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THE CHINA BUSINESS REVIEW

THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL

China's Other Epidemic

HIV/AIDS:
The Impact on Business

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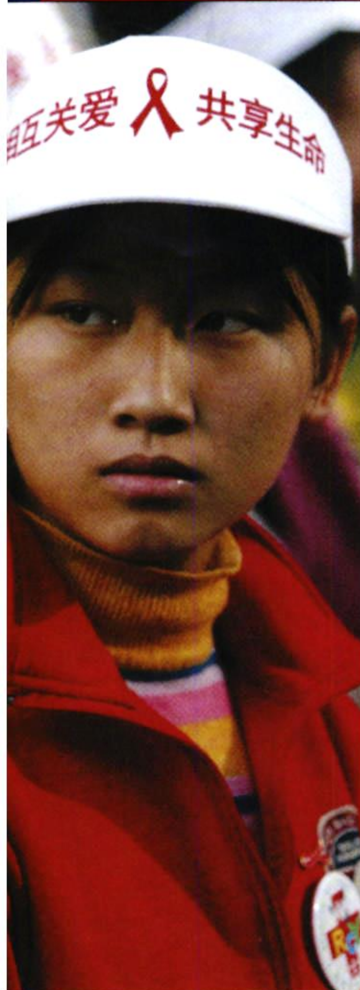

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THE US-CHINA BUSINESS COUNCIL
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Robert A. Kapp
PRESIDENT, THE US-CHINA BUSINESS COUNCIL

The SARS virus declines; the visa mess continues.

Of Viruses and Visas

Before atypical pneumonia, before the Metropole Hotel super-spreader, before the World Health Organization (WHO) advisories on travel to China, there was the visa mystery.

Long before China declared publicly that it faced a medical emergency in severe acute respiratory syndrome (SARS), American businesses knew they were facing a different emergency of unknown origin.

Last August 16, I wrote to the leadership of the US Department of State (DOS) that American companies working in the People's Republic of China were facing sudden, unexpected, and disruptive changes in procedures governing the issuance at US posts in China of visas for PRC citizens seeking to enter the United States for purposes directly related to legitimate US commercial interests.

The Council's corporate members were unable to learn the content and extent of the new procedures that seemed to be operating. Normal business functions in the large and expanding arena of US-China commerce were, and still are, severely challenged.

Nearly a year has passed since the visa mess insinuated itself without notice into the normal operations of American businesses—and universities, research labs, student exchange programs, and other forms of American interaction with the world.

In contrast, two and a half months have passed since SARS burst onto the world stage. Today, while uncertainties remain, the SARS tide appears to be receding. There can be little doubt that the energetic actions of governments at the local and national levels, along with the strenuous efforts of international health agencies led by the World Health Organization (WHO), have been crucial to stemming the epidemic.

On the visa mess, however, progress toward the restoration of balance is far less clear. US companies engaged in normal trade and investment with China continue to report that Chinese citizens on legitimate business missions are finding the process of securing normal US travel documents impenetrable, unpredictable, inordinately time-consuming, arbitrary, and more frequently negative where once it was otherwise.

The cost of this systemic implosion is clear to the affected individuals and businesses, whether the firms are small or large. A snapshot of the damage inflicted on smaller US companies by the visa mess was offered at a recent hearing by the House Small Business Committee. So far, other congressional committees with more direct jurisdiction over the entire visa process have failed to confront the visa problem, either in regard to China or globally.

Viruses and visas are different issues, of course, but some of the contrasts in the two situations are instructive.

The central contrast between the US and global responses to SARS, on the one hand, and the continuing visa meltdown on the other, lay in public authorities' approach to public information. Faced with the SARS crisis, national health authorities in the United States and many other nations leapt, together with the WHO in Geneva, into the work of hard science and of instant, sustained public outreach.

The authorities quickly informed health workers and the general public across the globe about what was happening and what could be done. (China was, as noted in my last Letter, slow to act, but then acted with energy). A whole set of policies and measures—especially the rapid deployment of information resources—are at the core of the decline in SARS numbers worldwide as summer begins.

Contrast the visa mess.

The visa crisis emerged in the wake of September 11, 2001. The impulse to act immediately to strengthen US border security was both understandable and necessary.

That the response was also profoundly bureaucratic and heavy-handed was perhaps, at

first, inevitable. It also carried heavy political freight. As the attempt to rationalize and strengthen the management of US border security got going, DOS, which had always held authority over the granting of visas, came in for withering political criticism for having granted visas to people bent on committing terrorist acts against American citizens within the United States. In due course, heads rolled in Consular Affairs. Junior officers handling visas heard a loud and clear message.

Furthermore, a tightening of border security revealed massive technical obstacles, including the existence of numerous bureaucratically distinct databases whose integration across agency lines now loomed as critically urgent. The government turned simultaneously to the tasks of institutional reorganization (including the formation of the Department of Homeland Security), technological rationalization, and tighter restriction on access to the United States.

Although details remain sketchy even now, it is clear that the visa process underwent massive changes in the early summer of 2002. A new program called CONDOR raised the bar for visa applications by certain citizens of certain countries and territories deemed to present the highest risk of terrorist infiltration into the United States. That was the bluntest new instrument deployed in the visa system.

China, however, was never regarded as a special source of potential terrorist infiltration into the United States. On terrorism, the United States has consistently regarded China as a cooperative partner.

Yet, by midsummer of last year, visa applications from Chinese nationals directly associated with American business operations in China were disappearing into a void, an opaque US review process with no explanation of what was happening and when decisions would be reached.

The kind of competent informational effort so quickly evident in the SARS case was regrettably absent in the case of the visa mess. For months, businesspeople and Washington-based organizations like The US-China Business Council probed politely, wrote letters, and talked to friends in government, simply trying to understand what had befallen them. Answers were often friendly, usually vague, never definitive.

It became clear that the big slowdown on China visas resulted from the vast increase in referrals from consular posts worldwide to an interagency "Security Advisory Opinion" (SAO) review process in Washington. We learned some other things along the way:

1 The "clock," as it was called—the familiar system whereby, in the absence of a formal decision on a particular visa application within a fixed period of time, the application was automatically approved—was unplugged. No time limit on the review of visa applications was retained. Thus reviewing agencies no longer felt a strong incentive to act expeditiously.

2 In early August, 2002, a new "guidance" was sent to consular offices worldwide, updating the wide-ranging Technology Alert List (TAL) on which visa officers were to focus and counseling them on when to reach out for a multi-agency SAO instead of making their own visa decisions. This guidance, called "Using the Technology Alert List (Update)" makes clear the confluence in midsummer 2002 of the emergency response to terrorism and longer-term challenges, such as "maintaining US advantages in certain military critical technologies." This program of interagency visa review, established years earlier, was called MANTIS. For China, it was not CONDOR but MANTIS that was now at the forefront.

Recommending that the so-called "critical fields list" attached to the update be "posted at the interview window where staff can become familiar with the contents," the update also encouraged visa officers to trust their instincts. "There may be times," visa officers were advised, "when the consular officer suspects *for whatever reason*, that an applicant may be /of concern/ *despite the absence of the applicant's profession or area of study on the TAL. Such cases can and should be submitted in an SAO for the Department's advisory opinion.*" (Emphasis added).

With the antiterrorism border-control effort (not aimed at China) thus melded with the broader goals of the MANTIS-TAL process by August of 2002, and visa officers urged to "trust their instincts" by moving visa decisions to interagency review, it is no surprise, in retrospect, that the number of MANTIS review cases for China quickly shot upwards, to perhaps four times prior levels.

Draped in the emergency response to September 11, the mysteries of the visa crisis remained unsolved to those, including a great many legitimate American companies in China, caught in the downdraft. Well-intentioned officials would explain obliquely that decisions were coming from "above." Sympathetic listeners would point out that the manpower in the embassies, consulates, and overburdened investigatory bodies in Washington was lacking, as were the technical resources: computers were ancient, systems did not interconnect, administrative priorities were elsewhere, and so forth.

Once it becomes clear who has the authority to repair this extraordinary bureaucratic flameout, balance simply must be restored to a visa system that must shut the door as tightly as possible to those who seek to destroy the security of the United States while keeping the door open to foreign citizens, including Chinese, whose entry into the United States is inoffensive or beneficial to this country.

The SARS emergency to date has demonstrated the capacity of national and international government agencies to respond vigorously, creatively, openly, and effectively to sudden dangers.

The visa mess has not done so.

If current SARS trends continue, Americans pursuing opportunities for successful business with China will soon flow in and out of China again in normal numbers. Meanwhile, they wait none too patiently for normality to return to the flow of Chinese customers, business partners, and employees to the United States. Whether the bureaucratic systems struggling to perform essential security tasks can develop the skills needed to minimize random damage along the path to protection is a critical question that demands an answer. 完

The Impact of HIV/AIDS on Business in China

Bates Gill and Andrew Thompson

Companies should act now to protect workers, corporations, and profits

The outbreak of severe acute respiratory syndrome (SARS) has exposed the immense challenges that face China's overburdened and underfunded healthcare system. But SARS is only one of several infectious diseases that are spreading through China, posing potentially long-term socioeconomic damage. The human immunodeficiency virus (HIV) and acquired immunodeficiency syndrome (AIDS) in particular will threaten China's economic growth and social stability in the coming decade.

All companies operating in China risk incurring significantly higher costs as a result of the rapid spread of HIV

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combined with China's weak healthcare system. The PRC government estimates that by the end of 2002, more than one million citizens were infected with HIV. Registered cases increased more than 30 percent per year in 2001 and 2002. The United Nations and the US National Intelligence Council estimate that China could have between 10 and 15 million infected citizens by 2010. If the experiences of companies in Africa and Southeast Asia are any guide, companies in China that are unprepared for the rise in HIV/AIDS cases may pay for their inaction through rising operating costs and diminished profits.

Who is at risk?

The inability of China's public health surveillance system to determine accurately the number of HIV infections in the general population makes it difficult to assess those at risk. At the end of 2002, there were only 158 national HIV/AIDS surveillance centers in operation—many affiliated with detoxification centers for drug users and commercial sex worker re-education centers run by the Ministry of Public Security. The Ministry of Health believes that more than 10,000 sites would be necessary to assess the full magnitude of the epidemic.

Other emerging infectious diseases provide important indications about HIV's potential to spread throughout China. Hepatitis B and C currently infect more than 200 million people in China and are analogous to HIV/AIDS in some ways because many people who become infected unknowingly carry the virus for years before manifesting symptoms. In the meantime they infect others through sexual contact, blood product donation, and improper reuse of medical equipment. The extent of the hepatitis epidemic and the rapid increase of sexually transmitted infections in both urban and rural areas since the early 1980s indicate that HIV/AIDS will likely spread to the general population. There is currently a false feeling of security among many Chinese people who believe that HIV/AIDS is a "foreigner's" disease that will only affect marginal populations, making prevention and education an important task for companies seeking to protect their employees and communities.

What are the costs of HIV/AIDS to businesses?

When HIV/AIDS enters the workforce in appreciable numbers, businesses face significant added costs and reduced revenues. HIV/AIDS affects businesses' competitiveness in three ways. Primary costs, such as labor, increase. When sick employees miss work, worker productivity declines and employee turnover, healthcare expenses, and social burdens such as insurance premiums and death benefits increase. Secondary costs, such as low morale and strained relations between workers and management, often occur. Businesses also experience tertiary costs such as damage to corporate reputations and the decline of product markets and investor interest.

- **Primary costs**

The well-documented increase in labor costs brought on by the HIV/AIDS epidemic in Africa and Southeast Asia indicate what companies operating in China may face in the future. Many people who contract HIV are unaware that they are ill and work for several years before their health begins to decline. The impact of HIV/AIDS first hits businesses when a worker's absenteeism increases and may be particularly severe for companies that employ skilled workers. A study in Beijing conducted between 1994 and 1999 found that HIV-infected people spent an average of 89.6 days per year in the hospital and made an additional 2.7 outpatient visits per year. Because of the highly personal nature of Chinese business relationships, moreover, the absence of key workers may amplify the impact of HIV/AIDS. Compounding matters, healthy employees often contribute to worker absenteeism rates when they take time off to care for HIV-infected family members. When workers are absent, remaining employees take on extra work, which results in higher overtime costs and workplace stress. Workers and their families may also demand death benefits, funeral expenses, and bereavement leave, further raising the costs of business for employers.

These costs—in terms of managers' time, staff disruption, training, and productivity—could have a major impact on companies in China. Hiring a new employee can cost several months' salary to three times an annual salary depending on the position and industry. Regardless of whether the person being replaced is skilled or unskilled, experienced workers are more productive and generate more profits.

- **Secondary costs**

It is difficult, yet necessary, to measure the secondary costs of HIV/AIDS. Employees and employers typically are unaware of any given worker's HIV status. A rising number of illnesses within a company may not initially be attributed to HIV/AIDS since few Chinese doctors are qualified to diagnose it. Because HIV depresses the immune system, patients may die from opportunistic infections, including tuberculosis, which may be named the official cause of death. As the incidence rate increases within the community and more doctors become aware of HIV/AIDS symptoms, the diagnosis will be made more often—affecting society more openly. Once the incidence of HIV/AIDS rises,

When HIV/AIDS enters the workforce in appreciable numbers, businesses face significant added costs and reduced revenues.

employee morale may plummet and industrial accidents may occur more frequently because of sickness, stress, depression, and even fatalism—further reducing productivity.

Worker-employer relations can suffer once HIV/AIDS permeates a workplace. The primary conflict arises when expensive, lifesaving treatments lie beyond the financial reach of employees and are not covered by insurance plans or employee healthcare systems. Currently, antiretroviral treatment, known as the "AIDS Cocktail" (*aizibing jiweijiu*) is available in Beijing and Shanghai using imported drugs. The cost, prohibitive to most patients, is around $5,000 per year. Several Chinese pharmaceutical companies are rushing generic versions to market, hoping to lower the price to a more manageable $1,200 per year. Companies will inevitably face difficult decisions about whether to expand benefits to include life-prolonging treatments for employees and their dependents.

● **Tertiary costs**

Companies in China face significant costs and risks from HIV/AIDS in the wider community. The most significant risk is to a company's brands and image. If a company does not provide life-prolonging treatments to its infected employees, it can be branded insensitive or ruthless and risks consumer boycotts. Consumer-product companies are particularly vulnerable to popular perceptions of their brands. Poorly planned HIV/AIDS policies, or an absence of such policies altogether, can thus have negative effects on the company. A company that is severely affected by HIV/AIDS can suffer from a lack of investor confidence and may lose access to capital.

Perhaps the greatest external cost of HIV/AIDS to a company is the impact of a decline in the greater economy. HIV/AIDS primarily affects workers in the most productive periods of their lives. Their incapacitation can reduce family incomes, and payment for treatment can eliminate their savings. The result is reduced spending and demand for goods and services, particularly for non-essential items and services. Writ large, this situation can spell macroeconomic decline, not only in areas where HIV/AIDS is prevalent, but across the country or region. Thailand is a case in point. A Thai government study in 2000 estimated that the direct and indirect cost of HIV/AIDS to the nation was $1.2 billion. Additional estimates suggested that the Thai HIV/AIDS epidemic could be costing the *Japanese* economy between 1 and 2 percent of its annual GNP through losses in trade and potential markets. As markets shrink and labor costs increase, profitability becomes harder to attain.

Learning from SARS

Severe acute respiratory syndrome (SARS) has raised troubling questions for Chinese citizens—including corporate citizens—about the nature of risk in China and the government's ability to respond to rapidly developing crises. The PRC government's response to SARS has mirrored the government's reaction to HIV/AIDS. The government initially reacted with misinformation and denial, then, after heavy international pressure, admitted the problem and eventually cooperated with foreign partners, though with some reluctance and suspicion at the outset. Though SARS has garnered significant political attention and has mobilized society, China's capacity to cope with more slowly spreading, more lethal, diseases is by no means assured.

The SARS outbreak revealed shortcomings in China's medical and political systems. Medically, SARS presented a huge challenge to the entire healthcare system. At the clinical level, doctors and nurses were infected in disproportionate numbers, hospitals quickly became overwhelmed, and the army stepped in to provide medical staff for civilian hospitals. Public health oversight capacity was also strained by SARS, as virtually all infectious disease specialists in the government were unable to continue their daily work on other diseases.

Politically, SARS exposed the PRC government's initial inability to address rapidly developing crises. The outbreak underlined Beijing's communication difficulties with provincial authorities. Poor communication between the Ministry of Health and Beijing city health authorities also showed that even in the capital, lower-level officials do not always report in a timely and accurate fashion. The subsequent sackings and reprimands of close to 1,000 provincial- and local-level officials for inadequate handling of the SARS epidemic illustrates the central government's frustration with officials who do not follow its commands quickly enough; the need to punish some officials in order to motivate others; and careful public relations. The government's obstruction of the World Health Organization and United Nations public health teams exposed a continuing distrust of outsiders, which does not bode well for more openness in the future. Though the political establishment eventually mobilized society and improved communication between the provinces and the center, it is unclear at this point if these developments will translate into more effective responses to other dynamic crises in the future.

SARS has done what other infectious diseases in China have thus far failed to do: capture the attention of the top leadership and the international community. Fortunately, it has infected a relatively small number of people, caused fewer deaths, and as this article goes to press, is on the decline. The economic impact has been sharp, but should be brief. Preventive measures, including screening and quarantine, have proven effective. Unlike SARS, however, HIV/AIDS is a terminal illness in all cases, infects the young and productive at high rates, and will have a long-term economic impact. Though some observers hope that SARS will engender a new sense of openness, it is still unclear that the PRC government has made such a commitment or that it will apply its experience in dealing with SARS to other infectious diseases.

—Bates Gill and Andrew Thompson

How businesses can mitigate the impact of HIV/AIDS

The Chinese workplace generally influences employees' personal lives, social values, and behavior. Though the work unit (*danwei*) system has removed itself from many aspects of workers' lives, all companies in China still influence workers' attitudes and are in a unique position to provide public health education and a healthy working environment. Preventing the spread of HIV and hepatitis within a company's workforce is both economically and humanely preferable to absorbing the costs of replacing workers lost to AIDS or other diseases, or to treating infected workers.

Though many managers and experts are concerned about the impact of HIV/AIDS on businesses in China, few companies have taken concrete steps to protect themselves from the economic costs of blood-borne diseases. A 2002 survey of businesses in Beijing conducted by the Futures Group Europe found that only 8 percent had an established HIV/AIDS policy, while 26 percent had policies concerning hepatitis, and 9 percent had policies on sexually transmitted diseases (STDs). Only 3 percent of the companies reported that they had policies and programs specifically designed to address HIV/AIDS in China.

To mitigate the future impact of HIV/AIDS, hepatitis, and other blood-borne diseases, a company should establish an HIV/AIDS, hepatitis, and STD policy and disseminate it to all employees; provide preventive education to its workforce and families; involve the wider community in education programs that, among other goals, attempt to reduce the stigma of such diseases; extend prevention messages and incentives to vendors and suppliers who also undertake prevention programs; and make preparations for the care and support of workers and their families.

- **Developing an HIV/AIDS policy for the workplace**

The issue of HIV/AIDS is socially sensitive in China because of the widely held misperception that the disease only afflicts marginalized groups, such as drug users, sex workers, and men who have sex with men. Most Chinese are also reluctant to discuss sexual topics, particularly when illegal or "immoral" activities are the focus. Others believe that HIV/AIDS is a personal issue similar to hygiene that companies do not need to address.

An HIV/AIDS, hepatitis, and STD policy should state the company's position and practices for preventing the transmission of these diseases and for handling infection among employees. The policy should comply with local and national laws, establish behavioral guidelines for all employees, and provide resources both within the company and outside it for assistance and counseling. The policy should specify the benefits and medical services that are included in the company's healthcare program and ensure that confidentiality and privacy are guaranteed. Ideally, employees will be involved in creating the policy so that they have a stake in the results, are receptive to future education programs, and can become a resource for other employees. An employee-designed policy more effectively influences attitudes and exerts peer pressure on the entire workforce. The formation of the workplace policy is the first step toward reducing the stigma of the disease, which should be a goal of any policy.

Organizations have used innovative methods to break down the stigma. Some companies have detailed expected behavior of all staff toward coworkers who are infected or who have infected family members. By including hepatitis and other diseases that have similar epidemiological characteristics as HIV/AIDS in their policy, companies have shown employees the impact and transmission routes of these similar diseases, demonstrated that these diseases are widespread, and (because of the potential for clinical transmission through illegally reused medical devices) emphasized that all employees and their family members may be at risk of contracting these diseases, regardless of their marital status.

As part of the policymaking process, companies should review existing policies and consider whether they could contribute to dangerous practices. For example, a manager in a Beijing company expressed concern that his company's policy of providing a certain number of paid "sick days" to employees, combined with a reimbursement policy for medical expenses, led employees to view these policies as part of a benefit package that needed to be used or lost. The manager was aware that many employees took days off, even when they were not ill, to use up their sick days and visit the doctor to get vitamin and other "pick-me-up" injections, intravenous drips of herbal medicines, and possibly even blood products. Because of the frequent reuse of needles and catheters in unregulated facilities in China, the manager was extremely concerned about the possible impact on the company's employees. Companies faced with similar situations need to consider solutions, such as providing workers who do not use up their sick days with bonuses, and reimbursing expenses only from qualified hospitals and clinics.

- **Developing health education programs for the workplace**

After a policy is in place, the next step for a company in China is a health education program for the workplace. The ultimate goal of such an education program should be to keep a company's workforce healthy and productive, thus maximizing productivity while reducing

To mitigate the future impact of HIV/AIDS, hepatitis, and other blood-borne diseases, a company should establish an HIV/AIDS, hepatitis, and STD policy and disseminate it to all employees.

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costs from absenteeism, increased healthcare services or insurance premiums, and staff turnover. The health education program should help prevent employees and their dependents from becoming infected with HIV (and other diseases) as well as eliminating the stigma of infected coworkers, as already mentioned. Of course all companies have different workforces and should tailor their programs to suit the age, education level, gender, and behavioral risk factors of their workers.

No one program will suit the needs of all companies, but successful programs share common elements. Education programs are most effective when delivered by peers and when workers are involved in program development. Programs need to teach the basic means through which HIV, hepatitis, syphilis, and other STDs are spread, along with preventive measures, such as condom use. Again, employees should be made aware of the danger of reused needles and syringes in clinical settings—and be empowered to demand clean, single-use needles and syringes, and screened blood products. Employees must also learn how these diseases are *not* spread—programs should emphasize that casual contact in the workplace presents no risk of HIV infection.

Good programs provide a forum for discussing how all employees, including senior management, should treat infected coworkers and how the company's policy affects everyone. Programs should discuss occupational hazards, how to handle accidents at work, training for onsite medical staff, and basic first aid procedures for all staff. Education programs that conduct mandatory training in small groups and on company time have high success rates. Perhaps most important, healthcare education programs need to be monitored for effectiveness with follow-up meetings, and companies must solicit feedback from workers to determine employee understanding of the issues.

Training programs should provide resource materials, including pamphlets or printouts with key messages, workplace issues, and company policies. Employees should be encouraged to bring handouts home and educate family members and peers outside the office. The 2002 business survey in Beijing confirmed that 75 percent of companies surveyed would like to provide an HIV/AIDS initiative, particularly if the program is culturally sensitive.

- **Supporting communities**

Companies, as members of the communities in which they operate, have a vested interest in involving the wider community in their education programs, reducing stigma, and extending prevention messages and incentives to vendors and suppliers who also undertake prevention programs. Companies also have a vested financial interest in maintaining the health of the community and ensuring that there is disposable income available for their products or services.

Insurance companies can be valuable resources to help their customers implement programs within their own organizations. The lower the rate of infection, the lower the cost to the insurance company in terms of healthcare payouts. Insurers may also find that support for educational programs enhances their brand by fostering positive public perceptions and attracts new business by providing value-added products. Insurance companies in many countries also provide discounts or credits to companies with effective workplace HIV/AIDS policies. These savings can help a company justify the cost of developing and implementing a healthcare program. In 1999, American International Assurance, Thailand, a subsidiary of American International Group, Inc., started an evaluation and accreditation program to provide premium credits to companies implementing HIV/AIDS policies and education programs in the workplace. By combining HIV, hepatitis, and other similar diseases into these programs, insurance companies in China stand to generate even greater savings.

Businesses outside of the insurance industry also have opportunities to provide incentives to suppliers to implement healthcare policies and education programs. Manufacturers face higher costs if their vendors' costs rise, so promoting healthy workplace policies and programs within their supplier networks makes good business sense. Many manufacturers already require their original equipment manufacturer and service suppliers to attain International Organization for Standardization certifications or require vendors' business practices to mesh with theirs. By sharing existing education programs and policies and using outside resources, companies can reduce the cost of designing and implementing their own policies and programs.

Providing care, support, and treatment

Not surprisingly, the 2002 corporate survey found that less than 10 percent of FIEs in Beijing had seen any impact from HIV/AIDS in their workforce. Little data exists about the impact on businesses throughout China, but companies should factor in the anticipated costs and scope of their programs when designing their care policies. The first step is to review local and national laws to determine the legal implications for the company. Second, companies should survey healthcare capacities—both within the company if applicable, and in the wider community—to ascertain high-quality

Continued on page 35

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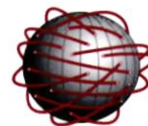

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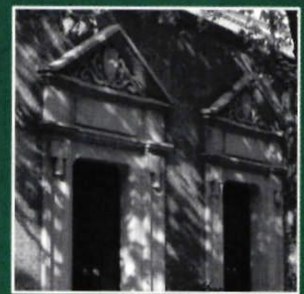

FOCUS: NEW INVESTMENT OPTIONS

A Roadmap for China's Mergers and Acquisitions

Emma Davies

The PRC government has been trying over the last year to create a clearer roadmap for foreign mergers and acquisitions (M&A) players looking at Chinese target companies other than the traditional foreign-invested enterprise (FIE). A flurry of new laws has covered acquisitions of domestic enterprises, state-owned enterprises (SOEs), unlisted shares in listed companies, and even the partial opening of the A-share market (*see* Table 1).

These new rules are a mixed blessing for foreign investors. On the plus side, they have opened up new investment opportunities that were previously closed or that had an unclear legal basis. For example, the government lifted the 1985 ban on buying unlisted shares in listed companies and sanctioned the acquisition of equity in a non-FIE

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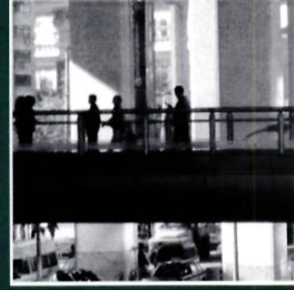

A clearer system emerges but a single, integrated M&A legal regime remains elusive

domestic enterprise for the first time. On the minus side, the rules introduce new hurdles including a potentially restrictive, difficult-to-interpret antitrust regime and an even more uncertain approvals regime. The idea of a single, integrated M&A legal regime thus remains elusive.

To get a sense of what has changed, we must examine the questions commonly asked by foreign M&A players in China and how these questions are best answered under the new regime.

Q: Can a foreign investor buy any type of company in China?

A: Yes, though the purchase is subject to government approvals and some of the more archaic forms of corporate vehicle, such as collectively owned enterprises, would first need to be converted to some other form. Clear legal procedures are now in place that permit foreign investors to buy shares or assets of an FIE, a non-FIE domestic enterprise, a company limited by shares (CLS), or an SOE. If the target company is listed on the Shenzhen or Shanghai stock exchange, the investor can either buy its unlisted shares (which generally make up about two-thirds of the share capital of listed companies in China) or listed B shares. Although an ordinary foreign investor still may not buy listed A shares, offshore funds and other types of financial institutions may now apply to the Chinese authorities for accreditation as a qualified foreign institutional investor (QFII) to invest in companies that have issued A shares. Ordinary foreign investors can therefore indirectly acquire A shares by buying investment products offered by the QFII.

Some companies in particular economic sectors are still either off-limits to foreign investment or require special approvals. When looking at any target, an investor therefore needs to check the latest version of the Catalogue Guiding Foreign Investment in Industry to see if the target company is in an economic sector that is closed to foreign investment or that requires a higher level of government approval. The latest catalogue took effect in April 2002, shortly after China's World Trade Organization entry, and has opened up key sectors to foreign investment that were previously closed (such as telecommunications, gas, and water) and reduced by two-thirds those sectors previously categorized as restricted.

Not only has the choice of targets multiplied over time, but so has the choice of acquiring vehicle that a foreign investor can adopt. For example, the investor can buy a direct stake in the target or use its own existing FIEs in China to buy the shares (provided the acquiring FIE is already profitable, its registered capital is paid up, and its investments in other companies are less than 50 percent of its net assets). Alternatively, the buyer can establish a special-purpose vehicle (SPV) in a favorable offshore jurisdiction to hold the shares in the target—a preferred option for many foreign investors given that any future disposal of the SPV can then usually be done without PRC approvals.

Q: Are there limits to the size of the foreign investor's stake?

A: Back in the 1980s, foreign investors expected to establish FIEs, which need at least 25 percent foreign ownership and the approval of the Ministry of Commerce (MOFCOM, formerly the Ministry of Foreign Trade and Economic Cooperation [MOFTEC]) or its local branch. FIEs enjoy special tax status compared with non-FIE domestic enterprises. In recent years, foreign investors have begun to buy stakes of less than 25 percent. The law was initially silent on whether the resulting enterprise should be classified as an FIE, so it was possible, in practice, for foreign investors to buy such low shareholdings without MOFCOM approval. This loophole was closed at the beginning of 2003. Now, a foreign investor is required to obtain the same MOFCOM approvals for an M&A transaction or greenfield project regardless of whether the foreign shareholding in the resulting FIE is more or less than 25 percent. An FIE with less than 25 percent foreign investment will not enjoy special tax status, however.

Generally, there is no maximum limit on the foreign ownership of a target unless it is in a sensitive economic sector, and such sectors are normally set out in the catalogue. They include industries such as telecommunications, financial services, and transportation.

Q: What are the different ways to buy the target?

A: The options are similar to those in the United States or in Europe. Investors may purchase shares of the target, either by acquiring existing shares from a seller or by acquiring newly issued shares from the target, or purchase the assets. Investors may also indirectly acquire the target by purchasing shares in its offshore parent company. Since 1999, a foreign investor has been able to merge one of its existing Chinese FIEs with another company in China, which can be either another FIE or a non-FIE domestic enterprise. A merger is sometimes an attractive option since it is basically "tax-free," but the statutory procedures for notifying creditors and obtaining government approvals can take a year or more to complete.

Q: Should the foreign investor buy assets or shares?

A: As in other jurisdictions, the main advantage of an asset deal is that it can be structured to avoid the assumption of the target's liabilities. The buyer can also avoid inheriting all of the target's employees and unwanted social welfare obligations, although under new rules an employee "settlement plan" should be included in the transfer papers that are subject to government review. Buying assets is therefore an

Table 1: China's M&A Laws

Name of law	Effective Date	Issuing Authority	Type of Target Covered
Several Provisions on Changes in Equity Interest of Investors in FIEs	May 28, 1997	MOFTEC, SAIC	CJV, EJV, WFOE, and FICLS (non-listed shares only)
Provisions on Merger and Division of FIEs	November 1, 1999, revised effective November 22, 2001	MOFTEC, SAIC	CJV, EJV, WFOE, FICLS, and domestic enterprises
Interim Provisions on Domestic Investment by FIEs	September 1, 2000	MOFTEC, SAIC	LLC and CLS
Notice on Relevant Issues Regarding the Transfer of State-owned Shares and Legal Person Shares of Listed Companies to Foreign Investors	November 1, 2002	CSRC, MOF, SETC	Listed companies (non-listed shares only)
Administrative Measures on Acquisition of Listed Companies	December 1, 2002	CSRC	Listed companies
Interim Provisions on the Administration of Securities Investment in China by Qualified Foreign Institutional Investors	December 1, 2002	CSRC, PBOC	Listed companies
Interim Provisions on the Utilization of Foreign Investment to Restructure State-owned Enterprises	January 1, 2003	SETC, MOF, SAIC, SAFE	State-owned enterprises (excluding listed companies and financial enterprises)
Interim Provisions on the Acquisition of Domestic Enterprises for Foreign Investors	April 12, 2003	MOFTEC, SAT, SAIC, SAFE	Domestic enterprises (excluding transfer of equity in FIEs)

Abbreviations: CJV: Contractual joint venture; CLS: company limited by shares; CSRC: China Securities Regulatory Commission; EJV: equity joint venture; FICLS: foreign-invested company limited by shares; FIE: foreign-invested enterprises; LLC: limited liability company; MOF: Ministry of Finance; MOFTEC: Ministry of Foreign Trade and Economic Cooperation; PBOC: People's Bank of China; SAFE: State Administration for Foreign Exchange; SAIC: State Administration for Industry and Commerce; SETC: State Economic and Trade Commission; SAT: State Administration of Taxation; and WFOE: wholly foreign-owned enterprise.

SOURCE: Emma Davies

attractive option when the target is, say, an SOE with a messy past.

Still, asset deals are more complicated to complete. For example, under new rules that took effect in April, the foreign investor sets up an FIE to acquire the assets of a target (either to inject the assets into the FIE as part of its capital contribution or to use the FIE to buy the assets directly from the target), then creditors of the target must be notified of the sale by way of direct notice and an announcement published in a national or provincial newspaper. The notified creditors can require the target to give security for its debt. If no security can be agreed upon with objecting creditors, then presumably the liabilities owed to those creditors must be discharged before the deal can be completed.

Q: Which government approvals are needed and at what level?

A: The approvals depend on the structure of the deal, the nature of the target, and the value of the transaction. China's approval regime has always been confusing and has been made even more so by the latest spate of legislation and the March 2003 government restructuring during which a number of ministries were merged or dissolved.

There are, however, some general rules of thumb. For example, investors may be able to avoid approvals altogether for an offshore deal (for instance, when the investor indirectly acquires the Chinese target by purchasing its offshore parent, as long as the ultimate parent of the target is not a Chinese company). For an onshore share or asset deal, government approvals are usually necessary. The main approval body for any project involving foreign investment is MOFCOM. Greenfield FIEs with a total investment of $30 million or more, unless the project is classified as "encouraged" in the catalogue, need MOFCOM approval. If total investment is less than $30 million, an approval from the provincial or lower-level branch of MOFCOM should suffice. These general principles are revised somewhat for M&A transactions. In particular, when buying equity of a non-FIE domestic enterprise or establishing a new FIE to acquire assets from a domestic enterprise (which appears to include an FIE), new rules now require MOFCOM approval to come from at least the provincial level even if the total investment of the project is less than $30 million.

If the target is an SOE, then the deal will likely need additional approvals from the Ministry of Finance, the National Development and Reform Commission (NDRC, which recently took over these functions from the now defunct State Economic and Trade Commission), and the State Asset Supervision and Administration Commission (SASAC).

If the target is a listed company and the stake being acquired accounts for more than 30 percent of the listed shares, then a general offer is triggered unless a waiver is obtained from the China Securities Regulatory Commission. Such a deal also needs approvals from the NDRC or its local branch (for the project proposal and feasibility study report) and from the "department-in-charge" of the target. For example, an acquisition involving a telecom operator needs approval from the Ministry of Information Industry.

Many unanswered questions remain about how the overlapping approvals that are required for different types of target should be coordinated. In practice, the investor usually has to navigate the approval process with the help of the target and by making enquiries of MOFCOM and other approval authorities.

Q: When investigating the target, what should a foreign investor watch out for?

A: The new legal regime has not altered the manner in which foreign investors should conduct due diligence investigations of the target. The most common problems encountered dur-

A merger is sometimes an attractive option since it is basically "tax-free," but the statutory procedures for notifying creditors and obtaining government approvals can take a year or more to complete.

Table 2: Antitrust Rules

Triggering Thresholds for Antitrust Review (for either party)	Onshore Deal	Offshore Deal
Current Year's Business Turnover in China	¥1.5 billion ($180.7 million) or more	¥1.5 billion ($180.7 million)
Assets in China	NA	¥3 billion ($361.4 million) or more
China Market Share Before Deal	20%	20%
China Market Share After Deal	25%	25%
Number of Foreign-Invested Enterprises in Related Industries After Deal	NA	More than 15
Number of Chinese Enterprises in Related Industry Acquired Within the Last Year	More than 10	NA

NOTE: NA = not applicable
SOURCE: Emma Davies

ing the investigations are poor transparency and inadequate documentation. A much more hands-on approach to due diligence is necessary in China to get effective results (*see* p.23). Detailed discussions with the target's management are recommended, as well as close coordination between legal and financial due diligence teams. Classic problem areas for SOEs include the under-reporting of tax, complicated debt and security arrangements (sometimes involving a tangled web of connections with affiliated companies), the under-funding of employee social welfare obligations, and incomplete evidence of title to land and buildings. Because China's corporate governance standards are far from perfect, any foreign acquirer has to accept a certain level of risk or uncertainty to close the deal. If past liabilities cannot be fenced off by cherry-picking assets, then investors can negotiate contractual warranties or indemnities with the seller to cover these matters.

Q: How should a foreign investor handle the transfer of employees?

A: The new regime fails to provide any satisfactory mechanism for transferring employees from one employer to another.

If the shares of the target company are purchased, then the position is pretty simple. The target company will continue to employ the existing work force, since by law the target company remains liable for all its obligations and liabilities, including labor contracts.

If only the target's assets are purchased, however, then employees are not automatically transferred from the seller to the buyer. Instead, the seller must terminate existing labor contracts, and the buyer must offer new labor contracts to the employees it wishes to retain.

When the buyer is uncertain whether it wants to retain the employees in the long term, it should ensure that the new labor contracts signed with the transferring employees have an appropriate probation period built into them.

The employees are entitled to refuse the new offer of employment. In other jurisdictions (such as Hong Kong), an employee who unreasonably refuses an offer of new employment on no less favorable terms is not entitled to receive severance payment. PRC law contains no such principle. Any employee in China who is laid off is entitled to one month's notice of termination and severance pay equal to one month's salary for each year of service—normally up to a maximum of 12 months' compensation.

Some companies in China that offer transferring employees new employment on the same or equally favorable terms with the acquiring company will ask the employees who accept the offer of new employment to sign a letter waiving any right to severance payment. It is unclear, however, whether the waiver letter is enforceable under PRC law. As a result, it is important for the buyer to agree with the seller about who will be responsible for the severance costs of transferred and laid-off employees during an asset deal, and also to check whether a transferred employee's period of service with the original company will count toward its period of service with the buyer company.

Q: Is the foreign investor free to agree to a price for the deal?

A: Generally, yes. But new rules require the purchase price to be based on a valuation made by a Chinese valuation firm and on internationally recognized valuation methods. The price should not be significantly lower than the valuation. In the past, a valuation was only necessary when the target was an SOE. Valuation reports for SOEs have to be filed and, in the case of projects involving "important economic activities," SASAC's Ownership Administration Bureau must confirm the report.

The April 2003 rules also restrict the freedom of the buyer and the seller on the time of payment. Depending on how the deal is structured, the price must now generally be paid in full within three to six months of the deal's completion (or 12 months, with special approval). The time limits may create problems when the parties have agreed to a post-completion audit after which the remaining portion of the purchase price is due.

Q: How does a foreign investor get control of the target?

A: The most important factor is whether the foreign investor is acquiring more than 50 percent of the ownership of the target. If so, the target can be converted into an equity joint venture (EJV), and the foreign investor can appoint the majority of the members to its highest governing body, the board of directors. Under PRC law, only a few decisions require unanimous board approval, and thus majority control of the board can give the investor effective control over the target. As the majority shareholder, the foreign investor also has a persuasive argument for ensuring that its nominees fill the important management posts.

Problems arise only if a foreign investor takes a minority stake in the target of, say, 25 percent. In such cases, the investor may consider a cooperative or contractual joint venture (CJV) rather than an EJV. Compared with an EJV, a CJV offers more flexibility and, in theory, it is possible for a minority investor to have majority con-

trol of the board. A more common strategy, though, is for the investor to use an EJV structure but negotiate so that the list of matters requiring unanimous board approval in the EJV contract is expanded to include certain important business decisions. The investor may also try to negotiate with the other investors so that important management posts are rotated, or managers recruited from the open market, with unanimous board approval.

For some foreign investors, majority control over the board of an FIE is not enough. They dislike the fact that the minority shareholders can still use their appointed directors to veto decisions that require unanimous board approval, including merger or division, dissolution, or amendment of the constitutional documents. There are several solutions to this dilemma. One option is to structure the deal so that the target is first converted into a wholly owned subsidiary of an offshore vehicle and for the foreign investor and minority Chinese investor to buy shares in the offshore vehicle.

Another option for a foreign investor acquiring more than two-thirds ownership is to convert the FIE into a foreign-invested CLS at the same time as the acquisition. A CLS has a different corporate governance structure. By acquiring more than two-thirds of the share capital, the foreign investor can acquire effective control of the CLS's highest governing body, the shareholder's general meeting, and can pass resolutions even on important decisions such as merger, division, dissolution, or amendment of the target's constitutional documents with only a 67 percent majority (unless there is special minority shareholder protection stipulated in the constitutional documents). The drawback of a CLS is that the conversion process requires central MOFCOM approval and thus takes longer to complete.

Q: What about China's new antitrust laws?

A: Probably the most controversial aspect of China's new M&A legal regime has been the new antitrust rules, which require positive clearance from MOFCOM and the State Administration of Industry and Commerce for deals that raise antitrust concerns in China. These rules are already a major headache for foreign investors. They apply to both onshore and offshore deals—with slightly different triggering thresholds—(*see* Table 2) and in theory, appear to be triggered even by relatively small transactions in which the seller or the buyer has significant operations in China or substantial business turnover in China. For example, clearance is apparently needed for any transaction in which one party to the deal has business turnover in China worth more than ¥1.5 billion ($181 million) or in which one party to an offshore deal has assets in China worth more than ¥3 billion ($362 million).

The antitrust laws are frustratingly vague and broad in their ambit. No guidance has been provided as yet on how to apply them.

The antitrust laws are frustratingly vague and broad in their ambit. No guidance has been provided as yet on how to apply them. Implementing regulations apparently are being drafted but informal inquiries suggest they will not be available until the end of the year. Without implementing rules, investors have no guidelines on how to interpret the thresholds, what documents should be submitted, the time limits within which the authorities should respond, or the consequences of noncompliance. As these uncertainties remain, many investors will likely try to avoid making a formal application for antitrust clearance by interpreting the rules as robustly as possible so as to fall outside their domain. 完

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Foreign Minority Equity Investments in Chinese Commercial Banks

Nicholas C. Howson and Lester Ross

Several formal announcements and rumors over the last year indicate that foreign investors—both industry players and financial and private equity investors—are taking an increasingly serious look at the acquisition of minority equity stakes in small and medium-sized commercial banking institutions in China. The serious dispute developing as this article goes to press between Newbridge Capital, Inc. (Newbridge) and certain government shareholders of Shenzhen Development Bank (SDB) regarding Newbridge's proposed acquisition of such government shareholders' shares in SDB will only intensify interest in these deals.

These transactions began in 1996 and accelerated in 2001 (*see* p.20). Market rumors and sometimes opaque announcements continue to circulate regarding other potential minority equity investments by foreign institutions in the likes of the Bank of Communications, Huaxia Bank, China Merchants

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Newbridge notwithstanding, passive stakes can be a growth activity

Bank, and China Minsheng Bank—in fact, almost any commercial bank other than the big four wholly state-owned banks: Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China. Foreign investors that have already participated include multilateral institutions like the Asian Development Bank (ADB) and the International Finance Corp. (IFC), financial institutions like Citigroup Inc. and The HSBC Group, and US private equity institutions such as Newbridge, although it is now extremely unlikely that Newbridge's deal will go through. Rumored new entrants include United Overseas Bank of Singapore, Hong Kong-based Bank of East Asia, and private equity powerhouse The Carlyle Group.

The regulatory environment

No PRC legislation specifically authorizes any of these transactions. Several PRC laws and regulations exist concerning foreign investment in Chinese commercial banks, and rules govern foreign purchases of equity in Chinese companies in private transactions (*see* p.21). But no law or regulation yet provides a specific legal basis for foreign or foreign-invested entities to purchase stock in Chinese commercial banks organized as companies limited by shares (CLSs) in private transactions, and such investments were prohibited by a 1994 People's Bank of China (PBOC) notice. Contrast this with foreign investments in Chinese insurance CLSs, which are undertaken in accordance with the China Insurance Regulatory Commission's (CIRC) 2000 Provisional Regulations on Investment Through Shares in Insurance Companies and 2001 Notice Concerning Standardization of Certain Items in the Absorption of Foreign Investment through Share Purchases in Chinese-Invested Insurance Companies.

Thus, each equity investment in a Chinese commercial bank has been undertaken pursuant to case-by-case approvals of the State Council acting on the advice of China's central bank and commercial banking regulator, PBOC. The formulation and "imminent" release of a regulation explicitly allowing foreign equity participation in Chinese commercial banking institutions has been a staple of the rumor mill in Beijing and Shanghai for more than a year. With the establishment of the China Banking Regulatory Commission (CBRC), to which the PBOC has ceded supervisory responsibility over commercial banks, the prospects for formal regulations governing these transactions have improved.

What seems certain is that CBRC alone will issue regulations governing these transactions and that the successor to the PRC Ministry of Foreign Trade and Economic Cooperation (MOFTEC)—the Ministry of Commerce (MOFCOM)—will not exercise its authority under the 1995 Several Issues Concerning the Establishment of Foreign-Invested Companies Limited by Shares (FICLS provisions) or play its traditional role as the gatekeeper for all foreign investment. CBRC, like PBOC, will limit aggregate foreign ownership to 24.9 percent in any one entity. PBOC, so far, has also tacitly set a 15 percent limit on ownership for any single foreign investor (although the Newbridge/SDB deal was announced in October 2002 at more than

18 percent). This is higher than the 10 percent permitted for individual foreign equity investments in Chinese insurance CLSs.

CBRC will likely take the same line as CIRC by deeming that foreign total investment of *less than* 25 percent in a CLS will bring the transactions outside the purview of the 1995 FICLS provisions (and MOFCOM approval) and thus will deprive the foreign investor or the investee entity of preferential treatment bestowed on traditional foreign-invested enterprises (FIEs). By the same token, however, foreign investors will not likely be subject to the regulated financial institution, two-year representative office, and minimum net assets requirements for FIE banks or branches of a foreign commercial bank.

Even without explicit regulations, a pattern in the approvals rendered by the highest levels of China's government seems to be emerging. First, China is moving away from approval of investments by "safe" multilateral institutions, such as ADB and IFC, and qualified "red chips" (offshore establishments of PRC institutions) and toward major private foreign banking institutions and, with less certainty, even pure financial or private equity investors such as Newbridge. In fact, the Chinese government may be more willing to cede minority participation to such nonstrategic investors, which, unlike large financial services groups, may be less likely, in the view of PRC authorities, to dominate smaller Chinese financial institutions or integrate them into a global business.

Second, PBOC approvals to date indicate that the "minority" equity interest made available to any single foreign shareholder may be as high as 15 percent, up from 3 to 8 percent in the earliest approvals.

Third, China is beginning to accept foreign direct investment in small Chinese banking institutions that have already listed on the domestic A-share market. Fourth, as confirmed by the 2002 Notice Regarding the Transfer to Foreign Investors of State-owned Shares and Legal Person Shares of Listed Companies and the Citigroup transaction structure, Chinese state institutions are being permitted to sell their existing interests in such banks, not merely suffer dilution as new investors enter the fray. Fifth, and perhaps most significant, PRC central banking regulators seem to be considering allowing certain foreign investors to exercise real management control. The Newbridge/SDB deal originally offered full management control (by contract—now apparently terminated) and board representation for Newbridge.

Why not expand by branching or through FIEs?

Given China's World Trade Organization (WTO) entry and new arrangements with

Foreign Minority Investments in PRC Banks to Date

- **China Everbright Bank** has foreign investment from the Asian Development Bank (3.03 percent, 1996) and PRC-invested but Hong Kong-domiciled China Everbright Holding Co. Ltd. (Hong Kong) (20.07 percent, 1997).
- **Bank of Shanghai** has foreign investment from the International Finance Corp. (IFC) (total 7 percent, 1999 and 2001), HSBC (8 percent, 2001), and Shanghai Commercial Bank (Hong Kong) (3 percent, 2001).
- **Nanjing City Commercial Bank** has foreign investment from IFC (15 percent, 2001).
- IFC and Canada's Scotiabank in September 2002 signed a memorandum of understanding under which IFC and Scotiabank would acquire 12.5 percent and 12.4 percent, respectively, of **Xi'an City Commercial Bank** (XCCB), for a total of 24.9 percent of XCCB.
- Shenzhen Exchange A-share-listed **Shenzhen Development Bank** (SDB) announced in October 2002 that Newbridge Capital Inc. (Newbridge) had negotiated a stake of 18.02 percent in SDB via an investment of new capital and the acquisition of existing holdings from PRC state shareholders. Newbridge would assume management control of SDB through both the establishment of an eight-person "acquisition transition management committee," which presumably was to evolve into some kind of permanent, Newbridge-appointed executive team, and at the board level.

  After months of conflicting rumors, on May 12, 2003, SDB announced that it would not go forward with closing the deal and that it was disbanding the transition management committee. Newbridge responded on the same day with a strongly worded press release in which it stated: "The announcement made today by the Shenzhen Development Bank has no effect on our binding agreement with the Shenzhen government shareholders signed in June of 2002. We expect that the Shenzhen government... to [sic] respect its international commitments and honor its obligations under this binding international contract with us." Judging from the Newbridge press release, pricing of the equity to be sold by Shenzhen state shareholders (likely tied to reserves and valuation of SDB) is at issue.
- Citigroup Inc. announced on January 2, 2003 that it would purchase a 5 percent stake in, and enter into a broader strategic co-operation focusing on the development of a credit card business with, **Shanghai Pudong Development Bank**, through its banking subsidiary, with options to increase its stake to as much as 24.9 percent. The shares were purchased from two state institutions, and the stake was diluted to 4.62 percent when Shanghai Pudong Development Bank issued 300 million new shares days later.
- PRC shareholder China Orient Group announced on May 14, 2003 that it had agreed to sell almost 41 million shares in A-share listed **China Minsheng Bank**—reputedly China's only commercial bank without state investment—to IFC for $23.5 million, giving IFC a 1.22 percent equity interest in the bank. Subject to government approvals, the price of ¥4.70 ($.057) per share is at a discount to the same day A-share trading price of ¥11.30 ($1.37) per share. Later it was reported that Hong Kong's Hang Seng Bank will purchase 8 percent of China Minsheng Bank for ¥1.4 billion ($169.4 million).

—Nicholas C. Howson and Lester Ross

respect to the financial sector generally, it may seem strange that foreign banking institutions are expressing such interest in China's banking sector via minority equity investments in established Chinese banks. As of April 30, 2003, foreign banks had established 148 branches and 9 sub-branches in China, as well as 210 representative offices, and 16 foreign-invested banks and finance companies had been established with 7 branches. Even prior to China's WTO entry, foreign banks had established strong beachheads in the PRC—with 221 representative offices of foreign commercial banks, 158 foreign bank branches (and 6 sub-branches), and 13 foreign-invested banks and finance companies.

Though WTO entry promised improvements in the regulatory landscape for foreign banks in China, subsequent PBOC regulation has burdened foreign banks with significant constraints on their activities in China. Thus, though geographical restrictions on renminbi (RMB) business by foreign bank branches are to be removed completely by December 11, 2006, foreign banks will still face burdens in establishing branches in China, including onerous representative office seasoning requirements; branch-level capital reserve, liquidity, and deposit requirements; foreign exchange deposit/foreign exchange asset ratio limitations; and lengthy branch application procedures. As a result, many foreign commercial banks realize that it will take a significant amount of time and expense to establish real in-country branch networks and/or obtain the ability to undertake RMB business. Because of these restrictions, and the problems associated with pursuing essentially greenfield joint venture projects, many foreign banks keen to enter the PRC market, and participate in the creation and expansion of a true network and the RMB market, have turned part or all of their attention to minority investments in Chinese banks organized as CLSs.

The advantages associated with minority equity investment as compared with the branching or FIE routes are clear given the above restrictions: a foreign bank investor making a minority investment in an existing Chinese commercial bank will be able to reach a broader range of retail customers more quickly, and its investee bank will not be subject to the same restrictions or requirements. In addition, approvals for branches of the investee bank will be far easier, and the investment will be more liquid (via either the private sale of its stock interest or participation in some kind of capital market transaction). There will also be opportunities to co-brand or jointly market products, such as credit cards. Conversely, the 24.9 percent ceiling limits foreign investors' interest for the foreseeable future, with attendant constraints on control—absent extensive minority rights or the proposed Newbridge/SDB-type structure.

State-owned shares and legal person shares

The announced Newbridge/SDB transaction originally attracted a great deal of attention not only because a foreign investor with a minority equity position was to be granted management control, but also because Shenzhen municipal government-related shareholders were to transfer their equity in the target bank. Reportedly, 16.46 percent of the rumored 18.02 percent to be purchased by Newbridge was composed of state-owned shares or legal person shares held by Shenzhen Investment Management Co., Shenzhen International Trust & Investment Co., Shenzhen Social Security Administration Bureau, and Shenzhen City Construction Development Group Co. From a legal standpoint, the 2002 Legal Person Shares Transfer Notice provided a theoretical basis (and approval track) for such purchases—which had been banned since 1995, at least with respect to the purchase of state shares and legal person shares in Chinese CLSs with listed shares.

But foreign purchasers, whether foreign banks or private equity groups, must also care-

Selected Relevant Regulations

Foreign investment in Chinese commercial banks

- 1995 Commercial Bank Law
- 2001 Regulations on the Administration of Foreign-invested Financial Institutions (superseding 1994 regulations of the same name)
- 2002 Implementing Rules for the Administration of Foreign-invested Financial Institutions

Rules governing foreign purchases of equity in Chinese companies in private transactions

- 1995 Several Issues Concerning the Establishment of Foreign-invested Companies Limited by Shares
- 2003 Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors

—Nicholas C. Howson and Lester Ross

Table 1: Pros and Cons of Entry Routes

Item	Foreign Branch and Foreign-Invested Bank	Foreign Minority Investment
Control	Absolute control over branch or WFOE, potential majority control over EJV	Only minority shareholder rights
Price of Investment	Capital contribution usually at par value	Negotiable
Initial Public Offering (IPO, for exit or additional funding)	No PBOC approval precedent; would require restructuring as company limited by shares	Domestic or overseas IPO possible
Availability for Prospective Entries	Onerous seasoning requirements	Very low requirements
Geographic Roll Out	Restrictions until December 2006; separate working capital requirements for each branch pose barriers to branch establishment	No restrictions; easy implementation
Speed of Execution	Up to 14 months for new branch or FIE	Case by case

NOTES: WFOE=wholly foreign-owned enterprise; EJV=equity joint venture; FIE=foreign-invested enterprise; PBOC=People's Bank of China
SOURCE: Nicholas C. Howson and Lester Ross

fully consider the difficulty of such transactions, given the high approval threshold, and sensitivities concerning valuation, when state shareholders—acting on behalf of "the whole people"—are permitted to sell their interests. Certainly, new investment in a Chinese bank (with a small dilution suffered by existing state shareholders) will be easier to effect and get approved and will provide new and much-needed capital for the target institution. As a case in point, the warring press releases that heralded the demise of the Newbridge/SDB deal indicate that disagreement over pricing between Newbridge and the Shenzhen state shareholders listed above may be the principal reason for the deal's apparent collapse.

Valuation and pricing

The valuation of a small or medium-sized Chinese bank, and pricing of a minority equity investment in such a bank, can present significant challenges. Potential foreign purchasers must work to understand, to the greatest extent possible, the true situation regarding solvency and asset quality, organization of the bank and its actual network, management and shareholder (or state) interest in operations, CBRC's view of the bank in question and the bank's ability to expand operations nationwide, and the web of laws, regulations, and pronouncements that will directly affect the operations of the target bank or the proposed foreign purchaser's investment

Table 2: Comparison of Entry Routes

	Foreign-Invested Enterprises					Domestic Banking Institutions with Foreign Minority Investment
Item	**Branch**	**Bank WFOE**	**Bank EJV**	**Finance Company WFOE**	**Finance Company EJV**	
Limitation of Foreign Equity Interest	NA	NA	None	NA	None	Individual 15% (exceptions may exist); total 24.9%
Main Requirements for Foreign Investors						
Capital Adequacy	Minimum 8% capital adequacy ratio	Financial institution	Financial institution	Financial institution	Financial institution	NA
Assets	$2 billion	$10 billion	$10 billion	$10 billion	$10 billion	NA
Seasoning/ Representative Office in China	2 years	2 years	No time minimum	2 years	2 years	NA
Minimum Registered Capital (for foreign exchange transactions with foreign customers)	¥100 million	¥300 million	¥300 million	¥200 million	¥200 million	¥1 billion (for commercial banks)
Prudential Requirements	30% of working capital in PBOC-designated interest-bearing assets, foreign exchange and RMB assets deposited separately (from each other); minimum 8% ratio of RMB working capital plus RMB reserves to RMB risk assets	Minimum 8% capital adequacy ratio Unutilized credit line not to exceed 25% of capital unless approved by PBOC Ratio of balance of liquid assets to balance of liquid debts at least 25% Fixed assets not to exceed 40% of equity Total absorbed foreign exchange deposits not to exceed 70% of total assets Ratio of RMB capital to RMB risk assets at least 8%				Minimum 8% capital adequacy ratio; ratio of balance of loans to balance of deposits not to exceed 75%; ratio of balance of liquid assets to balance of liquid debts at least 25%
Customer Base	May provide services only to foreign individuals and foreign enterprises upon accession (since December 11, 2001) May provide services to Chinese enterprises by December 11, 2003 May provide services to all Chinese clients by December 11, 2006					
Geographic Scope	Shanghai, Shenzhen, Tianjin, and Dalian upon accession (since December 11, 2001) Guangzhou, Zhuhai, Qingdao, Nanjing, and Wuhan (since December 11, 2002) Ji'nan, Fuzhou, Chengdu, and Chongqing by December 11, 2003 Kunming, Beijing, and Xiamen by December 11, 2004 Shantou, Ningbo, Shenyang, and Xi'an by December 11, 2005 All geographic restrictions removed by December 11, 2006					NA
Qualifications to Engage in RMB Business	Three years PRC business operating experience Two consecutive years of profits					NA

NOTES: WFOE=wholly foreign-owned enterprise; EJV=equity joint venture; PBOC=People's Bank of China; NA=not applicable
SOURCES: Nicholas C. Howson and Lester Ross

in, and participation in management of, the institution. Valuation is made even more complex because of differences that arise from the specific transaction contemplated (buyout of a promoter or government shareholder, or investment of new money into a future business) and the artificially constrained market for such transactions—which causes interested foreign banks and private equity investors to chase a small number of deals, possibly at higher prices than might be justified.

These considerations are of course merely financial and structural and ignore the important political concerns involved, from the desire to reward state shareholders "exiting" a small bank at a high value to official nervousness about ceding any kind of control over the target institution to foreign investors. And, in China's relatively new capital markets, investment pricing may give rise to another kind of turbulence—from Chinese public shareholders comparing public issue or market prices. Citigroup and Shanghai Pudong Development Bank (SPDB) were the target of some significant grumbling from shareholders on the Shanghai Stock Exchange and the dynamic Chinese financial press, who were presented with an issue price of ¥8.45 ($1.02) for A shares of SPDB immediately after SPDB and certain SPDB shareholders had agreed to issue or sell shares in a private transaction to Citigroup at only ¥3.32 ($0.40) per share. One would expect Citigroup to use the same formula for calculating a discounted price, reportedly 1.45 times SPDB's net asset value during the preceding year, if it exercises an option to increase its equity investment to a maximum of 24.9 percent in coming years. Although the lack of liquidity in the Citigroup shareholdings (as "unlisted foreign capital shares") and other aspects might justify such a discount, such awkward facts can bring unwanted attention to the acquirer and affect the market for an issuer's stock and possibly its ability to raise capital from the public.

Governance, minority rights, and investment in A-shares

It seems obvious that minority investment in any Chinese corporate vehicle may give rise to difficulties for a minority investor, foreign or Chinese. That is because China's corporate law, even for companies that list some shares publicly, is somewhat adverse to the protection or exercise

Continued on page 31

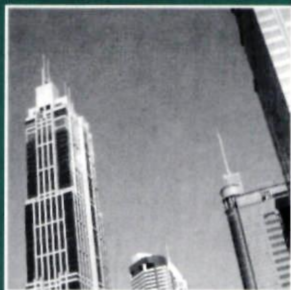
Due Diligence

As in any acquisition, due diligence, or the full examination of the target asset, is critical in any proposed bank acquisition. A minority or passive investment by foreign investors in China's smaller banks and financial institutions gives rise to special issues, which include:

- **Other shareholders** At present, most shareholders in China's banks are state or local government actors which, even after the acquisition, will likely maintain almost absolute control over the bank. Investors must understand the actual intentions of these shareholders, the ways in which they might prioritize non-shareholder value-related interests, their experience acting alongside foreign investors and institutions, and their real interest in sitting alongside a foreign banking institution or private equity investor that is not a multilateral institution.
- **Asset quality: Nonperforming loans (NPLs) and reserves** With the establishment of financial asset management companies in 1999, China acknowledged significant problems with respect to asset quality in China's major commercial banks. Some observers hoped that certain of the smaller and so-called "private" banks—all established relatively recently, and many with public listings and disclosure obligations—had not been forced into making the same kinds of bad loans, or at least not in the same high proportion as the largest state-owned banks. But as shareholders of many smaller banks are often local-level state entities, and China's credit analysis and liquidity systems have a short history, this hope has not been borne out.

  Perhaps more disappointing is the fact that such banks have not always made complete disclosures to the public, or to potential investors. This is among the reasons mentioned for the reported unraveling of the Newbridge/SDB transaction—Newbridge negotiated a deal based on about $20 billion in SDB assets, and sufficient reserves to cover potential NPLs of more than $3 billion. Subsequent reports put SDB's NPLs much higher, at almost 50 percent of assets ($10 billion), with reserves covering only about one-third of NPLs. Though it is not certain, it appears likely that the price to the SDB selling shareholders was in some way tied to the discovered asset quality of the bank, perhaps by a formula based upon necessary NPL reserves. Any pricing readjustment may have caused exiting state shareholders to balk at the significant resulting discount. Thus, potential acquirers of such minority interests are well advised to make a serious and intrusive evaluation of a potential target's true asset quality and solvency, if only to establish fair pricing.
- **Organizational and subsidiary arrangements** The largest state-owned banks have grown based on a branch network essentially donated to them upon the breakup of the People's Bank of China's former commercial branch network and via the establishment of legal person subsidiaries and divisions. The picture at certain smaller Chinese banks, especially when they have sought to expand outside of their home jurisdiction, is less clear. The unified legal-person status of commercial banks was not fixed in law until 1995 and is still imperfectly implemented. In some cases, bank branches are themselves joint ventures with, or at least in cooperation with, other local actors. For instance, a Shenzhen bank might have Beijing branches that are established, or invested in, by local Beijing institutions. An adequate due diligence investigation requires that any acquirer of a minority interest in a bank operation understand these anomalous relationships, any proposal that they continue, or any suggestion that these other participants be brought to the parent level with resulting dilution to existing (and new) shareholders.

—Nicholas C. Howson and Lester Ross



FOCUS: NEW INVESTMENT OPTIONS

Venture Capital Options Expand—A Bit

Michael E. Burke

As year two of China's World Trade Organization (WTO) membership rolls on, China continues to open its financial services sector to foreign investors. On January 30, 2003 the Ministry of Foreign Trade and Economic Cooperation (MOFTEC—now the Ministry of Commerce [MOFCOM, *see* p.26]), Ministry of Science and Technology (MOST), State Administration of Industry and Commerce (SAIC), State Administration of Taxation (SAT), and State Administration of Foreign Exchange (SAFE) jointly issued the Regulation on the Administration of Foreign-Invested Venture Capital Enterprises (the regulation).

The regulation encourages investment in China's high-technology sector and aims to further develop China's venture capital (VC) investment regime. The regulation covers the creation, operation, and dissolution of foreign-invested

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China's new venture capital regulations provide limited improvements for investors

venture capital enterprises (FIVCEs), defined as foreign-invested enterprises (FIEs) engaging in venture capital activities. Article 3 of the regulation defines VC activities as investing in the equity of nonlisted high-tech companies, providing VC management services, and earning capital gains over time. A FIVCE must have "venture capital" in its name. The regulation, which took effect March 1, 2003, replaces the ineffective 2001 Provisional Regulation on the Establishment of Foreign-Invested Venture Capital Investment Enterprises (provisional regulations). Many aspects of the provisional regulations, good and bad, reappear in the regulation. An overriding concern, from the perspective of foreign VC firms, is that FIVCEs remain subject to some degree of government interaction and direction.

Forming a FIVCE

The revised FIVCE structure is a welcome development for foreign venture capitalists, though the regulation imposes some frustrating limitations. Investors have some degree of flexibility in choosing the FIVCE's structure, although a wholly foreign-owned enterprise will likely be the most popular of the FIVCE structuring options. The regulation divides possible structures into nonlegal person and corporate categories—each with its own requirements and procedures. For example, investors in nonlegal person FIVCEs have unlimited liability, while corporate FIVCEs have capped liability. Nonlegal person FIVCEs may elect to have investors pay tax separately at the investor level or to be taxed at the FIVCE level, while corporate FIVCEs are subject to PRC tax on investment returns and gains (though dividends received are currently tax exempt, provided that both issuer and recipient have FIE status).

FIVCEs must have between two and 50 investors, including at least one "principal investor." The principal investor serves as the FIVCE's manager, and must be an experienced venture capitalist that has overseen $100 million in investment (of which at least $50 million must be VC-focused) during the three years prior to the FIVCE's creation. A Chinese principal investor must have overseen ¥100 million ($12.08 million), of which at least half was VC-focused during the three years prior to the FIVCE's formation. Principal investors must employ at least three professional management staffers, each with at least three years of VC experience and each without a disciplinary record in their home jurisdiction. A principal investor in a nonlegal person FIVCE must contribute more than 1 percent of the entity's aggregate capital; a principal investor in a corporate FIVCE must contribute more than 30 percent of the entity's aggregate capital. To satisfy these requirements, a potential principal investor may aggregate its experience and capital contributions with those of its affiliated entities.

Each nonprincipal FIVCE investor must contribute at least $1 million. Aggregate capitalization from all nonprincipal investors must exceed $10 million in a nonlegal person FIVCE and $5 million in a corporate FIVCE.

Principal and nonprincipal investors in a nonlegal person FIVCE may make capital contributions in installments extending up to five years after formation. Existing regulations

The Birth of MOFCOM

Now defunct, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission were merged into the new Ministry of Commerce (MOFCOM) in March. Although the Regulation on the Administration of Foreign-Invested Venture Capital Enterprises refers to "MOFTEC," such references have been replaced with MOFCOM throughout this article.

affecting corporate FIVCEs, such as regulations on equity joint ventures, specify capital contribution timing for those entities.

In addition to quantitative requirements, FIVCEs themselves must satisfy certain qualitative requirements, such as having appropriate formation documents and employing more than three professional staff members with experience in VC investment (unless the FIVCE entrusts its management to a venture capital investment management enterprise [VCIME]; *see* p.27).

FIVCEs must have a management committee to represent and protect investors' interests: a joint management committee for a nonlegal person FIVCE and a board of directors for a corporate FIVCE. This management committee, in turn, must establish an office to manage the FIVCE's daily operations. Operational management office staff must have full civilian status, no criminal record, and appropriate VC experience. Alternatively, a FIVCE may delegate its operational management responsibilities to a VCIME or another FIVCE.

Low liquidity and restrictive timing

Foreign investors forming FIVCEs will find that the regulation imposes several cumbersome requirements. For example, most foreign VC investors may have a difficult time reducing their capital contribution or changing investment status during the FIVCE's term. A nonlegal person FIVCE's formation documents may specify capital contribution reduction procedures for nonprincipal investors, but any such reduction requires the consent of investors holding more than 50 percent of the value of the FIVCE's aggregate capital and the consent of each principal investor. A principal investor in a nonlegal person FIVCE may not reduce its capital contribution during the FIVCE's term except in unusual circumstances. Such reduction depends on the principal investor obtaining the consent of the FIVCE investors that hold more than 50 percent of the value of the FIVCE's aggregate capital; transferring its interest to a qualified assignee principal investor; revising the FIVCE's formation and operational documents; and obtaining MOFCOM approval. The regulation prohibits any capital contribution reduction that would cause the FIVCE's aggregate capital to fall below $10 million. Existing regulations cover capital contribution reductions for corporate FIVCEs.

New nonprincipal investors in any FIVCE must satisfy conditions in the regulation and in the FIVCE's formation documents, must obtain the consent of the principal investor and MOFCOM, and must have the FIVCE's formation documents amended. A nonprincipal investor in a nonlegal person FIVCE may assign its FIVCE interest without following the above-mentioned steps, as long as the assignee satisfies conditions in the regulation and the FIVCE's formation documents.

Another shortcoming of the regulation is that the application and registration periods for both FIVCE formation and investments by a FIVCE are too long. If government entities abide by the letter of the regulation, it will take more than 60 days to form a FIVCE. Founders must submit an application to the provincial-level MOFCOM office (based on the FIVCE's proposed location). The provincial-level office must examine the application materials and report to central-level MOFCOM within 15 days of receipt of the application materials. Central-level MOFCOM then has 45 days from receipt of materials from the provincial-level MOFCOM to review, and approve or reject, the FIVCE's application. MOST must also consent before formal approval is granted.

Approved FIVCEs will receive written notification of approval and an FIE Approval Certificate that they must submit, along with other items, to the appropriate SAIC office for registration within one month of receipt. Upon SAIC approval, nonlegal person FIVCEs will receive Business Licenses, and corporate FIVCEs will receive Legal Person Enterprise Business Licenses.

Restrictions on investment and operational scope

Foreign investors will discover additional concerns when reading the regulation's restrictions on FIVCE investment and operational scope.

- FIVCEs are not permitted to invest in more than "plain vanilla" equity, nor may they invest in varying classes of preferred stock, quasi-equity such as equity warrants (available in Hong Kong) or varying classes of convertible debt.
- FIVCEs may not make investments through loans or any funds other than the FIVCE's own funds, or provide credit or guarantees (excluding investment in bonds issued by an investee company or convertible bonds with a term of at least one year). Further, FIVCEs may not lend an unrestricted amount to their investee companies, even though such lending could result in closer alignment of goals between the FIVCE and its investee company.
- As stated above, a FIVCE may only invest its own funds in unlisted equities, provide VC investment consulting, provide management consulting to investee enterprises, or engage in other operations as approved. FIVCE investment into target entities must comply with the Catalogue Guiding Foreign Investment in Industry and the Regulation on Guiding Foreign Investment Direction. A FIVCE may *not* invest in projects that the catalogue lists as prohibited; directly or indirectly invest in listed securities

(except when the FIVCE invested before the investee's initial public offering); directly or indirectly invest in fixed assets that are not for the FIVCE's own use; or invest in other projects as prohibited by laws, regulations, or the FIVCE's formation documents.

- FIVCE investments, and increases and transfers thereof, are subject to approval and registration requirements and potentially long timelines. When investing in an encouraged or permitted category entity, the FIVCE must notify the local-level MOFCOM where the investee is located. The local MOFCOM office must conclude its review and, if it approves, issue an FIE Approval Certificate within 15 days after receiving the completed application materials. FIVCEs investing in a restricted category entity must notify the local-level MOFCOM where the investee is located, although the local MOFCOM has 45, not 15, days to review the investment application. Upon approval the investee must file its FIE Approval Certificate with SAIC, which will issue an FIE Legal Person Enterprise Business License. A FIVCE must report to MOFCOM within one month of completing any portfolio investment. As service sectors open to foreign investment, FIVCE investments will be examined and approved according to relevant, and new, regulations.

Investee enterprises will enjoy FIE incentive treatment only if aggregate foreign investment (from a FIVCE or otherwise) exceeds 25 percent of the entity's registered capital. An existing domestic natural person enterprise that receives foreign investment and is eligible to become an FIE may retain its original domestic natural person investor's status.

Problems with profits and payments

As specified in the regulation, a FIVCE's profits are primarily to come from the disposition of its equity interests. A FIVCE may dispose of such interests by selling to other investors; entering into a repurchase agreement with the investee; transferring its interests via the stock markets after the investee publicly lists; or other methods as specified by relevant Chinese laws and regulations. Resale of equity interests held by a FIVCE should be, but is not, allowed automatically when both parties to the transaction are FIVCEs. MOFCOM and SAIC are drafting rules on repurchase agreements between a FIVCE and an investee company.

Nonlegal person FIVCEs may distribute investment gains as provided in their formation documents and as consistent with "international norms," a term left undefined in the regulation. Proceeds from such equity sale by a nonlegal person FIVCE may be distributed directly to the investors and be regarded as a reduction of their capital to the extent that such proceeds are less than an investor's original investment.

The nonlegal person FIVCE must file a notice on the distribution and related capital reduction with MOFCOM and SAFE 30 days before the proposed distribution. This notice must show that the nonlegal person FIVCE's remaining capital exceeds outstanding investment liabilities. The regulation does not specify whether such distribution is subject to approval. SAFE is expected to issue new regulations on this distribution process in the near future. Distributions by corporate FIVCEs are subject to existing regulations.

Though VC investors would prefer that there be no restrictions on the repatriation or transfer of gains, the regulation's foreign exchange process imposes burdensome transaction costs on FIVCEs that repatriate profits. A FIVCE must submit several documents to its foreign exchange bank prior to offshore distribution of profits or other payments. These documents include the management committee's resolution approving

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Venture Capital Investment Management Enterprises

The Regulation on the Administration of Foreign-Invested Venture Capital Enterprises introduces a new type of entity, a venture capital investment management enterprise (VCIME), subject to many of the same organizational requirements and processes as a foreign-invested venture capital enterprise (FIVCE). VCIME founders must submit an application to the provincial-level Ministry of Foreign Trade and Economic Cooperation (now the Ministry of Commerce [MOFCOM]) office, based on the VCIME's proposed location. The provincial-level MOFCOM has 45 days from receipt of the complete application to approve or reject a VCIME's formation. Upon approval, the VCIME receives a Foreign-Invested Enterprise Approval Certificate that must be registered with the appropriate State Administration of Industry and Commerce (SAIC) office within one month of receipt.

VCIMEs must employ more than three professional management personnel with at least three years of relevant experience each, have registered capital of at least ¥1 million ($120,773), and have a complete internal control system. A VCIME's business scope is restricted to FIVCE management, including the oversight and informational production requirements usually performed by a FIVCE's board of directors or management committee. A potential management contract between a VCIME in China and a FIVCE is not effective until it is unanimously approved by the FIVCE's investors and approved by MOFCOM. An overseas VCIME must file a registration application with the relevant SAIC office within 30 days of execution of a management contract with a FIVCE (though such agreement seems to be effective upon execution).

—Michael E. Burke

Relationship Mapping

Companies can use this powerful tool in acquisition due diligence in China

Qi Tang

Much has been written about the Chinese practice of *guanxi*, or relationships. The term conjures up shady deals—for special treatment, entry through a back door, or lower entry costs—made in smoke-filled rooms between sips of Maotai. Such images make Western firms nervous as they endeavor to operate lawfully in China.

In reality, Western firms can develop *guanxi* in China while obeying local laws. The key is understanding what sets the Chinese relationships apart from those in the West—namely, the social context. China is still very much a rule-of-man (as opposed to rule-of-law) society, and its market economy is far from mature. Chinese government and business structures often lack transparency, making it difficult to understand the business situation or the players involved. Assessing a potential alliance or business partnership is especially difficult. Often, lack of accurate documentation, the inaccessibility of information in the public domain, and questionable accounting practices obscure a candidate's operations. Even determining which individuals have the authority to make the deal can be a challenge.

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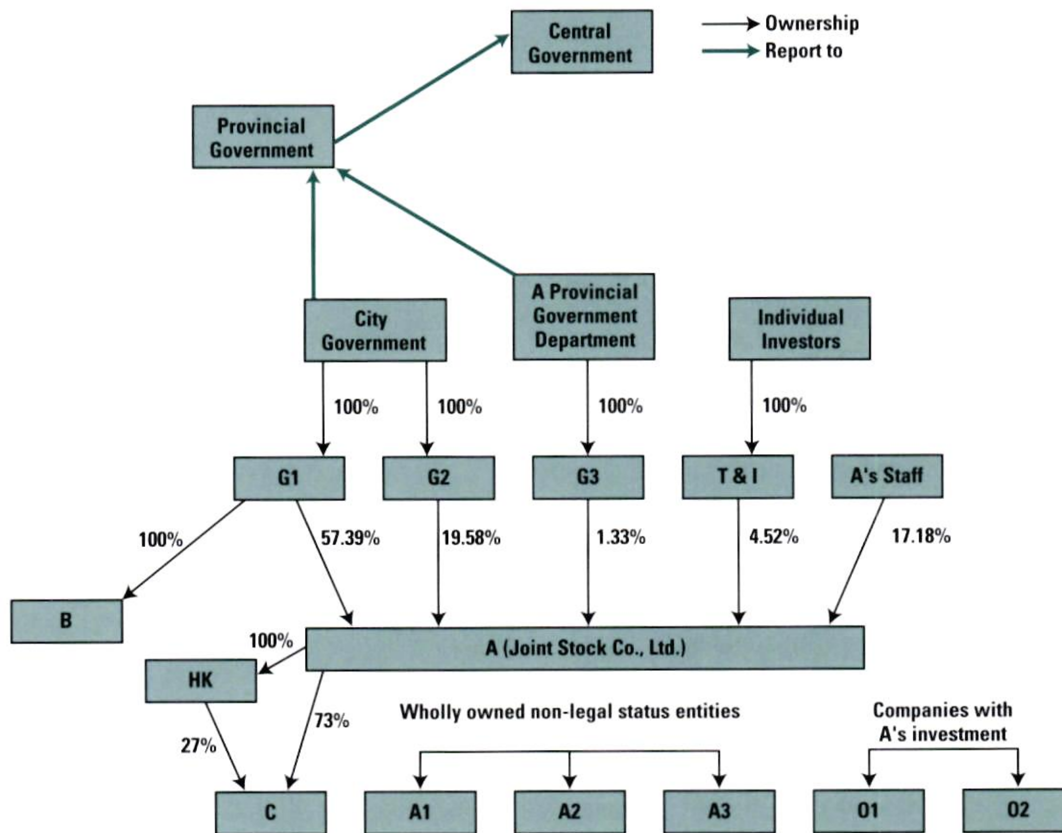
Figure 1: A Basic Relationship Map for Company "A"



SOURCE: Qi Tang

Understanding key relationships

Many businesses have entered into relationships in China that have quickly soured, in part because they did not know their partners well enough. In one case, for instance, a US firm set up a 50-50 joint venture with a Chinese entity. As part of the deal, the US firm's technology was transferred. Later, the US firm found a company related to the Chinese partner that was using the US firm's technology to compete with the joint venture. In other cases, Western firms based their financial calculations for their China joint venture on current raw material pricing information, only to find that the Chinese partner was related to the raw material supplier and had been getting low internal transfer prices, which were far below the prices that the joint venture subsequently faced.

Relationship mapping is a method of visualizing, describing, and analyzing all of the relationships (individual and organizational) of an existing or prospective Chinese business partner. This map provides background on the target company by showing direct and indirect, and business and social, relations among individuals within the organization and of the company as a whole. Relationship mapping allows companies looking at potential partners to go beyond financial statements and the contradictory bravado of many of the stakeholders to assess the real story behind the scenes and to better measure the off-balance sheet risks and benefits of a business arrangement.

Relationship mapping also identifies where the holders of power and influence lie and the nature of the relationships among them. These individuals will have authority over, or at least significantly influence, company decisions, especially financial ones. Finally, mapping helps a company looking at prospective partners understand the *real* objectives of all of the players in the map, uncover structural problems or hidden liabilities, and draw up a plan to construct a mutually beneficial deal. This knowledge also helps to outline the best way to manage the relationship. And it will certainly minimize the unpleasant surprises that many Western firms experienced in the 1990s.

Figure 1 is a map of the relationships of A, a target in a recent acquisition case, and gives an initial definition of the playing field and the key players on it. In constructing and analyzing this map, the company was able to discover:

- G1 and G2 are the corporate arms of the city government and, between them, are the majority owners of A, the target company.
- In a failed bid to restructure A for an initial public offering (IPO) a few years earlier, G1 cre-

Figure 2: The Mapping Cycle

SOURCE: Qi Tang

ated a separate corporate group, or "wastebasket," B, to hold A's poor and nonperforming assets to make A look attractive. B is owned by G1 and still managed by A.

- Under central-government orders to remove themselves from business, G1 and G2 would like to sell off their stakes in A, but as representatives of government interests, they want to defuse social tension surrounding the de facto privatization by protecting individual shareholders' interests.
- G3, initially intended to add value to an IPO because of its links with the provincial science and technology department, wishes to cash out its 1.33 percent share in A because the IPO fell through.
- T&I is merely a company on paper that represents individual investors holding a portion of A's shares to which only legal entities may subscribe. Now those individual investors, along with A's employee shareholders, are worried about A's poor operating results and want to sell their shares.
- HK is an offshore subsidiary, 100 percent owned by A. A has used HK to "round trip" money to launch C, a joint venture, to take advantage of preferential treatment accorded to foreign-invested companies.
- C is a major supplier to A, and transfer pricing helps A to maximize profits and minimize tax obligations.
- A1, A2, and A3 are divisions of A contracted out in terms of operational management. A1 is A's core, and most profitable, business. A2 and A3 supply A1.

These basic revelations helped the acquiring company ascertain the deal's attractiveness and develop a strategy to negotiate the deal. It should be noted that the map illustrated here is a basic partnership relationship map. To be able to understand the situation fully and formulate the best possible strategy for a particular deal, a company may also need a relationship map of stakeholders as individuals, a map of approval-path relationships, and one of regulatory relationships, among others.

This first map provided a platform on which the company was able to construct another map of all of the stakeholders as individuals, separate from their organizational roles. The second map revealed that the real powerholder and decisionmaker was the chair of A, who was backed by a powerful group within the city government that was unrelated to A's majority owners, G1 and G2. Having identified the real power as well as an understanding of the objectives and concerns of the powers and influencers, the company devised a package of deals that addressed the government's goals of stable employment, tax revenue, and "ownership transformation" through foreign investment; the chair's objective of exiting the business with proper compensation; and the younger generation of management's hopes for better career opportunities with a multinational corporation.

The relationship mapping process

Many companies also find a cyclical process useful to evaluate a target company's relationships (*see* Figure 2). This is because relationships in China are often dynamic and multilayered, and thus require regular review. Companies can construct such maps themselves, though this is time consuming, especially for foreign firms that are new to China or lack an understanding of Chinese business culture. Skilled third-party consultants may be able to help, but companies must build their own relationships, often through time-consuming lunches and dinners. These informal meetings build confidence and trust, as well as provide knowledge and insight. This relationship-building process cannot be shortchanged.

Indeed, companies should not view relationships as discrete, but rather as networked and often interdependent. In the case of company A, the chair and his power base in the city government—the ultimate decisionmakers—still had to balance the various interests of other stakeholders concerned before accepting a deal. A powerful benefit of the relationship map is that it enables the foreign company to find the ideal compromise that will make the relationship work for all parties.

Foreign companies aiming to explore acquisition or alliance opportunities in the emerging Chinese market need to understand, cultivate, and use relationships. Though the current drive to improve transparency may improve certain aspects of doing business in China, deeper societal change will likely remain slow, and *guanxi* will remain important for the foreseeable future. According to one Chinese saying, "If you have a relationship, you have a road." (有关系有路, *you guanxi, you lu*).

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Foreign Minority Equity Investments in Chinese Commercial Banks

Continued from page 23

of minority rights, whether affirmative participation rights or even veto power over significant issues. For instance, China's Company Law requires two-thirds approval for so-called "special resolutions" at Chinese CLSs, effectively stripping away the veto power even of holders of 33 percent of equity. Nor does Chinese corporate law permit such established mechanisms as different classes of shares or preferred share capital.

Aside from the deficiencies of China's corporate law, the unique capital structure of PRC corporate establishments, in particular financial institutions, has an impact; the other shareholders are often state-owned or -controlled (usually local-level agencies), approaching governance and operations from a unified standpoint. Acquirers should not ignore a minority shareholder's difficulty in truly having a voice against such entrenched interests and their directly appointed management. The result may be a truly "passive" investment for the minority holder (absent a special arrangement, such as the relatively unfettered contractual management right that was to be bestowed on Newbridge as part of its SDB acquisition). The problem becomes only more salient if the target already has, or succeeds in completing, an A- or B-share listing. In 1997, the China Securities Regulatory Commission (CSRC) laid out a rigid template form of articles of association for A- or B-share issuers, which are disadvantageous to minority (private) shareholders. CSRC's insistence on these forms of articles of association, and pronounced dislike for shareholders' agreements (or management agreements) for listed companies, are not good news for minority shareholders in PRC banks.

Liquidity

Foreign investors in PRC banks do not hold A or B shares, but instead "unlisted foreign capital shares." Because these shares are unlisted, they are not liquid. Of course, liquidity is a far greater concern for pure private equity investors, who will be interested in some form of capital appreciation, than for foreign commercial banks, which are more likely to be content to enter the PRC banking sector as long-term market participants. Accordingly, foreign acquirers entering the banking sector as equity participants must be aware of the significant restrictions on subsequent transfer or sale.

Without a clear legal basis for minority investment in PRC banking institutions, it is unclear what approvals are needed to dispose of an equity interest in a PRC bank, either by private sale to other foreign or Chinese investors or by conversion of the equity into listed shares on a public market. It seems certain that CBRC will impose strict examination and approval requirements on any kind of attempted disposition of shares, and that the Chinese foreign exchange control authorities will hinder the ability of potential PRC purchasers to convert RMB into foreign currency to make such purchases. In the wider world of foreign investment in Chinese CLSs and disposition of holdings, foreign investors may be prohibited from selling such shares for a period of three years and must overcome significant approval hurdles before effecting a trade sale. Any proposed exit into the public markets is almost a non-starter, although in the last couple of years MOFTEC and CSRC have cooperated to allow the conversion of unlisted foreign capital shareholdings into B shares—an unappetizing prospect given the moribund B-share markets. Foreign investors hope that such new mechanisms will allow foreign investors to gain sponsored listings of their private shareholdings in Chinese CLSs on the Hong Kong and foreign markets, and eventually the far more dynamic A-share markets. At this point, however, real liquidity for the private holdings of foreign investors in Chinese banks is a long way off.

First steps

As the growth of China's economy continues, as the burgeoning financial sector continues to be underserved, and as both foreign strategic investors and private equity value investors seek to participate in China's financial services industry, minority equity investments in China's small and medium-sized commercial banking institutions will only accelerate. Foreign financial players will also continue to seek footholds in financial services sectors other than commercial banking—corporate finance, insurance, asset management, and eventually domestic investment banking.

Given the entry barriers in each of these sectors, and depending on their corporate strategy, many large foreign groups may enter the retail banking area first, as minority equity participants, with some kind of added contractual (whether management or co-branding) mechanism. In time, and with increasing liberalization, such foreign groups may benefit from integration among PRC financial service companies, whether through mergers, broadened scopes of business, or even cross-holdings. At that time, minority participation in small-scale commercial banking operations with some element of control may prove to have been a good first step toward a full-service operation. 完

RESPONSIBLE GIVING

Timothy Prewitt

US companies contribute to improving social welfare—profitably—in China

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Most major multinational corporations with substantial investments in China have moved beyond the purely commercial realm to engage in projects that help the local communities in which they operate. In today's China, such projects are receiving more encouragement from the Chinese government and the emerging cadre of nongovernmental organizations (NGOs), both foreign and domestic.

Foreign companies in China have demonstrated that economic returns and social benefit are not mutually exclusive. These companies have reaped benefits by integrating their contributions to China's healthcare and educational systems and environment, in particular, into their strategic China plans. These benefits include lower staff turnover, greater employee participation in the company's operations, better brand recognition, government support, and enhanced competitiveness in China. Their efforts also make a tangible difference to local communities.

Thinking strategically

Foreign companies with substantial, and long-term, direct investments in China have contributed to China's social welfare from the earliest days of their investments. Today, a select group of firms have begun to integrate their charitable giving programs into their China operations to gain competitive advantage.

This trend has been slow to develop for several reasons. In the past, opportunities to assist communities in China have been comparatively few, as government restrictions and a nascent third (nongovernmental) sector left few options. Second, the bottom-line impact of community programs is indirect, with the exception of cause-related marketing. Third, managers often believe they must stretch the limited funds they have available for community relations programs across as many charities as possible. Finally, cash is allocated but nonfinancial resources, such as employee volunteer time, are not. Real impact to the community—and the bottom line—is ultimately diluted.

Programs to help the community "should reflect the way you do business, and not just be charitable giving," noted Corning (Shanghai) Co. Ltd. General Manager Joseph Allen at an American Chamber of Commerce forum on the subject this past spring in Shanghai. "For us, this means adding value to all involved: investors, employees, customers, suppliers, and the communities in which we work."

Reaching communities with help from NGOs

Even after they decide to contribute comprehensively to the local communities in which they operate, foreign companies have encountered difficulties identifying specific China projects that support the companies' overall goals. "In the US, mechanisms for getting involved are pretty well established," said John McKean, manager of Intel Asia Regional Public Affairs. Although communities in China are eager for support, they are often less accessible to foreign firms and have little experience working with foreign corporations. McKean also notes difficulties inherent in pioneer work: "If you parachute into Shanghai with volunteers and funds, it takes a lot of time to figure out where to go and what to do."

"In the past corporations have had to broaden their scope," notes Lori Burke, executive director of Shanghai Sunrise, an NGO that provides educational support to children in need. With only a few acceptable areas of intervention, and fewer still transparent mechanisms to support communities, companies were forced to adopt a less strategic approach. "I see that changing, as the government feels more willing to accept outside support."

Indeed, the PRC government has stood by as the number of foreign—and Chinese—NGOs operating in China has increased dramatically in recent years, expanding options for foreign companies looking for projects to support. Although a formal NGO registration process or local tax exemptions have yet to appear on PRC law books, more than 100 foreign NGOs, including Habitat for Humanity, Save the Children, and Junior Achievement, and hundreds of Chinese NGOs have cropped up in recent years, in areas as diverse as environmental mitigation, health awareness, business training, and microcredit. These Chinese NGOs have either overt or tacit PRC government support. But even NGOs set up by the government, called "GONGOs"—government-organized NGOs—operate independently of the government and are playing an important social welfare role in China. China Charity Federation is perhaps the leading charitable GONGO. Though officially backed by the government, China Charity Federation operates as an independent agency.

Cooperation between foreign and PRC NGOs is strong. Burke acknowledges the importance of partnerships to a foreign-managed charity working in Chinese communities. "For us, working with China Charity Federation was essential when we began seven years ago. They gave us legitimacy, which helped us work with the street committees, which in turn helped identify children in need." Corporations have sponsored 150 children and established more than 90 libraries in public schools through Shanghai Sunrise.

Foreign NGOs also have much to offer local charitable groups. "We have a responsibility to share our knowledge with local NGOs, particularly those new to raising corporate funds or keeping accurate financial records," said George Smith, vice president of Special Olympics in China. "As the number of international NGOs in China increases, we raise the bar for the entire sector."

Public acceptance of nongovernmental social welfare provision is also expanding, which is important for a country that has operated for decades under a state-dominated system that left little room for volunteerism. According to *China Development Brief*, volunteerism is on the rise, and more than 93 percent of Beijing respondents in a survey of a few hundred people could identify at least one charitable organization, such as the Ford Foundation or the China Charity Federation. Although recognition of charitable work may not be as prevalent elsewhere in China, the survey and growing number of NGOs represents a positive trend in a country in which the state is withdrawing from many social services.

Favorable coverage of NGO activities in the local media has also aided acceptance of these new participants in Chinese society. "In our experience, publicity has been overwhelmingly positive, particularly with our work at the Shanghai Second Medical University," noted C. M. Leung, the Shanghai-based director of Project Hope, the recipient of more corporate contributions than any other NGO in Shanghai. In March 2002, an article in the leading newsmagazine *China Viewpoint* boldly declared that "The role of NGOs in the twenty-first century will be as significant as the role of the nation state in the twentieth." This and other supportive articles that appeared during the run up to the 16th Chinese Communist Party Congress indicate the existence of at least tacit government support.

An even more promising indicator of the government's attitude toward social welfare-

The number of foreign—and Chinese—NGOs operating in China has increased dramatically in recent years, expanding options for foreign companies looking for projects to support.

Intel worked with the Shanghai Youth Technology Center to organize a citywide environmental debate contest.

related organizations and activities was the approval by the ministries of Foreign Affairs and Civil Affairs of Beijing's inaugural Business and Civil Society Forum and Exhibition, scheduled for late May of this year. The three-day event, which was postponed because of the outbreak of severe acute respiratory syndrome, was to explore potential collaboration between business and the so-called third sector. The forum had the support of the China Charity Federation, The US-China Business Council, and United Way International. Representatives from the National People's Congress and the Chinese People's Consultative Conference, as well as multinational business leaders, were to participate.

Corporate cases

In light of such governmental and popular support, many companies have built programs to match their business goals and the local environment. A few examples of such programs follow.

- **Intel: Projecting core values in community projects**

For Intel Corp., effective planning and in-country experience were essential in developing the company's extensive community affairs program in China. Many of Intel's activities are technology-based, such as donating computers and organizing student technology fairs. Other philanthropic support, such as sending volunteers to the Special Olympics in China or to public tree-planting efforts, also reinforces the Intel brand name. According to McKean: "Intel stands for quality, it stands for delivering on commitments. If you buy an Intel product you are going to get what you expect—same thing if Intel agrees to help a school."

Intel's volunteer program provides a good example of how the program leverages the company's technology-focused approach. Initiated by Intel's China operation in 1995, the program encourages employees to volunteer at charitable or community events of their choice, many of which are organized by Intel Community Affairs Manager Olivia Xu.

"A lot of Intel volunteers give their personal time," explains Xu. "Our projects focus on education, environmental education, and charity. Education is the most requested." In fact, the volunteer program was designed in response to a global employee survey that indicated that employees viewed personal contributions to their community as important.

In one project, Intel worked with the Shanghai Youth Technology Center to organize a citywide environmental debate contest. Intel funds the debate program and sends scores of volunteers to act as judges and coaches, and to assist with the live broadcast. The program aims to improve debate skills and environmental awareness. More than 28 schools participated in last year's televised debate. Other topics, chosen by the schools that participate in Intel's program, included community cleanup, wildlife protection, and environmental regulation. For example, students debated the merits of the Hong Ming Island Bird Sanctuary outside of Shanghai, arguing for expansion or replication of the state-funded project.

- **Perdue Farms: Fostering employee participation**

For Perdue Farms Inc., corporate charitable donations and employee assistance brought tangible rewards. "We have found that through our contributions, our employees give back to Purdue Farms and to the community," explains Brant Locklier, Perdue's executive director for China. Since establishing a joint venture in 1998, Perdue has helped farmers in Anhui and children living below the poverty level in Shanghai in ways that have had a positive impact on its China operation.

Perdue sponsored elementary school students through Shanghai Sunrise and provided the charity with one full-time staff member. Employees responded: "Once they saw management's commitment to those less fortunate, our staff members not only volunteered their time, but a portion of their own salaries as well," notes Locklier. He asserts that employee participation in the company's program has increased output and reduced staff turnover. Since participating in Purdue's community outreach efforts, employees have become more responsive in the workplace, offering dozens of suggestions on ways the company can lower costs and increase efficiency. "Because of participation, our costs dropped by 20 percent and output increased fourfold, all without additional labor."

- **Corning Shanghai: Help for child healthcare**

Corning Shanghai, a venture that produces catalytic converters, also considered community assistance projects that meshed with its core business proposition, namely to solve problems with technology. Although the company's budget is small, Corning wanted to make a tangible impact and respond to the charitable interests of the company's employees. As General Manager Allen explained, "Most of our local employees are young, and starting families of their own." The company decided that it would use its limited budget on a project that would improve the lives of local children. Corning established Shanghai's first pediatric burn unit at the Shanghai Children's Medical Center with Project Hope, which ensured that the project was effi-

ciently managed, transparent, and up to international standards.

Domestic giving

Foreign companies are not alone in donating to worthy causes in China. Donations from Chinese companies are already substantial. A 2000 survey conducted by the Shanghai Academy of Social Science indicated that a majority of state-owned enterprises had contributed to a charitable cause in the previous year. Of 503 respondents, 92.5 percent donated cash, goods, or services.

"Although the approach to economic development may differ, we found that in almost every case, the end goal was the same: to improve the economic circumstances of those in need," said Michael Doyle, president and CEO of Maryland-based CHF International. CHF, a nonprofit organization that supports the development of the nongovernmental sector in China, has advised the China Society for Promoting the Guancai, a Beijing-based group of entrepreneurs and business professionals, since 2000. "We have found hundreds of Chinese entrepreneurs with genuine interest in poverty alleviation, contributing both funds and expertise to the cause." Although difficult to estimate, this year's contributions total hundreds of thousands of dollars.

Options abound

Never before have foreign companies had so many options for charitable giving in China. The efforts of Intel, Perdue, and Corning illustrate just a few of the ways that foreign companies have meshed their efforts to assist local communities with their own strategic interests. Although areas such as human rights or local governance remain restricted, and the bulk of corporate activity is centered around China's larger cities, NGOs are expanding in number and scope, increasing the opportunities for corporations to contribute. 完

The Impact of HIV/AIDS on Business in China

Continued from page 10

care providers. If local clinics are reusing medical equipment, then workers might be at risk, and appropriate actions should be taken by the company to isolate those facilities and encourage staff to seek treatment elsewhere. Identifying additional community resources, including local health authorities, nongovernmental organizations, and insurance companies are key to assembling the components of a comprehensive care plan.

Once policies and educational programs are under way, companies can consider undertaking a testing program that will establish the baseline for treatment needs. Of course, no company should establish a compulsory testing program, and any voluntary program should ensure that employees' status be kept confidential. Testing for STDs enables workers to get treatments for curable diseases, increasing their productivity. STDs contribute to the spread of HIV through inflammation, ulcers, and more infected white blood cells—which facilitate the transmission of HIV during intercourse. Treating STDs is an effective means of preventing HIV, and diagnosing a curable STD can serve as a wake-up call for employees who do not consider themselves at risk of contracting HIV. Testing for hepatitis can also alert workers to potential liver problems and enable them to begin treatment regimens that will enhance their quality of life and make them better, more productive employees. HIV testing can be difficult to implement, particularly if employees do not wish their employers to know their HIV status and worry that they will face discrimination.

Companies also must consider other ethical issues with HIV screening policies, both for new hires and the existing workforce. For example, poorly designed HIV screening may be incompatible with prevention and empowerment programs.

The risks of inaction

The most important issue for businesses in China to understand is the serious consequence of inaction while prevalence rates of HIV and STDs are low. The risks presented by HIV/AIDS in China are severe and to deny or ignore them amplifies the economic risks that companies will face in the future—including reduced corporate profits. As the SARS crisis develops and the extent of the public healthcare system's inability to confront emerging infectious diseases becomes more apparent, the private sector in China will need to address health issues actively to avoid the social and economic disasters looming on the horizon. 完

NEWS OF CHINA-RELATED EDUCATIONAL, CULTURAL, AND CHARITABLE PROJECTS

Opportunities introduces significant charitable, cultural, and educational projects that seek American business support and aims to assist companies in identifying programs meriting their assistance. The materials contained in *Opportunities* are boiled down; our goal is to provide contact information and only the most skeletal description of each organization's interests. I strongly encourage interested companies to make direct contact with the programs contained here, so that each firm can review for itself the more-detailed materials that individual organizations can provide.

The importance of American corporate participation in programs that bring benefit to the people of China and strengthen the bonds of US-China friendship beyond the commercial realm cannot be overstated. We congratulate the many American firms that support a wide range of important and positive efforts in China and hope that *Opportunities* will help companies to explore new ways of making a difference.

Robert A. Kapp
President, The US-China Business Council

(Note: The purpose of *Opportunities* is to facilitate direct contact between interested companies and project developers. The US-China Business Council is not a sponsor of any project listed in *Opportunities* and makes no recommendation with regard to corporate assistance to any specific project.)

US Institution: **Special Olympics, Inc.**
Chinese Institution: **Special Olympics East Asia Chinese Programs**
Project Description: **Special Olympics' mission is to provide year-round sports training and athletic competition in a variety of Olympic-type sports for individuals with mental retardation.**

Special Olympics China is now the world's fastest growing Special Olympics program, with more than 100,000 athletes competing in local events year round. Shanghai will host the 2007 Special Olympics World Summer Games, one of the world's preeminent events highlighting the gifts and potential of people with mental retardation. Written into government policy and partnered with the country's largest disability group, the China Disabled Person's Federation, Special Olympics China is well on its way to expanding its promotion of volunteerism, education, and health screening efforts as it works to reach a goal of 500,000 athletes by 2005.

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US Institution: **US-China Environmental Fund (USCEF)**
Chinese Institution: **Wolong (Giant Panda) Nature Reserve Administration, Sichuan**
Project Description: **The Giant Pandas of Wolong: Donations for panda educational exhibits and investments for a sustainable development model**

The project presents unique donor and investor opportunities at China's Wolong Nature Reserve. Home to the largest populations of captive and wild Giant Pandas in the world, the Wolong Nature Reserve is recognized in China and around the globe as the leading center for sustaining the Giant Panda. Founded in 1963, Wolong will celebrate its 40th anniversary this October. On this occasion, USCEF will present an integrated master plan for Wolong's breeding center, located at the heart of the nature reserve. The State Forestry Administration, which oversees the reserve, just granted Wolong $500,000 to replace old cement panda cages with large, natural enclosures and construct new buildings for educational exhibits based on USCEF's plan. USCEF is now seeking donations to produce educational exhibits and materials for Wolong and for touring exhibitions. The plan also calls for the construction of a conference facility, including a hotel, which will become a model for sustainable development to produce revenue for conservation programs at Wolong. For further information about donor and investment opportunities associated with conserving the Giant Panda, please contact USCEF.

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USCEF's Beijing Office: Ms. Rosie Yu, director, Stewardship Education
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US Institution: **US-China Environmental Fund (USCEF)**
Chinese Institution: **Municipal Education Commissions and Environmental Protection Bureaus**
Project Description: **Theater for Environmental Awareness: Promoting environmental awareness through the performance arts**

This corporate citizenship program provides employee participation and corporate sponsorship opportunities for a youth initiative that not only has a proven track record in Beijing, but has received strong government support and prominent media attention. The Theater for Environmental Awareness (TEA) has a two-step process to help Chinese youth express their environmental concerns. First, TEA trains teachers and community group leaders in improvisational theater techniques and script development in intensive workshops led by US theater professionals. Second, certified Chinese TEA teachers lead students through a series of exercises that enable the students to create and perform their own dramas. TEA enjoys strong support among Chinese officials since it fulfills China's call for educational reform by introducing participatory, interactive teaching methods.

USCEF's Beijing office is ready to extend the TEA program to Chinese communities where corporate sponsors have operations. Contributions are needed for workshops to train and certify TEA teachers, for hands-on teacher's manuals, for summer camp scholarships, and for the "adopt a TEA school" program. Corporations can directly support area schools by funding performances and by funding TEA-certified trainers for after-school programs. TEA activities can also be targeted to specific geographic areas or focus on employee training (to strengthen leadership qualities or team-building exercises). TEA performances can be organized on any topic or theme (public health, science and technology, etc.) for corporate special events. For further information please contact USCEF.

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Chinese Institution: **Golden Key Research Center of Education for the Visually Impaired**
Project Description: **To provide education for blind children in China to enable them to support themselves as adults**

In cooperation with the Education Commission and local governments, the center sets up education centers and trains teachers so that blind children can enroll in their local village schools and study in the same class as sighted children. The center also publishes *Ode to Joy*, a magazine for blind children, and has held various activities, such as summer camp, for blind children. It also runs a rehabilitation center in Tai'an, Shandong, for adults who have lost their sight.

The Golden Key Center seeks funding to extend successful models developed in Guangxi and Inner Mongolia to other western regions, particularly Shaanxi, Gansu, and Ningxia; broaden opportunities for vocational training for visually impaired students; increase international cooperation to develop community partnerships and academic exchanges; and raise social awareness. Golden Key receives no government funding.

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Chinese Institution: **Sheng Gu Temple Restoration Foundation**
Project Description: **Restoration of Sheng Gu Temple in Anping County, Hebei**

The Sheng Gu Temple Restoration Foundation is a nongovernmental, nonprofit Chinese organization established to raise money for the reconstruction of the Sheng Gu Temple. The original Sheng Gu Temple was built at the beginning of the Eastern Han Dynasty (AD 25-220), in the traditional Chinese architectural style of all-wooden construction—not a single nail was used. It stood on the same site until 1938, when the Chinese army, suspecting that Japanese troops were using the temple to store ammunition, burned the entire complex to the ground.

The organization is unique in that it is the first to unite Chinese citizens and foreigners together to restore a site of Chinese religious and cultural heritage. The foundation will be responsible for fundraising for and overseeing the restoration process. After construction is complete, responsibility for the temple's management and upkeep will be passed to the appropriate bureau in Anping. Because Chinese law prohibits nonprofits from establishing parallel foundations outside China, the foundation has been unable to incorporate or apply for 501(c)3 status in the United States, but tax deductible contributions can be arranged by contacting the organization directly.

Contact information: Kerry Holahan, project manager
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Chinese Institution: **Stars and Rain Education Institute for Autism (Stars and Rain)**
Project Description: **Severe acute respiratory syndrome (SARS) emergency support**

Stars and Rain, founded in 1993 by a parent of an autistic child, is the first educational organization to serve children with autism in China. The organization provides individual therapy for children with autism, ages 3 to 12. Teaching techniques are based on applied behavior analysis (ABA), a method recognized in the United States. The goal of Stars and Rain is to help parents obtain knowledge about autism and the ABA approach so that they can teach and help their children in daily life. Over the last 10 years, Stars and Rain has served more than 2,000 families from across China. It now has a waiting list.

The SARS virus inflicted heavy damage on Stars and Rain. The school had to shut in April when an intern researcher was infected. Fearing the spread of SARS, Stars and Rain canceled the next semester, which more than 50 families were planning to attend. Because of the cancellation, Stars and Rain will lose a quarter of its income in 2003. The school depends on a combination of fees and donations and has no access to government funding. Chinese families with disabled children have no support from the government or social insurance. Help from international organizations has played an important role for Stars and Rain. Because the organization has fallen into special difficulty, it is appealing for donations from international sources.

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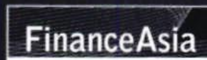

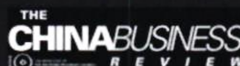

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GUANGZHOU'S PIONEERING FORAY INTO OPEN GOVERNMENT

Jamie P. Horsley

New provisions establish the people's right to know

Jamie P. Horsley
is associate director of The China Law Center and senior research scholar and lecturer-in-law at the Yale Law School. She lived and worked in China for 15 years as a lawyer, diplomat, and corporate executive and has written and lectured extensively on legal and other developments in China.

China's initial reticence in sharing information about the severe acute respiratory syndrome (SARS) epidemic highlighted anew the culture of secrecy that has for centuries shrouded the Chinese state and state-held information from not only the world but its own people as well. Stung by strong domestic and international criticism, the central government ultimately directed governments at all levels to report information on SARS accurately, honestly, and in a timely manner, threatening harsh punishment for delay or cover-up.

The SARS episode is playing out against the backdrop of a movement for greater openness in government affairs, aimed at supporting China's economic development drive, helping curb official corruption, and providing a safety valve to dissatisfied citizens who increasingly demand more accountability from government at all levels. Bills calling for national legislation on government information transparency were submitted to several recent annual meetings of the National People's Congress. Indeed, a scholars' draft of national regulations to establish a Chinese-style "freedom of information" system is currently before the State Council for review. Ironically, given its subject matter, the draft's specific content is still not widely known and has been circulated only to selected scholars and government agencies for comment.

Guangzhou leads the way

Meanwhile, the Guangzhou municipal government made history by pioneering the first legislation aiming to institutionalize government transparency on a wide range of matters. Breaking the Chinese imperial and socialist traditions of government secrecy, the Guangzhou Municipal Provisions on Open Government Information (the provisions) establish a presumption that government-held information should be public, making nondisclosure the exception rather than the norm. Moreover, the provisions call on the government to release drafts of policies and regulations for public input before they are finalized and implemented.

The Chinese government has long been the primary repository, producer, and publisher of all kinds of information relating to social, economic, and political affairs. In recent years, as part of a drive toward what the Chinese call "informatization" (信息化, *xinxihua*), twin nationwide programs were launched to make government affairs more open to the people (政务公开, *zhengwu gongkai*) and to build "e-government" networks under which government agencies at the central and local levels would make an ever-increasing amount of information available, and provide administrative services, on the Internet. These projects have made government more open—if not necessarily more accountable—to ordinary Chinese citizens. China's commitments under its World Trade Organization (WTO) entry agreement also require the country to make trade-related rules and requirements transparent.

But China lacks legislation in the area of government transparency and does not provide clearly for information rights. Efforts to promote greater transparency under the programs mentioned above have met with no small degree of resistance from officials accustomed to working behind a shield of secrecy. Statistics indicate that some 80 percent of all information is held by the government and that most of it is treated as nonpublic, thus impeding economic development. Chinese scholars point out that inaccessibility to relevant government-held information has led to economic losses and misallocations, corruption, and fraud, as well as policy-related constraints. Existing legislation, such as the 1988 Law on Guarding State Secrets, emphasizes confidentiality and secrecy, not disclosure of public information.

Guangzhou was one of the first jurisdictions to embrace the policy of making government affairs public, and undertook experiments in the late 1980s and adopted trial measures in 1992. To comply with WTO requirements and to gain even greater administrative efficiencies from enhanced transparency, the Guangzhou municipal government decided to formulate government information disclosure legislation that would standardize municipal practice and raise the standards for compliance. Drafted with the assistance of scholars from Guangzhou's Zhongshan University and taking account of international experience, the Guangzhou government announced the provisions to great public fanfare on October 30, 2002. They took effect on January 1, 2003.

New information rights

The provisions contain two fundamental and novel ideas: that Chinese government agencies have an obligation to disseminate automatically, and disclose upon request, most of the information that they hold and that Chinese citizens have a right to access such information. The provisions aim to protect the "right to know" (知情权, *zhiqingquan*) of individuals and organizations. They refer to individuals and organizations as "persons with the right to access" (公开权利人, *gongkai quanliren*) and refer to all levels of government and its functional departments and organizations that carry out administrative powers as "persons with the obligation to make public" (公开义务人, *gongkai yiwuren*). The provisions establish unprecedented rights and obligations in the area of access to government information.

The Guangzhou Municipal Provisions on Open Government Information establish a presumption that government-held information should be public, making nondisclosure the exception rather than the norm.

"Government information" covered by the provisions means information made, obtained, or possessed by all levels of government and its functional departments and related organizations in the course of managing or providing public services. It is unclear whether this definition covers every agency including, for example, the Ministry of Public Security and the People's Courts. Nonetheless, the provisions stipulate that government information shall in principle be made public, with nondisclosure only in exceptional cases. This principle of openness reverses past practice, under which government agencies jealously guarded information about their functions, staff, expenditures, and programs, as well as many of their policies, regulations, and decisions, as "state secrets." Moreover, the government must make such information available free of charge. Even foreigners are entitled under the provisions to access government information, subject to a reciprocity clause.

The provisions diverge from comparable US legislation by describing in detail—possibly to drive home the point—the categories of information that the government must disseminate on its own initiative and in the ordinary course of managing or providing public services. This kind of information includes what is called "governance-related" information such as development plans, rules, and regulations; the functions and structure of government agencies and the resolution of major events; financial matters such as budget information and government expenses; government personnel-related information; and administrative procedures. Compared to the days when China first "opened up" in the early 1980s—when one could not obtain an organization chart of an agency, let alone a description of what various departments did, the names and telephone numbers of staff, or copies of laws and regulations in effect—the current openness in government information available online and the

> **This principle of openness reverses past practice, under which government agencies jealously guarded information about their functions, staff, expenditures, and programs, as well as many of their policies, regulations, and decisions, as "state secrets."**

additional disclosure requirements of the provisions are nothing short of revolutionary.

The provisions also require agencies to notify persons in advance, and after a decision is made, of administrative actions concerning those persons in particular. The notice must include the name of the agency concerned; the procedures, basis, and reasons for making the decision; the decision itself; and the means and time period during which the person can take remedial action, if desired.

As for other types of information or information that should have been disclosed in the ordinary course of managing or providing public services but was not, citizens can file requests for disclosure. The relevant government agency must normally comply within 15-30 business days, depending on the type of information involved. One Guangzhou official illustrated the utility of this request procedure, noting that many Guangzhou citizens are now buying homes and want to know the development plans for various districts in the city where they are contemplating a purchase. Under the provisions, they can ask to see these and, if the government agency refuses to comply, they can turn to the courts for enforcement or seek administrative reconsideration.

The provisions further establish another new right: the right of any person to see information concerning himself or herself that a government agency possesses, as well as to request correction of any errors or inaccuracies in such information. Individuals have not had the right to review their personnel files, for example. This right is important to help establish the concept of and to protect privacy rights. The ability to correct personnel file information compiled by government employers is increasingly important as citizens seek to change jobs and as China begins to establish a credit reporting system that applies to consumers as well as to companies. Unfortunately, the provisions do not spell out time periods for correction or specific remedies if the government agency does not comply with the request. Nonetheless, the very articulation of this right is an important landmark.

Exceptions

The provisions set forth some general categories of information that are not subject to disclosure, including private information about individuals, commercial secrets, state secrets, information regarding matters under deliberation, and the catch-all categories of information relating to "social and public interests" and "other government information prohibited from being made public by law or regulation." One goal of international legislation in this area is to specify as precisely as possible the scope of necessary exceptions to the rule of openness, so as to prevent them from becoming huge loopholes for government nondisclosure. In China, the concept of a "commercial secret" has been under development for several years, although the precise contours are not yet well defined. But notions of individual privacy or the protection of personal data, nowhere clearly expressed in law, remain to be fleshed out (*see The CBR*, July-August 2002, p.36), and the determination of what constitutes a "state secret" is relatively broad under existing legislation and practice. Public health information—including information about diseases not yet listed as a contagion that should be announced to the public—is, for example, treated as a state secret under existing legislation. Certainly, the category of "social and public interests" also begs for clarification.

Public participation in decisionmaking

Another major innovation of the provisions is that of announcing "matters affecting important interests of individuals or organizations or that have a major social influence" before they are finalized and implemented for public input. Though the text of the article is unclear on this point, commentary about it by officials involved in drafting the provisions suggests that the "matters" include draft rules as well as policies and administrative decisions. The responsible government department is to publicize the proposed regulation, policy, or decision and its justification and make the final decision only after seeking "sufficient" public opinion and adjusting the proposal as appropriate. The concept, again, is revolutionary, but conforms to recent Chinese Communist Party calls for greater public participation in government affairs. Most of the media reports on the promulgation of the provisions praise this article, anticipating that it will permit "ordinary people" to participate in government decisionmaking and make governance more transparent and democratic.

Specific procedures on how to implement an advance disclosure system, which might include notice and comment procedures, advisory committees, and public hearings when called for, need to be worked out. Guangzhou might well look to the example set by the Shantou municipal government, also in Guangdong, which published its draft Open Government Information (OGI) Provisions on its website for public input. During a comment period of 14 days, comments could be directed either to the specified Shantou

official at a given address or by e-mail. Shantou promulgated its OGI provisions, which are modeled generally on those of Guangzhou, with some substantive revisions made after initial publication on April 11, 2003.

Implementing openness

Under the provisions, "agencies in charge of openness in government affairs" implement the OGI system, and the legal agencies and supervisory departments supervise implementation. Reportedly, the Guangzhou municipal government has formed an Open Government Affairs Leadership Small Group (headed by the deputy mayor), the business office of which is located within the municipal government's powerful General Office. Presumably, this is the "agency in charge of openness in government affairs" in Guangzhou. The creation of new, specially designated and empowered institutions, independent of the bureaucracy holding the information, to implement the provisions might seem a preferable approach if Guangzhou wants to show it takes these new rights and obligations seriously. But new agencies require additional personnel and budgets, and by making use of existing entities, Guangzhou could move quickly to begin putting the new system in place.

The provisions require the relevant supervisory agencies to conduct periodic investigations, evaluations, and "democratic discussions" of; establish telephone and e-mail "hotlines" for citizen complaints about; and periodically appraise and assess the implementation of the OGI system at various levels of government.

Remedies

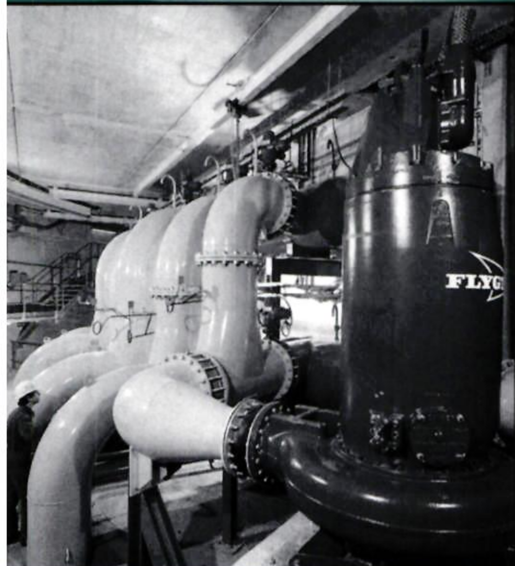
Those who are unhappy with a decision on making government information public have the right to request reconsideration, bring a lawsuit, or request compensation in accordance with the law. The provisions further stipulate that those who suffer economic injury because a government agency conceals information, provides false information, or reveals commercial secrets or private information concerning individuals should be compensated by that agency. The basis for civil recovery probably needs to be clarified before the courts will actually accept cases. Since Chinese law does not provide for any rights to information, or a "right to know," Chinese civil courts may, if past experience is any guide, feel uncomfortable dealing with uncharted new areas of law created by municipal-level rules before national legislation on the subject.

Toward greater openness

The Guangzhou provisions are an important first step on the road to a national open government information law and a broader system that empowers China's citizens to participate in the governance of their own lives and country. The provisions create new rights—the "right to know" and the right of access to government information. They fall short of what the national draft OGI regulations reportedly attempt to do—create new institutions to enforce these rights, such as a chief information officer or information commission to oversee implementation and handle complaints and a registry of information in an agency's possession. But as local legislation the Guangzhou provisions already face a considerable uphill battle in implementation, as vividly demonstrated by the recent struggle to obtain disclosure of accurate information about SARS, which is believed to have originated near Guangzhou and was initially treated as a state secret.

Public health crises lead to their own particular balancing of interest challenges around the world, but the SARS crisis revealed the depth of the problem of getting Chinese officialdom to share information fully and in a timely manner. Guangzhou and Guangdong provincial officials deserve praise for having held unprecedented press conferences to update the public about the disease within days of initial rumor-driven panic in February. Guangzhou's pioneering first legislative step to change an ingrained culture of secrecy also merits praise. It is important in and of itself and, in a country where local experimentation is often the precursor to national legislation, suggests that the central government may well soon follow. 完

Those who suffer economic injury because a government agency conceals information, provides false information, or reveals commercial secrets or private information concerning individuals should be compensated by that agency.



ITT Industries

A global engineering and manufacturing company sets out to clean and move China's water

Paula M. Miller

Global engineering and manufacturing company ITT Industries, Inc., produces electronic interconnects, switches, and pump equipment and systems for moving fresh water and treating wastewater in China. The company is linking its future in China to the country's development goals—particularly regarding water management.

ITT's long history in China

ITT was founded in 1920 as the telecommunications company International Telephone and Telegraph. The company gradually expanded its business into the insurance, hotel, and manufacturing sectors until 1995 when the company split up and created ITT Industries, which is the legal successor to the original ITT. In 2002 the company, which is headquartered in White Plains, New York, had global sales of $4.9 billion and employed 38,000 people. Today, the company is made up of four main divisions: fluid technology (39 percent of revenue), defense electronics and services (30 percent), motion and flow control (19 percent), and electronic components (12 percent). ITT Industries is the world's largest pump maker—producing systems and services to move and control water and other fluids.

ITT's presence in China dates back to 1928 when the company established the country's first major telecommunications exchange system. Today, ITT Industries has roughly 7,500 employees in China with a total investment of more than $100 million, making China one of ITT's major manufacturing bases. The company manages its investments in China through a Beijing holding company and has 10 facilities in eight cities: Nanjing and Nantong, Jiangsu; Shanghai; Shenyang, Liaoning; Shenzhen; Tianjin; Xiamen, Fujian; and Zhenjiang, Jiangsu (*see* p.45).

"China is very strategic to ITT's future, and our products and services fit the PRC government's development plans well," remarked Mark Steele, president of ITT Industries-China, referring to the company's water and wastewater pump systems and electronic components. To pursue these opportunities and expand its position as a key supplier to the China market, ITT continues to move production lines from North America and Europe to China. The company is also diversifying from manufacturing traditional pumps to producing systems that not only pump water, but also clean and treat it.

It's in the water

Roughly seventy percent of China's population still lives in the countryside and needs water management systems for agriculture and daily life. Thomas R. Martin, ITT Industries senior vice president and director of corporate relations says, "China includes water management as a top developmental priority. The PRC government recognizes the connection between development, public health, and safe water. Many people don't realize that unsafe drinking water is a global problem and is not confined to less-developed countries. Each year roughly 2.2 million people die of water-related diseases worldwide, the

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majority children under five. Globally, one-half of all people don't have access to clean water, and the vast majority of these are in Asia. Although Asia accounts for roughly 60 percent of the global population, it has less than 40 percent of the world's usable water supply."

In China, ITT manufactures two main types of fluid technology products: pumps (which can involve water, sewage, irrigation, and drainage) and filtration systems used in the treatment of water and wastewater. Steele adds, "A lot of the pumps we manufacture are made with new, high-level technology that have added value by using less energy to operate. Our pump solutions can reduce the cost of pumping by as much as 40 percent, saving our customers money in the long term. Although China's wastewater market is fragmented, with roughly 80 percent of the nation's pumps supplied by indigenous manufacturers, ITT is one of the largest pump manufacturers...and is well positioned to address the country's future requirements."

ITT's customers in China are frequently cities and project-based corporations working on major government infrastructure projects such as the Three Gorges Dam, the South-North water diversion project, and the country's numerous wastewater initiatives. ITT's Goulds pumps are installed in the Three Gorges Dam, and the company's Flygt, Lowara, and Goulds products are being positioned for projects tied to the 2008 Olympics in Beijing. (ITT's Flygt Division built an artificial white water course for the 2000 Olympics in Sydney, Australia.)

An investment in people

ITT's largely Chinese staff is helping China build its infrastructure through the company's pump systems and electronic components. "People are our strength. By providing employees with training and leadership opportunities, our organization ultimately becomes rich in talent, especially when employees stay on board for long-term careers," Steele remarked.

Steele—who in his spare time has climbed to the Mount Everest base camp, skied to the North Pole, and completed a six-day, 150-mile marathon through the Sahara desert—worked in ITT's Hong Kong-based electronic components group for nine years before moving to his Shanghai post in November 2002. As ITT Industries' China president, Steele focuses on government and legislative affairs, corporate development, internal systems, and management development—which includes training ITT's China workforce on the company's key management disciplines, including its Value-Based Six Sigma (VBSS) certification program. VBSS is a management discipline that encourages employees to work efficiently, focus on quality, and learn to solve problems—ultimately, Steele asserts, creating internal expertise and improving value for customers.

ITT Industries introduced its extensive nine-month VBSS certification program in 2000. The program operates under a black-belt hierarchy—with "champion" as the highest ranking, followed by black belts and green belts. The program also integrates elements of the company's Value-Based Management program, which goes beyond cost to assess overall project value.

Steele said he is confident that ITT's long-standing presence in China and the company's manufacturing "footprint" and talented workforce will enable ITT to contribute successfully to China's development. 完

Chinese Students Compete for Water Prize

Chinese students will participate in the ITT-sponsored Stockholm Junior Water Prize (SJWP) for the first time in 2003. The SJWP is an international youth award for water-science research projects. The competition, administered by the Stockholm International Water Institute, is designed to raise high school students' interest in water-related issues and research and to prepare the students for environmental leadership. "China's participation in the contest will raise awareness of water challenges in China and enhance ITT's relationship with China's State Environmental Protection Administration. Because public sentiment drives clean-water projects, the contest is a good beginning," remarked ITT's Senior Vice President and Director of Corporate Relations Thomas R. Martin.

—Paula M. Miller

ITT's Ten Manufacturing Sites in China

Fluid Technology

- Nanjing Goulds Pumps Ltd.
  Joint venture established in 1985; makes pumps for agricultural market and municipal and construction trades.
- ITT Flygt Shenyang
  Joint venture established in 1994 (now wholly owned by ITT Industries); manufactures submersible pumps for wastewater and municipal projects.
- Shanghai Goulds Pumps
  Joint venture established in 1998; produces process pumps for chemical, petrochemical, and general industry.

Connectors & Switches

- Cannon Zhenjiang Connectors
  Joint venture established in 1995; manufactures connectors for mobile phones.
- Cablecom Shenzhen
  Joint venture established in 1998 (now wholly owned by ITT Industries); makes cable assemblies.
- San Teh Tianjin, Nantong, and Xiamen (2 plants)
  Acquired in 2000; the four plants produce keypads for mobile communications and automotive markets.
- Man-Machine Interface Tianjin
  Acquired in 2000; manufactures contact dome arrays for mobile phones and hand-held devices.

SOURCE: ITT Industries

Toward a Rules-Based FDI Policy Framework

A recent OECD report suggests ways China can improve its environment for foreign direct investment

Kenneth Davies

China has been highly successful in attracting and absorbing large quantities of foreign direct investment (FDI) as a result of policies developed over the past quarter of a century. There is scope for both quantitative and qualitative improvement of China's FDI inflows, however.

Policy options intended to increase China's attractiveness as a destination for long-term, high-technology, high-value-added investments from Organization for Economic Cooperation and Development (OECD) countries are outlined in *China: Progress and Reform Challenges*, the latest in the OECD's Investment Policy Review series. This report was produced after consultation with numerous governmental and business organizations (including The US-China Business Council) at the request of the Chinese government and constitutes an input into the policymaking process in China. The report's findings provide a useful overview of the role FDI plays in China's economy.

A mixed review

In 2002, China became the world's largest recipient of FDI. Yet in per capita terms, China receives less FDI than many other developing countries and far less than developed countries such as those in the OECD. Hong Kong and the overseas-Chinese diaspora account for a disproportionately large share of China's FDI inflows, while the OECD countries are generally under-represented compared with both their share of global FDI and their share of China's international trade. Although foreign investors have started to bring relatively advanced technology into China, FDI in China is still heavily weighted towards labor-intensive manufacturing. Attempts to spread the benefits of FDI from the coastal region into China's poorer hinterland have yet to bear fruit.

There is no doubt that FDI has brought benefits to China. It has created millions of jobs not only in foreign-invested enterprises (FIEs) themselves but also in domestic concerns that supply FIEs with inputs and distribute their products. FIEs have brought new products to Chinese consumers as well as new production processes that have spread to domestic enterprises. Competition from FIEs was initially feared by domestic enterprises, but the latter have, on balance, gained more than they have lost from such competition: It is precisely in those sectors that were first opened to foreign investment that domestic companies have improved and expanded and are now holding

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their own in the global marketplace. FIEs are responsible for the rapid growth of China's merchandise trade in the past two decades. They now account for half of all exports and imports and have moved from deficit to surplus in such trade.

China has amassed a copious quantity of laws and regulations governing FDI since the open-door policy was initiated in 1978. Such legislation has provided a basis for foreign investment, but it has also added unnecessary complexity. For instance, each type of FIE in China has its own law, resulting in an element of inflexibility—notably in the field of mergers and acquisitions (M&A) involving different types of FIEs—which could be removed by making FIEs instead subject to an overall company law.

The regulatory environment for FDI has improved as a result of China's accession to the World Trade Organization (WTO) in 2001. Trade-related measures in China's FDI laws such as requirements for export performance, foreign-exchange balancing, foreign trade balancing, and local content requirements have been abolished. Service sectors previously closed to foreign investment are being gradually opened over a five-year period. FIEs are able to trade abroad and distribute their products more freely within China.

Room for improvement

China maintains numerous restrictions on FDI, however. Proposed FDI projects are classified into four categories according to the Catalogue Guiding Foreign Investment in Industry: prohibited, restricted, permitted, and encouraged. The prohibited category understandably contains items that are off-limits in most countries on grounds of national security. It also includes sectors—for example, production of bodiless lacquerware or enamel products—in which the presumed intention of protecting traditional techniques could be better fulfilled by means other than obstructing financial inflows. Subjecting proposed FDI projects to the stringent and time-consuming approval process used for projects in restricted areas is difficult to justify. It would be far simpler to abolish the catalogues and publish instead a short list of prohibitions on clearly explained grounds, such as those of national security.

Applying for project approval has become easier in recent years, especially in areas like Shanghai where the authorities have greater experience of foreign investment. Foreign investors still complain that the process is too cumbersome and involves the submission of forms to an excessively large number of official bodies. The application and approval process could be streamlined and made more transparent. It would be easier if an investor could obtain automatic approval within a set period,

In per capita terms, China receives less FDI than many other developing countries and far less than developed countries such as those in the OECD.

for example two weeks, after ascertaining and fulfilling all approval criteria, unless the authorities could show due cause for not allowing it. For this to happen, all internal (*neibu*) regulations operated by local authorities would have to be published and, if not in conformity with national regulations, abolished.

China is committed to improving the transparency of government policy and regulation as a result of its WTO accession. China can achieve greater transparency by ensuring regular publication and updates of policy decisions, laws, and regulations relating to FDI in both Chinese and English. The Chinese government is increasingly using the Internet for this purpose and is working with the OECD to perfect a single site that will eventually contain most of the information needed by a potential foreign investor.

The rule of law

Another essential component of an enabling environment for foreign investment (and for domestic investment) is the rule of law. The legal system has made great strides since it was reestablished under Deng Xiaoping in the 1980s, but China's courts still lack qualified lawyers and judges and are not yet independent of political influence. The Chinese authorities are to be commended for their efforts to train more lawyers and encouraged to strengthen the robustness of the courts in the face of pressure from local officials to issue biased judgments.

One area in which domestic as well as foreign investors will benefit from stronger implementation of existing laws is in the field of the protection of intellectual property rights (IPR). A start has been made in the establishment of specialized tribunals to try cases involving trademarks, copyright, and patents, but flagrant violations of the law in this area persist. Stronger IPR protection can foster greater creativity and encourage more foreign investors to bring high technology to China.

Continued on page 57

Sales and Investment

MARCH 16, 2003–MAY 15, 2003

Compiled by Isaac Cheng

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.

Architecture, Construction, & Engineering

CHINA'S IMPORTS

Elegant Concrete Inc. (US)

Signed a letter of intent to license and train Tianqi Real Estate Co. Ltd. in Elegant's application processes. $1 million. 03/03.

INVESTMENTS IN CHINA

Asia Dekor (Singapore), Top Mark (British Virgin Islands)

Will form high-density fiber board joint venture in Heyuan, Guangdong. (Singapore:70%-UK:30%). $12.1 million. 03/03.

Automotive

INVESTMENTS IN CHINA

Lear (Mauritius) Co., a subsidiary of Lear Corp. (US)/Shanghai Brilliance Holdings Co.

Will form joint venture to make car seats in Shenyang, Liaoning. (US:60%-PRC:40%). $3 million. 05/03.

DENSO (China) Investment Co. Ltd., a subsidiary of DENSO Corp. (Japan)/Guangzhou Automobile Group Component Co. Ltd. (Guangdong)

Will form joint venture, Guangzhou DENSO Co. Ltd., to produce air conditioners for automobiles. (Japan:60%-PRC:40%). $23 million. 04/03.

Singapore Technologies Kinetics, a subsidiary of Singapore Technologies Engineering Ltd./Beijing Heavy Duty Truck Plant

Will form joint venture, Beijing Zhonghuan Kinetics Heavy Vehicles Co. Ltd., to design and produce heavy vehicles and vehicle-based construction equipment. (Singapore:50%-PRC:50%). $15 million. 04/03.

Aisin Seiki Co. (Japan)

Bought 65% stake in Tangshan Aisin Gear Co. from Tangshan Gear Group Corp., bringing its stake to 97%. $29 million. 03/03.

OTHER

Perusahaan Otomobil Nasional Bhd (Malaysia)/Guangdong Goldenstar Heavy Industries Corp.

Received approval for joint venture Goldenstar Proton Automobile Co. (Malaysia:50%-PRC:50%). $500 million. 05/03.

Brilliance China Automotive Holdings Ltd. (Liaoning)

Bought 4.05% stake in its joint venture with Bayerische Motoren Werke AG from Shenyang city government, bringing its stake to 44.55%. $16.3 million. 04/03.

Aviation/Aerospace

CHINA'S EXPORTS

Chengdu Aircraft Corp. (Sichuan)

Won contract from Airbus SAS to construct single-aisle aircraft-nose landing-gear bays, single-aisle aircraft frames, and long-range aircraft frames. $33 million. 03/03.

CHINA'S IMPORTS

Airbus SAS (France)

Won contract from China Aviation Supplies Import and Export Group Corp. for 30 aircraft for use by a consortium of Chinese airlines. 04/03.

Euraspace GmbH, a joint venture of Daimler-Benz Aerospace (Germany) and the China Aerospace Corp.

Won contract from the Chinese Academy of Space Technology to build a compact antenna test range. $13 million. 04/03.

OTHER

China Southern Airlines Co. Ltd. (Guangdong)/China UnionPay Co. Ltd. (Shanghai)

Will cooperate to provide electronic ticketing systems for China Southern Airlines. 05/03.

China Airlines (Taiwan)

Received approval to fly through China's airspace during the Iraq war. 03/03.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; ETDZ: economic and technological development zone; GSM: Global System for Mobile Communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; MII: Ministry of Information Industry; MOFTEC: Ministry of Foreign Trade and Economic Cooperation; MOU: memorandum of understanding; NA: not available; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; SARFT: State Administration of Radio, Film, and Television; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

Banking & Finance

CHINA'S IMPORTS

Morgan Stanley (US)
Retained by China Resources Power Holding Co. (Beijing) for initial public offering advice. 03/03.

INVESTMENTS IN CHINA

Ascendas Pte Ltd. (Singapore), KLM Capital (US)/Tsinghua Science Park (Beijing)
Will form joint venture capital fund, Global Synertech Fund, specializing in technology. $50 million. 05/03.

International Finance Corp., a unit of the World Bank
Agreed to purchase 1.22% stake in China Minsheng Banking Corp. Ltd. from Orient Group Inc. $23.5 million. 05/03.

JP Morgan Fleming Asset Management (US)/Shanghai International Trust and Investment Corp.
Will form fund-management joint venture. (US:33%-PRC:67%). $18 million. 05/03.

OTHER

Shenzhen Development Bank (Guangdong)
Cancelled transfer of 20% stake from Shenzhen government to Newbridge Capital (US). 05/03.

China Minsheng Banking Corp. Ltd. (Shanghai)/Dresdner Bank AG (Germany)
Will cooperate to provide advisory services in the intermediary banking sector. 04/03.

Fortis NV (Belgium-the Netherlands)/Haitong Securities Co. Ltd. (Shanghai)
Received approval from CSRC for fund-management joint venture. (Belgium:33%-PRC:67%). $12.1 million. 04/03.

Société Générale SA (France)/Fortune Trust & Investment Co., a subsidiary of Baoshan Iron & Steel Co. (Shanghai)
Received approval for Fortune SG AM Fund Management Co., a fund management joint venture (France:33%-PRC:67%). 03/03.

Chemicals, Petrochemicals, & Related Equipment

CHINA'S IMPORTS

Chemoprojekt AS (Czech Republic)
Won contract from Shanxi Ruicheng First Chemical to build a plastics factory. $29.3 million. 05/03.

Air Liquide SA (France)
Won contract from China Petrochemical International Co. to build a large air-separation facility in Nanjing. 04/03.

INVESTMENTS IN CHINA

Aica Kogyo Co., Mitsui & Co. Ltd. (Japan)
Set up joint venture, Kunshan Aica Kogyo Co., to produce construction chemicals in Kunshan, Jiangsu. $3 million. 05/03.

Far Eastern Polychem Industries Ltd. (Hong Kong)
Will form joint venture, Oriental Petrochemical (Shanghai) Corp., with two Taiwan companies to build a purified terephthalic acid production plant in Shanghai. (Hong Kong:11%-Taiwan:89%). $101.5 million. 05/03.

OTHER

Alltech Associates, Inc., a subsidiary of Alltech International Holdings, Inc. (US)
Opened office in Guangzhou, Guangdong. 03/03.

BASF AG (Germany)
Opened office in Qingdao, Shandong. 03/03.

BASF AG (Germany)/SINOPEC, Yangtze Petrochemical Co. (Jiangsu)
Signed agreement to raise funds for petrochemical project, Yangtze Petrochem-BASF Co. Ltd., in Nanjing. (Germany:50%-PRC:50%). 03/03.

Celanese Acetate LLC, a subsidiary of Celanese AG (Germany)/China National Tobacco Corp. (Beijing)
Signed agreement to double production at their three joint ventures, Nantong Cellulose Fibers Co. in Jiangsu; Zhuhai Cellulose Fibers Co. in Guangdong; and Kunming Cellulose Fibers Co. in Yunnan. 03/03.

Consulting

CHINA'S IMPORTS

Unisys (US)
Won contract from Air China to establish an IT network between its international offices and to provide maintenance and engineering consulting services. 05/03.

INVESTMENTS IN CHINA

Usugidenkai (Japan)/Ferrotech Shanghai, Ferrotech (Beijing)
Will form joint venture for technical consulting on precision plating in Shanghai. (Japan:30%-PRC:70%). $250,000. 05/03.

Distribution, Logistics, & Related Services

INVESTMENTS IN CHINA

Capstone & Co. LLC, Dynamic I-T Inc. (US)/UID International (Holdings) Co. Ltd. (Beijing)
Formed joint management and finance venture to facilitate Chinese SME exports to US markets. 04/03.

OTHER

TPG NV (the Netherlands)/State Postal Bureau
Signed MOU to cooperate in exploring global markets in mail, express delivery, and logistics. 04/03.

Electronics, Hardware, & Software

INVESTMENTS IN CHINA

vMoksha Technologies (India)/CDC Outsourcing Co., a subsidiary of chinadotcom Corp. (Shanghai)

Will form Shanghai-based joint venture to serve international IT outsourcing clients. (PRC:51%-India:49%). 05/03.

Ultimate Semiconductor Co. (Malaysia)

Signed agreement with Shanghai city government to build a 6-inch and 8-inch chip manufacturing factory. $400 million. 04/03.

MSI Pacific International Holding Co., a subsidiary of Micro-Star International Co. Ltd. (Taiwan)

Increased its stake in its computer notebook production joint venture in Kunshan, Jiangsu, with South Korea's LG Electronics. (Taiwan:49%-South Korea:51%). $882,000. 03/03.

NEC Corp. (Japan)/SVA Information Industry Co. (Shanghai)

Will form LCD panel joint venture to start production in October 2004 in Shanghai. (Japan:25%-PRC:75%). $417 million. 03/03.

OTHER

CDC Software Corp., a subsidiary of chinadotcom Corp. (Shanghai)

Signed a master distribution agreement with Ross Systems Inc. to sell and service Ross's enterprise resources planning software. 05/03.

Infineon Technologies AG (Germany)

Will transfer 300mm and 0.11-um DRAM technology to Semiconductor Manufacturing International Corp. in exchange for exclusive production lines. 04/03.

Dell Computer Corp. (US)

Launched new portfolio of IT management solutions in China. 03/03.

Energy & Electric Power

CHINA'S IMPORTS

Alstom Co. (France)

Won contract to build China's biggest circulating fluidized bed (CFB) boiler in Baima, Sichuan, and transfer CFB technology to Chinese boiler manufacturers. $71.5 million. 04/03.

INVESTMENTS IN CHINA

SembCorp Utilities, a subsidiary of SembCorp Industries Ltd. (Singapore)/Shanghai Chemical Industrial Park Development Co., Shanghai Electrical Power Co., Shanghai Shenergy Co.

Will form joint venture, Shanghai Caojing Cogeneration Co., to build China's largest gas-fired cogeneration power plant. (Singapore:30%-PRC:70%). $418.6 million. 04/03.

Environmental Equipment & Technology

CHINA'S EXPORTS

Malaysia-China Hydro Joint Venture, a joint venture between Sime JV (Malaysia) and China Water Resources and Hydropower Engineering Corp. (Beijing)

Won contract from Sarawak Hidro Sdn Bhd (Malaysia) for work on the Bakun hydroelectric dam in Malaysia. $217 million. 03/03.

INVESTMENTS IN CHINA

Dayen Environmental (Singapore)/Shenyang Aircraft Corp. (Liaoning)

Will form joint venture to build water and waste environmental works in Liaoning. (Singapore:51%-PRC:49%). $2.5 million. 04/03.

Food & Food Processing

CHINA'S INVESTMENTS ABROAD

Sanyuan Foods Co. Ltd. (Beijing)/Australia Challenge Cooperative Dairy Co. Ltd.

Formed a milk-powder and cheese production venture, the Australia Sanyuan-Challenge Dairy Co. Ltd., in Australia. (PRC:50%-Australia:50%). $27 million. 03/03.

INVESTMENTS IN CHINA

Interbrew SA (Belgium)

Acquired 70% stake in K.K. Brewery (KKB), the leading brewer in Zhejiang, and sold KKB's Yunnan operations. $35 million. 04/03.

Ng Fung Hong Ltd. (Hong Kong)/Shanghai New Asia (Group) Co.

Formed joint venture, Shanghai Meat Processing Center, to build a modern slaughterhouse and meat processing plant. (Hong Kong:51%-PRC:49%). $43.5 million. 04/03.

Archer Daniels Midland Co. (US), Wilmar Holdings (Singapore)

Will construct soy-processing facility in Shanhaiguan, Hebei. 03/03.

Super Coffeemix Manufacturing Ltd. (Singapore)/Xuzhou V V Cereal Co. (Jiangsu)

Will form joint venture, Wuxi V V Super Coffee, to make coffee products in Jiangsu. (Singapore:49%-PRC:51%). $20 million. 03/03.

Insurance

OTHER

AEGON-CNOOC Life Insurance Co. Ltd., a joint venture of AEGON Insurance Group (the Netherlands) and CNOOC

Approved by CIRC to sell policies in Shanghai and started operations. 04/03.

Allianz AG (Germany)

Approved to launch property and casualty insurance operation, Allianz Insurance Co. Guangzhou Branch, in Guangdong. 03/03.

Prudential Plc (UK)

Approved by CIRC for life insurance joint venture with CITIC. (UK:50%-PRC:50%). 03/03.

Skandia Forsakrings AB (Sweden)
Approved by CIRC for life insurance joint venture with Beijing State-Owned Asset Corp. (Sweden:50%-PRC:50%). $24 million. 03/03.

Machinery & Machine Tools

INVESTMENTS IN CHINA

Gunze Ltd. (Japan)/Beiren Group (Beijing)
Will form joint venture, Beiren Gunze Machinery Co. Ltd., to produce and sell peripheral equipment for printing machines. (Japan:52%-PRC:48%). $1.7 million. 05/03.

Herrmann Ultraschalltechnik GmbH (Germany)/Xizi Elevator Group (Zhejiang)
Will form joint venture for ultrasonic welding technology. 05/03.

Tadano Ltd. (Japan)/Beijing Jingcheng Construction Machinery Co.
Formed joint venture, BQ-Tadano (Beijing) Crane Co., to produce cranes for construction use. (Japan:25%-PRC:75%). $20 million. 04/03.

Media, Publishing, & Entertainment

INVESTMENTS IN CHINA

Actoz (South Korea)/Haihong Holdings (Shenzhen)
Will form joint venture, Oriental Interactive Inc., to tap China's booming online game market. $5 million. 05/03.

OTHER

AOL Time Warner (US)
Received a license to broadcast its Mandarin-language China Entertainment Television Broadcast nationwide. 04/03.

Viacom International Inc. (US)
Received approval from SARFT to broadcast a 24-hour MTV channel in the Pearl River delta region. 04/03.

Medical Equipment & Devices

OTHER

MedMira Inc. (Canada)
Received approval from China's State Drug Administration for its three-minute human immunodeficiency virus test and started export production in Halifax, Nova Scotia. 04/03.

Metals, Minerals, & Mining

CHINA'S INVESTMENTS ABROAD

Jinyan Co., a subsidiary of Shandong Gold/CVG Minervan (Venezuela)
Will invest $13 million in joint venture to reactivate dormant gold mine in Venezuela. 04/03.

INVESTMENTS IN CHINA

SKN Resources Ltd. (Canada)/Yunnan Golden Industry Investment Co. Ltd.
Will form gold exploration joint venture in Yunnan. (Canada:70%-PRC:30%). 04/03.

Packaging & Labeling

INVESTMENTS IN CHINA

Chuo Kagaku Co. Ltd., Mitsubishi Corp., Riken Technos Co. Ltd. (Japan)
Will form joint venture to manufacture food packaging stretch film. $8.5 million. 04/03.

PT Sampoerna Percetakan Nusantara (Indonesia)/Jiangyin Liantong Industries Co. Ltd. (Jiangsu)
Will form joint venture, Jiangsu Liantong Sampoerna Printing Co. Ltd., to print packaging for cigarettes and other products. (Indonesia:30%-PRC:70%). $12 million. 03/03.

Petroleum, Natural Gas, & Related Equipment

INVESTMENTS IN CHINA

Hong Kong & China Gas Co. (Hong Kong)/Nanjing General Gas (Jiangsu)
Will set up piped-gas joint venture. (Hong Kong:50%-PRC:50%). $145 million. 03/03.

Hong Kong & China Gas Co. (Hong Kong)/Wuhan Gas & Heat Group (Hubei)
Will set up piped-gas joint venture. (Hong Kong:50%-PRC:50%). $145 million. 03/03.

OTHER

CNPC
Signed MOU with Aurado Exploration Ltd. in Kazakhstan stating its interest in a minimum 51% stake in Liman Block resources. 05/03.

SINOPEC, CNOOC
Blocked from jointly purchasing 16.67% stake in North Caspian Production Sharing Agreement (Kashagan oil and gas field). 05/03.

Sunwing Energy, a subsidiary of Ivanhoe Energy Inc. (Canada)/CITIC Energy, a subsidiary of CITIC (Shanghai)
Signed energy alliance agreement to jointly explore and develop Chinese and overseas energy projects. 04/03.

Ports & Shipping

CHINA'S EXPORTS

Waigaoqiao Shipmaking Co. Ltd. (Shanghai)
Won contract from Greece's Stealth Maritime Corp. for four oil tankers. 04/03.

INVESTMENTS IN CHINA

Eng Kong Investments (China) Ltd., a subsidiary of Eng Kong Holding Ltd. (Singapore)/Qingdao Sanbaotong (Shandong)
Formed joint venture, Qingdao Eng Kong Container Services Co. Ltd., to provide container depot services in Qingdao. (Singapore:70%-PRC:30%). $2.9 million. 04/03.

Raw Materials

CHINA'S IMPORTS

Morgan Construction Co. (US)
Won contract from Shandong Shiheng Special Steel Co. Ltd. to supply equipment for steel rod mill. 04/03.

CHINA'S INVESTMENTS ABROAD

China Steel Corp. (Taiwan), Sumitomo Metal Industries Ltd., Sumitomo Corp. (Japan)
Will form joint venture, East Asia United Steel Corp., to supply steel slabs in Tokyo for China Steel. (Taiwan:33%-Japan:67%). $253 million. 05/03.

INVESTMENTS IN CHINA

Taiwan Cement Corp./Liuzhou Iron & Steel (Group) Co. (Guangxi)
Will form joint venture to produce slag-based construction material. (Taiwan:60%-PRC:40%). $15 million. 04/03.

OTHER

Baosteel Group International Trade Corp., a subsidiary of Baosteel Group (Shanghai)/Jiangsu CP Xingcheng Special Steel Co. Ltd.
Signed partnership agreement on joint procurement of steel scrap imports. 05/03.

Research & Development

CHINA'S INVESTMENTS ABROAD

Dalian Zhen-AO Bioengineering Co. Ltd. (Liaoning)/INS Holdings Bhd (Malaysia)
Formed joint venture to build research and development center in Malaysia and co-brand products. (PRC:50%-Malaysia:50%). $2.4 million. 04/03.

Retail/Wholesale

INVESTMENTS IN CHINA

Distribuidora Internacional de Alimentacion SA, run by Promodes SA, a unit of Carrefour SA (France)/Shanghai Lianhua Supermarket Co.
Will form joint venture, Shanghai Dia Lianhua Retailing Co., in Shanghai. (France:55%-PRC:45%). $11.2 million. 03/03.

OTHER

Shanghai Yibai (Group) Co. Ltd.
Bought 51% of Shanghai Orient Shopping Center from Shanghai Industrial Holding Co. Ltd. to become sole owner. $14.5 million. 05/03.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co. Ltd. (Guangdong)
Won contract from Omantel to expand Oman's telecom network capacity. $19 million. 04/03.

Zhongxing Telecom (ZTE) Corp. (Guangdong)
Won contract from Government of Ethiopia to expand GSM network from 50,000 to 200,000 lines. $29 million. 04/03.

CHINA'S IMPORTS

Gilat Satellite Networks Ltd. (Israel)
Won contract from China Telecom to build a large-scale, satellite-based, rural telephony network in Tibet. 05/03.

Nortel Networks Ltd. (US)
Won contract from Shandong Unicom, a subsidiary of China Unicom, to deploy an optical backbone in Shandong. 05/03.

UTStarcom, Inc. (US)
Won contract from China Telecom to expand PAS networks in Jiangsu. $20 million. 05/03.

ViaSat Inc. (US)
Won contract from Beijing Application Institute of Information Technology to expand its private satellite-based networks. 05/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contract from Ningxia Mobile to expand its GSM mobile network. 04/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contract from National Power Telecommunications Center to build a transmission backbone network from Hubei to Guangdong. 04/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contract from Shanghai Mobile Communications Co. Ltd. to expand its GSM mobile network. 04/03.

Lucent Technologies (US)
Won contract from Shandong Unicom, a subsidiary of China Unicom, to build a high-capacity optical network in Shandong. 04/03.

Nokia Corp. (Japan)/Beijing Just Top Network Communications Co.
Signed contract to jointly build digital mobile radio communications network in Beijing area. 04/03.

Nortel Networks Ltd. (US)
Won contract from government of Yangpu, Shanghai, for network equipment and solutions. 04/03.

Nortel Networks Ltd. (US)
Won contract from Hainan Telecom, a subsidiary of China Telecom, for equipment to upgrade its fixed-line ATM network in Hainan. 04/03.

Sharp Corp. (Japan)
Won contract to supply Datang Telecom Technology Co. in Beijing with camera-equipped GSM cell phones. 04/03.

UTStarcom, Inc. (US)
Won contract from China Netcom for deployment of PAS networks in Beijing. $17.5 million. 04/03.

UTStarcom, Inc. (US)
Won contract from China Netcom for expansion of its PAS network in Yunnan. $30 million. 04/03.

Cisco Systems, Inc., Ingram Micro Inc. (US)/China Netcom, Red Sail Telecom Co. (Beijing)
Formed alliance to provide broadband communication services to SMEs in China. 03/03.

UTStarcom, Inc. (US)
Won contract from China Telecom for expansion of PAS networks in Jiangsu and Guangdong. $40 million. 03/03.

INVESTMENTS IN CHINA

Concerto Software, Inc. (US), New World Xianglong Communication Ltd. (Hong Kong)
Will form joint venture, Concerto Software New World, to provide call center support in Shanghai, Beijing, and Guangzhou. 04/03.

Solectron Corp. (US)/Guangzhou Soutec (Group) Technology Co. Ltd. (Guangdong)
Will form joint venture, Soutectron Technology (Guangzhou) Co. Ltd., to design, market, and produce cell phones. 04/03.

3Com Corp. (US)/Huawei Technologies Co. Ltd. (Beijing)
Will form network equipment joint venture, 3Com-Huawei, with offices in Hong Kong and Hangzhou, Zhejiang. (US:49%-PRC:51%). 03/03.

Digital Aria Co. Ltd. (South Korea)/China Putian Capital Group (Beijing)
Will form a joint venture to make Flash animations available over mobile phones (South Korea:49%-PRC:51%). $1.2 million. 03/03.

Sumitomo Corp. (Japan)/Walden International Investment Group (US)
Bought stake in United Platform Technologies Inc., a telecom equipment manufacturer in Beijing. $21.1 million. 03/03.

OTHER

Nokia Corp. (Japan)
Will consolidate joint ventures in China into one large firm and start production of CDMA phones. 04/03.

Textiles & Apparel

CHINA'S IMPORTS

Zimmer AG (Germany)
Won contract from Jiangsu Hengli Chemical Fibre Co. Ltd. to construct a direct spinning plant for polyester. $35.2 million. 03/03.

INVESTMENTS IN CHINA

Ronco Trading Co. Ltd., a subsidiary of Rontex International Holdings Ltd. (Hong Kong)/Yan Ai Lin
Will form a knitwear joint venture. (Hong Kong:48%-PRC:52%). $1.2 million. 04/03.

Tourism & Hotels

CHINA'S IMPORTS

Starwood Hotels & Resorts Worldwide, Inc. (US)
Won contract from Sichuan Xinchengxin Industrial Co. Ltd. to operate and manage the Sheraton Jiuzhaigou Hotel. 04/03.

In the September-October 2003 Issue:

THE SUPPLY CHAIN

- Distribution, Logistics, and the WTO
- Sourcing for Small Companies
- Wal-Mart in China

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STRUCTURAL ANALYSIS IN THE SOCIAL SCIENCES 21

Social Connections in China

Institutions, Culture, and the Changing Nature of *Guanxi*

Edited by Thomas Gold, Doug Guthrie, and David Wank

Social Connections in China: Institutions, Culture, and the Changing Nature of *Guanxi*

edited by Thomas Gold, Doug Guthrie, and David Wank.
New York: Cambridge University Press, 2002. 272 pp.
$60 hardcover, $22 softcover.

Connections are universally useful in social and business activities. In *Social Connections in China: Institutions, Culture and the Changing Nature of Guanxi*, Thomas Gold, former chair of the Center for Chinese Studies at the University of California, Berkeley; Doug Guthrie, professor of Sociology at New York University; and David Wank, of Sophia University in Tokyo, edit a volume of pieces that attempt to assess the role of *guanxi* in modern China. Some authors argue that *guanxi* itself inhibits the development of modern Chinese society. Others argue that it is—and will continue to be—a necessary regulating factor in ensuring efficiency in social, economic, and legal interactions.

The book begins with an insightful overview of the recent scholarship on *guanxi*, which attempts to define, first, which practices should be considered *guanxi*. The second part examines the methodological and conceptual considerations of *guanxi*, including the problems in evaluating its effectiveness in China, and the third-party effects of its use.

Most of the book delves into the question of the prevalence of *guanxi* in various aspects of Chinese life today. The discussion examines the way *guanxi* is used in economic relations, its influence on the shape of business-state relations, and its role in China's emerging labor markets. The book also analyzes the degree to which *guanxi* is used in job searches in urban China, the connection between *guanxi* and the Chinese concept of face, whether *guanxi* compliments or contradicts the development of China's legal system, the link between *guanxi* and gossip in social interactions, and the ways in which individuals can foster *guanxi*.

Though each chapter could stand on its own, the book's main purpose is to demonstrate that *guanxi* is still present in many aspects of Chinese social and business interaction today. The question the book raises is whether relationships, in the midst of China's massive institutional change, will maintain their importance. All authors, save for Guthrie, agree they will.

Guthrie not only examines the problems inherent in measuring the extent to which *guanxi* produces tangible results, but also argues that the tendency to use *guanxi* is a result of one's social standing. In China's unequal society, those in the upper social strata rely on it less than those at the bottom.

Because of China's increasing integration with the rest of the world, *guanxi* is an important phenomenon to understand in business relations. As the PRC government and Chinese Communist Party system continues to loosen its draconian grip on society, and in light of China's entry into the World Trade Organization, it will be interesting to see the role that *guanxi* plays in its developing legal and economic systems. Though the book primarily deals with urban China, it would be richer if it had explored the role of *guanxi* in China's ethnic minority communities (unless *guanxi* is predominately a mark of Han Chinese culture).

Social Connections in China is a well-written and thought-provoking investigation of the use of *guanxi* in business and social dealings in China today. It is a useful book for those interested in sociology, cultural anthropology, law, and business—and provides great insight into the undercurrents of the Chinese political world today. —*Shannon Conrad*

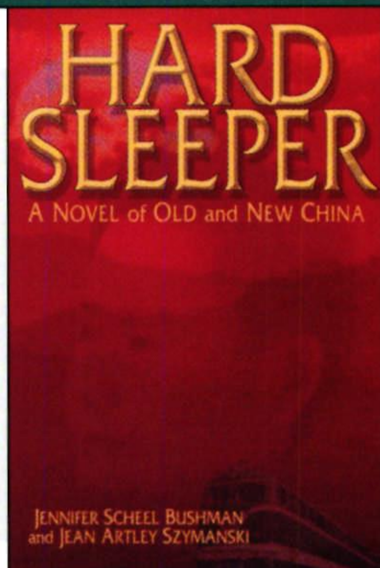
Shannon Conrad is an information specialist focusing on China and Tibet in the East Asian Research Division of the Voice of America.

China Wireless Landscape (wall chart)

London: ARCchart (*www.arcchart.com*), 2002. Size: A1 (841mm x 594mm). $99.

China Wireless Landscape is a fairly comprehensive wall chart of wireless activity in mainland China, excluding Hong Kong and Macao. Produced by ARCchart Ltd. and researched and designed in association with Beijing-based MFC Insight, the chart includes data through May 2002 and was published in September 2002. (The chart will be updated in September 2003.) All of the data is also available for purchase in a spreadsheet format. Overall, the chart provides a detailed yet easy-to-read visual snapshot of China's wireless technology market.

The chart's centerpiece is a map of China that lists data for each province: subscribers by global system for mobile communication (GSM), general packet radio service (GPRS), code-division multiple access (CDMA), and personal access services (PAS); primarily mobile service providers; monthly average revenue per



Hard Sleeper

by Jennifer Scheel Bushman and Jean Artley Szymanski. Fort Bragg, CA: Lost Coast Press, 2003. 253 pp. $24.95 hardcover.

Hard Sleeper, so named because the story is partially set in a Chinese hard-sleeper train car, is a gripping novel that addresses change, war, family, and mother-daughter bonds. The story unfolds in contemporary times, when an American documentary film producer, Pippa James, attempts to flesh out a documentary lead on a mother-daughter reunion in Chengdu, Sichuan. She is told that the mother, Jane McPherson, is an elderly American who has not seen her half-Chinese daughter, Di Meihua (Mei), for roughly 60 years. Jane, who was born and raised in China until she was 17, and Mei slowly share their life stories with Pippa over the course of a cross-country train ride.

Through a series of flashbacks, readers learn that Jane's parents were missionaries in Beijing in the 1920s and 1930s. After Jane's mother and father are murdered, Jane and her brother move to Shanghai to live with family friends whose lifestyles clash with their missionary upbringing. Because of their parents' unsolved murder—and several other unanswered questions—the novel quickly becomes a suspenseful, page-turning mystery.

The stories of the two women unfold against the backdrop of China in the 1930s, a period marked by the dominance of foreign concessions and other humiliating legacies of the Opium War, warlordism, poverty, internal strife, and the Anti-Japanese War leading up to World War II. *Hard Sleeper* details foreign missionary life as well as the life of swanky, party-hopping Western businesspeople in Shanghai. An American Sinophile who adopts Chinese ways and has many Chinese friends is contrasted with foreigners who live in China years without learning a word of Chinese. Chinese friends, missionaries, servants, communists, businesspeople, and gangsters are also portrayed. Race and class problems pervade the story. At one point, contemporary-era Jane questions whether feelings between foreigners and Chinese have changed over the decades or whether there is still underlying prejudice.

The story's main character, Jane, retains her positive outlook on life despite a series of devastating events, and when she looks back at her early years in China, she finds that "tragedy led to blessing"—a reference to her personal life and to China's history. But even with these positive affirmations, I was exhausted by the myriad of plot twists and personal tragedies.

All in all, *Hard Sleeper* is a fast-paced book that is suitable for a wide range of readers, including those with little knowledge of China (because Pippa is a China novice, ample historical background is provided). The novel will satisfy readers interested in China, history, and mysteries, among other subjects.

The authors—Jean Artley Szymanski, a former foreign service officer in Beijing, and Jennifer Scheel Bushman, who has lived and worked in several countries—wrote as a mother-daughter team. They undoubtedly worked closely over long nights on the book—a project that focused on mother-daughter relations. Adding to the weight of the personal tragedies in the book, Jean Szymanski died of breast cancer in 1998, shortly after the book's completion.

—*Paula M. Miller*

Paula M. Miller is assistant editor, *The CBR*.

user (ARPU); network construction contracts; and mobile penetration rate. A side chart compares the average provincial ARPU and total subscribers for each province.

A small but useful section of the chart is a series of pie graphs detailing equipment vendor network building contracts for each mobile technology: GSM, GPRS, CDMA, and PAS. A corresponding section on mobile handset providers would have been a useful addition. The final part of the chart lists China's telecom service providers and their ownership structures, including overseas listings.

—*Julie Walton*

Julie Walton is Business Advisory Services associate at The US-China Business Council in Washington, DC.

中国税收流失问题研究

贾绍华 著

Research on China's Lost Tax Revenue

by Jia Shaohua. Beijing: Finance and Economics Publishing House of China, 2002. 477pp. ¥32 ($3.87) softcover.

Recent studies by Chinese researchers have attempted to determine the amount of money lost to China's economy and government budget through smuggling, corruption, capital flight, and value-added tax rebate fraud. In 2002, the country focused unprecedented attention on a crackdown on tax evasion by individuals and companies. The crackdown has coincided with the publication of several studies that try to estimate the amount of money lost to tax evasion, of which Dr. Jia Shaohua's *Research on China's Lost Tax Revenue* has had the highest profile.

Jia, a professor of economics and presently director of the State Administration of Taxation's Yangzhou Tax Reform Institute in Jiangsu, has produced a comprehensive analysis of the losses caused by tax evasion in China. Jia defines tax loss as the revenues that should have been collected under current tax law and regulations from both individuals and companies but went unreported or uncollected. With examples and statistics, Jia estimates the extent of China's missing tax revenue by looking at the official "above-ground economy" data and unofficial underground economy estimates. Analyzing data from 1995 to 2000, Jia estimates losses of ¥371.7 billion ($44.9 billion) for the official economy and losses of ¥72.9 billion ($8.8 billion) for the underground economy in 2000. Among other trends, the chart shows that tax loss from personal income tax has been increasing every year as more earners pass the ¥800 ($96.76) monthly income level, the level at which income tax kicks in. Jia estimates that ¥73.2 billion ($8.8 billion) of personal income tax was lost in 2000, two-and-a-half times the amount thought to have been lost in 1997.

Jia then analyzes the reasons for tax loss by employing game theory and budget maximization models. He suggests that tax evasion in China results from an irrationally designed system, which encourages individuals and enterprises to avoid paying taxes. He says that the lack of supervision, monitoring, and even basic collection mechanisms is preventing tax collection at adequate rates.

The third part of Jia's study offers comparisons with other countries that have addressed similar difficulties in tax collection. He introduces practices used in developed countries, as well as in Hong Kong and Taiwan, to produce a list of 12 recommendations to reduce tax evasion in China. The recommendations include tightening supervision of invoices and payments, developing professional tax auditors, raising penalties, and improving the quality of tax administrators. Jia concludes his book with measures the Chinese government should take to control tax evasion, including strengthening the rule of law and educating the public about the benefits they receive from paying taxes.

With the crackdown on tax evasion by celebrities and the recent institution of a revised Law on Levying and Collecting Taxes and its implementing rules, Chinese officials seem to be taking Jia's advice. *Research on China's Lost Tax Revenue* is a helpful reference for government officials and scholars interested in quantifying the magnitude of China's tax collection problems and seeking means to lessen China's fiscal woes.

—*Brian Goldstein and Sharon Liu*

Brian Goldstein is former research manager at The US-China Business Council in Beijing. Sharon Liu, a former intern at the Council's Beijing office, now works for KPMG.

Venture Capital Options Expand—A Bit

Continued from page 27

the distribution or payment, an auditing report, proof of and inspection report on the funds injected by the foreign investors, and proof of tax payment and tax examination reporting form issued by an accounting firm. Profits may be used to purchase foreign exchange for repatriation consistent with relevant laws and regulations. A corporate FIVCE's foreign exchange account, capital distribution, and other foreign exchange receipt and expenditure items are subject to existing foreign exchange management regulations. SAFE is currently drafting foreign exchange regulations for nonlegal person FIVCEs.

As with the provisional regulations, the regulation specifies that FIVCEs are to be taxed according to relevant laws and regulations. FIVCE funds thus are at a disadvantage since more tax-efficient structures are possible using offshore or tax haven structures. Ideally, a FIVCE could pass gains and losses to its investors and its affiliates without incurring taxes, deduct losses generated by investments against gains, and deduct financing costs associated with VC investments. Corporate FIVCEs must submit one comprehensive corporate tax payment. A nonlegal person FIVCE may allocate its tax liability to its individual investors as provided in its operational documents—as long as such allocation is consistent with relevant tax laws. SAT is drafting further regulations on the collection of taxes from nonlegal person FIVCEs.

Termination and liquidation

A FIVCE's term must be stipulated in its organizational documents and normally may not exceed 12 years. MOFCOM must approve any extension of the FIVCE's operating term and must approve a corporate FIVCE's dissolution prior to expiration. A nonlegal person FIVCE may dissolve before its term expires without prior MOFCOM approval if it has disposed of all of its equity investments, satisfied all debts, and provided for capital distribution. In such a case, the nonlegal person FIVCE must submit a notice of dissolution with MOFCOM 30 days before the proposed dissolution date. FIVCEs must apply to SAIC to cancel their registration within 30 days after completing liquidation. This cancellation package must include a report from the FIVCE's management committee, a cancellation application, liquidation report, and other documents as required by applicable laws. The FIVCE will be terminated upon SAIC approval, but the nonlegal person FIVCE's principal investor's obligations extend past the termination of the venture.

Better, but not good enough

The regulation is an ambitious attempt to nurture China's venture capital and high-tech sectors. But it fails to correct many problems carried over from the provisional regulations. In addition to the problems mentioned above, the regulation does not sufficiently address investors' concerns about the transparency and accuracy of an investee company's books and records—requiring FIVCEs to spend significant time and money on due diligence, thus increasing transaction costs.

Despite this and other flaws, the regulation is a positive step in the development of China's VC market. The qualitative and quantitative requirements placed on FIVCE investors show that the regulation is aimed at attracting investors with market experience, not purely financial speculators. Greater foreign involvement in this sector will continue to drive regulatory development, and VC rules no doubt will continue to evolve. 完

Toward a Rules-Based FDI Policy Framework

Continued from page 47

Untapped potential

The vast majority of FDI flows among OECD member countries (which account for more than 90 percent of global FDI flows) are now in the form of cross-border M&A. By contrast, cross-border M&A accounts for a negligible proportion of China's FDI inflows, which come mainly in the form of joint-venture partnerships or greenfield investments. Yet M&A offers a tremendous potential for foreign investors to participate in the restructuring of China's state-owned enterprises, many of which are inefficient and could benefit from new management techniques at least as much as from imported, new technology. One reason for the lack of M&A activity is the uncertain legal status of cross-border M&A in China (*see* p.12). A consistent, coherent, and transparent competitive environment would encourage foreign investors to play a fuller role in state-owned enterprise restructuring.

China's capital markets are largely closed to direct foreign involvement. Foreigners have not, in the past, officially been able to purchase A shares, which constitute the majority of shares on the Shanghai and Shenzhen stock markets. FIEs are not permitted to issue bonds in China; only a handful of FIEs are likely to be allowed to issue shares. Allowing foreign investors to participate in China's capital markets on the same basis as domestic investors would help create depth and liquidity in those markets; it would also allow foreign investors greater flexibility in financing their operations in China and engaging in M&A.

Policy options that will enhance the enabling environment for foreign investors will also be good for domestic investors. A rules-based system can create the transparency and predictability that all businesses need if they are to make large-scale, long-term investments. And China's experience over the past two decades demonstrates that opening sectors to FDI is a surer way of strengthening domestic Chinese companies than protectionism. 完

USCBC

THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

BULLETIN

UPCOMING EVENTS

China and SARS: The Crisis and Its Effect on Politics and the Economy

Washington, DC
July 2, 2003

Featuring Richard Bush, senior fellow and director of Brookings Center for Northeast Asian Policy Studies; Laurie Garrett, medical and science writer for *Newsday* and Peabody, Polk, and Pulitzer prize winner; Robert Kapp, president, The US-China Business Council; and Minxin Pei and Michael D. Swaine, senior associates and co-directors of the China Program, Carnegie Endowment for International Peace. Co-sponsored by the Carnegie Endowment for International Peace, The US-China Business Council, The Brookings Institution, and the Atlantic Council of the United States.

July Issues Luncheon

July 17, 2003
Washington, DC

EVENT WRAP-UP

Washington

May

Issues Luncheon Featured Craig Allen, incoming senior commercial officer, US Embassy in Beijing

China on the Hill Briefing: Discussion of the Economic, Political, and Business Impacts of SARS on China and Beyond Featured Erika Elvander, US Department of Health and Human Services; Robert Kapp, The US-China Business Council; Homi Kharas, the World Bank; David M. Lampton, Johns Hopkins University's School of Advanced International Studies; David Zweig, Hong Kong University of Science and Technology. Supported by Senator Joseph Biden, Representative Phil Crane, Representative Jim Leach, and Representative Donald Manzullo

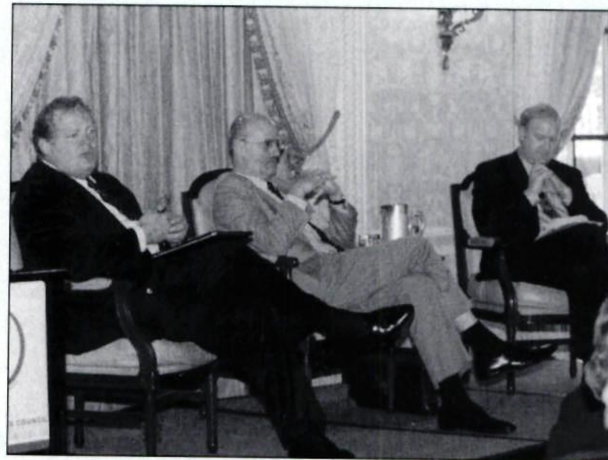
Briefing: Prospects for Economic Development and Cooperation in Asia Featured Long Yongtu, secretary general, Boao Forum for Asia. Hosted by the Center for Strategic and International Studies, the National Committee on US-China Relations, and The US-China Business Council

June

Briefing: Current Standards Issues in China Featured Angela Davis, US Embassy in Beijing; Christine DeVaux, National Institute of Standards and Technology; Matthew Gettman, US Embassy in Beijing; and Timothy Wineland, US Department of Commerce

Quarterly WTO Working Group Briefing: China's WTO Implementation—A Mid-Year Assessment Featured Wendy Cutler, assistant US Trade Representative (USTR), North Asia and Charles Freeman, deputy assistant USTR for China, Taiwan Hong Kong, Macao, and Mongolia

USCBC Hosts 30th Annual Membership Meeting



Aldonas, Kapp, and Craner at the Council's 30th Annual Membership Meeting

The US-China Business Council held its 30th Annual Membership Meeting, China Market 2003, on June 5 in Washington, DC. The meeting's plenary session began with a discussion of the implications of severe acute respiratory syndrome (SARS) for China, led by Patrick Powers and Iain McDaniels of the USCBC's China offices. Victor Yuan of Horizon Research and Roy Sheldon of ITT Industries, Inc. then spoke on consumer market trends in China. Kenneth Lieberthal of the University of Michigan and Margaret Pearson of the University of Maryland presented their views on decisionmaking in China.

At one of two concurrent afternoon sessions, Robert A. Kapp, USCBC; Thomas P. Conley, Toy Industry Association; Richard Herold, BP; and Richard Brecher, Motorola Inc. discussed corporate best practices. The second concurrent session, led by David Fernyhough, Hill and Associates; Douglas Clark, Lovells; and David Simon, Intel Corp., addressed controlling intellectual property in China.

US Under Secretary of Commerce for International Trade Grant Aldonas and US Assistant Secretary of State for Democracy, Human Rights, and Labor Lorne Craner were keynote speakers.

The Smithsonian's 2002 Silk Road folklife festival provided a cultural bridge between East and West

Sandra Kauffman

Imagine walking among Uzbek weavers, Kazakh nomads, and Chinese storytellers; watching martial artists and hearing the unique sounds of singers and musicians from Mongolia and Beijing; discovering an ancient Xi'an Bell Tower; and wandering through a bazaar that overflows with Turkmen carpets, Japanese paper, Uyghur calligraphy, and Turkish ceramics.

Amazingly enough, this vision of the fabled Silk Road came to life on the National Mall in Washington, DC, in June and July 2002, when a 10-day folklife festival showcased the talents of artists and performers from more than 20 Asian and European countries. At a time when US cultural institutions had yet to recover from the events of September 11, 2001, the Smithsonian Institution's multimedia extravaganza broke attendance records, bringing more than 1.3 million people face to face with a world they knew little about. West met East, the privileged met the disenfranchised, the famous met the obscure, and because everyone ate, played, laughed, and philosophized together, minds opened and lives changed. Subtitled "Connecting Cultures, Creating Trust," the Silk Road folklife festival defined the term "cultural exchange" and explained why such exchanges are crucial to the world's continued well-being. The story of the Silk Road festival—a story almost as fascinating as the Silk Road itself—begins with one man, the world-famous cellist Yo-Yo Ma. Born in Paris to Chinese parents, Ma emigrated to New York City where, as a child prodigy, he began exploring his artistic roots. Touring as a performer, he noticed resemblances among instruments from distant countries and often wondered why a specific Chinese folk song sounded so much like a Hungarian one. Because of his own multicultural heritage, he was excited by the similarities between Eastern and Western music, tracing them back to the exchange of ideas along the Silk Road.

Ma launched the Silk Road Project in 1998 to study the musical connections among diverse people. He formed strategic alliances with Dartmouth College Professor Ted Levin and the Aga Khan Trust for Culture. The trust underwrites the preservation and promotion of Central Asian music by funding concerts, recordings, and research. When Levin, an expert in such music, introduced Ma to a number of Central Asian musicians, the Silk Road Ensemble was born. The ensemble travels around the world,

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playing classical and modern compositions—among them 20 new works by nine Silk Road composers—that blend Eastern and Western instruments.

On his journey along the Silk Road, Yo-Yo Ma found that he had much in common with its ancient travelers and that the more people he met, the more possibilities he saw. Vishakha Desai, director of the Asia Society in New York, recalled one of Ma's visits to the museum, where he is a frequent patron and performer. To complement "Monks and Merchants," its own Silk Road exhibit, the society produced—with funding from the Ford Motor Co.—an imaginative teacher's guide that was, in itself, a work of art. After seeing the guide, Ma told Desai that it would be wonderful to add a visual component to the ensemble's music. The ensemble was soon distributing the guides wherever it played. The Silk Road Project was growing. Before long, it was producing lectures and exhibitions, films and folk festivals. Ma's message, stated in the Silk Road festival's program guide, was clear: "By starting a conversation and building shared trust, strangers could become allies, partners, and friends, learning from one another along the way and working creatively together."

A similar philosophy infuses the Smithsonian's Center for Folklife and Cultural Heritage and its annual folklife festival. Perhaps it was inevitable that the two organizations join forces, but their initial meetings were inconclusive. Ma's group was proposing a recreation of the Silk Road in all its multicultural splendor—its sights, sounds, and people. "The conception was fantastic," says Richard Kennedy, the festival's co-curator. "But we didn't think it could be done." Smithsonian festivals normally focus on only two or three countries or regions within countries. The Silk Road stretched from Japan to Italy, traversing mountains, deserts, and plateaus as its trade routes wound through China, India, Central Asia, and the Middle East. Smithsonian organizers asked, Could we represent more than 20 countries? Where can we find practitioners of all the ancient arts? And once found, how do we get them to Washington? The numbers were daunting. "A logistical nightmare," according to Kennedy. But the idea was too intriguing to give up, and the brainstorming began.

Organizing

The first step was to locate the potters, weavers, cooks, porcelain- and paper-makers, gymnasts, musicians, and storytellers who would demonstrate their arts at the festival. The Smithsonian works with institutions around the globe for its projects. A network of 40-50 people—researchers, university professors, and museum staff—seeks out the best available talent. Then comes the weeding and sifting. What are the stories and who will tell them? Does one presenter have an advantage over another? The selection of martial arts groups for the Silk Road Project was a case in point. The multitude of disciplines in China made choosing a definitive group impossible so the Smithsonian opted for a group from the San Francisco Bay area whose work combines elements of several ancient arts and tells the story of those arts through movement. It was a plus that the group was American—what better way to show how one country absorbs and reinvents the traditions of another?

The Smithsonian talent search eventually yielded 350 to 400 people. "That was when we thought the project might just work," Kennedy remarked. But substantial problems remained. Most major international shows come about through high-level, government-to-government negotiations. Had the Smithsonian negotiated on that level with 20 countries, its Silk Road festival might never have gotten off the ground. Kennedy and co-curator Levin simplified matters by keeping a low profile. They relied on their good relationships with provincial governments, rather than central-government officials.

Working only with these provincial governments, Kennedy and Levin managed to secure passports and visas for almost all of the presenters. It was not an easy task. Post-September 11 security measures placed travelers from many Silk Road countries under intense scrutiny, particularly males between the ages of 18 and 45. All were interviewed, and many were asked to substantiate their identities by demonstrating their skills. Some were from obscure villages and lacked the documents needed even to begin the visa process. Others were from young nations carved out of the former Soviet Union whose rules and regulations had yet to be hammered out. Because of diplomatic complications, Iranian participants were forced to seek their visas in Turkey—and Tajiks in Kazakhstan. For months, phone calls, faxes, and e-mails flowed around the world as the Smithsonian's Office of International Relations struggled to get its invitees cleared and into Washington, DC, on time and in good shape. Two esteemed Chinese potters never made it. Chinese officials would not grant them permission to leave the country. The Smithsonian, however, was lucky. In the months since the festival, the United States has cracked down on visas for visitors from many countries, making another show of its size and scope a virtual impossibility.

Funding

The Silk Road Folklife Festival cost $3-4 million to plan, produce, and mount. With its government funding cut back after September 11, the Smithsonian's Center for Folklife and Cultural Heritage—the festival's producers—

worried about where the money would come from. Normally the center works with a region or country that provides financial backing as part of an anniversary or some other special occasion. The fundraising process generally follows a pattern: the state finds money, the Smithsonian finds money, then both go out to seek corporate and individual support. Smithsonian officials did not believe that any country would or could fund its Silk Road project. There were too many countries involved, and many of them were less-developed countries with poor economies. The organizers also doubted the project could secure corporate sponsors. Fortunately they were mistaken. Inspired by Yo-Yo Ma, the Aga Khan Trust put up roughly 40 percent of the money, the Smithsonian put up another 40 percent, and the final 20 percent came from a host of donors, including the National Endowment for the Arts, Ford, the Wolfensohn Family Foundation, Sony Classical, Siemens AG, and Henry Kravis.

If you build it...

On June 26, 2002, a weekday in the midst of one of Washington's famous summer heat waves, the Silk Road festival opened on the National Mall. More than 1,000 people, including cultural coordinators fluent in two dozen languages, had worked for two years to bring it there. Still, worries remained. Like New York City, Washington, DC, relies on tourists to fill its great museums and historic buildings. Since September 11, 2001 those tourists had been noticeably absent and, despite a multimedia publicity blitz, no one really knew if they would show up at the festival. As it turned out, they did not. But Washingtonians did—in record numbers. They jammed the tents to hear Yo-Yo Ma and the Silk Road Ensemble riff with a Kazakh folk-rock group, to admire Mongolian wrestlers, Persian bodybuilders, Japanese dance theatre, puppeteers from Italy, Beijing Opera, and fashion shows staged by designers from Uzbekistan and Kyrgyzstan. On the 20-acre Mall, they mingled with Buddhist monks, Tuvan throat singers, dervishes from Turkey, and Silk Road cooks; and they ogled yurts and camels, and brilliantly painted trucks from Pakistan. In the Freer Gallery of Art, the Arthur M. Sackler Gallery, the National Gallery of Art, and the National Museum of Natural History, they listened to storytellers, watched movies, and studied paintings and photographs. Crowds came for the dazzling sights and sounds and smells, but they also came to learn.

Commenting on the festival's success, press reports suggested that after September 11, many Americans sought to understand unfamiliar places and cultures. At the festival they were able to do just that.

The Silk Road festival ran in more than one direction, however. While Americans were soaking up diverse cultures, so were the festival's artists and performers. Many came from remote villages, had never seen the capital cities of their own countries, had never been away from home before, and had never met a foreign person. Several expressed shock that other people would be interested in what they did. Most felt that their visit enlarged their art and, in only 10 days, changed their outlook from local to global.

Indrani DeSilva, one of the event's cultural coordinators, recalls a transforming moment, "the kind of thing you hope will happen, but can never plan." Every night from 9:00 pm to 2:00 am, the Smithsonian held socials to break the ice among festival participants and organizers. At first, people were friendly, but restrained. But one night a young Mongolian rock group—throat singers, percussionists, zither players—took the stage set up in the meeting areas and began to jam. Suddenly classical Indian singers with hand instruments joined in. Soon 12 other instrumentalists were onstage improvising, learning how to meld their wildly disparate sounds into incredible music.

Positive results

Richard Kennedy still marvels that "it all worked. All got visas, all got on the plane, no one collapsed, there were no heart attacks."

By any standard, the Silk Road festival was a hit, truly connecting cultures and identifying common threads. But what now? Richard Kurin, director of the Center, and Diana Parker, director of the festival, suggest that cultural connections should encourage people to explore their own potential. The directors believe that, especially after September 11, it is immensely important for people and societies to know their neighbors and to learn of and from them, and that insularity and xenophobia are recipes for disaster in a complicated world.

Kathy Mathieson, one of the festival's storytellers, expressed her mission this way: "My parents came from mainland China, I was born in Taiwan, and I am an American citizen. I am a bridge. There are wide bridges and narrow bridges. Yo-Yo Ma is a wide bridge, I am only a narrow one, but I am a bridge nonetheless. That is why I have to tell my stories." 完

The Smithsonian's Silk Road and the Silk Road Ensemble

For information about the Smithsonian's continuing Silk Road events, its storytelling project, and teacher's guides, see *www.silkroadproject.org/ smithsonian*. To invite storytellers to your school or organization, or to join the group, e-mail silkroadstories@asia.si.edu or call 202-357-4880, x350.

For information about Yo-Yo Ma and the Silk Road Ensemble, visit *www.silkroadproject.org*.

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Short Takes

Beijing Lifts Hotel Restrictions for Foreigners

The Beijing city government recently lifted a regulation that has restricted foreigners to government-designated hotels for more than 50 years. Since May 28, foreigners may stay at any hotel within eight Beijing districts, including Chaoyang, Chongwen, and Dongcheng. On October 1, the Beijing city government will open all Beijing hotels to foreigners.

Many other areas in China (including Guangdong, Hubei, Jiangxi, Shanghai, and Yunnan) have already removed accommodation restrictions.

US-China Legal Cooperation Fund Awards Six New Grants

The US-China Legal Cooperation Fund announced on June 3 six new awards in its ninth round of grants supporting China's legal development. Each grant will assist a joint effort by American and Chinese lawyers, scholars, and civil society workers. Sustained by corporate donations since its founding in 1998, the US-China Legal Cooperation Fund is a program of The China Business Forum, the education and research arm of The US-China Business Council. For details about the new awards, see *http://www.uschina.org/public/documents/2003/06/03-legalfund.html.*

Obscure Chinese Names Under Fire

The State Language Working Committee, a division under China's Department of Education, is working with state ministries and academic institutions to create the Regulation on Chinese Names. The regulation aims to prevent parents from giving their new-born children obscure Chinese names. The committee believes that rare Chinese characters are unrecognizable to many and are not contained in word-processing programs. Up to 50,000 characters may be banned—leaving only 10,000 for parents to choose from.

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