Coalitions supportive of stronger US-China relations, especially economic and commercial ties, made their views known in many states—precisely as members of Congress had implored MFN's supporters to do. The views of constituents—including those in small companies who lack the resources to "work the issues" in the nation's capital month after month—were expressed in hometown weekend meetings with members of Congress, local newspapers, and community gatherings. These voices seemed to break through the high-pitched hum of the Washington, DC policy apparatus.

Powerful and respected figures from the Chinese dissident community in the United States came forward, in congressional hearings and through published statements, to point out that killing economic ties between the United States and China was exactly the opposite of what was needed if hopes of further political opening in China were to be realized.

And once again, with particular courage in the face of the anti-MFN side, the committed and steadfast congressional supporters of MFN, including their talented and untiring staffers, worked diligently to spread the message of responsible policymaking among their colleagues. The White House and key Administration figures also turned their attention to the future of US-China relations, and argued ringingly for the maintenance of normal trade ties as the keystone of a much larger and more complex relationship.

The business community, long the workhorse of the battle to maintain stable US-China economic relations, came together as never before. Blasted by its opponents as political and moral renegades, the business community found itself this year sharing the burden with a broad coalition of concerned Americans who, in their own words, made the case for MFN on humanitarian and ethical grounds. The business community's comments in Congress, press conferences, letters, and news articles, refuted the outrageous contention that killing MFN was the only legitimate course for people of ethical and religious conviction. My own testimony in the House of Representatives this June attempted to bring together in a single brief document the core moral issues and the eloquent voices of Americans and Chinese outside of business, who provided the clearest justification of continued MFN in the terms that many in Congress chose to emphasize this year.

The Search for the Perfect Message

In the end, MFN's opponents were left to claim that, even though MFN's future was never really in doubt because both the US Senate and the President were certain to ensure its continuation, House defeat of MFN was needed to "send a message." But what the message was, and to whom it ought to be sent, was something the anti-MFN legions could never quite clarify: A message to Hong Kong, perhaps? A message to others in one's own political party? Maybe a message from Congress to the White House about control of trade policy? A message to President Clinton, as more than one anti-MFN member of Congress put it? A message to China, as several columnists dubbed it? A message to US consumers? A message to China's leaders?

On June 24, the House of Representatives faced up to the reality that, after eight years of wrenching annual debate, the "message" is still impossible to pinpoint. As one impatient congressman made clear, sending a message is no substitute for a substantive and credible policy.

Amazingly, in the final days before the House vote, the national media seemed to turn their attention to other matters. Hong Kong as an MFN issue had fizzled weeks before; the imminence of the Hong Kong handover galvanized media attention, and MFN faded into the shadows. By the time of the critical House vote, the whole subject had virtually disappeared from the American press.

So the 1997 MFN battle is over; normal trade is preserved for one more year. Once again, members of Congress in both parties, including some of the most strenuous critics of China, have seen that the annual struggle over tariffs on Chinese imports is of little use in handling the complexities of US-China relations.

The rest of 1997 will be busy: Hong Kong will put in place new governing structures and officials in line with its new status as a Special Administrative Region of the PRC; PRC President Jiang Zemin will visit President Clinton this fall; and bilateral negotiations on China's accession to the World Trade Organization will continue. The need for effective US-China dialogue on many issues is increasing, not diminishing. Opportunities for further progress, interrupted since late 1996, are at hand this autumn. This summer may see additional China-focused proposals in Congress that require careful examination even if they are not specifically tied to continued MFN status for China. But we should take satisfaction in the outcome of this year's struggle, which represents a recovery from adversity and a significant broadening of the social and intellectual foundations for US commitment to stable and enduring commercial and economic ties with China. 完

Food for Thought

Chinese consumers are increasingly voting with their yuan *for the food brands they prefer*

Richard Bowles

After decades of buying generic food products manufactured by State-owned enterprises, China's consumers nowadays can choose from a growing array of domestic and foreign brand-name products each time they go shopping. Given the country's vast size, some food industry analysts have tended to believe that the development of food brands in China, especially national-level brands, could take many years. Only brands of high-priced "status" goods, such as cars, stereos, and clothing, were believed to have attained widespread recognition among China's consumers. But according to a recent survey, a national market for brand-name food products has already begun to emerge in China, and the regional variations in market share of brand names appear to be much smaller than previous research suggests.

Conducted by the food industry consulting firm Seymour-Cooke Ltd. in late 1996, the survey was the first attempt to gauge the extent to which brand-name food products have penetrated six regional urban hubs—Beijing; Chengdu, Sichuan Province; Guangzhou, Guangdong Province; Shanghai; Shenyang, Liaoning Province; and Wuhan, Hubei Province. Through detailed audits of five supermarkets in each city, the survey evaluated the market shares of over 1,000 brands in 30 food categories and quantified the degree to which international brands have penetrated the processed foods market. The survey also examined the extent to which these brands are now made in-country by either joint ventures or wholly foreign-owned subsidiaries, and investigated the pricing strategies of multinational food companies.

Richard Bowles is research manager at Seymour-Cooke Ltd., a food industry consulting firm based in London. This article is based on the company's 1996 report, *Food Brands in China*, which analyzes China's food market by region, product, and brand.

Spreading the Word

China's retail food market remains relatively small—estimates put its current sales volume at roughly $126 billion, which is equivalent to Britain's. Nonetheless, according to the survey, China has 135 "national" food brands, defined as those brands available in at least three of the six surveyed cities. A number of major food categories, including baby foods, breakfast cereals, frozen foods, noodles, and snacks, all have at least five brands that are distributed nationwide (*see* Table 1). For soft drinks and biscuits—the two products for which markets are most developed in terms of size and the number of national brands—more than 10 brands are distributed nationally. Nearly all of these are produced domestically by foreign companies or joint ventures. Many of the brands are Western, but Hong Kong, Japanese, and Taiwan brands are also major players. The survey also found that almost all of the foreign-brand goods surveyed, whether produced in China or imported, are distributed nationwide. Foreign products with high sales volumes, such as powdered milk, soft drinks, and biscuits, tend to be produced in China. Goods with lower sales volumes—cheese, butter, and canned soup and vegetables—tend to be imported.

Many analysts of the Chinese consumer market emphasize its fragmented, regional nature. Interestingly, the Seymour-Cooke survey revealed that while there is considerable regional variation in product prices, the variations tend to be random—there is as much price variation within a particular city as between regions. For example, despite the large number of expatriates in Beijing and the perceived affluence of Shanghai residents, prices for brand-name food products are not significantly higher in these two cities than in the other four cities surveyed. And, though some of the retail centers surveyed are closer to the production plants of certain goods—meaning lower transportation costs for the product—these cost savings do not appear to translate into lower retail prices for any given brand. For example, in Wuhan, located some 600 miles up the Yangtze River from Shanghai, prices for the surveyed products were not significantly higher than in Shanghai. Because the survey covered only major urban centers, however, it is possible that there is less price homogeneity among brand names in China's smaller cities and towns, where the market for processed foods is generally smaller than in major urban centers.

As for a company's market share in different Chinese cities, regional variations are evident but few consistent patterns exist. For example, the French firm Danone Group has produced biscuits in Shanghai since 1993 and has a 16 percent market share in the city, but can claim only a 5 percent share of the national biscuit market. The local market share of America's Kellogg's breakfast cereal, produced in Guangzhou, is about 9 percent; and Keebler biscuits, a British brand made in Shanghai, claims a 19 percent stake in that city. The national market shares for both products, though, are roughly the same as their local market shares.

Battling for buyers

In most of the world's emerging markets, domestic brands and international brands, whether imported or produced locally, compete vigorously for market share. International food brands sold in China—brands that are owned and produced by non-PRC companies—include many Western household names, such as Cadbury (Cadbury Schweppes P.L.C.), Nescafe (Nestle S.A.), Kellogg's (Kellogg Co.), Keebler (United Biscuits UK Ltd.), and Wrigley's (Wm. Wrigley, Jr. Co.); as well as well-known Asian brands Lotte (chewing gum), Khong Yuan (biscuits), Nissin (biscuits), and Lam Soon and Hop Hing (cooking oil).

The Seymour-Cooke survey revealed that despite the occasional campaign in Beijing to "buy domestic," Chinese food brands tend to have lower market shares than foreign brands, even in inland cities (*see* Table 2). Consumers in Wuhan, for example, appear to try Western brands of processed foods as frequently as consumers in Shanghai and Guangzhou. For some products, especially foodstuffs new to the Chinese market, domestic brands can barely compete with international brands. For example, the markets for processed cheese, baby food, ketchup, canned soup, mayonnaise, branded butter, margarine, UHT milk, pasta, and instant noodles are all dominated by international brands. Even in long-established food categories such as biscuits and cooking oil, domestic brands may have difficulty competing. The survey found, for example, that only joint-venture biscuit brands were available in all six cities; Chinese brands such as Seven Seven, made by Hongya Food Co., appear on grocery shelves in only a handful of stores in a given city, and do not appear to be distributed nationally.

Local brands hold their own in relatively few markets, including beer, Chinese noodles, frozen foods, and soy milk powder. Though China's beer market has attracted investment from foreign brewers, including Anheuser-Busch, Inc., Asahi Breweries Ltd., Bass Brewers Ltd., Carlsberg-Tetley Alloa Ltd., and Foster's Brewing Group Ltd., the market is so large that these foreign brewers have made only limited inroads so far. Presumably, the recently issued government rules restricting foreign brewers' output to 30 percent of China's total beer production stems from a desire to protect domestic producers in this large and lucrative industry.

As for frozen foods, perhaps because the sector consists largely of Chinese-style foods—flour-based dumplings, wontons, vegetable rolls, and bean curd—the market leaders tend to be either domestic companies or PRC-Hong Kong joint ventures. The lack of reliable cold storage distribution networks may also explain why frozen foods are still dominated by domestic producers (*see* p.12).

Macro approaches...

Despite the often-cited difficulties of distributing nationally in China, which stem largely from the country's poor transportation infrastructure and the uneven reliability of private contractors, most foreign food-product investors initially source from only one plant. This one-factory strategy is possible because most processed foods have shelf lives of at least several weeks and can survive a lengthy trip from factory to store. The notable exception to the one-factory approach has been in the soft drink market, in which the large volumes and relatively low retail prices have encouraged investors to set up regional plants. The Coca-Cola Co. currently has 19 bottling plants in China, with another 4 under construction. PepsiCo Inc. also has a significant number of bottling plants, and plans to expand its investment in China.

The survey revealed that there is as much price variation within a particular city as between regions.

Unless a company has considerable financial resources, though, most find it best to start with one plant and expand to other locations as needed. For example, United Biscuits invested in a joint-venture factory in Shekou, Guangdong Province, in 1990 and reportedly turned a profit in its first year. The problems and costs of transporting its products to northern China led the company to invest in a wholly owned factory further north, in Zhejiang Province, in 1995. Other companies have found that one factory can meet their needs for some markets, but not all. Nestle, for example, has gained 20 percent of the country's powdered milk market through its plants in Shanghai, Shuangcheng, and Tianjin, but has captured half of the national instant coffee market by sourcing from just one plant in Dongguan, Guangdong Province. Nestle's competitor in the instant coffee market, Philip Morris Co., claims a 30 percent national market share and also has only one plant, in Guangzhou.

Though many experts tout the importance of having a Chinese partner, if only to facilitate access to local officials and distribution networks, more and more foreign companies that have been involved in joint ventures are moving to increase their equity shares or establish wholly owned plants. Some of Coca-Cola's foreign partners and PepsiCo have recently increased their equity shares in some of these companies' China plants.

Less formal alliances between PRC and foreign companies than the standard joint-venture pact are also becoming popular. For example, PepsiCo has initiated an informal distribution and production arrangement with a Sino-Taiwan joint-venture company, Wang Wang, which is a market leader in China's snack food sector and has been particularly successful in distributing its products nationally. Under a production-for-distribution swap arrangement between the two companies, Wang Wang, which produces Wang Wang rice crackers and Lonely God potato twists in Beijing; Nanjing, Jiangsu Province; and Hunan Province, distributes Cheetos and other PepsiCo

Despite the occasional campaign in Beijing to "buy domestic," Chinese food brands tend to have lower market shares than foreign brands.

snack food brands. In return, PepsiCo added Wang Wang's Lonely God potato twists to its production lines at its joint-venture plant in Guangzhou.

For the most part, foreign-funded companies tend to specialize in lines in which the companies have prior product knowledge and experience. European and American companies typically market or produce Western foods in China, while their Asian counterparts focus on Asian food products. Many foreign investors in instant noodle production ventures, for example, are from Japan, South Korea, and Taiwan. Makers of such frozen foods as wontons and dumplings generally are based in Hong Kong.

Nonetheless, some foreign food producers have chosen to adapt their products to Chinese consumer preferences. For example, United Biscuits makes products in China that the company does not market in the West, including biscuits in sesame and spring onion flavors; peanut, lemon, and mango wafers; and lemon- and mango-flavored potato chips. Asian manufacturers of instant noodles also adapted their product to China's regional tastes: soy sauce-braised beef, shrimp, and black pepper beef are just some of the flavors marketed in China. Nestle produces soy- and rice-based cereal products as well as its standard wheat-based lines. McCormick & Co., Inc. has developed several seasoning products specifically for sale in China, including "ma-po tofu" and other Sichuan-style seasoning packets (*see* p.25). Meanwhile, other Western companies have instituted more subtle changes. Cadbury Schweppes, for example, sweetens the chocolate in its China-bound products, since Chinese consumers tend to dislike bitter chocolate.

...AND MICRO TECHNIQUES

Another key means of penetrating the Chinese food market is strict management of pricing. According to Seymour-Cooke's survey, retail prices for processed food products vary considerably, but the price variations within one city can be as great as those between regions. Though several factors likely contribute to the price variations, it is possible that manufacturers and distributors are simply unable to control the retail prices of their products; retail managers likely set prices based on their own perceptions of what the market will bear. Thus, a foreign investor should be aware that attempting to position its product as a mass-market processed food by pricing it low could prove futile if Chinese retailers mark up the product's price to boost its cachet—and their profit margins. Many foreign products, regardless of their home-country status, seem unable to avoid the "premium" reputation in China.

Some foreign soft drink makers, though, have been able to set—and maintain—competitive prices for their products. PepsiCo and Coca-Cola have achieved this largely by managing at least some of their own distribution networks and maintaining national sales forces that can monitor their products' retail prices. Pricing competitively has been crucial to these two companies' success, since both marketed their products near the retail prices of such PRC competitors as *Jianlibao* and *Yeshu*.

TABLE 1
NATIONAL BRANDS BY CATEGORY

PRODUCT CATEGORY	NUMBER OF NATIONAL BRANDS*
Baby food	2
Biscuits	11
Breakfast cereal	13
Canned soup	2
Cheese	2
Chewing gum	2
Chinese noodles	1
Chocolate confectionery	7
Coffee	2
Cooking oils	7
Frozen foods	1
Fruit pudding	1
Instant noodles	7
Jam	4
Mayonnaise	1
Milk (powdered)	11
Mineral water	7
Pasta	1
Snack foods	10
Soft drinks	15
Soy milk	3
Spices	3
Sugar confectionery	10
Tea bags	4
UHT milk	5
Yogurt	1

SOURCE: Seymour-Cooke Ltd.
NOTE: Based on Seymour-Cooke's 1996 survey of supermarkets in Beijing, Chengdu, Guangzhou, Shanghai, Shenyang, and Wuhan
* "National brand" is defined as a brand that is available in at least three of the six surveyed cities.

Price segmentation—the availability of high-, medium-, and low-quality brands within one product sector—is commonly seen in developed markets, but most of China's processed food markets are too immature for such segmentation. Imported brands of powdered milk, though, have started to compete with domestic brands in quality and price, and small volumes of high-quality imported chocolate are finding a market among Chinese consumers. In China's instant noodle market, which is growing at 20 percent per year, quality and price are becoming more important to consumers' purchasing decisions. PRC-made noodles face stiff competition in urban markets from higher-quality, joint-venture products. Market leaders Chef Kang and President Enterprises Corp., from Taiwan, now market a full range of products, from noodles sold in plastic packs for ¥20/kg ($2.40) to those in ready-to-use plastic bowls priced at ¥60/kg ($7.20).

The vast majority of firms adopt well-researched strategies in China, but a few firms appear to use underhanded or even illegal tactics, taking advantage of the infancy of the market and the lack of regulatory oversight. For example, a brand of chocolate packaged as "Swiss chocolate" and made by a Sino-foreign joint venture has captured about 15 percent of the chocolate confectionery market. However, the foreign partner is unknown outside of China and the Swiss Chocolate Manufacturers' Association has indicated that it is unfamiliar with the product.

A MATURING MARKET

Market concentration—the market share claimed by leading brands—is often used to measure the level of market development. Surprisingly, China's food markets are almost as concentrated as those of Western Europe, where the top three brands of any given processed food product generally account for about 50 percent of the market. But China's sugar confectionery and snack food markets are exceptions; the large number of brands in these sectors has resulted in low market concentrations. Different regions in China tend to be dominated by different confectionery brands, as most were developed by State-owned companies. Many brands, including White Rabbit and SF, are still produced by State-owned companies. The snack food concentration level is also low, likely a reflection of both the immaturity of the market and the multitude of product types. Though in the short term, high rates of growth in the snack food market may allow many brands to survive, over the longer term, mergers likely will reduce the number of brands and bring the brand concentration figures more closely in line with those in the West.

Fending off foreign competition

With a number of foreign food products on their way to becoming household names, some Chinese officials are becoming concerned that domestic producers face a difficult road ahead. For example, Nescafe, with 50 percent of the instant coffee market, could soon become the generic term for that product in China. And after Danone acquired the Chinese food producer Bright, Bright's products were phased out while the marketing and distribution of Danone's international brands took center stage.

Such developments give Chinese authorities reason to worry about the future of PRC brands. In some cases, PRC investment approval authorities require foreign companies acquiring PRC consumer goods companies to pledge that they will continue to support the local brand name. When Danone acquired a stake in Wahaha, a PRC dairy company, the French firm had to guarantee to preserve the Wahaha brand name.

With such challenges from foreign companies, domestic firms will have to develop technical advantages or advanced marketing skills, or invite foreign investment, if they are to increase their competitiveness in the brand-name food products market. For example, domestic Chinese food companies could prosper if they establish economies of scale and access to sourcing and distribution networks. In addition, PRC firms operating in sectors in which the ability to sell high volumes of such products as agricultural commodities could find success not only in China, but in global markets as well. China accounts for 23 percent of world meat production and 45 percent of the world pig population; its herd of 400 million pigs far outnumbers the 59 million pigs in the United States. China also accounts for one-third of the world rice harvest and one-fifth of global wheat production. Because the scale of China's production of basic foodstuffs is so large, Chinese firms have much potential to become competitive exporters of unbranded food products. Small, private Chinese food processing companies, which are already emerging, also could grow rapidly and establish brand names as their markets expand and they merge with competitors.

Some foreign food producers have chosen to adapt their products to Chinese consumer preferences.

Table 2
Market Shares of Chinese and International Food Brands in China, 1996

	Chinese brands (%)	International brands (%)
Baby food	5	95
Beer	94	6
Biscuits	5	95
Breakfast cereals	10	90
Butter, margarine	5	95
Canned soup and vegetables	5	95
Cheese	0	100
Chinese noodles	40	60
Cooking oil	20	80
Frozen foods	85	15
Ice cream	20	80
Instant noodles	5	95
Jam	25	75
Mayonnaise, tomato ketchup	5	95
Milk powder	20	80
Pasta	10	90
Soy milk powder	85	15
Spices and seasonings	5	95
UHT milk	40	60
Yogurt	50	50

SOURCE: Seymour-Cooke Ltd.
NOTE: Based on Seymour-Cooke's 1996 survey of supermarkets in Beijing, Chengdu, Guangzhou, Shanghai, Shenyang, and Wuhan

Developing a national brand

In one sense, the Chinese market for branded food products is like any other, in that success hinges on providing the right product, at the right price and at the right place and time. The Chinese processed food market, however, remains constrained by distribution problems and inconsistent retail pricing. Foreign or FIE-made goods of many kinds have been able to develop quickly into national food brands because of the lack of domestic competition. In many cases, setting up a domestic production facility and effective distribution networks has been enough to establish a brand. Establishing a brand does not guarantee profits, though, because of the small size of the market, so foreign companies in China must take a long-term view of profitability.

There is every reason to expect the Chinese food market to develop along familiar lines. The product sector markets will grow as the economy expands and brings more people into the "consumer" bracket (*see* p.34). At the same time, some sectors will fragment as opportunities develop for high- and low-value brands and a wider range of product types. In such a context it seems likely that, in the near term, the main focus of competition will be among foreign investors. Over the long run, though, domestic companies—likely new commercial operators rather than the State-owned enterprises—are sure to become significant players in the branded food products market. 完

The Big Chill

Bob Burke and Carol Wingard

The clamor for chilled and frozen foods is forcing change in China's food distribution infrastructure

Behind the gleaming new supermarket freezers stocked with ice cream and the hungry hordes lined up to buy chicken dinners at ubiquitous Kentucky Fried Chicken (KFC) outlets lies a revolution in the handling and distribution of food throughout urban China. Far-reaching changes are under way in the eating patterns of China's city dwellers, from changes in diets and food purchases to a growing premium placed on speed and convenience, and an increase in the number of meals eaten outside of the home. These changes, in turn, are driven by powerful economic and demographic forces in China, including higher per capita incomes and discretionary spending levels, smaller household units, and increasingly hectic lifestyles.

To meet the demand among consumers and restaurants for frozen and chilled foods, China must move perishable food products quickly, efficiently, and hygienically from the farm or food processor to the consumer. China's cold chain infrastructure (the term given to the complex network of processes and services used to transport and preserve edible products in a controlled-temperature environment), though, is like much of the country's infrastructure: old, under-invested, and now scrambling to keep up with enormous new demand.

These pressures are forcing changes in each link of the cold chain network—from cold warehousing at the point of production or import, to temperature-controlled transport, to wholesale distribution, to the retail level. While the inadequacies of the current cold chain infrastructure present short-term challenges for foreign food manufacturers looking to distribute chilled and frozen products in China, they also provide new opportunities for foreign companies doing business in related products or services.

A FROZEN FOOD INVENTORY

The markets for consumer-ready frozen and refrigerated food in China have taken off only in the last few years, due largely to the rise in ownership of refrigerators, which are now found in an estimated 96 percent of urban Chinese households, and the emergence of new retail options, notably supermarkets. One immediate result of the availability of household refrigeration has been the proliferation of dairy products and other refrigerated foods such as chilled meats. The myth of the lactose-intolerant Middle Kingdom has finally given way, as witnessed by the presence of 42 foreign-invested enterprises (FIEs) with operations in the PRC dairy sector, including such food-processing giants as Nestle S.A., the Danone Group, and Kraft General Foods.

Major urban markets now sell a wide range of consumer-ready frozen foods, including ice cream, frozen appetizers and entrees, and frozen vegetables, fruits, meats, and seafood. Domestic consumption of consumer-ready, frozen products, excluding ice cream, was estimated at approximately 2 million tons in 1996, according to Cao Desheng, secretary general of the China Refrigeration Association, and is projected to grow over 5 million tons by 2000. The China Food Industry Association, applying a more inclusive definition of frozen food, estimates consumption at 4.5 million tons in 1996 and predicts this figure will expand to 8 million by the end of the decade. But by all accounts, China's market for frozen foods is in the earliest stages of development. Per capita output of frozen foods in China was less than 2 kg in 1996, far below the 15 kg per head consumed in Taiwan or the 53 kg per head in the United States.

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One indisputable frozen product success in China is ice cream, a popular treat that has effortlessly crossed the barriers of culture and taste into China (*see The CBR*, January-February 1996, p.44). Global mass-market producers like Nestle and Unilever PLC (Walls) have invested heavily in China, while The Haagen-Dazs Co., Inc., Baskin-Robbins International Co., and other premium-brand manufacturers have established flagship shops in Beijing and Shanghai. Chinese industry sources estimate that total 1996 domestic ice cream output exceeded one million tons, split roughly in half between milk-based and water-based ices.

While ice cream brands typically occupy more than two-thirds of PRC supermarket freezers and an even greater percentage of freezer space in smaller, "mom and pop" shops, the variety of frozen products for sale in China is on the rise. Though frozen fruits and vegetables have not yet supplanted local preferences for fresh produce, the number of locally produced frozen entrees and appetizers catering to Chinese tastes is growing rapidly. According to Cao Desheng, more than 50 percent of quick-frozen food demand is for pastry products such as steamed bread, buns, dumplings, spring rolls, and sweet dumplings.

An Emerging Trader

The development of China's frozen food industry is also having an impact on international foodstuffs trade. Investments in foreign technology, along with the emergence of FIEs involved in food processing, have helped boost China's trade in frozen foods. Both imports and exports of chilled and frozen foods have grown substantially in recent years.

China exports increasing amounts of a number of frozen foods, most notably poultry and seafood. Exports of frozen chicken alone totaled $631 million in 1996, reflecting an annual increase of 45 percent since 1992. Other export products include frozen fish ($797 million in 1996) and frozen vegetables ($212 million). To date, much of China's frozen chicken, fish, and vegetable exports have been destined for the Japanese market. Only a short haul from China's eastern ports, Japan is a logical trading partner for temperature-sensitive products. In 1996, China exported $473 million of frozen chicken to Japan, a full 75 percent of total PRC chicken exports that year. Japanese companies also purchased over 50 percent of China's frozen fish exports and 78 percent of PRC vegetable exports last year. Several Japanese food processors have established export-oriented frozen vegetable, fish, and dumpling operations in China's coastal agricultural areas to take advantage of the lower costs of doing business in the PRC.

China is fast becoming a major importer of frozen foods as well, much to the benefit of US exporters. US exports of consumer-oriented frozen food products to China and Hong Kong have increased 20 percent per year in the 1990s, reaching a total of $1.3 billion in 1996, according to the US Department of Agriculture. US poultry exports have driven much of this growth, despite the strong development of China's domestic poultry industry. China's poultry trade has been complementary: Japanese and Western consumers demand Chinese-raised broilers and processed poultry products (notably *yakitori* in Japan), while dark meat chicken parts, as well as chicken feet and necks—all parts that are in relatively low demand in the United States—are in high demand in the PRC.

Forging the Chain

To accommodate both domestic and international demand for chilled and frozen foods, though, China needs to continue improving its cold chain management infrastructure. Processed food markets in developed countries are characterized by a network of public cold storage warehouses and private companies that consolidate food from farms, processors, and packaged goods companies and then distribute to regional and local warehouses, which ultimately deliver foods to individual consumers.

In China, these crucial intermediary links have been slow to develop. Historically, the Ministry of Internal Trade (formerly the Ministry of Commerce [MOC]), the China National Cereals, Oils, and Foodstuffs Import and Export Corp. (CEROILS), and the Ministry of Agriculture and their bureaus throughout the country directed the allocation of food products in China. Economic reforms have dismantled these former State-run distribution monopolies, leaving a fragmented system of small-scale traders with limited geographic scope. Producers have been left to cobble together shipment and delivery networks, while their customers receive small, inefficient shipments from large numbers of suppliers. Each producer must deal separately with cold storage warehouses as well as arrange for inter-city transport via rail or truck, and intra-city transport.

Until recently, investment in trading, wholesaling, and distribution has been officially off-limits to foreign investors. China opened the door a crack in September 1996 with the promulgation of regulations allowing investors to take minority stakes in foreign trade joint ventures in Pudong, Shanghai, and the Shenzhen Special Economic Zone. These rules are subject to considerable restrictions and substantial investment thresholds. To date, the few licenses that have been granted have been for general trade. Large-scale international food products wholesalers and traders, lacking official encouragement from Beijing and intimidated by the formidable investment needed to establish a meaningful nationwide presence in China, remain on the fence.

China is fast becoming a major importer of frozen foods.

In the interim, foreign food processors looking to sell chilled or frozen foods in China have a limited range of distribution options. They can rely on China's existing local distribution mechanisms, hook up with a network of private Chinese or international distribution companies, or go it alone. A few smaller-scale foreign-invested distribution/consolidation companies are emerging to serve the fast-food industry (*see* p.16), but options are scarcer for retail consumer food products. Some large Hong Kong food products traders, including Inchcape PLC, Sims Trading Co. Ltd., and Angliss Pacific Ltd., have pieced together various networks focusing primarily on four- and five-star hotels.

Selecting a distributor, though, is only the first step. Transporting frozen food from either the port of entry or local production center entails navigating China's existing cold storage warehousing system, another remnant of the centralized command economy. China National Foodstuffs Corp. estimates national commercial cold storage capacity at 4 million metric tons, nearly 80 percent of which is controlled by the provincial and local bureaus formerly under the old MOC. Lack of investment has left an aging physical plant that requires not only modernization but extensive maintenance. To date, few foreign investors have been attracted to China's cold storage warehousing sector. One exception, the Panyu Premier Cold Storage venture, chose to construct a greenfield warehouse rather than at-

Foreign food processors looking to sell chilled or frozen foods in China have a limited range of distribution options.

tempt a costly modernization of an existing cold storage facility (*see* box). Compounding the capital investment problem is the fact that many of the State-owned commercial warehouses are being corporatized—and cut loose from State subsidies.

However, for some commodities—such as bulk-frozen beef, pork, and poultry—the system seems to work well enough. Problems in China's cold chain "haven't made us lose sleep, yet," notes Jeff Johnson of US pork exporter Smithfield. Frozen products can be maintained for extended periods and are less vulnerable than chilled/refrigerated goods to temporary interruptions in the storage chain. Chicken, for example, has a rated shelf life of one year at -18°C (0°F), though problems can mount fast, as the bacteria count in chicken doubles every six hours for chicken stored at 4°C (40°F), or typical refrigerator temperature.

Other frozen products require more sophisticated temperature-controlled handling, and may not fare well in China's warehouses, which customarily store frozen products at -18°C. For example, ice cream made with fresh milk and cream is extremely sensitive to contamination and requires storage at -26°C. For US producer Haagen-Dazs, the unavailability of an unbroken -26°C cold chain from the factory to the consumer looms as the main obstacle to its expansion in China. A recent State Bureau of Technology Supervision survey of ice cream products made by 45 different companies found that 45 percent of the 110 ice cream products tested exceeded the maximum bacteria allowance. A secondary concern for ice cream producers is odor contamination. In many of China's warehouses, it is difficult to ensure that ice cream stocks are kept separate from seafood and similar products, in order to avoid spoilage.

At the other end of the cold chain spectrum, problems arise in the maintenance and distribution of chilled meats and produce. As more and more urban Chinese are eating out, the restaurant demand for fresh meats and produce is rising. The rapid expansion of international fast-food restaurants, in particular, has put added stress on the food distribution chain, while China's cold storage networks generally lack the delicate time-and-temperature expertise to handle chilled products. From a distributor's point of view, frozen goods are easier to handle, as these products can more easily endure temporary breakdowns in the cold chain. Chilled meats, dairy products, and produce, on the other hand, have short shelf lives and will deteriorate rapidly without efficient handling under controlled conditions.

While major US poultry and meat producers are able to export fresh, chilled meats to Japan, Korea, and Hong Kong, the story in China is quite different. Though China can handle imports of frozen meat, the infrastructure for importing chilled products remains weak. "China is years away from being able to handle an imported refrigerated product," says Jeff Muchow of Nebraska-based IBP, Inc., the world's largest producer of fresh beef and pork. And fresh milk in China is distributed entirely on a local basis—most dairies eliminate the chilled warehousing step entirely, and deliver directly to retailers using nonrefrigerated trucks.

Warehousing: An Inside View

Developments at the Shanghai No.3 Foodstuffs Import & Export Corp. Cold Storage Plant, recently re-christened the Shenhong Cold Storage and Shipping Co., Ltd., indicate the extent to which industry trends are helping to transform some of China's cold storage dinosaurs. Situated only 3 km from Shanghai's main container port, Shenhong is strategically located for international trade, but remains constrained by its inefficient and aging warehouses. The company has 17,000 metric tons of warehouse space: 15,000 tons for -18°C to -20°C frozen storage and 2,000 tons for chilled storage down to 0°C.

Shenhong's cold storage facilities consist of two buildings (6 and 7 stories, respectively), each over 30 years old. The multi-story design makes access to stores relatively slow and reliant on elevators. The ceiling clearance is only 3.8-4 m, meaning that Shenhong cannot improve efficiency by installing multiple racking levels that can be serviced by modern fork-lift trucks. The loading platforms, meanwhile, are unsealed, exposing food products to ambient air temperatures during loading and unloading.

Panyu Premier Cold Storage/Distribution Center

Ex-banker Randy King's effort to establish a retail business in Guangzhou was in some respects a casualty of China's distribution sector. King, a Hong Kong-based American, saw a critical need for efficient warehousing in China. A relative experienced in the fruit trade steered him toward cold storage warehousing, which resulted in the wholly foreign-owned enterprise Panyu Premier Cold Storage and Distribution Center.

Located in the Pearl River delta city of Panyu, Panyu Premier has modern warehousing services that King hopes will prove attractive to major international food companies looking to export to China. "Quality service will distinguish us," says King. "If your top concern is *renminbi* per ton per day, you probably won't want to use us."

Panyu Premier is a single-story, 7,500 sq m facility located adjacent to Panyu's Lianhuashan container port. When completed later this year, the plant will be able to store over 10,000 metric tons in three rooms. Two freezers will offer −23°C storage, while a third room will be available for chilled foods (0°C to 4°C). Each room has a clearance of over 10 meters, with space for 5 palletized racking levels. Frozen and chilled products will be handled in sealed loading docks maintained at 7°C, allowing workers to avoid exposing products to ambient air temperatures during loading and unloading.

Most food companies distributing temperature-sensitive foods have been inclined either to do it themselves, or contract with the State-owned system and seek to maintain strict control over the distribution of their products. However, King sees great opportunities in China for truly independent operators. He believes the State system has a bias toward its own products, and allows third-party leasing only as space permits. "There is no true public warehousing in China. We are the first."

—*Carol Wingard*

Even with its portside location, Shenhong has become increasingly less involved in exports: 80 percent of the products the facility handles are domestically supplied and bound for domestic customers. Shenhong has become, however, a distribution center for frozen food destined for the local Shanghai market, serving as a major distribution center for the Shanghai KFC outlets (30 restaurants to date), the Japanese Mosburger chain, and others. For KFC, frozen products are stored in the facility's warehouses and distributed locally via KFC's own trucks.

As these arrangements indicate, Shenhong is becoming a public warehouse operation, no longer tied directly to the trading business of CEROILS. "We do some repacking and labeling, but our main business is to provide cold storage and cold storage transport," says Liu Peixiong, Shenhong's deputy director. Shenhong charges a ¥3 ($0.36) per metric ton per day basic fee for leasing cold storage warehouse space, plus a one-time handling fee of ¥30 ($3.61) per ton and a loading fee of ¥5 ($0.60) per ton.

While Shenhong functions much as a public warehousing facility, other cold storage operators have moved in the opposite direction—away from simple leasing of space and toward value-added food processing—in an effort to survive. One facility that has taken this approach is the Beijing Western Suburbs Food Cold Storage Co. (BWSFCS), which formerly held the local monopoly for meat storage and distribution in Beijing. To capitalize on the company's 18,000 tons of underutilized cold storage space, BWSFCS established a food-processing joint venture with a Macao-based company in 1992. The Beijing Long Qi Foods Co. Ltd. venture produces frozen vegetable rolls, spring rolls, and tofu for export. The venture exports much of its output to Japan, but also packs dumplings and rice balls for the domestic market. A second joint venture produces frozen onion sauce and vegetable rolls for export to Japan. Long Qi has the capacity to produce 2,500 tons of frozen goods per year, and reports shipping 1,000 tons to Japanese buyers in 1996.

Keeping cold on the road

Cold warehousing facilities are one important link in the cold chain; temperature-controlled transportation is another.

China's trucking industry is growing rapidly, fueled by the competitive demands of free markets.

While all types of goods suffer from slow or inefficient transportation modes in China, the problems are particularly critical in the distribution of refrigerated and frozen goods, which require special equipment to maintain product quality. China's rail system—historically best suited for the shipment of commodities—is predictably a weak link in the cold chain.

Nonetheless, railways continue to be the most common channel for the large-scale distribution of food in China, including frozen food products. Bulk frozen chicken imports, packaged in 25 kg cartons and imported in refrigerated containers, known as "reefers," are typically transferred in Hong Kong to container trucks routed to railheads across the border. There, the chicken is transferred to refrigerated or insulated rail cars for destinations in northern China.

Transporting frozen goods by rail in China, however, has enormous drawbacks, including the need for advanced bookings and special connections or *guanxi* with the local stationmaster. As temperature-controlled equipment is often unavailable, food products, in some cases, are simply cooled with bagged ice and covered with a blanket. Marketers of consumer-oriented, temperature-sensitive food products have additional concerns, including excessive loading and unloading under less than ideal conditions, excessive damage potential, and unreliable delivery times. Interviews with numerous consumer foods FIEs indicate that few rely on the rail system, opting instead to use their own or third-party trucking fleets. "We could save 60 percent [of our costs] shipping by rail, but would need to book six months in advance," says HG Fuller Ice Cream's Deputy General Manager Miao Kanghua. Miao also notes that his company has experienced a lot of product damage with rail shipments.

Fortunately, China's trucking industry is growing rapidly, fueled by the competitive demands of free markets and the PRC's integration into international trade. Even though road networks in China are notoriously underdeveloped, improved highway segments—including new Beijing-Tianjin, Shenyang-Dalian, Shanghai-Nanjing, and Guangzhou-Shenzhen routes—are making regional truck distribution a more practical option for the food industry.

Such improvements are much welcomed, as the flexibility of truck transport makes it especially suited to the movement of perishable foods. Many of China's restaurants and supermarkets require frequent deliveries of food products. By delivering shipments via truck, the distributor can supervise door-to-door service to accommodate the demanding schedules. Shanghai-based ice cream maker HG Fuller, for example, makes inter-city deliveries exclusively in the company's own fleet of 30 trucks, which range in capacity from 2.75 to 8 metric tons.

The increasing viability of trucking in China has enabled some companies, including ice cream giants Nestle and Walls, to adopt an integrated China manufacturing strategy and to attempt inter-regional transport. Each company aspires to be a national leader in ice cream and produces from multiple locations near important regional markets. Nestle (Dairy Farm) is now producing ice cream in Tianjin, Qingdao, and Guangzhou; Walls produces in Beijing and in Taicang, a Shanghai suburb. With multiple production and distribution points, Nestle and Walls can control intra-regional delivery from each plant, using their own refrigerated trucks or common carriers. In addi-

The Fast-Food Challenge

Lettuce, tomatoes, hamburger patties, chicken parts, and french fries are just some of the standard building blocks of Western-style fast-food meals anywhere in the world. These meals have found a receptive market in China, where the proliferation of quick-serve restaurant (QSR) chains has been rapid. But getting these building blocks to QSR outlets continues to be a challenge, as the industry must rely heavily on China's outdated cold chain infrastructure. Some recent foreign investments in this sector, though, bode well for improved cold storage networks.

Kentucky Fried Chicken (KFC), weary of the logistics involved in procuring fresh produce from Chinese farmers to make cole slaw for its many restaurants, has sought to outsource the entire job. Creative Food Technologies (CFT), a wholly foreign-owned enterprise, now supplies all of the lettuce and cole slaw for KFC's Shanghai-area restaurants. CFT is a provider of contract-managed food services to institutions, retail food stores, and QSRs. CFT, which has food-processing operations in Shanghai and Beijing, is wholly owned by Asia Food Ltd., an offshore firm formed in 1993 by Mike DeNoma. An American with experience in China's food service sector, DeNoma sees an enormous opportunity in servicing China's "away from home" meal industry.

For KFC, CFT procures and processes cabbage into cole slaw at its modern, temperature-controlled, and hygiene-conscious processing facilities in Beijing and Shanghai. These facilities then make same-day deliveries in company-owned refrigerated trucks to KFC restaurants. KFC outlets in China can be unusually demanding: some units, for example, have reported serving up to 20,000 customers in a week, ten times the average number of meals served at a typical franchise in the United States. According to David Landers, CFT senior vice president, using CFT as a centralized kitchen allows each restaurant to "minimize its food preparation area and therefore its footprint" in expensive downtown real estate. This allows KFC to go about the business they do best, which is market their restaurants.

CFT is also pioneering the sale of chilled-fresh entrees to supermarkets catering to China's urban middle class. Using cook-chill technology, meals prepared at CFT factories are blast-chilled to 4°C, then vacuum packed into high-barrier plastic bags, which the customer then reheats and serves.

McDonald's Corp., another QSR chain that has found a steady stream of customers in China, opened its 128th restaurant unit in the PRC in March. To improve its supply networks in China, McDonald's has attempted to draw suppliers from its highly efficient North American system to China. Frozen french fry king JR Simplot, for instance, established a french-fry processing plant in Beijing, and has experimented with growing Idaho russet potatoes on farms in Hebei Province. Frozen desserts are made in Beijing by another McDonald's supplier, Bama Pies.

The management of McDonald's China supply logistics has taken a step forward with the entry of The Havi Group, McDonald's main US distribution manager. Havi has established the wholly foreign-owned Husi Food Co. Ltd. to function as the consolidator and distributor of virtually all of McDonald's inputs in China. Currently, Husi operates out of leased space in local cold storage warehouses in Beijing and Shanghai, using its own trucks for delivery. Eventually, Husi would like to develop a centralized distribution warehouse system, playing much the same role in China as its parent plays in the United States. But inadequate roads, overcrowded transport, and shortages of temperature-controlled highway, rail, and waterborne transportation are just some of the obstacles standing in Husi's way.

—Carol Wingard

tion, each factory makes certain ice cream products exclusively, and delivers these products to other regions in a cost-effective manner by "backhauling" other products or ingredients on return trips, rather than returning empty.

Several large international shipping and logistics companies are making inroads into China's distribution system, in some cases providing controlled-temperature trucking services. The business licenses for these firms in China may also include warehousing in the specified scope of business, but for the most part these firms concentrate on transporting goods. None of these firms has made a capital investment in cold storage warehousing, but most operate a dry warehouse at their container yard at one of China's ports.

Sea-Land Service Inc.'s Orient Trucking Limited (OTL), for example, offers trucking service, including refrigerated container shipments, in five main coastal cities and the inland cities of Wuhan and Chengdu. OTL, a joint venture involving Sea-Land, a subsidiary of US-based CSX Corp., has over 50 trucks based at the Yantian container port in Shenzhen, and 25 tractors and 30 chassis operating out of its Shanghai base. Sea-Land also operates a dry warehouse in Shanghai for storage and consolidation services, but has no cold-storage warehousing facilities. Instead, Sea-Land can store temperature-controlled shipments in reefer containers in an area of its container yard in Shanghai with access to electrical outlets. Land-Ocean Inchcape, a joint venture involving British firm Inchape PLC, offers Shanghai-based container transport service, and some Chinese shipping companies such as China Ocean Shipping Co. (COSCO) also offer inter-city reefer and refrigerated truck shipping.

At the local level

Whether the goods travel initially by road or rail, efficient transport for the final few miles of food distribution is essential. Traffic problems and regulatory hurdles make timely distribution to retailers in Chinese cities a challenge. Many of China's cities have adopted traffic controls as a means of combating gridlock, and restrict trucks from entering the central business district during daytime hours. In Shanghai, for example, this restriction runs from 7:00 AM to 7:00 PM; special licenses are required for night-time deliveries as well. When the truck enters the central business district, the driver will likely have some difficulty finding a place to "stop and drop." Passenger cars and vans are permitted in central Shanghai only on alternating days, based on odd/even license plate numbers, although the government has accommodated some FIEs with a critical need to make frequent downtown deliveries. Alternatively, some firms have adopted a strategy pioneered by The Coca-Cola Co.—using three-wheeled bikes with thermal containers on the back to make deliveries to small retail outlets.

A last but critical link in the cold chain is food retailing. Despite the fact that Chinese tastes, customs, and culinary culture dictate a strong preference for freshness and a bias against packaged foods, supermarkets are beginning to make their mark. For China, "supermarket" refers to stores of at least 50 sq m with frozen and chilled sections and self-service shelves. In 1991, the US Agricultural Trade Office (ATO) counted only one store in Shanghai that would qualify as a supermarket. Today, Shanghai supermarkets number over 700, with nearly half of these larger than 100 sq m. A Gallup survey, carried out in Shanghai in September 1996 for the US ATO, found that 80 percent of consumers shopped regularly at wet markets—the traditional, open-air stalls selling everything from fresh fish to vegetables—while only 11 percent said they shopped regularly at supermarkets. However, younger customers were more likely to frequent supermarkets: 22 percent of respondents between the ages of 18-35 reported shopping regularly in supermarkets.

Among China's supermarket shoppers, frozen goods, including frozen dumplings and frozen chicken products, are the most popular purchases, according to the recent Gallup survey. Such products would prove convenient to prepare in microwaves, already a staple appliance in as many as 40-50 percent of households in wealthier Chinese cities, according to industry experts.

The advent of supermarkets in China also promises greater sales potential for chilled products such as packaged meat or fish.

The advent of supermarkets in China also promises greater sales potential for chilled products such as packaged meat or fish, which offer consumers the taste advantages of fresh products as well as the flexibility to store the wrapped and sealed product in the refrigerator for consumption a few days later. Meat or fish purchased at a wet market, in contrast, usually must be prepared and consumed immediately. Consequently, packaging will play an increasingly important role in cold chain management and the extension of product shelf lives. For example, the need for high-quality, high-barrier plastic packaging for vacuum or modified-atmosphere packing of meats goes hand-in-hand with the development of the delivery systems to get these packaged products to the retail outlet. W.R.

Grace's Cryovac unit, a global leader in flexible packaging technology, is actively marketing its high-barrier plastics in China.

While traditional Chinese wet markets will continue to be a mainstay, the needs of urban dwellers, with smaller household units, greater household discretionary spending, and more hectic working days, favor the development of supermarkets and the popularity of chilled and frozen products. And central- and local-level policies are encouraging the development of large-scale chain stores. In Shanghai, two municipally owned groups have led the development of the city's supermarkets: the Shanghai Hualian Supermarket Co. and the Shanghai Lianhua Supermarket Commerce Co. By year-end 1996, each had more than 100 stores. Hualian's 1996 sales revenues were reported at ¥902 million ($109 million); Lianhua sales registered ¥800 million ($96 million).

Foreign food retailers have also shown great interest in Shanghai. Hutchison Whampoa's Park 'N Shop, Ltd. formed a joint venture with the Lu Wan District Non-staple Foods Co. and has established 20 Park 'N Shop supermarkets. Another six Park 'N Shop outlets were operating in Guangzhou by the end of 1996. Netherlands-based Royal Ahold N.V., operator of The Stop & Shop Co., Inc. in the United States, established a venture with the Shanghai Zhonghui Supermarket Co. in 1996 and has opened three Tops supermarkets in Shanghai. Royal Ahold has announced plans to invest $50 million and open 100 stores within three years.

The discount store format has also arrived in China and will have an impact on food purchasing habits. The entire basement of French retailer Carrefour's Shanghai store is devoted to foodstuffs, with large-scale refrigerator display cases and freezers, as is most of the first floor of Wal-Mart Stores, Inc.'s three-story 1,800 sq m Super Center in Shenzhen. But large discount stores are likely to develop more slowly than supermarkets, since Chinese shoppers likely will refrain from making large-volume purchases they would have trouble carrying home on public transportation.

Frozen sections, meanwhile, are also proliferating in smaller neighborhood stores. Frozen food producers—primarily ice cream manufacturers—have loaned thousands of small-sized, branded freezers to small-scale vendors as an inducement to stock their products. The Walls, Nestle, and Meadowgold ice cream freezers seem nearly as widespread as Coca-Cola umbrellas in many Chinese neighborhoods. Some problems with this strategy have emerged, however: producers complain that shopkeepers often use these freezers to carry goods other than the branded product; and producers are unable to ensure that shopkeepers keep the freezers running at night. And simply recovering these freezers at some later point has been difficult, as the rate of disappearance is high.

The Table of Tomorrow

But new diet and food purchasing habits have set the stage for major changes in China's food industry, including the logistics of food distribution. Consumers' expectations will continue to rise, demanding more convenience, fewer food-shopping and preparation hassles, and more options in how and where meals are purchased and prepared.

The major advances in China's food industry sector have been at either end of the distribution chain: processing and retailing. The constraints are in the intermediary links in the chain—lack of sophisticated cold storage warehousing, overburdened railways, lack of interprovincial highways, and inadequate stock of refrigerated carriers. Perhaps most important, the absence of large-scale food wholesalers with wide geographic scope means that producers, distributors, and retailers cannot turn to any one source for an integrated solution to their distribution needs on either a national or regional basis.

Business opportunities will thus abound for cold chain supply services: refrigeration technology, materials handling equipment, refrigerated transportation, information technology, food retailing, and overall know-how in cold chain management. For the moment, until the restrictions on foreign trade and distribution are eased further, producers, importers, and others interested in getting their products in front of Chinese consumers will need to piece together their own distribution systems. Integrated third-party solutions remain in the future. 完

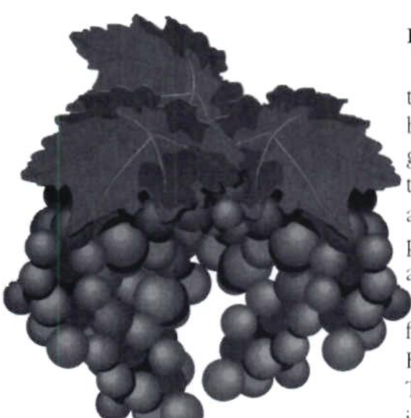
One Sip at a Time

US and other foreign winemakers hope to cultivate the PRC's taste for Western-style wine

Gordon W. Murchie and Tali Levine Kamis

Long before the Chinese invented paper, gunpowder, or noodles, they were growing grapes. And as early as the Tang Dynasty (618-907 AD), China's grape growers were making sweet, potent wines. Using cultivated grapes (*vitis vinifera*) to produce dry wines in the European tradition, however, is a more recent phenomenon. China's oldest commercial winery, the Chang Yu Pioneer Wine Co., was formed in Yantai in 1892, and was followed by several prominent Chinese and joint-venture wineries early this century. In 1915, the Chang Yu winery even won a gold medal for its red wine at the Panama Exposition in San Francisco.

Despite these early experiences with wine production, China's market for wine, particularly drier Western-style wines, remains undeveloped. Only about one-fifth of China's current grape harvest is made into wine, while the rest end up as raisins or table grapes. Grape wine output totaled a mere 300,000 metric tons in 1996, well below production levels in more developed wine markets. In France, Italy, and the United States, in contrast, total 1996 output reached 5.5, 5.5, and 1.6 million metric tons, respectively. Annual wine production in China also trails far behind PRC output of distilled liquor and beer, which in 1996 totaled 6.8 and 16.3 million metric tons, respectively.



Far from saturated

Aware that China's wine industry has significant room for growth, Beijing has taken several steps to develop the sector. Chinese officials are also looking to promote alternatives to ever-more popular beer and liquor, both of which require large amounts of grain for production. Eager to lessen China's growing demand for imported grain, officials began in 1987 to encourage the production of alternative beverages, particularly wine, that are relatively low in alcohol content and are made from grapes and other fruits, instead of grain. In recent months, Beijing has placed new limits on foreign participation in the domestic beer industry in an effort to protect domestic brewers, yet the government appears to be continuing its policy of encouraging foreign participation in wine joint ventures.

As of May 1997, according to Xinhua News Agency reports, Chinese and foreign partners had formed eight wine joint ventures, including the Tianjin-based Dynasty Winery, a joint venture among France's Remy Martin, INTTRA Hong Kong, and the Grapery of Tianjin (a vineyard owned by the Tianjin municipal government). China now boasts some 110 wineries, including the Sino-foreign joint ventures, located in over 20 different provinces.

Along with the expansion in the number of wineries in operation, the area of land allocated for grape cultivation and production had grown by 1994 to roughly 4.7 times the 1980 acreage. China's primary winemaking areas include Hebei (where the climate and soil in some areas is comparable to that of the Bordeaux region of France), Henan, Liaoning, and Shandong provinces, and the Xinjiang Uygur Autonomous Region. Together, these areas account for over two-thirds of China's total grape production. Guoguang Luo, a professor at Beijing Agricultural University, notes that Xinjiang is China's top grape source, producing 489,000 metric tons in 1995, followed by Hebei Province, with 293,000 metric tons.

In April 1996, a group of US and French wine experts was invited to participate in the first official US delegation to China on winemaking and grape cultivation since 1949. During a meeting with this delegation, An Zhi, deputy director general of the Chinese General Association of Light Industry (CGALI)'s Department of International Cooperation, summarized the PRC government's objectives for the Chinese wine industry, stating: "We need to improve technology in the production of wine...to

Gordon W. Murchie is president of the Vinifera Wine Growers Association and former executive director of the National Wine Coalition. In April 1996, he led the first officially invited US delegation on grape cultivation and winemaking to the PRC since 1949. Tali Levine Kamis is assistant editor of *The CBR*.

Only about one percent of the Chinese population drinks wine regularly.

improve the quality and increase the varieties [of wine grapes] and upgrade equipment for production....Our manufacturers and wineries in China would very much like to establish cooperation with wine contacts in other countries in order to promote progressive development of grape planting and wine production."

Since the April 1996 meetings, delegation participants and their Chinese colleagues have discussed with officials from the US Department of State and the Bureau of Alcohol, Tobacco, and Firearms (ATF) the possibility of establishing an ATF advisory team to help Chinese officials draft national wine-related standards and regulations. US winemakers looking to form joint ventures or export their wines, root stock, and winemaking equipment to China all stand to benefit from such developments.

TRAINING THE TASTE BUDS

But before US and other foreign winemakers can hope to see their wines on every Chinese shopping list, Chinese consumers must first develop a taste for drier Western-style wines. The alcoholic beverages of choice in China today tend to be beer or distilled liquor, such as brandy or cognac. Annual per capita beer and distilled liquor consumption in China currently stand at 12.8 and 5.6 liters (l), respectively. The average Chinese drinks just one glass of wine (0.2-0.3 l) each year; the average American, in contrast, consumes 6.7 l annually. Only about one percent of the Chinese population drinks wine regularly and few Chinese consumers view wine as a beverage to accompany meals. China's wine drinkers tend to be women, while men prefer distilled spirits.

The Chinese government is reportedly developing an informational campaign, to be conducted largely through newspaper and television advertisements, with the goal of educating consumers about drier grape wine and the health benefits of moderate wine consumption. Both this informational campaign and central-level efforts to discourage the use of grain to produce luxuries such as beer and distilled spirits may facilitate foreign winemakers' efforts to create demand for a new taste. While most Chinese consumers still think of wine as a heavy, sweet, and high-alcohol drink (typically at least 18 percent alcohol content), in recent months foreign winemakers have found that the demand for drier, low-alcohol red wines is on the rise in China's richer coastal areas. One importer of foreign wine, for example, now sells more than 1,000 cases each month and expects sales to double this year. Much of this demand seems to have been sparked by press reports from Taiwan and Hong Kong that tout the beneficial effects of red wine on health and virility (*see* p.22).

Over the long term, foreign winemakers could capitalize on the growing popularity of drier wines by following the lead of foreign soft drink manufacturers and designing intensive nationwide marketing campaigns that highlight the pleasure of drinking wine in various social settings—particularly as a beverage to accompany meals. In just over a decade, Coca-Cola and Pepsi Cola, the first foreign soft drinks to be sold in China, have become household staples. Beer, a favored beverage for much of this century, has become even more popular in recent years, thanks to both extensive advertising campaigns and rising PRC incomes.

Foreign winemakers also could prosper from the fact that heavily advertised foreign products usually hold more cachet with China's emerging middle class and are favored over domestic brands. Many consumers, looking to flaunt their newfound wealth, have started purchasing expensive liquor with status-symbol appeal, including Regency Brandy XO and Johnny Walker scotch. If marketed heavily, foreign-made wines, especially red wines and sweeter white wines such as Gewurtztraminer, Riesling, or Muscat, could become more popular among young, affluent, health-conscious Chinese. These wines are priced well below expensive foreign liquor, but are more expensive than traditional Chinese wines, which currently sell for about ¥10-¥32 ($1.21-$3.86) per 750 ml bottle.

TRADE HURDLES

Though demand for foreign wine appears to be on the rise and US wine exports to China have increased dramatically since 1990 (*see* Table 1), tariff and other trade barriers currently present significant deterrents to import growth. For example, China currently levies a 70 percent duty on foreign wine imports. When other taxes and duties are taken into account, the final retail price of a bottle of imported wine increases by approximately 121 percent, making imported wines prohibitively expensive for the majority of Chinese consumers.

In an effort to accelerate China's accession to the World Trade Organization (WTO), Beijing pledged in November 1996 to reduce its average tariff rate to roughly 15 percent. Though China has yet to make a specific commitment to reduce the high tariff on imported wine, once it accedes to the WTO, Beijing will be required to cut tariffs, including the duty on wine, to levels consistent with WTO guidelines. China, for example, could be required to reduce its wine tariff to $.081/l, the standard US tariff level for Uruguay Round signatories. However, Beijing may attempt to negotiate a phased-in reduction of the 70 percent duty, arguing that China's wine sector merits protection as an infant industry. In such a case, it may be many years before PRC duties on wine fall to a level that would make imported wine affordable for large numbers of Chinese consumers.

A second deterrent to increased wine imports is the inability of foreign firms to obtain wine trading and distribution rights. Currently, US wine is imported by State or quasi-governmental trading companies and then sold by the trading companies to hotels, restaurants, and friendship stores, or distributed to a few

TABLE 1
US WINE EXPORTS TO CHINA, 1990-96

	1990	1991	1992	1993	1994	1995	1996
Bottled table wine	$18,568	$11,163	$7,136	$95,349	$95,290	$51,180	$951,331
Bulk table wine	0	0	5,489	42,109	9,411	108,123	46,456
Nongrape wines*	0	0	5,050	22,256	16,126	25,960	32,928
Sparkling wines	13,722	3,316	0	10,896	2,627	43,168	39,081
Total exports	32,390	14,479	17,675	170,610	123,454	228,431	1,069,796

SOURCE: US Department of Agriculture's Foreign Agricultural Service
* Nongrape wines include cider and other fermented beverages such as wine coolers, perry, and mead.

China's grape growers can reap greater profits from table grapes—such as the Thompson Seedless variety—than from wine grapes.

upscale supermarkets catering to expatriates and wealthy Chinese. To transport their wine to consumers, foreign winemakers typically rely on the nationwide distribution network of the China National Cereals, Oil, and Foodstuffs Import and Export Corp. and the individual networks of State trading companies, which often consist of relationships among a number of private outlets. Foreign wine and distilled spirits industry groups have urged that China be required to allow foreign companies to obtain trading rights and establish distribution channels as a prerequisite to WTO membership. China, however, contends that trading and distribution rights are issues to be addressed later, under the General Agreement on Trade in Services, *after* China accedes to the WTO.

Quality control problems

If Beijing reduces the tariff rate on wine and liberalizes trading in wine, foreign-made wine could make significant inroads in China simply because of the growing popularity of Western-style wine and the insufficient domestic supply of high-quality wines. Western vintners, for example, carefully gauge grape quality and sugar content to allow grapes to ripen fully so that they ferment adequately and produce aromatic, high-quality wines. In contrast, traditional Chinese wines sometimes were made simply by adding sugar to inadequately ripened grapes, producing low-quality wines. Many grape growers in China still harvest immature fruit in an attempt to produce as large a crop as possible. The wine produced from these grapes tends to have lower alcohol content and higher acidity levels than global industry norms. Vintners must then add sugar to the crushed grapes to boost the alcohol level, a process which results in poor varietal character. Chinese wine experts admit that overcropping—producing more fruit than the vines' capacity allows, where ca-

Selling to China

Montrose Food & Wine, a division of US-based Montrose International, has been importing wines in China for four years. CBR *Assistant Editor Tali Levine Kamis recently interviewed Montrose Food & Wine General Manager Carl Crook about the company's experience in China. Crook, who was born in Beijing of British and Canadian parents, has lived in China for nearly 30 years.*

CBR: What wines is Montrose currently importing into China?

MONTROSE: Montrose Food & Wine presently imports more than 150 wines from close to 20 suppliers in California, France, Italy, Spain, Portugal, Germany, and Australia. We select our products based on compatibility and brand recognition. Among our suppliers are Kendall-Jackson, Wente Brothers, Concannon, and Mirassou vineyards of California; Chateau Lafite-Rothschild and Bichot of France; Banfi and Bersano of Italy; and Torres of Spain. We are also importing some 70 food items and are the exclusive PRC distributor of UK-based Bass Ale products. We hold exclusive distribution agreements with most of our suppliers.

CBR: How are wine sales doing in China?

MONTROSE: Since we started importing wine four years ago, sales have expanded more than 100 percent each year. We currently have the largest selection of imported wines in China and are a key supplier of premium wines to supermarkets, restaurants, and hotels in 15 cities in China. Our products range in wholesale price from ¥60 ($7.23) a bottle for some low-end California table wines to ¥1,250 ($150.60) a bottle for Chateau Lafite-Rothschild. Our best-selling wines are in the ¥100-¥150 ($12.05-$18.07) wholesale price range. Red wines, in particular, have become very popular with Chinese consumers during the past two years, primarily on account of their reputed health benefits. Currently, our red wines outsell white wines by a ratio of 3 to 1.

CBR: What have been the major challenges in selling wine to the China market?

MONTROSE: I would rank the major challenges facing the imported wine market in China as follows: high tariffs, uneven regulatory development, and the influx of low-quality imported products. On the tariff front, the import duty is currently 70 percent. With the 10 percent consumption tax and 17 percent value-added tax tacked on, the duty compounds to 121 percent of the C.I.F. landed price. In terms of regulatory development, sanitation and labeling requirements are getting more sophisticated by the day. Enforcement of these new regulations has also become more rigorous. Complying with these regulations takes a great deal of effort and patience on the part of importers and distributors, as each regional market or city could require separate application procedures. There also appear to be dozens of containers of cheap wines entering every major port in China every month. If Chinese consumers do not learn to differentiate between low- and high-quality brands soon, the reputation of imported wines as a whole could be damaged. Domestic wines will be the beneficiaries of this situation.

CBR: We have heard rumors that China may reduce the import tariff on wine. Are such rumors correct?

MONTROSE: It has been rumored that the import duty will soon drop to 50 percent. Even if this should come to pass, the barrier will not be significantly lowered.

CBR: Where do you think China's wine market is heading?

MONTROSE: All indications are that the Chinese wine market will continue to grow rapidly in coming years. Imported wines will hold an advantage in this market for at least 3-5 years, because the newly planted vineyards will not mature for another three years. It will also take some years before improvements in quality will allow domestic wine to enter the premium wine market.

pacity is measured in terms of reproductive (fruit) and vine growth potential—occurs in some cases, and these experts suggest that grape growers be given a price incentive to harvest only mature, ripe fruit for the wine industry.

A bigger obstacle may be that many of China's grape growers can reap greater profits from table grapes—such as the Thompson Seedless, Muscat de Hamburg, and Kyoho varieties—than from wine grapes. Cabernet Sauvignon grapes, for example, typically bring in only between ¥1.7-¥2.0 ($0.21-$0.24) per kg, while one kg of Thompson Seedless grapes, when dried into raisins, can sell for ¥12-¥18 ($1.45-$2.17). Other table grapes generally sell for ¥2-¥10 ($0.24-$1.21) per kg depending on the variety, location, and time of year harvested.

Another problem affecting the harvests of high-quality grapes in China is the lack of sufficient disease and pest control systems. Fungal and bacterial diseases such as white and bitter rot and downy mildew, for example, often diminish grape yields.

These types of quality control problems serve as added inducements for PRC winemakers looking for foreign partners or foreign sellers of root stocks. Over the past year, several PRC wineries have expressed interest in attracting foreign investment. Among them is the Beijing Pernod Ricard Winery, commonly known as the Dragon Seal Winery, a joint venture formed in 1987 between France's Groupe Pernod Ricard and the Chinese government. The venture is reportedly seeking additional foreign partners. And the general manager of the Chang Yu winery is reportedly eager to discuss joint-venture possibilities with US wineries.

Many PRC winemakers are also in the market for foreign grape root stocks to improve wine quality and variety. CGALI's research arm, the National Research Institute of Food and Fermentation Industries (NRIFFI), which is tasked with developing national standards for China's food and alcoholic beverage industries, has found that foreign cultivars generally produce healthier vines and better wine grapes than Chinese root stocks. Most Chinese vintners import new cultivars from Europe, as the past 15 years of French joint-venture activities in China have helped familiarize the Chinese industry with French and other European root stocks.

PRC wineries—including China's largest government-owned winery, the Great Wall Winery—rely primarily on imports of French and Italian wine equipment and technology, including temperature-controlled tanks and pneumatic presses, and many are in the process of buying more technologically advanced equipment. The Chang Yu winery will reportedly spend more than $15 million between 1997-2000 to upgrade its equipment, adding to the $2 million in Italian equipment the winery imported in 1995. Despite the European wine industry's apparent head start, there is little reason US root stock growers and equipment suppliers would have trouble competing in China.

In the near term, though, quality control problems will continue to plague China's wine industry. The Ministry of Agriculture, which has jurisdiction over grape growing, has yet to issue a comprehensive set of national regulations and standards for wine production. And, though informal standards are being set through contracts between individual wineries and local vineyards, general acceptance of vineyard management practices that produce high-quality wine grapes is still lacking.

Moreover, China is not a member of the International Office of Vine and Wine (OIV). PRC winemakers thus are not required to follow OIV standards, including those related to limits on pesticides and other chemicals that can be used in vineyard management. Because China is not an OIV member, prospective buyers have no guarantee that Chinese wines meet pesticide content limits and other international quality standards, placing the small volume of PRC exports at a competitive disadvantage globally.

Another problem is that wine-related research in China remains relatively limited. Most government-sponsored agricultural research is devoted to grain, and NRIFFI only recently began extensive wine research and testing. Moreover, just a handful of universities currently offer instruction in grape growing and winemaking.

In 1996, PRC bulk table wine exports were $5.5 million (2.9 million liters), while PRC bulk table wine imports totaled $5.9 million (4.6 million liters).

A GLASS HALF FULL

At the same time that Beijing is targeting foreign winemaking equipment, technology, and expertise to help spur the long-term growth of the domestic wine industry, officials are also eager to develop PRC exports of both traditional Chinese and Western-style wines. In 1996, PRC bulk table wine imports exceeded exports in dollar terms, and the volume of imports was 1.6 times that of exports (*see* Table 2). Traditional rice, fruit, and medicinal Chinese-style wines are being exported to Europe, Southeast Asia, and the United States, while drier Western-style wines produced by wineries such as Great Wall and Dynasty are beginning to appear on store shelves in Chinatowns in the United States and Europe. As part of China's wine export push, Chinese wine officials also have expressed interest in developing nationwide networks to distribute Chinese-style wine to Chinese restaurants and other outlets in the United States. To compete with French, US, Italian, Chilean, or Australian vintners, though, Chinese winemakers realize that they must improve the quality of their dry wines.

As Chinese vintners continue to modernize their wineries and tackle tough quality control problems, US winemakers and wine equipment suppliers will likely face new opportunities to enter the China market. Rising consumer incomes and shifting tastes may help boost wine imports as well. But just as it takes many years for a fine wine to age, it may take many more years for the PRC wine sector to mature. Winemakers and wine equipment suppliers who take advantage of the current opportunities to play an active role in the development of the PRC domestic and export wine markets, though, will likely see the fruits of their efforts in the years to come. 完

TABLE 2
PRC WINE EXPORTS AND IMPORTS

	1995	1996	1997 (1ST QUARTER)
Bulk Table Wine Exports	$4.4 million (2.6 million liters)	$5.5 million (2.9 million liters)	$1.4 million (0.6 million liters)
Bulk Table Wine Imports	$2.2 million (0.7 million liters)	$5.9 million (4.6 million liters)	$6.4 million (6.3 million liters)

SOURCE: PRC General Administration of Customs

Spicing up the Chinese Market

Catherine Gelb

Shanghai McCormick aims to add zest to every Chinese meal

Even today, the mention of spices conjures up images of the global spice trade that existed for centuries. Following in the footsteps of the Arab, Portuguese, Dutch, and British merchants that ran the trade in the past, McCormick & Co., Inc. has emerged as a modern-day version of these global spice traders. Established in 1889 in Baltimore, McCormick has grown into the world's largest spice company. With sales of over $1.7 billion and 9,000 employees worldwide last year, the US company has a global sourcing program that sends purchasers around the world in search of quality herbs and spices for its retail and industrial operations. At the same time, McCormick has established operations in dozens of countries to develop and sell spices, seasonings, and specialty foods catering to local tastes.

McCormick's main China operation, a 1988 Shanghai joint venture initially charged with exporting Chinese spices, has quickly shifted its focus and now sells most of its output in China. This puts the venture, Shanghai McCormick Foods Co. Ltd., not only in the position of carrying out McCormick's worldwide mission to "bring flavor to consumers," but also on the front lines of consumer marketing in China. The company is faced with the task of educating a relatively conservative consumer market about how to use Shanghai McCormick's spices and seasoning products—developed solely for the China market—to spice up home-cooked meals.

Catherine Gelb is assistant editor of *The CBR*.

Recipe for success

According to Gary Zimmerman, group vice president of McCormick's Asia/Pacific Zone, McCormick has been purchasing spices in China since the 1930s. In the mid-1980s, the company decided to expand its sourcing operations in China, primarily for such herbs and spices as chilies, cumin, fennel, garlic, ginger, and pepper. At the time, China was a competitive source for these products, though the country has become less so in recent years.

McCormick began conservatively, taking a 35 percent stake in a joint venture with Shanghai Foodstuff Grocery General Co., a Shanghai government-owned enterprise that produced spices, dried fruit, and other foodstuffs. PepsiCo, Inc. was the joint venture's third partner, holding 25 percent equity. In 1994, however, PepsiCo sold its stake to McCormick and, in 1995, Shanghai Foodstuffs sold 30 percent of its share to McCormick, leaving McCormick with 90 percent ownership of Shanghai McCormick.

Victor Sy, vice president of McCormick's East Asia division, stressed that Shanghai McCormick has been fortunate to have found a supportive local partner in Shanghai Foodstuffs. Sy attributed the venture's success in part to the good relationship between the partners, and said that the Shanghai venture's startup problems were no worse than those McCormick has encountered in other Asian ventures.

The joint venture's main facility on Zhu Mei Road in southwestern Shanghai, which is equipped to process and package dry spices, began operations in January 1990. Activities at the plant include milling and cleaning, industrial blending of dry seasoning mixes, retail packaging in pouches and jars, food service packaging in jars and foil bags, storage of raw and semi-processed materials, product safety and quality testing, and new product research and development. The plant is outfitted with both imported and PRC milling and cleaning, blending, and packaging equipment. The packaging machines produce bottles and plastic and foil sachets, and Shanghai McCormick has plans to add to existing packaging capacity. The company currently operates two to three employee shifts, explained Shanghai McCormick's general manager, Hou Xiao Fang, a Chinese citizen who has been with the venture since its inception.

In addition to the processing and packaging equipment, Shanghai McCormick's technical department utilizes sterilization equipment that allows Shanghai McCormick to meet quality and phytosanitary standards anywhere in the world. The technical department, which oversees product testing and development, tests samples of both the incoming raw materials and the final products. According to Technical Manager Cherie Lim, all new food products must be approved for sale in China by the epidemic bureau of the local Ministry of Health.

The technical department also uses two fully equipped kitchens for product testing and development. One kitchen is modeled on the typical urban Chinese kitchen so that new products can be tested on the same kinds of appliances as those found in a Chinese home. The other kitchen is furnished with industrial equipment, including large ovens and deep fryers, allowing Shanghai McCormick to replicate the preparation conditions of its industrial customers.

Shanghai McCormick currently has sales and distribution centers in Shanghai, Beijing, Guangzhou, and Chongqing. Several of the distribution centers are undergoing renovation and expansion to meet the growing demand for Shanghai McCormick products. Distribution of the company's products extends to 37 cities along the Yangtze River and coastal China, and the company is beginning to branch out into the northeast, central, and western parts of the country. Typically, Shanghai McCormick has 2-3 distributors for each city. The distributors are selected according to a range of criteria, including experience and quality of delivery network. A prospective distributor is disqualified from consideration if it delivers any competing product.

Shanghai McCormick products are sold in small "mom and pop" stores; traditional Chinese supermarkets, where products are displayed behind a counter; in upscale Western-style supermarkets, such as Shanghai's Lianhua and Hualian supermarket chains; and bulk stores such as E-Mart (*Yimaide*), a Korean-Chinese joint venture modeled after Wal-Mart Stores, Inc., and French retailer Carrefour. Shanghai McCormick supplies retailers with convenient, customized display containers for its products. Batches of dry seasoning mix sachets, for example, are pre-packed in white-and-green cardboard display boxes before being placed in a larger shipping box. The retailer need only open the McCormick box and place the ready-made display on the shelf. For more traditional stores, in which most products rest on shelves behind sales counters, McCormick developed a countertop display case.

A supermarket clerk handles a McCormick product display in Shanghai.

Photo courtesy of Catherine Gelb

Shifting the Mix

The current expansion of Shanghai McCormick's distribution centers, and the doubling of its staff in the past two years, reflect the venture's overall sales growth and its shift into the domestic market. In 1990, roughly 70 percent of Shanghai McCormick's output was exported, destined primarily for McCormick's worldwide industrial spice and seasoning business. McCormick supplies some of world's largest food and beverage companies with spices and flavorings. The remaining 30 percent of Shanghai McCormick's output was sold domestically. By the end of 1996, however, the percentages had nearly reversed.

Shanghai McCormick sells not only bottled spices and small spice sachets in China (under the *Weibaomei* brand), but also has several successful lines of dry seasoning mixes that the joint venture's technical department has developed specifically for Chinese consumers. In fact, McCormick's biggest seller in China is the "Season 'n Fry" line of dry seasoning mixes—spicy coatings for fried chicken and other fried foods. The "Season 'n Fry" products, which retail for around ¥2.5 ($0.30) per single-use package, include the top-selling "American Style Coating for Chicken," as well as spicy, garlic, and five-spice styles, and mixes for pork chops, Japanese-style tempura, and banana fritters.

Bottled and packaged herbs and spices, which retail for around ¥5.5 ($0.66) per 45-65 g bottle, also accounted for a significant percentage of Shanghai McCormick's total sales last year. The venture's most popular bottled product is "Szechuan Pepper Salt," a mix including Sichuan pepper, a distinct variety of peppercorn native to China that is a key ingredient in Sichuan-style cooking. Other bottled spices include curry, five-spice, garlic, and ginger powders; meat tenderizer; and ground black, red, Sichuan, and white pepper. The range of bottled spices in China is somewhat limited compared to the McCormick products sold in other countries because Chinese cooking tends to use relatively few spices, Marketing Manager Daniel Craig explained.

Another promising product is the "Szechuan-Style" line of four seasoning mixes introduced in 1995, which also retail for around ¥2.5 ($0.30). The "Ma-Po To Fu" (spicy bean curd), "Gong Bao Chicken" (chicken with peanuts), "Yu Xiang Rou Si" (braised shredded beef or pork), and "Hui Guo Rou" (twice-cooked pork) seasoning mixes have proven popular among the relatively prosperous coastal residents who make up the majority of Shanghai McCormick's customers. Though they might want to prepare these popular, spicy dishes at home, these urban residents may not have the time, spices, or culinary expertise to cook Sichuan-style meals.

Fried rice seasoning mixes that retail for ¥1.5 ($0.18) and include Chinese, Indonesian, and other varieties, were introduced in 1993. Another new Shanghai McCormick product is a line of dessert gelatin mixes, which go by the brand name "Jelly Mix" and come in four fruit flavors—honeydew melon, orange, peach, and strawberry—as well as almond flavor. The jelly mixes underwent substantial product development at Shanghai McCormick, which drew on input from focus groups. The mixes are enriched with vitamin C to appeal to increasingly nutrition-conscious parents. The remaining sales of the joint venture consisted of a line of instant soup mixes, including hot and sour, corn, and vegetable soup; and a few imported products such as ketchup, which comes from McCormick's venture in the Philippines.

With its Shanghai venture already well established, the US parent has recently expanded operations elsewhere in China. In late 1996, McCormick opened a wholly owned, state-of-the-art industrial plant in Guangzhou to produce wet seasoning products, such as ketchup, for the industrial market. Shanghai McCormick, too, is branching out—in early 1997 the venture rented a garlic-processing facility in Liquan, Anhui Province, to mill, clean, and dry garlic. The Anhui plant will permit more efficient processing of garlic in one of China's premier garlic-growing regions and also will improve efficiency at the Shanghai plant, according to General Manager Hou. Eighty percent of the Anhui-processed garlic is exported because, as Vice President Sy explained, garlic is one of the few herbs or spices in which China remains globally competitive.

McCormick's biggest seller in China is the "Season 'n Fry" line of dry seasoning mixes—spicy coatings for fried chicken and other fried foods.

A GLOBAL STRATEGY...

It is probably no coincidence that as Shanghai McCormick has increasingly been able to sell to China's consumers, the Maryland-based corporate headquarters has pointed to McCormick's presence in Asia—and especially China—as an important part of its global strategy. The parent company expects much of its future growth to come from outside the United States, and its 1996 annual report states that "no area offers greater potential for expansion than the Asia/Pacific Zone" for its retail, industrial, and food service businesses. The report highlights a number of factors in China that bode well for McCormick's ambitions in the country. For one, China is home to 14 of the 100 largest cities in the world, and McCormick has traditionally been successful in selling its products in urban

Shanghai McCormick is the only company in China—foreign or domestic—that sells spices and seasonings nationwide.

areas. And China's small but growing urban middle class is indeed the target market for Shanghai McCormick's high-quality, "premium" products.

...AND LOCAL INDEPENDENCE

Despite the fact that Shanghai McCormick plays an important part in the parent company's overall ambitions, the operation has a significant amount of freedom to develop, market, and sell products for the local market. Shanghai McCormick must meet annual sales targets, but how those goals are achieved is largely up to the venture.

Shanghai McCormick obtains nearly all of its ingredients from various regions of China. Cinnamon comes from Guangdong Province; cumin from the Xinjiang Uygur Autonomous Region; garlic from Anhui; ginger from Yunnan; black and white pepper from Guangdong and Hainan Island; red pepper from Hebei and Shandong; and Sichuan pepper from Shandong. Suppliers include both State-owned and private firms and the prices are negotiated on a free-market basis, with contracts signed prior to each harvest. The suppliers are responsible for delivering the spices to the plant.

EDUCATING THE CONSUMER

Shanghai McCormick officials—along with McCormick & Co. executives in the United States—believe that the venture is uniquely positioned to establish the McCormick name as a national, premium brand in China. While each department recognizes that its strategies need to be tailored to the Chinese consumer, this is nowhere more obvious than in the marketing and sales divisions. Shanghai McCormick is the only company in China—foreign or domestic—that sells spices and seasonings nationwide; the chief competitors for Shanghai McCormick products tend to be either local or imported spices and other seasonings. In general, though, the greatest barrier to growth seems to be the immaturity of the Chinese consumer market. Shanghai McCormick, like other Western consumer product companies in China, must convince Chinese people to try their products for the first time. And, as Marketing Manager Craig observed, Chinese consumers are conservative—they may be reluctant to spend an extra *yuan* on an unfamiliar product. In contrast, he said, McCormick does not seem to face this problem in the Philippines, where the more adventurous Filipinos tend to be willing to try new products at least once.

From the small corner grocery stores to the shiny new retail and warehouse-style supermarkets, Shanghai McCormick's marketing efforts, like others both foreign and domestic, rely heavily on in-store demonstrations that offer free samples of ma po tofu and hot and sour soup prepared from Shanghai McCormick mixes; flyers inserted in local newspapers that invite customers to mail in tickets for free prizes; and bonus packs of four dry seasoning mixes bundled with a free soup mix. To attract the younger consumers likely to make up the primary market for Shanghai McCormick's Jelly Mixes, the desserts have their own mascot, a cartoon character called *Mei Mei*, who appears on the product package, on promotional gifts like hats and soft frisbees, and on the Shanghai McCormick delivery trucks.

In addition to printed advertisements in Shanghai subway stations and on billboards throughout the city, Shanghai McCormick has also run television commercials advertising its different seasoning mixes. The commercials stress the products' convenience and appropriateness for the modern urban Chinese lifestyle. One advertisement for the "Szechuan-Style" mixes depicts in black-and-white a traditional Chinese kitchen with the family sweating over a hot wok, followed by color images of a modern kitchen with the family sitting down to a McCormick-seasoned meal. The slogan "Bring home the good flavor" appears in each ad. The slogan used in China is in fact a slightly altered version of that used by McCormick in other countries: "Bringing home a world of flavor."

A TASTY FUTURE

Seven years is not a long time to be in business in China, making the Shanghai McCormick venture's rapid growth especially remarkable. And the venture is clearly set to expand its operations and scope further. One area to watch is the recently established food service division, headed by American Thomas Doran. Doran spends most days visiting restaurants throughout Shanghai scouting out customers for the company's bulk containers of herbs and spices. Though little more than a year old, the food service division is already finding a ready supply of customers among upscale restaurants and fast-food chains.

Despite its comfortable position in China, Shanghai McCormick keeps a close eye on its competitors. Some have imitated McCormick's green and gold packaging colors, marketing similar products at a slightly lower price. Though intellectual property violations are of concern to both the Shanghai operation and the US parent, Group Vice President Zimmerman in Baltimore explained that the company's goal is to find price points for its products that are low enough to discourage counterfeiters from underselling legitimate McCormick products. Shanghai McCormick officials add that although fakes are always a problem, they are confident that China's consumers will become less willing to sacrifice the quality promised by the McCormick name for the sake of a few *fen* saved on a purchase of a rival—or counterfeit—product.

The company's sales force also makes regular visits to markets that stock McCormick products and, in some cases, makes recommendations to store personnel about the McCormick displays. At one store, for example, Shanghai McCormick's national sales manager was concerned that the store's price tags were obscuring the names of the bottled spices. Moreover, the sales force must be vigilant about collections from the stores. Shanghai McCormick, like all firms in China, has found collections a headache. As a result, the Shanghai McCormick salespeople are responsible for collecting payment from the retailers with whom they do business.

All of these problems have proven relatively minor, though, and Shanghai McCormick shows no signs of disappointing its US parent. The market for spices, seasonings, and convenience foods will only increase as Chinese citizens become more prosperous. With rising incomes and an urban lifestyle that is coming to resemble those of more developed countries, China's populace will no doubt continue to demand convenient and flavorful foods. The key will be spreading throughout China—via advertising and marketing promotions—the McCormick name and its reputation for quality. Shanghai McCormick already seems well on its way, though, to securing a lasting presence at the Chinese dinner table. 完

China's New Partnership Law

Donald Clarke, Nicholas Howson, and Qiao Gangliang

The basis for a new business form has emerged, but its implications for foreign investors remain unclear

Though China has made much progress over the last 15 years toward establishing the legal structures necessary for commercial activity—including statutes for Sino-foreign cooperative and equity joint ventures, companies limited by shares, limited liability companies, holding companies, and sole proprietorships—one important omission persisted. In early 1997, the National People's Congress Standing Committee moved to remedy this omission with the passage of the Partnership Enterprise Law of the People's Republic of China (the Partnership Law), which comes into effect August 1, 1997.

In many ways, the Partnership Law merely summarizes in a national statute concepts pertaining to partnerships contained in the General Principles of Civil Law of the PRC (the General Principles) of 1986 and a 1988 Supreme People's Court opinion on the General Principles. It also codifies certain existing practices with respect to the establishment of domestic cooperative arrangements in China, which to date have been established without any explicit legal basis. Though the Partnership Law does not refer specifically to foreign participation, China's new partnerships will be of crucial importance to foreign investors and finance professionals, as registered partnerships are likely to be presented increasingly to foreign investors as targets or potential co-venturers. The new partnerships, and the way in which they are regulated, also could influence how Sino-foreign cooperative joint ventures (CJVs) develop—if CJVs ultimately survive as legal entities distinct from partnerships.

LIABILITY

Under the Partnership Law, a partnership is formed by a written partnership agreement entered into by at least two parties, each of whom bears unlimited joint and several liability for all, and not merely a proportionate share, of the debts of the partnership. Partners who pay out more than they are obligated to bear under the partnership agreement may seek contribution from other partners. The law also makes allowance for internal allocations of liability among partners, where one partner usurps benefits, acts without authorization, or exceeds the scope of his or her authorization when acting on behalf of the partnership.

Former partners bear joint and several liability with the other partners for debts of the partnership incurred prior to their retirement, while new partners bear full liability for debts of the partnership incurred before they became partners as well as those incurred after. The Partnership Law, however, distinguishes between a partner and the partnership in stipulating that "The creditor of a partner in a partnership may not offset its claim against [the creditor's] debts to the partnership." This provision is of practical importance in China, where the distinction between an enterprise and enterprise managers tends to be unclear—especially for creditors seeking to recover on debt by any means possible or for debtors seeking to avoid their debts. It is interesting to note that creditors of a partnership may not bring claims against partners more than five years after the dissolution of the partnership.

Contrary to expectations and unlike many of China's other laws, the Partnership Law declares no explicit minimum capital requirement for PRC partnerships. And, though many had anticipated that the law would restrict a partner from entering into multiple partnerships, in fact the law allows partners to be involved in more than one partnership. But the law stipulates that partners (alone or in cooperation with others) are not permitted to engage in activities that are

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deemed "competitive with" or "detrimental to" any partnership in which they invest. With incestuous business structures increasingly common in Chinese industry, interpretation of this clause may prove challenging.

The law does not explicitly provide for foreign-invested partnerships, presumably because such entities are covered by the PRC law on CJVs (*see The CBR*, January-February 1996, p.39). It remains to be seen, though, whether Chinese approval and registration authorities will insist that all partnership arrangements involving foreign participation conform to the legal requirements of CJVs. For tax purposes, the State Tax Administration (STA)'s Foreign Invested Enterprise Income Tax Department is already on record as stating that CJVs will continue to be governed *exclusively* by the CJV statutes and that no Sino-foreign cooperative arrangement will be governed by the new law.

Establishing a Partnership

As is legally required of all other business forms in China, partnerships must be registered by the "enterprise registration authority"—presumably the local Administration of Industry and Commerce (AIC). The new law grants this authority the power to decide within 30 days of receiving the application whether to register the partnership and issue a business license. This may be the point at which a minimum capitalization requirement, absent from the law itself, is actually imposed. The partnership's name may not contain the words "limited" or "limited liability" and the date of issuance of the business license is deemed the "establishment" date of the partnership.

The fact that a partnership is required to register, albeit as an entity without limited liability, is a potential source of confusion. In Chinese law and bureaucratic practice, registration implies that the entity is a "legal person." However, the General Principles exclude partnerships from the category of legal persons. In a baffling omission, the new law fails to state explicitly whether or not PRC partnerships are legal persons. CJVs, in contrast, can choose whether to opt for "legal person" status and, thus, limited liability (it is generally accepted in PRC law that only entities that have legal-person status enjoy limited liability). If partnerships are to have unlimited liability, notwithstanding their registration and taxation as independent entities, the converse might be inferred: that partnerships do not enjoy legal-person status. Unfortunately, this legal ambiguity will only be clarified once an AIC produces the first partnership business license, with or without the notation "enterprise legal person" displayed.

The Partnership Law stipulates that, where other laws and regulations require it, approval of partnership applications by other relevant authorities may also be necessary. Any changes to the particulars of registration, including changes to the partnership agreement or admission of new partners, must be registered with—and presumably approved by—the enterprise registration authority within 15 days of their occurrence. Potential partners should note, though, that the partnership agreement itself becomes effective upon signature (and the affixing of the official "chops") of all partners, which will always precede registration and "establishment." However, prior to registration, partners are prohibited by the law from engaging in any business on behalf of the partnership.

Getting In

The law leaves the specifics regarding the partnership's capitalization largely up to the individual parties. Capital contributions can be in currency, in kind, or in the form of leaseholds, intellectual property rights, or other property rights, as well as in the form of labor. While the value of non-currency contributions may be assessed by the partners or registered evaluation firms, the law does not make valuation mandatory—an indication of PRC lawmakers' increasing willingness to allow economic actors to make independent decisions regarding value. Like many countries' partnership laws, the PRC law requires that the admission of a new partner to the partnership, or the transfer of a partnership interest to a new partner, receive the unanimous approval of all existing partners. Existing partners also enjoy a statutory right of first refusal on proposed transfers of partnership interests to third parties.

Management Issues

The affairs of a partnership can be carried out "jointly" (*gongtong*) by the partners, or the partners can specify in the partnership agreement the appointment of one or more "managing partners," in which case the remaining partners cannot participate in conducting the affairs of the partnership. The Partnership Law provides that if any partner objects to the management of a specific matter by the partner assigned thereto, the partner in question can be suspended from the conduct of such affairs. Unfortunately, the law does not seem to allow for alteration of this potentially disruptive rule by contract (via the partnership agreement).

Except as otherwise stipulated in the partnership agreement, each partner has one vote. However, the new law lists several matters for which the consent of all partners is required, including: the disposal of the immovable property of the enterprise; the assignment or disposal of intellectual property rights or other property rights of the enterprise; a change of registration; the granting of security in a partnership interest; and the admission of a new partner. The law does not permit the partners to deviate from this stipulation in the partnership agreement.

Like the laws and regulations governing CJVs, the Partnership Law allows the partners to agree upon the ratio for sharing profits and losses. Thus, profits need not be split in accordance with the ratio of capital contributions—an important factor for new partners who enter into partnerships when the value of the partnership interest exceeds the amount of the original capital contributions equivalent to that interest. In the absence of such an agreement on profit-sharing, profits and losses are to be shared equally among the partners. The law also stipulates that the capital contributions of the partners and all "profit" (*shouyi*) obtained in the name of the partnership shall be the property of the partnership. The use of a more general term in the new law such as "income" or "revenues" (*shouru*) would have been preferable to "profit," but this is presumably simply the result of imprecise drafting.

The new law contains no stipulation on the extent to which partnerships themselves can hold equity, registered capital, or partnership interests in subsidiary enterprises or partnerships. The Company Law of the PRC, for instance, limits the extent to which a PRC company can hold interests in other entities to no more than 50 percent of the said company's net assets. Thus, tax and governance concerns permitting, the partnership form could conceivably be used to structure holding entities in China.

Getting out

Partners may be removed by the unanimous resolution of all other partners for certain breaches of duty, or for other transgressions enumerated in the partnership agreement. As for voluntary withdrawal from a partnership, partners may simply retire by providing 30 days' notice to the other partners "provided that they do not adversely affect the conduct of the affairs of the partnership." If the partnership agreement stipulates a certain term length for the partnership, however, a partner cannot retire unless one of the following conditions is met: the grounds for leaving the partnership stipulated in the partnership agreement occur; retirement from the partnership is approved by all of the partners; circumstances arise that "make it difficult" for the partner to continue to participate in the partnership; or other partners seriously breach the obligations stipulated in the partnership agreement. Clearly, the vagueness of the condition regarding "difficult circumstances" leaves much room for interpretation and dispute.

The Partnership Law also addresses the death of a partner. When a partner dies, his or her lawful heirs or successors become partners in place of the deceased "in accordance with the stipulations of the partnership agreement or upon the consent of all the partners." If the lawful heir or successor does not wish to become a partner, the partnership share belonging to the deceased partner may be returned to the partnership, though the law does not indicate at what value. Article 53 states that the method for the refund or return of partners' property may be stipulated in the partnership agreement or decided by all of the partners. The law contains no specific provisions for cases in which the partnership agreement fails to provide for a succession to the position of partner, or if the partners do not agree unanimously to accept the heirs or successors as partners. But Article 52 of the Partnership Law may apply to such cases: when a partner "retires" from the partnership (death, according to Article 49, is effectively the same as retirement), the other partners shall return the partner's property share.

Tax matters

The new law states simply that a partnership must pay taxes "in accordance with the law." While the partnership will no doubt be responsible for paying any applicable value-added tax, business tax, and other duties and levies, it remains unclear whether a partnership will be treated for income tax purposes as a separate entity (a concept used in certain civil law countries) or as a nontaxable conduit (similar to US law, which recognizes a partnership as an aggregate of the partners). Officials of STA's Domestic Enterprise Income Tax Department have confirmed their view that a partnership is an entity maintaining accounting controls and deriving income from business operations, as defined in Article 2 of the 1993 PRC Interim Regulations on Enterprise Income Tax. As such, a partnership should be treated as an independent taxpayer, subject to the flat 33 percent business income tax rate. Further, STA has confirmed that the partners then will be taxed on distributions from the partnership of after-tax distributable income—in effect, double taxation. This is a departure from STA's handling of "domestic joint enterprises" (*lianying qiye*), which, since the 1994 tax reforms, have been taxed as legal entities (whether or not they had legal-person status), with tax-free distribution of after-tax profits to the participants.

Liquidating the arrangement

Prospective partners should be aware that, like many PRC statutes, the Partnership Law's provisions regarding the distribution of property upon dissolution and liquidation of a partnership distinguish between "original investment" and "return on capital." The law provides that any surplus remaining after payment of taxes, all wages owed, and other debts of the partnership shall be distributed as follows: first, the capital contributions of the parties shall be repaid; second, any remaining funds shall be distributed to the partners in the same ratio in which they share profits.

Thus, like the law on Sino-foreign equity joint ventures, the Partnership Law treats one dollar of capital contributed at the founding of the partnership as equivalent to one dollar of capital contributed years later in the life of the partnership. In fact, one dollar contributed later in the partnership's life may represent a much smaller portion of the total value of the partnership, since the going concern value of the partnership may have increased and later capital contributions will be worth less because of inflation. There is no obvious reason why partners should not be allowed to settle this matter by agreement, with a default provision for distribution in accordance with profit-sharing ratios.

Still to be resolved

The Partnership Law lacks a set of implementing rules that would clarify various important issues, including the legal status of partners and the delineation of who has authority to act on behalf of the partnership. Further, the law contains no provision specifically addressing whether other business entities (legal persons), which generally enjoy limited liability in China, as well as individuals (natural persons) can be partners. Several of the law's provisions make little sense if only natural persons are permitted to form partnerships: one article, for example, forbids "persons prohibited from engaging in profit-making activities," such as non-profit organizations, from acting as partners (no natural person is prohibited from engaging in profit-making activities). Though the law states that partners must have "full capacity for civil acts" and bear unlimited liability for the debts of the partnership, this likely means that creditors may seek the assets of the partners as well as those of the partnership—not that partners must be individuals or unlimited liability companies. This point will no doubt be tested when the first partnership between corporate entities seeks to register.

The Partnership Law also fails to state clearly who has authority to bind the partnership. The new law indicates (by negative inference) that the unanimous consent of all the partners is *not* required for all acts that bind the partnership. Elsewhere in the statute, those identified as managing partners are given authority to bind the partnership in contracts with other parties. The 1988 Supreme People's Court opinion seems to confirm that the acts of a managing partner are binding on the partnership. However, Article 38 of the new law suggests that all partners have apparent authority to bind the partnership. The lack of consistency on this point will likely cause third parties to be cautious in entering into transactions with partners purporting to act on behalf of partnerships, and unclear on the scope of their duty to investigate the real authority of such partners.

The Partnership Law also raises the question of whether local or profession-specific rules (and practices) take precedence over national law. For example, under existing Beijing Judicial Bureau rules relating to the establishment of law firms in partnership form, a law firm must be formed by at least three licensed attorneys with a specific number of years of experience and certain other qualifications. The Partnership Law, however, requires only that the number of partners be no less than two. Any future implementing rules should address such inconsistencies and clarify whether such local or sectoral regulations may be more restrictive than the national enabling statute.

INVESTOR CONCERNS

Now that partnerships have a formal legal basis, they are likely to be presented more frequently to foreign investors as potential co-venturers. But for actual business arrangements between PRC partnerships and foreign parties to proliferate, the ability of partnerships to act as co-venturers with foreign investors must be clarified: longstanding PRC pronouncements mandate that only "enterprise legal persons" may enter into joint ventures with foreign entities and the General Principles seem to exclude partnerships (of individuals) from the umbrella of legal-person entities. Until this is clarified, foreign investors will and should be cautious about entering into joint ventures with Chinese partnerships.

While the mere articulation of a solid basis in law for partnerships is an important development for foreign parties studying opportunities in China, the Partnership Law also fails to make explicit the relationship between PRC partnerships and CJVs. Presumably, CJVs could now be considered merely partnerships with foreign investment under the Partnership Law. However, there remain crucial differences between the CJV and partnership statutes that suggest CJV-type arrangements should continue to conform to the CJV law. (The Company Law does not make this mistake, as it declares that foreign-invested limited liability companies will continue to be governed by statutes on foreign-invested enterprises.) For instance, how will both legal-person CJVs and non-legal person CJVs—both of which are specifically authorized under the CJV rules—be treated under the Partnership Law? Will STA continue to respect the early return of investment authorized for foreign investors in CJVs (via distribution of depreciation funds), even though the Partnership Law is silent on this point? Would purely domestic partnerships be able to effect early return of investment to their partners, drawing from the statute applicable to CJVs? These, along with a host of other questions arising from gaps or conflicts in the law and the CJV statutes must be addressed quickly in implementing regulations or through formal explanation by either the Ministry of Foreign Trade and Economic Cooperation or the Standing Committee of the National People's Congress. Only through such clarification will this new business entity prove useful for foreign investors, who, after all, have been setting up "partnerships" under the CJV law for over a decade. 完

The Different Faces of the Chinese Consumer

China's consumers are more diverse—and more discriminating—than some marketers of foreign goods may realize

Geng Cui

China's emergence over the last 15 years as a viable consumer market has attracted multinational corporations (MNCs) selling everything from baby food to passenger jets. The country's massive population of 1.2 billion citizens—all of whom, according to the age-old cliche, are potential consumers—has led many MNCs to envision significant opportunities for growth and expansion. The success stories of such companies as Avon, The Procter & Gamble Co., Unilever PLC, The Coca-Cola Co., and PepsiCo, Inc. only entice more newcomers to the China market.

Despite the publicity surrounding the newfound spending power of the Chinese people and the successes of many foreign firms, a number of MNCs discovered soon after entering the market that China's huge population did not translate easily into a steady stream of customers. Many foreign as well as Chinese firms saw less than gratifying returns on their investments as they fell victim to the "edifice complex": rushing to expand their operations in the country, they failed to understand fully Chinese consumer preferences. In large part, these miscalculations reflect the tendency of foreign marketing experts to view China as a single, homogeneous market.

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The Rise of Retail

Over the long term, few economists doubt that China will evolve into a nation of spenders. In time, China is certain to join the ranks of Asia's newly industrialized economies, such as Thailand and South Korea, as the purchasing power of Chinese consumers continues to rise. The World Bank, using the purchasing-power-parity (PPP) method of measuring per capita GNP (*see The CBR*, May-June 1996, p.12), estimates that the average Chinese consumer's annual income in 1994 was roughly $2,510—a level at which some consumption of foreign-made goods is possible. With low apartment rents and income taxes, government-sponsored medical care and public education, and virtually no mortgage debt to speak of, many Chinese citizens are able to save as much as 40 percent of their incomes. In aggregate, China's market represents a much larger consumer base than countries with higher average per capita incomes but with smaller populations, such as Japan. China thus remains potentially one of the largest consumer markets in the world.

The growing spending power of China's citizens has already meant dramatic growth in the retail market—a fact that has not been lost on foreign retailers and manufacturers. Retail sales in 1996 were ¥2.5 trillion ($297 billion), according to official US Department of Commerce figures, and are expected to triple by 2000. Sales of cosmetics, for example, have risen sharply since 1990, totaling $1.9 billion in 1995, and the Hong Kong firm ASL estimated that they would jump another 32 percent to reach $2.5 billion in 1996.

Encouraged by these rapidly multiplying figures, foreign retailers such as Yaohan International Co. Ltd. from Japan and 7-Eleven of the United States have ambitious plans to open hundreds of retail outlets in China. And foreign manufacturers of consumer goods continue to flock to China as well;

although foreign-funded manufacturing enterprises that produce consumer products generally are expected to export much of their output, in many cases these companies have been able to sell significant percentages of their total production in the domestic market.

The Chinese consumer

Translating these trends into actual marketing success, however, has never been a sure bet. Though the popular press has written much about the growth of the China market, accurate analysis of China's consumer demand has been a common problem for MNCs. One popular misconception is that all of China's consumers have increasing disposable incomes and insatiable appetites for foreign-made goods—a conclusion easily reached by anyone strolling along Shanghai's Nanjing Road or through Wangfujing in Beijing. But marketing a product to the Chinese consumer based on this kind of superficial assessment ignores the heterogeneity of the China market.

To be successful in any market, MNCs need to understand the market's structure and its consumers. In recent years, a growing number of market studies has helped assess the true purchasing power of Chinese consumers. A 1994 Roper Research International study targeting 280 well-off residents of Shanghai and Guangzhou found that these "super consumers" earned 10 times the average annual Chinese income and that 85 percent preferred to purchase items with cash. Many of these consumers are entrepreneurs, professionals in private companies, and workers in township enterprises.

But the majority of Chinese hardly fit this consumer profile. Typical Chinese consumers tend to be in their twenties and live with their parents in urban apartments, according to a Gallup China Ltd. consumer survey—the first nationwide survey of China by a foreign research company (*see The CBR*, September-October 1995, p.19). After analyzing personal interviews with 3,400 people, Gallup characterized the average Chinese consumer as generally pragmatic, price and quality conscious, a careful planner, and patriotic. More recently, a 1995 SRG/Nielsen report identified a number of consumer groups as individual markets: the "Little Emperor" market (consisting of the large number of one-child families); Chinese yuppies (young professionals with disposable income); working women (who are likely to opt for convenience products); and the "practical-minded," more conservative, older consumers.

Although those who work in China's booming coastal cities have plenty of spare change and are spending freely, MNCs need to bear in mind that 70 percent of all Chinese live in rural areas and still live hand-to-mouth. A number of Chinese consumers can afford foreign-made appliances, food, and other goods. But regional differences in levels of economic development, infrastructure, consumer purchasing power, and distribution and transportation logistics are serious stumbling blocks for any MNC hoping to develop one standard, national marketing strategy. More and more MNCs now consider such complexities when assessing consumer demand and formulating marketing strategies in China.

Moreover, though foreign-made goods generally are of better quality and can symbolize prestige and status, Chinese consumers tend to be more sophisticated and discriminating than many Western analysts anticipated. While they clearly prefer imported, high-quality products, they do not blindly buy Western. Rather, they look for quality at a good price (*see The CBR*, May-June 1996, p.30).

Not all of one mind

Simply put, foreign companies will not find a nationwide, majority middle class in China like that in Japan or the United States. On the contrary, geographic factors, demographics, and differences in attitudes, values, beliefs, or even personality—factors known as "psychographics" —are all important predictors of consumer behavior. Segmenting China's market using a hybrid approach that examines all of these factors paints a more realistic picture of the different consumer categories in China, as well as each group's "readiness" to purchase foreign-made goods.

China's consumer preferences tend to differ according to geographic location, as regions vary in their levels of economic development. The PRC government's economic policies have allowed some coastal areas to prosper first, creating tremendous economic disparities between China's coastal and interior regions. There are also significant differences in purchasing power and attitudes between rural and urban residents. Income and education levels, as well as types of occupation, often determine who purchases more expensive imported products or goods manufactured by foreign-invested enterprises (FIEs). Psychographics such as innovativeness or creativity, risk aversion, and lifestyle also affect consumer readiness. For example, *The number of Chinese consumers able to afford imported or FIE-made goods is just over 60 million.*

an innovative, less risk-averse consumer with an active lifestyle is more likely to purchase foreign-made products than a conservative or more cautious one.

Based on these descriptive factors, China's consumers can be grouped into four segments (*see* Table). Topping the list, the "nouveau riche" (*baofahu*) group is the most obvious target of many marketers of imported or FIE-made goods. This group encompasses entrepreneurs, businessmen, celebrities, and government officials of various ranks between the ages of 30-65. These are China's super spenders, who make over $5,000 a year, as calculated by simple exchange-rate conversion (if the PPP method were used, their incomes undoubtedly would be significantly higher). The nouveau riche are likely to use credit cards and own a cellular phone and a car. They are eager to purchase products that they perceive as status symbols. According to a 1995 PRC State Statistical Bureau (SSB) survey of four large cities, 1.5 percent of urban families surveyed earned more than $12,000 per year. The number of nouveau riche households nationwide thus ranges from a conservative estimate of 200,000 to the 2 million figure suggested by the SSB survey, but the exact number is unknown.

Next in terms of purchasing power are China's yuppies (*dushi yapishi*). These individuals range in age from 25-45, tend to have at least some college education or technical training, and reside in major metropolitan areas. They work in China's new enterprises, joint ventures, and foreign companies for generous wages by Chinese standards: their annual household income is between $1,800-$5,000. These young urban professionals are decidedly upwardly mobile and are likely to be receptive to new ideas and products. Clint Laurent of Asia Studies Ltd., a Hong Kong-based market research firm, in a 1995 *South China Morning Post* article, suggested that "the younger and better educated have separated themselves from the traditions of the past and in many cases from the government as an employer. They are experimenting with new lifestyles and clearly these will be the easier sell for new products and services."

The yuppies, together with the nouveau riche, can be considered China's emerging middle class and are the primary consumers of foreign products. The number of Chinese consumers able to afford imported or FIE-made goods, according to the author's estimate, is thus just over 60 million—about five percent of the population—scattered in pockets in wealthy cities throughout the country. The top five markets—Beijing, Shanghai, and Guangdong, Jiangsu, and Zhejiang provinces—for example, comprise 16.9 percent of the country's population, yet accounted for 33 percent of national retail sales in 1994. Consumers in these prosperous coastal cities are considered the trend-setters and opinion leaders for the rest of China.

A third category of consumers, China's "salary men" (*gongxin jieceng*), consists of roughly 330 million people who still work for State-owned enterprises for a fixed salary and occasional bonus; their annual household incomes range from $1,150-$1,799. If their work units are profitable, these workers are paid regularly and have health care coverage; if not, they will receive partial pay and probably must moonlight to supplement their income. They represent most closely the "average" Chinese consumer, and generally can afford foreign products and major appliances only by spending long-term savings. Thus, their purchases of imported or FIE-made goods tend to be infrequent and calculated, though they often aspire to follow the more carefree spending patterns of the yuppies and the nouveau riche. Many peasants who live near major metropolitan areas are much better off than many city workers on fixed salaries, and would also fall into this category, but their situation is not typical of the average live-off-the-land Chinese peasant.

The vast majority of Chinese belong to the group known as the "working poor" (*qionglaogong*). This group includes the majority of China's peasants and retirees with limited incomes. The 800 million-

Profiles of China's Consumers

Market segment	Nouveau riche (Baofahu)	Yuppies (Dushi Yapishi)	Salary men (Gongxin Jieceng)	Working poor (Qionglaogong)
Size	200,000	60 million	330 million	800 million
Geographic location	Coastal urban areas	Major urban areas	Urban areas	Rural areas, small towns, urban areas
Average annual household income	Over $5,000	$1,800-$5,000	$1,150-$1,799	Less than $1,150
Age	30-65	25-45	18-60	15-65
Highest level of education	Various levels	College	High school	Elementary school
Type of employment	Commercial/entrepreneurial, entertainment, government	Managerial, professional, technical	Low-skilled office work, factory work, teaching	Manual labor, farming, migrant work
Psychographics*				
Lifestyle characteristics	Wheeling and dealing, wining and dining	Frequent travel and dining out	8-to-5 daily work week, limited budget, infrequent purchases	Struggling to make ends meet
Consumer readiness	High	Moderate	Low	Minimal
Innovativeness	Trend-setters	Opinion leaders	Emulators	Laggards
Risk aversion	Low	Moderate	High	Very high

SOURCE: Geng Cui

* Psychographics are differences in attitudes, beliefs, or personality

strong working poor have benefited least from China's economic reforms; they tend to have low education levels and few marketable skills. Most engage in manual labor in small State-owned or township enterprises, and many of their work units are unprofitable. With meager means, they tend to purchase less-expensive domestic products.

Sizing up the market

Despite these vast differences in consumer purchasing power, the common cultural heritage of China's population allows for a certain extent of standardization and coordination in product introduction and advertising. For example, a company can standardize any written promotions, as well as the imagery it uses in its advertising campaigns, since written Chinese is common to all dialects (*see* p.40). But regional differences in levels of consumer awareness may inhibit a company's ability to standardize its marketing strategies in China, particularly concerning the timing and place of product introduction, and distribution channels. Traditionally, sales of imported goods and goods produced domestically by foreign-funded manufacturing enterprises have been highest in large metropolitan areas where consumers have significant amounts of disposable income.

Foreign firms entering China might thus start with its biggest cities—Beijing, Guangzhou, and Shanghai—where the physical infrastructure is far more developed and there are wealthier consumers who are likely to be receptive to new products. Such locations can act as test markets before MNCs launch their products nationwide. Moreover, success of a flagship operation in a major Chinese city can help prime the market in outlying areas, as people in small towns and rural areas often travel to a nearby city to make major purchases of durable goods such as appliances or electronics. Once firms identify a point of entry, that city can be used as a base for future expansion.

To evaluate the attractiveness of a particular consumer segment, foreign marketers also might want to gauge whether a particular segment meets the standard marketing criteria—is it "measurable," "substantial," "accessible," and "actionable?" For example, although the working poor is easily the largest consumer group in China, it is not easily accessible through advertising campaigns or product distribution, nor easily influenced (actionable) via marketing strategies, because most members of this segment live in hard-to-reach rural areas and earn modest incomes. The only segments that currently satisfy all of these marketing criteria are China's nouveau riche and yuppies. And, although regional differences cannot be dismissed, MNCs can identify the cross-regional market segments. Yuppies, for example, are emerging in major urban areas across China.

Whether a company's target market includes one or more segments depends heavily on product type. Marketers of luxury items, for example, are often introducing an entirely new product to the market and tend to be more successful when they focus on the innovators and opinion leaders—generally the nouveau riche and the yuppies. Producers of lower-priced consumables such as skincare products, on the other hand, can also target the salary man group. Marketers of convenience goods, including fast-moving consumer goods such as snack foods and soft drinks, may be able to target multiple segments.

Launching a new product simultaneously in several markets may prove costly, however, and may target some less-sophisticated consumer segments prematurely. Moreover, even the examples of foreign-brand soft drinks like Coca-Cola or Pepsi Cola, in which foreign marketers successfully reached China's less wealthy consumer segments, factors other than marketing may also be at work. Coke and Pepsi owe their success in large part to their ability to set up effective distribution links nationwide. Once a company has attracted a consumer through advertising, the company must make sure that its products reach the consumer's neighborhood store shelves.

> *Consumer spending in China seems to undergo waves, influenced by economic cycles and policy changes.*

In China, many say, "Hong Kong learns from the West, Guangzhou learns from Hong Kong, and the rest of China learns from Guangzhou." This phrase suggests that marketers can take advantage of the Chinese consumer's tendency to try new products that they hear about through others. By relying on word-of-mouth, marketers might also be able to reduce the expenses associated with consumer education. Further, a foreign marketer facing large sunk costs associated with advertising and promotion to educate consumers about a new or unfamiliar product may want to avoid being the first entrant into the China market and having to absorb these expenses all by itself. Rather, the marketer could wait to introduce its product until after other companies have begun their marketing efforts. Despite the large market share some early entrants currently enjoy, China remains too big a market for any single firm to retain a monopoly indefinitely. MNCs can be sure that competition will emerge sooner or

Foreign firms have no guarantee that even the best marketing strategies will prove successful.

later. Over the long term, by structuring operations to minimize costs and training sales personnel to provide friendly service, foreign firms should be able to establish an image of quality and dependability, attract more customers, and build profit margins.

MOVING ON UP

Consumer ownership of durable goods such as refrigerators and air conditioners has been growing steadily in China, and demand for these products will no doubt rise in tandem with disposable incomes. But many products considered inexpensive or commonplace in the West, such as food processors or hot water heaters, continue to be "treats" for the average urban Chinese family. In addition, consumer spending seems to undergo waves, influenced by economic cycles and policy changes (*see The CBR*, January-February 1994, p.14). For instance, color television producers initially benefited from a surge of Chinese consumer demand, but the flood of new television ventures left the market saturated. Videocassette recorders, washing machines, electric heaters, and karaoke machines all have been part of similar Chinese consumer crazes. More recently, the durables most in demand have been air conditioners and modern kitchen appliances.

Savvy marketers can use leading economic indicators in the PRC to forecast demand for consumer durables as well as other products. For instance, growing disposable incomes and improved housing conditions in many parts of the country have generated a tremendous demand for electric water heaters as well as interior decoration items, including furniture and ceramic tiles. Home improvement products such as floor coverings and kitchen appliances have proven popular among urban purchasers. And pronouncements by the PRC leadership can be an important source of information about changes in China's economic climate. For example, in January 1997 State Planning Commission head Chen Jinhua stated publicly that "the demand structure of Chinese consumers is undergoing a major transition" from "concentration in consumer durables such as televisions and refrigerators" to new goods, such as housing and related products; information-based products such as telecommunications equipment, computers, and computer software, and educational and entertainment products; and services, from tourism to insurance and banking. Recent (if modest) PRC moves to allow some foreign participation in banking, insurance, and airline reservation services indicate that China's leadership has begun to focus on these new consumer markets.

Demographics, too, can help marketers gauge consumer trends. China's population of "little emperors and empresses" will assure that demand for high-quality toys, games, and educational aids will remain strong for years to come. The SRG/Nielsen study also suggests that lifestyle changes are important to watch. The preponderance of two-salary households in China should mean the continued expansion of supermarket shopping and growing popularity of products with convenience features, such as ready-to-serve frozen meals and fast-food restaurants (*see* p.12). By closely monitoring changes in consumer lifestyles, marketers thus can discover the underlying consumer needs. For instance, the government's decision to reduce the work week to five days has provided urban workers and their families more time for leisure activities such as watching videos and going to movies.

Of course, in any developing economy, foreign firms have no guarantee that even the best marketing strategies will prove successful. In China's case, political instability, regional disparities in economic development, and unexpected policy changes could still pose potential hazards down the road. What seems clear, however, is that continued economic development eventually should help create a large middle class with strong purchasing power. SRG/Nielsen, for example, has identified a subgroup of the nouveau riche/yuppie segments as the "Little Rich" (*xiao kang*) family. With approximately 35 million members, this subgroup could represent the beginnings of a middle class, with unique consumption patterns and distinct aspirations.

With economic growth averaging 9-10 percent a year, some economists estimate that China's average household income could reach $11,000 by PPP measures in 2010. In the near term, though, sales of high-end foreign-made goods will likely remain confined to the more affluent consumers in major metropolitan areas. Even though repeat purchases of such products may be infrequent, the sheer size of the market may sustain a company's desired sales levels.

The younger and well-educated Chinese, meanwhile, who are rapidly acquiring driver's licenses and such skills as foreign language proficiency and computer literacy, are also commanding ever-higher salaries. As their disposable incomes increase, they can be expected to aspire to a middle-class lifestyle, including bigger and better housing, brand-name fashions, high-end electronics such as personal computers, and even a family car. Many of these yuppies are traveling or studying overseas, making it more likely that they are familiar with Western goods and amenities—and receptive to foreign products. Some international companies, such as Nestle, have already begun to target this segment by sponsoring sporting events and music videos on China's music television network. The average-income Chinese consumer, in turn, may well follow the spending patterns of these consumers. In the long run, as the market becomes more fragmented and competition among both foreign and domestic brands increases, MNCs will no doubt find their marketing strategies in China come to resemble those used in more developed countries. 完

Making the Consumer Connection

Heroes can mean everything when marketing in China

Joseph Scarry

Marketers around the world, in an effort to make their products more appealing, are charged with identifying and meeting the needs of potential consumers. In the advertising world, it is well known that many consumers—whether subconsciously or consciously—are drawn to certain "hero" figures because they admire the heroes' behavior or what the heroes symbolize. As a case in point, sports legends are commonly used to endorse products in the United States.

This notion is especially interesting for those trying to market their products in China, where economic and societal changes have proceeded at a furious pace. Some Western marketing experts have questioned whether heroes are as important to the Chinese consumer as they are to most Westerners. Many sociologists point to fundamental differences between the Western and Chinese cultures, noting in particular the Western emphasis on the *individual* and the importance Chinese place on the *group*. Individual heroes, thus, may not appeal to the Chinese consumer.

As the Chinese economy has become more market-oriented and disposable incomes in the PRC have risen, however, the Chinese population has evolved into an increasingly discerning group of consumers, showing clear preferences both in terms of product quality and how a particular product fulfills individual needs. Following the lead of foreign firms, some Chinese companies now link well-known persons or characters to their advertising displays to differentiate their products from other brands. The Haomen Brewery in Beijing, for example, recently used a photo of the brewery's president standing with President Clinton for a display in the Wangfujing shopping district.

Other firms in China have also begun to realize the usefulness of associating their product with the "right" heroes—whether celebrities or mythic figures—to convey a clear message about the specific product to potential customers. Many Western companies, including the Philip Morris Co., The Walt Disney Co., and NIKE, Inc., have created global markets for their products in part through advertising campaigns that use powerful figures like the Marlboro man, Mickey Mouse, and basketball superstar Michael Jordan. Those companies that accomplish the difficult task of discovering specific heroes with widespread consumer appeal and use these figures to create symbolic marketing imagery may be more likely to become market leaders in many countries, including China.

Hunting for Heroes

In China, four specific image types may have a strong influence on consumer behavior and purchasing patterns. One archetype which may give Western marketing executives a sense of what will work in advertising campaigns is the old revolutionary. In the late 19th and early 20th centuries, elders in China, particularly deceased ancestors, were revered, because ancestral spirits were thought to determine a family's fortune or misfortune. The high esteem granted the emperor was in part due to the fact that he was considered by most Chinese to be the ultimate elder. Even after the fall of the last dynasty and the ensuing decades of revolution and rebuilding, elders are making a comeback as Chinese heroes. A notable example is the "old revolutionary," Zhou Enlai, who is revered by many in China today for his quiet but forceful criticism of the excesses of the Cultural Revolution.

Marketers may be able to capitalize on the Chinese sentiment that their elders are the *bu dao weng*, or the backbone of society. While no firm in China is permitted to use images of Zhou, Mao

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Zedong, or other past or current government officials to promote its products in China, using indirect references to these figures is a possible marketing strategy. Similar to Smith Barney ads that featured well-known actor John Houseman proclaiming that the firm "makes money the old-fashioned way," a trustworthy Zhou-like elder could, for example, deliver a pitch for a foreign financial services firm about the value of dealing with a reliable, consistent investment firm.

A second heroic figure, the modern tycoon, is a more recent phenomenon in China. Tycoons familiar to many in China include overseas Chinese such as Acer Inc. President Stan Shih and Hutchison Whampoa founder Li Kashing, as well as mainland businesspeople who have made their fortunes through their connections with established political and business channels; and *getihu*, or private entrepreneurs, who have made their money by taking advantage of the new commercial opportunities created by China's transition to a market economy. Both types of mainland and overseas Chinese tycoons are perceived as conspicuous consumers who eagerly snap up luxury goods like imported cars, clothes, watches, and alcoholic beverages.

The vision of the "good life" has potential appeal for Chinese, who aspire to become rich and flaunt their wealth. This imagery is not lost on advertisers; one product series popular in Hong Kong and Shanghai plays on the tycoon image by billing itself as Diamond Jeans. Each pair of these J-brand blue jeans, priced at $100, contains a very small diamond mounted above the label on the right back pocket. The Hong Kong company, J's, also operates a chain of J's jewelry stores in Hong Kong, Shanghai, and Guangdong Province. The company locates the jeans and jewelry stores near each other in prime shopping spots, selling the jewelry at street level and the jeans in the upper-level space, encouraging people to purchase jewelry on their way to buy jeans.

The emergence of a Chinese middle class in pursuit of material wealth reflects China's growing integration with the world economy. As China's participation in global markets has increased, so has its presence on another global stage—world-class sporting events. Chinese athletes have won medals in numerous Olympic events, including swimming, diving, and gymnastics, and are now considered heroes by many of their compatriots.

In recent years, the development of the athlete as a third hero archetype has been aided greatly by Beijing's efforts to foster such imagery. Like its recurring glorification of Lei Feng as the ideal, selfless young worker who died helping to build a better China, Beijing has promoted the country's athletes as new models of ideal citizens. Athletes have gained hero status in present-day China because the average Chinese person believes that athletic excellence is achieved through discipline, determination, and dedication—qualities highly valued in the Chinese culture. Moreover, many Chinese citizens believe that athletes have a social obligation to develop their talents for the benefit of all. Like many Americans, Chinese also consider PRC athletes to be making a genuinely patriotic effort when engaged in international competition. Given these positive associations, it is hardly surprising that PRC athletes like two-time Olympic diving champion Fu Mingxia have been awarded high-profile endorsements from several Chinese companies. Foreign firms hoping to gain market share also stand to benefit from enlisting prominent Chinese athletes to endorse products or appear in advertisements.

Just as the Chinese universally admire sports superstars, so, too, do Chinese parents adore and pamper their children. Like parents around the world, Chinese parents often live vicariously through their children and are willing to make sacrifices for their children's benefit. Marketers who advertise their products as satisfying the perceived needs of the millions of Chinese children are utilizing a fourth image—that of the new generation of sibling-less Chinese children, or "little emperors." As Chinese parents are faced with far more buying choices than those of previous generations, marketing strategies that appeal to the parental desire to facilitate their children's educational, nutritional, or social development are more likely to succeed (*see The CBR*, May-June 1996, p.30). McDonald's Corp., Kentucky Fried Chicken, and McCormick & Co., Inc. are just some of the foreign firms that have set up marketing campaigns aimed at Chinese children and their parents.

TOP-NOTCH DRINKS

All four of these image types appear in the packaging and marketing of various types of beverages popular in China. For example, much of the success of *maotai*, the traditional Chinese distilled grain liquor, can be attributed to the fact that it was the preferred drink of Zhou Enlai. For many years, *maotai* was not heavily advertised, but nonetheless reigned supreme as the ceremonial drink of choice at government-sponsored banquets. It continues to function as a "social lubricant," a beverage drunk to signify sincerity and, therefore, is often consumed at deal-signing ceremonies.

Cognac, the liquor of choice today in China, has strong links to the modern-day tycoon.

Just as *maotai* embodies the desire of many Chinese to keep in touch with past heroes, cognac, the liquor of choice today, has strong links to the modern-day tycoon. Chinese, including overseas Chinese, now account for one-fourth of global cognac sales. Appealing to the mainland Chinese fascination for things foreign, expensive imported cognac has been positioned as a "social marker," a liquor consumed by China's newly rich. Perhaps aware of the desire of many middle-class Chinese to live a tycoon-like lifestyle, in 1994, Joseph E. Seagram & Sons, Inc. introduced Martell Noblige, a mid-priced cognac aimed at a new generation of consumers in France, China, Hong Kong, and Taiwan. The 1995 Seagram annual report notes that just days after the brand was launched, it had become a house brand in more than 60 clubs in China.

Unlike imported cognac, *Jianlibao*, a popular sports drink, is marketed via close association with PRC sports teams. Considered by many consumers to be a tonic or magical brew, complete with a scientific pedigree listing the various vitamins and minerals in each can, this drink was developed specifically in connection with the PRC team's participation in the 1984 Los Angeles Olympics. The sports drink manufacturer then offered a gold soda can and a cash prize to each PRC medalist at the 1992 Barcelona Games. Following the 1996 Olympics, the company started lining up endorsement contracts with a number of PRC athletes, including diving champion Fu Mingxia.

Like *Jianlibao*, the popular *Wahaha* beverage derives much of its appeal from its link with a heroic image, that of the devoted parent doing everything possible to ensure the well-being of his or her only child. When introduced to

In years to come, China's beverage sector is hardly likely to be the only sector in which heroic imagery is used to promote products.

the market in the early 1990s, Wahaha, the beverage's manufacturer, advertised the product extensively on television during prime-time hours. The *Far Eastern Economic Review* reports that *Wahaha*'s success also stems from its elaborate packaging, which gives the parent the illusion of opening a special elixir. In China, similar presentations were used in the past for precious herbal tonics, such as Peking Royal Jelly. By using this elaborate packaging, making parents feel they are providing a precious tonic for their children, the drink has attracted a strong following among Chinese parents; children, meanwhile, have apparently been drawn to the sugary taste. Buoyed by the success of *Wahaha*, in April 1996 the company announced the formation of a joint venture with the Danone Group of France to produce milk beverages in China.

Images for the Future

In years to come, China's beverage sector is hardly likely to be the only sector in which heroic imagery is used to promote products. Finding the right image for each product will be important, though. Although Chinese entrepreneurs have capitalized directly on the old revolutionary image by opening up restaurants with a Cultural Revolution theme, or by creating summer camps to instill children with revolutionary-type values, foreign firms may have difficulty doing so. Nevertheless, some foreign firms may be able to profit from such imagery. Foreign insurance firms, for instance, could acquire a competitive advantage in coming decades by running ads that show trustworthy, happy elders discussing their new insurance policies.

In contrast, those hoping to advertise expensive foreign-made products, including watches, cars, and pens, might find the tycoon image useful. Marketers should be aware, though, that not all expensive goods can be marketed as "exclusive." Red wine, for instance, has become popular in China primarily because of its alleged health benefits; marketers would likely be better off trying to advertise their wines as healthful, rather than exclusive (*see* p.19). And, in the end, many consumers may find distasteful the growing reports of tycoon behavior—such as burning money and smashing expensive liquor and wine bottles—and may avoid buying "tycoon"-associated products.

In the short and long terms, countless opportunities exist for foreign firms to market their products using the appeal of the athlete, without the down sides associated with the tycoon image. What has worked for *Jianlibao* could also work for such products as Coca-Cola, Pepsi, athletic shoes, and even milk. But with the exception of basketball superstar Michael Jordan or tennis star Michael Chang, most foreign athletes will not likely be recognized by Chinese consumers and therefore may not prove suitable for Chinese marketing campaigns.

Similarly, those hoping to capitalize on the image of the parent/child relationship also can find ways to pitch their products as healthy, nutritious, educational, or in some other way beneficial to children. Products that possess scientifically documented nutritional benefits, such as Tang, have become popular in China. Instant cereals and other breakfast or healthy snack products could also be marketed as products that appeal to children—as well as something a devoted parent would want to provide for his or her child.

When marketers select an appropriate hero to advertise their product, they also must ensure that the overall image associated with the hero seems genuine. A television advertisement for a fast-food restaurant chain in Shanghai, for example, should feature actors speaking the correct dialect and wearing region-specific clothing.

Ultimately, though, what sells a product need not be a celebrity testimonial. Marketing research, in fact, has shown that celebrity testimonials can backfire if consumers feel that the celebrity has been bought or if the advertisements lead the consumer to remember the celebrity rather than the product. And, while using the right imagery to meet perceived consumer needs may be enough to sell a product today, China's heroes may well change over time. Foreign companies that want to continue marketing their products successfully in China will need to keep an eye on the heroes of tomorrow. 完

Celebrity Watch

Notwithstanding the fundamental importance of athletes, tycoons, and other heroes in marketing products in China, Chinese film and entertainment celebrities also appear increasingly as sponsors of products. To date, few US companies have used Chinese entertainers in their advertisements, though The Procter & Gamble Co. has run ads in China featuring Chinese-American tennis professional Michael Chang. The results of an October 1996 poll by *Guoji Guanggao* (International Advertising) magazine suggest that foreign firms could benefit from enlisting Chinese entertainers to sponsor their products.

The Chinese poll asked approximately 1,000 residents in Beijing, Dalian, Guangzhou, Qingdao, and Shanghai to rank their favorite celebrities. Nineteen of the top 20 celebrities nominated were entertainers; Michael Chang was the only athlete mentioned by respondents. Eight of the celebrities on the list were Hong Kong or Taiwan superstars who advertise principally for cosmetics firms. Curiously, many high-profile celebrities, including film stars Zhang Weir, Chen Daomei, and Wang Zhiwei, did not make the list.

Topping the list was Hong Kong starlet Liu Dehua, a familiar face on many advertisements in China. Liu was rated most popular among Chinese aged 36-45. In the number two spot was Chinese actress Gong Li, star of "Farewell My Concubine" (1992), "Raise the Red Lantern" (1991), and other well-known Chinese films. Rounding out the top five were comedian Guo You and film stars Liu Shaoqing and Wang Chen.

Respondents also nominated some non-Chinese celebrities (though these celebrities failed to make the top-20 list), including NIKE, Inc. spokesmen Michael Jordan and Pete Sampras, Pepsi endorser Michael Jackson, and Lishi cosmetics sponsor Nastassja Kinski. Many foreign celebrities popular in China were not nominated at all, including Arnold Schwarzenegger, Sylvester Stallone, and Sharon Stone.

—Joseph Scarry

The Coming Conflict with China

By Richard Bernstein and Ross H. Munro. New York, NY: Alfred A. Knopf, 1997. 245 pp. $23 hardcover.

It is hard to describe in a short review what a great piece of commercial enterprise this book is, and what a terrible book it is at the same time.

As a product, a commercial object, a journalistic piece, this book is fantastic. From the hysterical promotional language of the publisher's advance notices to the ominous cover design showing a fearsome fiery glow rising from a dark horizon, and the progressively larger letters proclaiming *The Coming Conflict with China*, this book is media magic. Who could have foreseen, as the authors whizzed through the writing, editing, and printing of *Coming Conflict*, that it would hit the stands precisely as the American political furor over China (driven by the funding scandals of the 1996 campaign) was shifting into high gear. Talk about "timed-release" products! This book instantly established its authors on the TV talk show circuit, and made these two former *Time* magazine Asia journalists respected authorities on issues of Chinese military strategy and other weighty matters.

At the same time, a few words cannot describe how irresponsible this book is. It is not a matter of agreeing or disagreeing with the authors' arguments and claims. They are entitled to put forth their central and alarming theme: that the United States and China are headed for long-term conflict because China is not only an ambitious power with its sights set on regional dominance in the Asia Pacific, but also is convinced that the United States is its primary strategic adversary.

What is so appalling about this book is the intentional choice of the most inflammatory verbiage; the imputing of complex psychological motives to people and nations (principally China) with no supporting evidence; the manipulative assembling of bits and pieces of fact to prove complex webs of evil intent; and the utterly phony—and often contradictory—logic it employs.

For people with some background in Chinese affairs, this book is a familiar American artifact, reminiscent of some of the colorful writings of the 1950s (Freda Utley's *The China Story* or Anthony Kubek's *How the Far East Was Lost* come to mind). It generates a hearty brew: China as a looming foreign menace; a treacherous "New China Lobby," made up of US businesses and former US government officials who do China's work in America in order to curry favor with the bosses in Beijing; and dramatic "war games" scenarios leading to US-China hostilities. For example, the authors claim that China's strategy regarding US-China trade is to "let the invader thrust deep into China and then slaughter him with the deadly pinpricks of guerrilla warfare."

This book is not a research piece. It is a product of our times, a confusing and disorganized polemic that scares where it should analyze. I recently spoke bluntly with one of the authors of the book about what I regarded as the cheap, manipulative way in which they presented their views to the reader. The author smiled genially and said, "Well, it *is* readable...." What an indictment.

I, for one, hope this book finds its way quickly to the bookstore "remainder" shelves, as the Freda Utley genre of the 1950s finally did. In the meantime, give the authors and their talented publicists credit for a marketing coup, and dig far deeper than Bernstein and Munro apparently managed to do if you're seriously interested in the subjects about which they write so blithely.

—Robert A. Kapp

Robert A. Kapp is president of the US-China Business Council.

Managing Distribution in China

Hong Kong: Arthur Andersen Business Consulting, 1996. 51 pp. $200 softcover.

After receiving numerous inquiries from clients regarding China's distribution system, a team of researchers in Arthur Andersen's Hong Kong office set out to interview distributors, retailers, and government officials in Shanghai and Guangzhou in order to answer basic questions on supply chain management and logistics for fast-moving consumer goods. The result, *Managing Distribution in China*, is a clearly written, easy-to-use guide covering changes in China's traditional distribution networks, useful tactics for working with Chinese distributors, modes of transportation available in China, and a checklist of issues to consider when developing a distribution strategy. The appendices provide an in-depth look at beer distribution in China and list highlights of China's new joint-venture trading company regulations.

Managing Distribution in China will be particularly welcome to newcomers to the issues, as the guide provides a concise review of the current system and salient tips on how to select and work with Chinese distributors. While those already active in the field may find the checklist a useful tool for reviewing their own distribution strategies, they are unlikely to learn anything new, as the study is broadly focused and descriptive, rather than prescriptive. The exception is for companies in the beer industry, which may find the more detailed information on market segmentation and pricing of foreign brands in Appendix I quite useful.

—Pamela Baldinger

Pamela Baldinger is director of the US-China Business Council's Hong Kong office.

Multinational Companies in China: Winners and Losers

Hong Kong: The Economist Intelligence Unit Ltd., 1997. 204 pp. $600 softcover.

Rarely is a research report published that is both a phenomenal accomplishment and an invaluable resource for any company library, regardless of the company's industry sector or line of business. *Multinational Companies in China: Winners and Losers* fits the bill nicely, supplying the reader with a number of case studies containing key information on what spells success or failure for a China venture.

What makes this report so invaluable—and such a fascinating read—are the 50 case studies of 22 multinational companies (MNCs) in nine PRC industry sectors: autos, chemicals, consumer goods, electronics, food and beverages, oil and gas, pharmaceuticals, telecommunications, and services. Each chapter begins with a sector overview, outlining the major developments and obstacles to foreign business development in China in that industry. The company-specific case studies then describe business strategies, how well the strategies worked, and the lessons learned. Tables containing detailed information on company investments in China complement a number of the case studies. These boxes contain the names and type of venture, total registered capital, the equity distribution among the partners, and products or services produced by the venture.

The authors contend that of the nine sectors outlined, the consumer goods sector—including household and personal care products—has come closest to experiencing the "China Miracle." The reason is that the products are genuinely affordable, given China's per capita income levels: "when makers of shampoo and soap talk about the potential of a market of 1.2 billion consumers in China, they are at least being more plausible than colleagues selling mobile phones, cars, and professional services," assert the authors. Moreover, there is far less PRC bureaucratic interference in consumer goods than in other sectors, allowing multinationals to apply in China the business development methods that have proven successful in other developing Asian countries.

In contrast, services firms have experienced the most difficulties in China. This finding reflects the dearth of qualified PRC personnel and the overwhelming number of regulatory constraints in China's accounting, advertising, banking, insurance, and legal sectors.

According to the report, success in the oil and gas sector has been hard to gauge. For example, Total of France was able to build an $800 million refining facility in Dalian, while Anglo-Dutch Shell has been "stuck in the shifting sands of the Chinese bureaucracy" in its effort to build a refinery in Guangdong. The authors claim that Total "anticipated Beijing's opposition to joint venture refineries [selling to] the domestic market," while Shell insists on producing for the domestic market.

No matter the sector, the case studies illustrate that some challenges in China are universal, namely, distributing products, finding qualified personnel, maintaining quality control, minimizing bureaucratic interference, and protecting intellectual property rights. Though not inexpensive, the report is sure to reward readers with valuable insights into what makes for a successful business future in China.

—*Meredith L. Singer*

Meredith L. Singer is a business advisory services associate at the US-China Business Council.

A Macro Perspective on Technology Transfer

Allan C. Reddy. Westport, CT: Quorum Books, 1996. 139 pp. $57.95 hardcover.

This book provides a general overview of issues relating to technology transfer between countries from the perspective of both developed and less-developed countries (LDCs). A quick read, the book covers basic definitions and concepts, examples of barriers to technology transfer, and ethical issues associated with transferring technology to LDCs. However, *A Macro Perspective* should not be mistaken for a guidebook on licensing technology in LDCs.

Many technology transferors in developed countries face the ethical dilemma of whether to share with LDCs sensitive technologies that could be used—or abused—to manufacture destructive weapons. Reddy details this and other political, social, religious, ethical, and economic barriers to technology transfer. He also discusses technology "mismatches," in which the level of technology LDCs seek is quite different from the level developed nations are willing to offer. A developed-country firm producing sophisticated electronic typewriters in a developing country, for instance, might find its product unsuitable to local requirements because of frequent power outages. A standard manual typewriter, though considered outdated in developed countries, would be the more appropriate level of technology to transfer in such cases. Reddy devotes an entire chapter to the means of improving technology transfers to LDCs, stressing any technology transferred should be both affordable and appropriate given the country's conditions.

Though Reddy mentions technology transfer problems specific to China, including copyright infringements and human rights, for the most part he discusses technology transfer issues on a far broader scale. Policymakers and those involved in technical research and development will find the book interesting reading, but business executives looking for tips on navigating China's technology transfer approval process are not likely to find that this volume offers practical advice to take to the next round of licensing negotiations.

—*Piper Lounsbury*

Piper Lounsbury is deputy director of the Council's Beijing office.

Qian Qichen Speaks at Council Luncheon

Over 200 people attended an April 29 luncheon cosponsored by the Council, the Council on Foreign Relations, and the National Committee on United States-China Relations in honor of PRC Vice Premier and Foreign Minister Qian Qichen. Qian was in Washington for talks with President Clinton and Secretary of State Albright.

In his speech to Council member firms and other guests, Qian noted that the continuing growth in bilateral trade and the recent high-level official exchanges between China and the United States suggest a significant improvement in bilateral relations. Qian denied the allegations of improper contributions to US political campaigns by the Chinese government and asserted that China "does not in any way meddle in other countries' business." He lauded efforts by the US business community to encourage Congress and the President to renew China's Most Favored Nation (MFN) status this year and expressed the hope that China would soon be granted permanent MFN. Qian called Taiwan the single most important issue in US-China relations, stressing that it is important that the United States honor its commitment to the "One China" policy and the three US-China communiques.

Qian, who will likely be one of several high-ranking PRC officials in attendance for Hong Kong's July 1 reversion to PRC sovereignty, reiterated Beijing's support of the "one country, two systems" policy, emphasizing that Hong Kong will retain a high degree of autonomy. He stated that Beijing would only be responsible for Hong Kong's defense and foreign affairs. Qian discounted assertions that China is pursuing overly expansionist military policies, noting that China's $8.7 billion defense budget in 1996 was the lowest among large nations in absolute dollar terms. In contrast, US defense spending last year, Qian claimed, was roughly $260 billion.

During the question-and-answer session, Qian outlined a prospective bilateral agenda for the months leading up to the proposed fall summit between President Clinton and PRC President Jiang Zemin. He stated that both countries should attempt to facilitate China's accession to the World Trade Organization and implement the 1985 agreement on the peaceful use of nuclear energy, which would enable US firms to obtain export licenses for nuclear power plant components. To date, the agreement has not been implemented because no US president has certified adequate PRC compliance with certain nonproliferation conditions.

Finance and Labor Discussions in Beijing

The Council's Finance Working Group held its regular bimonthly meeting in Beijing on May 23 and agreed to draft a position paper on tax issues affecting foreign companies in China. The group intends to present the paper to US trade negotiators and the US Department of the Treasury, to bring to the US government's attention the issue of double taxation of representative offices in China. These offices are obliged to pay income tax to the Chinese government on a "cost-plus" or a "deemed profit" basis, but the United States does not give a tax credit for taxes assessed in this manner. In addition, the companies attending the meeting plan to articulate their objections to US authorities regarding China's recent tax policy changes, which they believe impede market access for foreign companies engaged in trade and financial services.

During the group's May meeting, the Finance Working Group also heard presentations from Sou Ho, an international taxation partner with KPMG Peat Marwick in Beijing, on the taxation of representative offices. Pamela Baldinger, director of the Council's Hong Kong office, subsequently discussed the financial implications of Hong Kong's July 1 reversion to PRC sovereignty.

The Labor Issues Working Group met on May 23 as well to hear a presentation from Allan Marson of Baker & McKenzie on collective contracts and unionization. Chen Jinpu of the State Commission on Restructuring the Economic System also spoke on China's health reform. The final topics of discussion for the group were the new PRC regulations on salary "guidance" for foreign-invested enterprises, housing provisions, and compensation studies.

Members Elect Board of Directors and New Chairman

At this year's annual meeting, member company delegates elected George M.C. Fisher, chairman and CEO of Eastman Kodak Co., to the Council's chairmanship. Fisher succeeds Donald L. Staheli, former chairman and CEO of Continental Grain Co. Michael R. Bonsignore, chairman and CEO of Honeywell Inc.; Carla A. Hills, chairman and CEO of Hills & Co.; and Frederick W. Smith, chairman and CEO of Federal Express Corp., were elected vice chairmen. Selected to fill the board's secretary-treasurer position was Dale P. Jones, vice chairman of Halliburton Co.

Council members also elected five new and three incumbent directors to three-year terms, including Philip M. Condit, chairman, president and CEO, The Boeing Co.; James R. Long, executive vice president and group executive Asia, Northern Telecom (Asia) Ltd.; James J. Schiro, chairman and senior partner, Price Waterhouse LLP; Joseph F. Toot, Jr., president and CEO, The Timken Co.; and Craig E. Weatherup, chairman and CEO, PepsiCo, Inc. Elected to their second three-year terms were Steven J. Douglass, chairman and CEO, Payless ShoeSource; Alex Trotman, chairman and CEO, Ford Motor Co.; and William J. Warwick, chairman and CEO, AT&T China Inc.

RUBIN TALKS MFN AT COUNCIL'S ANNUAL MEETING

China's Most Favored Nation (MFN) trade status renewal, accession to the World Trade Organization (WTO), and progress on intellectual property rights were some of the major themes of the Council's 24th Annual Membership Meeting, held in Washington, DC, on June 5. Hong Kong's reversion to Chinese rule, investment in China's interior provinces, and coping with China's new protectionist measures were other topics of discussion.

Council President Robert A. Kapp opened the meeting with a report on the Council's continued health—member companies total close to 300 and the Shanghai office has begun operations.

Robert B. Cassidy, assistant US trade representative for China, Hong Kong, and Taiwan, followed Kapp at the podium. According to Cassidy, China's WTO accession boils down to two broad issues—basic principles and market access. With respect to basic WTO principles—including trading rights, non-discriminatory treatment of foreign firms, and judicial review—the bilateral WTO negotiations have made substantial progress. Forward movement on market access issues, however, has been far more problematic. Issues posing the greatest difficulty from Cassidy's perspective for successful WTO negotiations include foreign participation in distribution services, intellectual property rights, and foreign investment in China's telecommunications sector. Cassidy urged the business community to encourage China to move toward a more rules-based system.

Pamela Baldinger, director of the US-China Business Council's Hong Kong office, described the current atmosphere in Hong Kong and the implications of the handover for business. The Hong Kong handover, Baldinger said, will test China's ability to honor its "one China, two systems" commitment. For businesses, perhaps the most important post-handover issue will be intellectual property rights, as Hong Kong will begin drafting its own legislation on the issue. Moreover, the unfolding of the Basic Law's Article 23, which requires the Special Administrative Region (SAR) to draft subversion, secession, and treason legislation, will determine whether Hong Kong can maintain a free flow of information. In evaluating the Hong Kong business climate, Baldinger advised keeping an eye on whom Chief Executive Tung appoints to various positions, the pace of civil servant turnover, whether the Preparatory Committee is disbanded as scheduled on July 15, 1997, the outcomes of upcoming elections, and whether Tung can maintain a certain degree of independence from Beijing.

Gary Zimmerman, group vice president for the Asia/Pacific Zone, McCormick & Co., Inc., delivered a slide and video presentation on the evolution of McCormick's China operations. Zimmerman identified three keys to doing business in China—developing distribution networks, improving public knowledge of the product, and increasing public exposure to the product. McCormick has skirted distribution difficulties by using its own delivery vehicles to transport products to distributors in various cities. When discussing the issue of combating counterfeit goods, Zimmerman indicated that appealing to PRC courts was futile because imitators are often "here today, gone tomorrow." Further, McCormick pays attention to quality and pricing to stave off imitators (*see* p.25).

The media event of the day was US Treasury Secretary Robert Rubin's pre-lunch address. Rubin outlined three US objectives regarding its economic relationship with China: to integrate China into the global economy, support Hong Kong as a vital financial center, and move China in the direction of a more market-oriented economy. Severing normal trade relations by revoking MFN, "will not isolate China, it will isolate the United States," Rubin said. Revocation of MFN would block US participation in China's economic activity as well as hurt the US commitment to Hong Kong's prosperity. Rubin urged businesses to do their part in advancing non-economic objectives while helping to preserve bilateral economic ties.

The lunch session featured a lively exchange between David R. Gergen, editor-at-large, *U.S. News & World Report*, and The Heritage Foundation President Edwin Feulner. The two shared their views on China-related topics ranging from what sets 1997 apart from previous years to how businesses handle the "values" issue.

In an afternoon workshop on MFN, Council Vice President Richard Brecher, Peter Mangione of the Footwear Distributors and Retailers of America, Ambassador Alan Larson of the US State Department, and State Department Acting Senior Coordinator for Business Affairs Christopher Szymanski discussed the dynamics of this year's vote and the prospects and timing for China's WTO accession. The political consequences of the return of Hong Kong to PRC sovereignty and domestic political issues associated with both MFN renewal and WTO accession were discussed at length.

The afternoon session covering China's new protectionist measures included presentations by Patrick T. Siewert, vice president of Eastman Kodak Co., and Ronald Colgan, manager, international marketing international services, Caterpillar Inc. In examining China's investment climate, Siewert detailed several areas that businesses should track to identify opportunities for foreign participation in China's economy—recent foreign investment trends, factors driving China's policy changes (including industrial policies), the influence of State-owned enterprise reform on foreign investment incentives, and WTO negotiations. Colgan stressed that US businesses must determine what laws govern a given type of investment and understand the manner in which such laws are applied.

Participants at the session on investing in the interior heard from John Brennan, a US Foreign Service officer posted in Chengdu from 1991-94, on the investment opportunities in one of China's largest provinces, Sichuan. Ravi Bugga, head of the Asia division at the International Finance Corp. (IFC), discussed the multilateral investment's bank new focus on projects in China's interior. IFC recently decided to fund a timber plantation project in Sichuan Province and is looking at other projects in Hubei and Jiangxi provinces. Following on a less optimistic note, Stephanie Tallet, corporate counsel for Borg-Warner Automotive Inc., discussed the problems her firm has encountered in setting up a joint-venture plant in Hubei Province. Despite a number of safeguards in the joint-venture contract, local officials have thus far ignored the Chinese partner's breaches of contract.

Council Sponsors China Power Project Seminar

State Planning Commission (SPC) Executive Vice Chairman Ye Qing visited Washington on May 27 for a US-China Business Council-sponsored roundtable on financing power projects in China. The conference was held in conjunction with the first annual China-US Bilateral Energy Consultation between the US Department of Energy and China's SPC. Ye met with over 30 US power and finance industry executives, as well as officials of the departments of commerce, energy, and state, to discuss electric power development in China.

The meeting began with an overview of China's Ninth Five-Year Plan (1995-2000) by Ye and a description of China's current energy policy. In his presentation, Cao Zhengyan, deputy director general of the SPC's Department of Transport and Communications, welcomed further participation by US companies and financial institutions in cooperative projects and noted that China continues to improve the transparency of its energy-related policies.

During the afternoon presentations, US Export-Import Bank representatives discussed their experiences in financing private power projects in emerging markets, including China, over the past three years. US industry representatives then discussed some of their existing operations in China and offered suggestions to the SPC delegation regarding the establishment and financing of conventional energy projects, advanced technology projects, and alternative energy projects such as solar- and wind-power projects. US participants also raised the issue of transparency in the PRC's project-approval process, and questioned the mandatory annual tariff review conducted by China's Price Bureau. The seminar concluded with an evening reception at the law office of Skadden, Arps, Slate, Meagher & Flom, host of the full-day event.

China BUSINESS

Christopher V. Harris

The following tables contain recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by *The CBR*. Contracts denominated in foreign currencies are converted into US dollars at the most recent monthly rate quoted in the International Monetary Fund's *International Financial Statistics*.

Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in *The CBR* by sending the information to the attention of the editor.

SALES AND INVESTMENT *March 15–May 15, 1997*

Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Colonial Mutual Group (Australia)/People's Insurance Corp., a unit of China Life Insurance Co., Ltd.
Signed cooperation agreement on providing staff and management training assistance. 5/97.

Deloitte Touche Tohmatsu (Canada)/Kwan Wong Tan & Fong (HK)
Announced that the two firms would merge. 4/97.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Deere & Co. (US)/Jiamusi Combine Harvester Factory (Heilongjiang)
Established John Deere Jialian Harvester Co. Ltd. joint venture to produce agricultural equipment. $29 million. 5/97.

Banking and Finance

CHINA'S IMPORTS

Check Technology Corp. (US)
Sold check-printing equipment to Beijing Banknote Printing Co., a subsidiary of China Banknote Printing and Minting Co. 5/97.

YourNet Inc. (US)
Will sell smartcard chips to Silone MagCard in Guangdong Province. $3 million. 4/97.

OTHER

DBS Bank (Singapore), Dai-Ichi Kangyo Bank, KDB Asia (Japan)/Xiamen International Trust and Investment Corp. (XITIC) (Fujian)
Arranged five-year transferable term loan for XITIC. $30 million. 5/97.

Banque Indosuez (France)
Received People's Bank of China approval to engage in *renminbi* business. 4/97.

Imperial Trade Services, Ltd., a subsidiary of Imperial Bancorp, Citibank (US)
Established alliance to issue, advise, and pay letters of credit in Hong Kong. 4/97.

Sanwa Bank Ltd. (Japan)
Relocated its Shanghai branch to the Pudong New Area to be eligible to conduct *renminbi* business. 4/97.

Schroders Asia Ltd. (HK)
Opened representative office in Beijing. 4/97.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

Kawasaki Sanko Kasei Co., Nichimen Corp. (Japan)/NA
Established joint venture in Dalian, Liaoning Province, to manufacture and sell resin compounds. 5/97.

NatSteel Broadway Ltd., a subsidiary of NatSteel Ltd. (Singapore), NA/NA
Established Hero Plastic Pigment Co., Ltd. joint venture in Shenzhen. $480,000. 5/97.

Sharp Corp. (Japan)/Shanghai Guangdian Group
Established Shanghai Sharp Dye Industry Monitoring System Co. joint venture to produce industrial dyes. $15 million. 5/97.

Amoco Corp. (US)/National Textile Council
Will receive State Development Bank loans to establish joint venture to produce purified terephthalic acid in Zhuhai, Guangdong Province. $36.2 million. 4/97.

Abbreviations used throughout text: ADB: Asian Development Bank; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CNAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Posts and Telecommunications; PBOC: People's Bank of China; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SPC: State Planning Commission; UNDP: United Nations Development Program; UNICOM: China United Telecommunications Corp.

EMICO Holdings Bhd (Malaysia)
Will purchase a 60% stake in Teddy (Hong Kong) Ltd. to become part owner of Teddy Nanchong Chemical Fibre Co., Ltd. joint venture in Sichuan Province. $12 million. 4/97.

Herberts GmbH (Germany)
Signed contract for the acquisition of a 56% stake in Huajia Powder and Chemical Co., Ltd. (Anhui). 4/97.

Herberts GmbH (Germany)
Signed letter of intent to acquire a 55% stake in Langfang Chemicals Co., Ltd. (Hebei). 4/97.

NA (S. Korea)/Shenzhen Petrochemical (Holdings) Co., Zhongcheng Industrial Group (Guangdong)
Created joint venture to establish ABS resin factory in Shenzhen, Guangdong Province. $14.5 million. 4/97.

Consumer Goods

OTHER

Europe Craft Imports, Inc., a wholly owned subsidiary of Aris Industries, Inc. (US)/Guangdong Enterprises (Holdings) Ltd.
Signed licensing agreement to sell Aris's Members Only line of clothing in China. 5/97.

Electronics and Computer Software

CHINA'S IMPORTS

Symbol Technologies Inc. (US)/SANC Co., Ltd., a joint venture between ANCC Bar Code System Service Co. (US) and NA
Signed licensing and supply agreement to assemble and market Symbol's two-dimensional PDF417 laser scanners, portable terminals, and card readers in China. 5/97.

Effective Management Systems Inc. (US)/Shenyang Dawn Group Ltd. (Liaoning)
Signed marketing agreement for EMS software. 4/97.

INVESTMENTS IN CHINA

NEC Corp. (Japan)/Shanghai Huahong Microelectronics Co.
Signed contract to build an advanced integrated circuit factory in Shanghai. $1 billion. 5/97.

Digital Equipment Corp. (US)/China Aerospace Corp. (Beijing)
Signed memorandum of understanding to establish computer production joint venture in Beijing. 4/97.

Rockwell (US)/Ministry of Electronics Industry
Signed memorandum of understanding to build computer modem and wireless communications design centers in Shanghai. $40 million. 4/97.

Tomen Corp. (Japan)/Shanghai Hua Hong Microelectronics Co.
Established Shanghai Hua Hong Tomen International Electronics Co. joint venture in Shanghai to sell chips, liquid crystals, and other electronics parts in China. $2 million. 4/97.

Viisage Technology (Tianjin) Co., Ltd., China, a joint venture between Viisage Technology, Inc. (US) and NA/China Jon Son Group (Tianjin)
Signed agreement to develop and produce smartcards to be used in driver "Penalty Card" program, in which traffic fines are paid on the spot. $1 million. 4/97.

OTHER

JetForm Corp. (Canada)
Opened representative office in Beijing. 4/97.

Microtec, a unit of Mentor Graphics (US)/University of Electronic Science and Technology (Sichuan)
Established partnership to create nonprofit embedded systems software center. 4/97.

Source One Enterprises Inc. (US)/Legend Computer Group (Beijing)
Signed agreement to ship 150,000 Legend-brand computers to North America over the next two years. $110 million. 4/97.

Engineering and Construction

INVESTMENTS IN CHINA

Asia Pacific Concrete Inc. (Canada)/Kaifeng Building Materials Supply Co. (Henan)
Signed letter of intent to establish ready-mix concrete joint venture in Kaifeng, Henan Province. 4/97.

Ingersoll-Rand Co. (US)/Wuxi Boiler Works (Jiangsu)
Will establish Ingersoll-Rand (Wuxi) Road Machinery Co. joint venture in Wuxi, Jiangsu Province, to manufacture surface compaction equipment. $10 million. (US:92%-PRC:8%). 4/97.

Tsuba Kimoto Chain Co. (Japan)/Hangzhou Dunpai Chain Drive Group (Zhejiang)
Established Hangzhou Dunpai Tsuba Kimoto Chain Drive Co., Ltd. joint venture in Hangzhou, Zhejiang Province, to produce chains. $29.5 million. 3/97.

OTHER

ADB
Will offer technical assistance grant on preparing a national register and classification system for contractors in China. $350,000. 3/97.

Phillips Petroleum Co. (US)/Shanghai Petrochemical Co. Ltd.
Signed letter of intent to conduct feasibility study on building a polyethylene pipe plant in the Pudong New Area. 3/97.

Environmental Technology and Equipment

CHINA'S IMPORTS

Hughes STX Corp., a unit of Hughes Electronics Co. (US)
Won China Center for Resources Satellite Data and Applications contract to develop a satellite-ground processing system to monitor environmental changes. $10 million. 3/97.

OTHER

ADB
Will offer technical assistance grant on water purification, flood control, and irrigation technology for the Zhejiang Water Conservancy Project in Wenzhou, Zhejiang Province. $100,000. 4/97.

ADB
Will offer technical assistance grant on implementing economic instruments for environmental management. $600,000. 4/97.

Ecology and Environment, Inc. (US)
Won World Bank contract to provide environmental and infrastructure consulting services to three cities in Yunnan Province. $4.9 million. 4/97.

ADB
Will offer technical assistance grant to improve environmental conditions in Nanchang, Jiujiang, and Jingdezhen in Jiangxi Province. $400,000. 3/97.

ADB
Will offer technical assistance grant to improve ambient air and water quality in Xian, Xianyang, and Tongchuan in Shaanxi Province. $150,000. 3/97.

Food and Food Processing

INVESTMENTS IN CHINA

Yeo Hap Seng Ltd., Sstal Engineering Ltd. (HK)/China Guangzhou Xin Zhu Jiang Foods & Beverage Group Co. (Guangdong)
Will establish Yeo Hap Seng (Hua Bei) Beverages Co., Ltd. joint venture in Langfang, Hebei Province, to manufacture and distribute soybean and other non-carbonated beverages. $6 million. (HK:51%, 24.5%-PRC:24.5%). 5/97.

Mycal Corp. (Japan)/NA
Will establish supermarket joint venture in Dalian, Liaoning Province. $5 million. (Japan:95%-PRC:5%). 4/97.

International Distillers and Vintners, a unit of Grand Metropolitan (UK)/Qufu Distillery (Shandong)
Established alcohol production joint venture in Qufu, Shandong Province. $27 million. (UK:67%-PRC:33%). 3/97.

Machinery and Machine Tools

CHINA'S IMPORTS

Thermatool Mill Systems (US)
Sold 24-inch API pipe mill to Shanghai Just-Huahai Metal Products Co., Ltd. 4/97.

U.S.-China Industrial Exchange, Inc. (Chindex), Hyster Co. (US)/NA
Signed distribution agreement allowing Chindex to provide marketing, sales, and service for Hyster's industrial forklifts and container-handling machinery in China. 4/97.

INVESTMENTS IN CHINA

Fuji Electric Co., Ltd., Fuji Denki Reiki Co., an affiliate of the Fuji Electric Co., Ltd. (Japan)/Shanghai General Machinery (Group) Corp.
Established Shanghai General Fuji Refrigeration Equipment Co. to manufacture and market refrigerated showcases in China. $12.8 million. (Japan:25.5%, 25.5%-PRC:49%). 5/97.

Medical Equipment and Devices

CHINA'S IMPORTS

ALZA Corp., SmithKline Beecham PLC (UK)
Signed agreement allowing SmithKline Beecham to market ALZA's Nicoderm transdermal nicotine product in China. 4/97.

OTHER

Lions Clubs International Foundation (US)
Will give the Chinese government a grant to support efforts to reduce preventable blindness in China. $15.4 million. 5/97.

Biomatrix, Inc. (US)
Received PRC government approval to register its Synvisc treatment device for osteoarthritis of the knee in China. 4/97.

Metals, Minerals, and Mining

CHINA'S IMPORTS

Ferrofluidics Corp. (US)
Will sell 8-inch crystal puller system to unidentified Chinese research institution. $1.2 million. 5/97.

OTHER

Astro Mining NL, Quantum Resources Ltd. (Australia)/ Liaoning Bureau of Geology and Mineral Resources
Signed agreement to explore for diamonds in Liaoning Province. 5/97.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

New Toyo International Bte (Singapore)/Wuhu Economic and Technological Development Zone (Anhui)
Signed letter of intent to establish corrugated paper carton plant in Wuhu, Anhui Province. $3.5 million. 4/97.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Bitumenes Orinoco S.A. (Venezuela)/CNOOC
Signed supply contract for the import of one million metric tons of Orimulsion boiler fuel in 1997. 5/97.

Hyundai Oil Refinery Co., a unit of the Hyundai Corp. (S. Korea)/CNOOC
Signed import contract for 4 million barrels of crude oil in 1997. 4/97.

CHINA'S INVESTMENTS ABROAD

Kalub Gas Share Co. (Ethiopia)/Zhongyuan Petroleum Exploration Bureau (Henan)
Established joint venture to explore for and refine gas, diesel, kerosene, and petroleum in the Ogaden oil field in Ethiopia. $5.6 million. 5/97.

INVESTMENTS IN CHINA

Esso (Tianjin) Co., Ltd., an affiliate of Exxon Corp. (US)/NA
Will establish lube oil blending plant in Tianjin municipality. 4/97.

Esso (Zhejiang) Co., Ltd., an affiliate of Exxon Corp. (US)/NA
Will establish a lube oil blending plant in Ningbo, Zhejiang Province. 4/97.

Harris P.E. Marine (UK)
Awarded Hyundai Corp. (S. Korea) contract to convert oil tanker off the coast of Shanhaiguan, Hebei Province, into a floating production platform. 4/97.

Samsung Corp. (S. Korea)/Ningxia Petroleum Corp.
Will establish Ningxia Samsung Lantian Petroleum Development Co. joint venture to explore for oil in the Ningxia Hui Autonomous Region. 4/97.

Pharmaceuticals

INVESTMENTS IN CHINA

China Pharmaceutical Enterprise and Investment Corp. (HK)/Shijiazhuang Pharmaceutical Group Co. (Hebei)
Established Shijiazhuang Weibao Pharmaceutical Co. joint venture to produce theobromine and pentoxifylline. $4.1 million. 5/97.

Schering AG (Germany)/NA
Established Shanghai Schering Pharmaceutical Co. joint venture to produce Schering products for distribution in China. $37 million. 5/97.

Ports and Shipping

INVESTMENTS IN CHINA

Port of Singapore Authority/Fuzhou Port Authority (Fujian)
Established joint venture to build and manage new deep-water container terminal near Minjiang, Fujian Province. 4/97.

Kawasaki Heavy Industries, Ltd. (Japan)/COSCO
Established ship-manufacturing joint venture to build 150,000-160,000 ton vessels. $146.3 million. (Japan:50%-PRC:50%). 3/97.

OTHER

CIG (HK)/Wuhan Municipal Government
Signed preliminary commitment to develop a container port in Wuhan, Hubei Province. 4/97.

Guangzhou Shipyard International Co. (Guangdong)
Will sell five cargo ships to the State Shipping Co. (Iran). $125 million. 4/97.

A.P. Moeller (Denmark)
Purchased three tanker ships from Guangzhou Shipyard International. $75 million. 3/97.

Power Generation Equipment

CHINA'S IMPORTS

The Shaw Group (US)/NA
Won pipe fabrication contract for two power plants in China. 4/97.

INVESTMENTS IN CHINA

China Light & Power, Ltd., (HK), Exxon Energy Ltd., a subsidiary of Exxon Corp. (US), Kanematsu Power (South China) Co., Ltd., a unit of the Kanematsu Corp. (Japan)/Shenzhen Qianwan Electric Power Development Co., Ltd. (Guangdong), Guangdong Electric
Established power plant joint venture in Guangdong Province. 4/97.

Fuji Electric Co. (Japan)/Shanghai Guangdian Electric Group
Established Shanghai Fuji Electric Switchgear Co. and Shanghai Fuji Electric Transformer Co. joint ventures to produce advanced electric circuit breakers and transformers. $28.8 million. 4/97.

Mitsubishi Heavy Industries Ltd., Mitsubishi Corp. (Japan)/China Technology Import-Export Corp. (Beijing), Hejin Power Generation Liability Co. (Shanxi)
Signed supply agreement for boilers, turbines, and generators for the Hejin power plant project in Shanxi Province. $164 million. 4/97.

OTHER

National Power PLC (UK), Power Pacific Co. (HK)
Announced plans to invest between $200-$300 million in power plants up to 200MW in size in China over the next three years. 4/97.

ADB
Will offer technical assistance grant to assess the feasibility, engineering design, and environmental impact of new power lines and switching stations in Yunnan Province. $400,000. 3/97.

Property Management and Development

INVESTMENTS IN CHINA

Trammell Crow International China, an affiliate of the Trammel Crow Group, The Prudential Insurance Company of America (US)
Established China Sistri-Park Ltd. wholly foreign-owned venture to develop warehouses and distribution centers in China. $200 million. 5/97.

CIL Holdings (HK)
Purchased a 50% stake in the Nanning Haiqi Real Estate Development joint venture between the Hillary Group (HK) and Nanning City Housing Construction and Land Development Co. (Guangxi). $3.9 million. 4/97.

Daewoo Corp. (S. Korea)
Won Shanghai Daewoo Centre Development Corp. contract to build the Daewoo Center building in Shanghai. $540 million. 4/97.

Hua Yuan Holdings (Shanghai), a wholly owned subsidiary of DBS Land (HK)/Shanghai Pudong Real Estate (Group) Co.
Signed joint venture to develop residential housing project in the Pudong New Area. (HK:95%-PRC:5%). 4/97.

Telecommunications

CHINA'S IMPORTS

Glenayre Technologies Inc. (US)
Will supply equipment for a high-speed paging network to the Radio Administration Committee in Guangdong Province. $5.1 million. 5/97.

Orckit Communications (Israel)
Won MPT contract to supply HDSL technology to help with the extension of transmission and frame relay systems throughout China. 5/97.

LM Ericsson (Sweden)
Signed two contracts with Hebei P&T Administration to expand the GSM and TACS mobile networks in Hebei Province. $71 million. 4/97.

LM Ericsson (Sweden)/Liaoning Mobile Co.
Announced plans to double existing local GSM mobile network capacity. $51 million. 4/97.

Motorola Inc. (US), LM Ericsson (Sweden)
Won Shandong Provincial P&T Administration mobile phone network contracts to expand Shandong's telecommunications capacity. $121 million. 4/97.

Phoenix Wireless Group, World Communication Group (US)
Won local P&T Administration contract to deploy a wireless local loop system in Pengzhao, Sichuan Province. 4/97.

QUALCOMM Inc. (US)
Signed four-year supply agreement with Telecom Great Wall Development Co. (Beijing) to supply QUALCOMM code division multiple access digital phones. $300 million. 4/97.

Tellabs Operations Inc. (US)
Won supply contract for its MartisDXX managed access and transport network system for the Beijing Telecom Great Wall Mobile Network. 4/97.

Samsung Electronics, a unit of Samsung Group (S. Korea)
Won Shanghai Changcheng Mobile Communications Ltd. contract to provide code division multiple access hardware for switching station in Shanghai. 3/97.

INVESTMENTS IN CHINA

American Pacific Aviation & Technology Corp. (US)/Shanghai Zhongli Pharmaceutical Co.
Will open joint venture in Shanghai to produce chip components for wireless communications devices. $100 million. 4/97.

Hebei United Communications Equipment Co., a joint venture between AVIC Group International Inc. (US) and NA/Hebei Provincial Cable Television Station
Signed contract to upgrade Hebei's cable TV network. $45 million. 4/97.

Material Handling Engineering Ltd. (Singapore)/Chengdu Tongfa Telecom Co. Ltd. (Sichuan)
Signed memorandum of understanding to establish joint venture in Chengdu, Sichuan Province, to provide paging services and sell telecommunications products. $2.4 million. 4/97.

OTHER

King Products Inc. (Canada), INFA Telecom Asia Ltd. (HK)
Will provide interactive multimedia public telephones to be used in Hong Kong. $2.2 million. 5/97.

VSI Enterprises Inc. (US)
Opened offices in Beijing and Chengdu. 5/97.

AT&T Corp., Sprint Corp., MCI Communications Corp., SBC Communications Inc. (US), Nippon Telegraph and Telephone Corp., Kokusai Denshin Denwa (Japan), Hong Kong Telecom, Singapore Telecommunications, Korea Telecom/ China Posts and Telecommunications Inc.
Signed memorandum of understanding to collaborate on the first undersea fiber-optic cable linking China and the United States. $1.2 billion. 4/97.

New Star (Australia)/Guangzhou Television & Radio Broadcasting Corp. (Guangdong)
Signed free-to-air media agreement to broadcast New Star programs in Guangdong Province. 4/97.

Transportation

CHINA'S IMPORTS

Airbus Industrie (EU)/CAAC
Will sell 10 new A320 and 20 new A321 passenger jets and finalize plans for the development of the 100-seat AE31X passenger plane in China. $1.5 billion. 5/97.

Airbus Industrie (EU)/CAAC
Sold five ATR-72s to CAAC. $150 million. 5/97.

BREED Technologies Inc. (US)/NA
Signed one-year supply agreement to supply BREED driver-side SRS-40 airbag systems. 4/97.

Siemens AG (Germany)
Won contract to provide part of a freight system for an electrified rail network between Baoji and Chengdu in Sichuan Province. $71 million. 4/97.

Toyo Electric Corp, NABCO Ltd., a unit of Kobe Steel Ltd., Nichimen Corp. (Japan)/CITIC, Changchun Passenger Train Co.
Signed equipment supply contract for Beijing subway expansion project. $38.4 million. 4/97.

INVESTMENTS IN CHINA

NA (Singapore)/Dandong Auto-Manufacturing Plant (Liaoning)
Established the Huanghai Automobile Manufacturing Industrial Co., Ltd. in Dandong, Liaoning Province, to manufacture large and medium-sized buses. $36 million. 5/97.

Rolls Royce PLC (UK)/Xian Engine Corp. (Shaanxi)
Established Xian XRA Aerocomponents Ltd. joint venture to produce advanced aircraft-engine turbine blades for Rolls Royce. (UK:49%-PRC:51%). 5/97.

Carbone Lorraine SA (France)/Johnson Electric Holdings Ltd. (HK)
Will establish Carbone Lorraine Shenzhen Ltd. venture to produce carbon brushes for micro motors. (France:90%-HK:10%). $2.6 million. 4/97.

Caterpillar Inc., Asian Strategic Investment Corp. (US)/CITIC
Established joint venture to manufacture engine castings in Shanxi Province. $98.8 million. 4/97.

China Auto Parts Ltd., a subsidiary of GPE Industries Bte (Singapore)/Shanghai Anting Industry Corp.
Won contract to manufacture automotive wire harness products. $1.6 million. 4/97.

Zexel Corp. (Japan)/NA
Will establish joint venture in Wuxi, Jiangsu Province, to produce fuel injection pumps for diesel engines. $7.9 million. 4/97.

Continuous Cycle Engine Development (New Zealand), Pacific Base Pte. (Malaysia)/Sichuan Donghua Machinery Works
Signed memorandum of understanding to establish engine-manufacturing joint venture. 3/97.

Delphi Energy and Engine Manufacturing Systems, a subsidiary of General Motors Co. (US)/Shanghai Electrical Machinery
Established battery production joint venture in Pudong New Area. $55 million. 3/97.

Varity Perkins PLC (UK)/Tianjin Power Equipment Plant
Established Perkins Engines (Tianjin) Co., Ltd. joint venture to produce Perkins phasers and diesel engines in Tianjin. (UK:60%-PRC:40%). 3/97.

OTHER

Eurocopter Holdings S.A. (EU)/CAAC
Signed technology cooperation agreement for the design and manufacture of the rotor to be used for the new Z-10 Chinese-made helicopter. 5/97.

Delta Air Lines Inc. (US)/China Southern Airlines Co., Ltd.
Signed preliminary agreement for code-sharing technology to improve reservations system. 4/97.

Federal Express Corp. (US)
Extended its US-China and China-Asia service to four direct flights a week. 4/97.

Nissan Diesel Motor Co. (Japan)
Will purchase diesel engines from Hangzhou Automotive Engine Plant (Zhejiang) for use in its large trucks. 4/97.

The Timken Co. (US)
Opened representative office in Beijing. 4/97.

Miscellaneous

INVESTMENTS IN CHINA

Singapore Technologies Industrial Corp./Golden Harvest Ltd. (HK)
Will open multiplex cinemas across China. $4 million. 4/97.

OTHER

PR Newswire (US), Yonhap News Agency (S.Korea), Nihon Keizei Shimbun Inc. (Japan), the Press Trust of India Ltd. (India), LKBN Antara (Indonesia), AAP Information Services Pty Ltd. (Australia), Bernama (Malaysia)/Xinhua News Agency of China.
Announced the formation of Asia Pulse Pte Ltd joint venture wire service, offering tailored business information on Asian markets. 5/97.

CSCC Casino Software Corp. (Canada)/China Everbright Holdings Co. (HK)
Signed memorandum of intent to establish joint venture to manufacture hardware components for casino machinery. 4/97.

Secom Co., Ltd. (Japan)/NA
Will jointly operate security monitoring firm in Qingdao, Shandong Province. $1 million. 4/97.

ADB
Will offer technical assistance grant to prepare regulations on national procurement and competitive bidding. $600,000. 3/97.

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STREET SMARTS

Shanghai is the place to go for information about Chinese stocks. I learned this firsthand on my quest to find out, during my stay in China, how hard—or easy—it is for foreigners to invest in China's stock market.

I left for Shanghai with a fair amount of basic information about the country's young, and sometimes wild, stock markets. I knew, for example, that foreigners could only buy certain shares, known as B shares, on the exchange (though PRC citizens, restricted to A shares, were finding ways to buy B shares themselves). And I knew that after a sluggish 1996, early 1997 was proving profitable for investors on both the Shanghai and Shenzhen exchanges. The indexes were rising so quickly and steadily that the central government, with reason, had recently issued several warnings to shareholders to proceed with caution. Because companies are selected for listing as much for their political importance as their economic fundamentals, it was unlikely that the stock markets' rise reflected any dramatic, across-the-board improvement in the health of the listed companies. (Sure enough, by June the stock markets' steady rise had turned into an uneasy decline.)

But the information about China's stock markets that filtered down to me in Washington was only half of the story. What I encountered in Shanghai was the other half—or, rather, how to find the other half.

As soon as I arrived I discovered that almost everyone in Shanghai was connected in some way to the stock market. Whether Chinese or foreign, the market was one of *the* topics of conversation in the city, ranking right up there with the hazards of driving (or bicycling). If not investors themselves, most Shanghai residents know someone who is. And everyone is a virtual encyclopedia of stories about investors and investments—including my Shanghai-based colleague, Sheila Melvin, who had been in the city only a few months but who was already up on the latest market news.

Which leads me to my second discovery: Shanghai residents seem to be uniquely in the know about what is really going on. Owners of Motorola beepers receive instant ticker-tape readouts of price movements on the exchange, but the news driving these movements, like other news in China, often is communicated face-to-face. Shanghai stocks rise and fall on news that doesn't always make it into print. Thus, it's essential, I learned, for dedicated shareholders to belong to informal groups, called *shalong* (salons), if they are to hear the latest word on the prospects of listed companies. Salons are everywhere in Shanghai. My various Shanghai-based companions pointed out several of these often streetside gatherings during my stay.

Since the same PRC companies often list both A and B shares, the key would be finding out as much as possible about the listed companies. Thus, a crucial step is locating a broker to set up a B-share account. In Shanghai at least, this task appears fairly straightforward if you have the time to visit individual brokers.

There seems to be quite a range in the level of services offered from broker to broker. At the first of two companies we visited, China Guotai Securities Co., Ltd., we were told that B-share accounts required a minimum investment of $10,000, and that the company would not provide any services other than executing our trading orders. We could stop by the brokerage house to pick up receipts of our trades, but would not be entitled to periodic statements about the performance of our holdings or of activity on our account. We asked how to obtain information about listed companies and were told that short of subscribing to *Shanghai Securities News*, which publishes listed companies' earnings reports, we would have to attend each company's annual shareholder meeting to obtain an annual report. Nonetheless, we were able to confirm that the more popular listed companies are not necessarily "hot" because of their business fundamentals. The company representative we spoke to mentioned, as an example, a company called Huangshan Travel that was particularly sought-after at the moment but had no traits we could discern that merited such investor enthusiasm. The salons knew something we didn't, perhaps.

At the second securities firm, China Securities Co., Ltd., we found a company willing to provide us with annual reports, English-language research reports of listed companies, and our own English-speaking trader. One of the top three firms in the country, China Securities did not require a minimum balance, but the representative insisted that it would be foolish to open an account of only a few thousand dollars. The commission on trades is 1 percent, he said, making frequent trading expensive. And one foreign investor in 1992 lost half of his $300,000 investment in six months when the market dropped.

The China Securities analyst with whom we spoke stressed that our best bet was to go through a foreign securities house back home. When we asked whether many foreign stock brokers were familiar with China's stock exchanges, he acknowledged that there were "very few" involved in the B-share market and those who were tended to be based in Hong Kong or Taiwan.

On the China Securities analyst's advice, I have been looking into purchasing B-shares through US-based securities firms. My forays so far have yielded little. I called a respected stock broker at Dean Witter and was told that the only stock Dean Witter recommends for its clients is the American Depository Receipts of Shanghai Petrochemical listed on the New York Stock Exchange. Other money managers have told me they invest in H shares, the "red chips" or PRC firms traded on the Hong Kong stock exchange, but not B shares.

If I lived in Shanghai, I'd probably be unable to resist attending a salon to find out the scoop on China's listed companies (my colleague in Shanghai planned to start visiting one in preparation for some future investments). Since I live here in the States, though, I will probably continue to search for brokers with experience trading B shares for their clients. But, after all, I suppose I shouldn't be too surprised that few US brokers have found their way to the salons on the streets of Shanghai.

—*Catherine Gelb*

Catherine Gelb is assistant editor of The CBR. *This article could not have been written without the assistance of Sheila Melvin and Sophie Zhao of the US-China Business Council's Shanghai office.*