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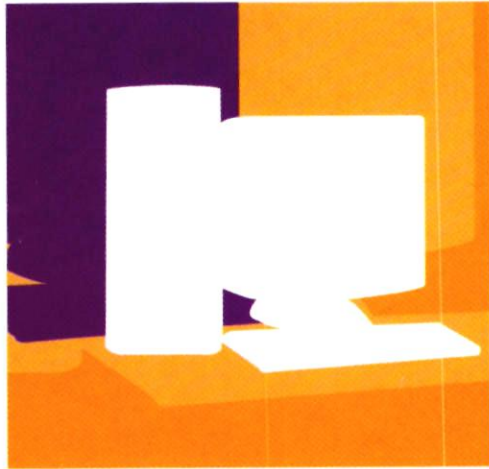
# CHINA BUSINESS



THE MAGAZINE OF  
THE US-CHINA BUSINESS COUNCIL

**R E V I E W**

## CHINA'S CONSUMER CULTURE



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**CHINA BUSINESS**  
R E V I E W

 THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

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## Short Takes

### Hong Kong and Southern Provinces Form "9+2" Regional Bloc

Nine provinces and two special administrative regions joined together in June to form a regional economic bloc with a population of similar size to that of the European Union. The members—special administrative regions Hong Kong and Macao, and the provinces of Fujian, Guangdong, Guangxi, Guizhou, Hainan, Hunan, Jiangxi, Sichuan, and Yunnan—will work together to eliminate nontariff trade barriers within the region and to coordinate provincial government policy.

The first meeting of the Pan-Pearl River Delta Regional Cooperation and Development Forum, in the first week of June, focused on internal transportation ties and other regional projects. Observers note that the forum's formation, which was suggested by Guangdong last August, shows a remarkable tolerance by a central government traditionally more cautious of regional independence.

### Newbridge Takes Controlling Stake in Shenzhen Development Bank (At Last)

A year after an agreement between Newbridge Capital Group and Shenzhen Development Bank (SDB) publicly fell apart, SDB announced that Newbridge will take a controlling, 17.89 percent stake, according to press reports. Newbridge will become SDB's single largest shareholder, will be entitled to a majority of board seats under Chinese law, and will become the first foreign investor to control a Chinese bank.

Four government shareholders—Shenzhen Investment Management Co., Shenzhen International Trust and Investment Co., Shenzhen Social Security Co., and Shenzhen Changjian Development Group—will sell 348.1 million non-tradable shares to Newbridge for roughly \$150 million. This amount is far less than the stake's market value, but stock prices in China are generally considered overvalued because of the scarcity of investment options, and strategic investors rarely pay market price for their stakes.

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Ray Hu, an ExxonMobil China employee with Zhang Chun-yan and Qin Wu-bing, two of the students receiving our donation. Qin wrote, "My parents are in poor health, my family has become gradually poorer. Yet, I'm still very fortunate, as I still have the warmth of my family and also have received your help... this has given us the confidence and courage to carry on in life--shining our path forward."



Some of the students who will further their education due to help from ExxonMobil China employees.



Zhang's proud mother with her daughter's numerous scholastic awards on the wall. She said thankfully, "Without your company's help last year, Chun-yan would have to drop out of school."

"On February 28, 2004, I was on another journey to China's Three Gorges. I had been there over 100 times through the years on company business, but this time it was different. Last September and this January, our company donated some money to San Dou Ping Middle School near the Three Gorges. On this trip, I went to visit the home of Zhang Chun-yan (one of the students) deep in the big mountains of the Three Gorges." -- Ray Hu, Infrastructure/Agriculture Manager, Autolubes, ExxonMobil Hong Kong Limited

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**EVENT WRAP-UP**

(Left to right) USCBC Vice Chair and Barbara Franklin Enterprises President and CEO Barbara Hackman Franklin, PRC Ambassador Yang Jiechi, PRC Vice Premier Wu Yi, interpreter I-chuan Chen, and USCBC President Robert A. Kapp at the April 22 dinner in honor of Wu.

(Photograph by Ian Wagreich, US Chamber of Commerce)

**Washington****April**

**Dinner in Honor of PRC Vice Premier Wu Yi** Hosted by the National Committee on United States-China Relations, US Chamber of Commerce, and the US-China Business Council (USCBC), the reception and dinner honored Wu, senior members of the PRC Delegation to the US-China Joint Commission on Commerce and Trade, and China Council for the Promotion of International Trade (CCPIT) business representatives. The Honorable Barbara Hackman Franklin, vice chair of USCBC and president and CEO of Barbara Franklin Enterprises, offered opening remarks before Vice Premier Wu's speech. More than 450 business leaders, government officials, and academics attended the event.

**Meeting with Sharon Mann, Senior Director, US Department of Commerce Trade Facilitation Office (Beijing)** Mann briefed USCBC members on the Trade Facilitation Office's focus and activities and discussed the priorities and concerns of member companies.

**May**

**Breakfast Meeting in Honor of China's National Development and Reform Commission (NDRC) Vice Chair Zhu Zhixin** Vice Chair Zhu and the NDRC delegation were joined by Alan P. Larson, under secretary for Economics, Business, and Agricultural Affairs at the US State Department, and other senior officials from the State Department and the PRC Embassy.

**UPCOMING EVENTS****Issues Luncheons, Washington, DC**

September 16, 2004

October 21, 2004

**China Operations Conference, Shanghai**

October 21, 2004

**2008 Olympics: Do Opportunities for US Companies Still Exist?** Featured Gilbert Van Kerckhove, managing director of Beijing Global Strategy Consulting Co. Ltd.

**June**

**Biennial Gala 2004 and 31st Annual Membership Meeting** (see right)

**Issues Luncheon** Featured Joseph Donovan, director, Office of Chinese and Mongolian Affairs, and several members of his China Desk staff for an informal, off-the-record discussion on current US-China issues.

**Breakfast Meeting in Honor of Ministry of Information Industry (MII) Minister Wang Xudong** Featured Wang and an MII delegation.

**Beijing****May**

**US-China Logistics Conference** At the two-day seminar on logistics in China, co-hosted by the USCBC, Coalition of Service Industries, Department of Commerce, and NDRC, US speakers discussed the development of US logistics systems and PRC speakers discussed modernizing China's logistics industry.

**Governor's Forum Luncheon** The USCBC inaugurated a new series of "Governor's Forum" programs, co-hosted with CCPIT. Chongqing Mayor Wang Hongju and Vice Mayor Wu Jianong, who is responsible for foreign investment in Chongqing, were the Council's honored guests for the first forum. The event, conducted largely in Mandarin but with translation when necessary, was well received by attendees, most of whom got a chance to speak with the mayor or vice mayor individually. The format for this event series requires our guests to move from table to table with an interpreter and meet the attendees directly after a brief introductory speech. Future programs will feature governors and big-city mayors from around China.

**Shanghai****May**

**Trading and Distribution Rights: What Changes and What It Means** Featured John V. Grobowski from Baker & McKenzie and Thomas M. Shoesmith from Paul, Hastings, Janofsky & Walker LLP.

# USCBC Gala 2004



(Left to right) Josette Shiner, deputy US Trade Representative; Michael Kennedy, Motorola, Inc.; Deven Sharma, Mc-Graw-Hill Companies, Inc.; and PRC Ambassador Yang at the USCBC's Gala celebration.

USCBC Chair and UPS Chairman and CEO Michael L. Eskew, presents Ambassador Yang with a distinguished service award.

United States Institute of Peace President Richard H. Solomon addressing Gala guests.

With roughly 370 guests in attendance, including corporate executives, academics, and US and PRC public officials, the USCBC Biennial Gala honored PRC Ambassador Yang Jiechi. UPS Chairman and CEO Michael L. Eskew, as USCBC chair, welcomed guests on behalf of the USCBC and presented Yang with a distinguished service award. After Yang's brief remarks, United States Institute of Peace President Dr. Richard Solomon delivered the dinner address, "Managing the Great Asian Transformation: Challenges and Opportunities in US-China Relations."

## Annual Membership Meeting



Luncheon keynote speaker Stephen S. Roach, managing director and chief economist, Morgan Stanley.

(Left to right) USCBC President Kapp and morning panelists Loring W. Knoblauch, Underwriters Laboratories, Inc.; Alan P. Larson, the US State Department; and David W. Raisbeck, Cargill Inc.

The USCBC's 31st Annual Membership Meeting began on June 4 with a morning discussion on China's manufacturing, commodities, and transportation sectors led, respectively, by Loring W. Knoblauch, president and CEO of Underwriters Laboratories, Inc.; David W. Raisbeck, vice chair of Cargill Inc.; and Alan P. Larson of the US Department of State. Charles E. Cook, Jr., editor and publisher of the *Cook Political Report* and political analyst for the National Journal Group, then gave a lively overview of the current state of US presidential politics. Stephen S. Roach, managing director and chief economist at Morgan Stanley, shared his entertaining and valuable perspective on the Chinese economy in his luncheon keynote address, "China's Economic Prospects: The Boom Heard Round the World?"

(Photographs by Kaveh Sardari)



## THE US-CHINA BUSINESS COUNCIL

美中贸易全国委员会

### Robert A. Kapp

PRESIDENT, THE US-CHINA BUSINESS COUNCIL



*After 10 years at the helm of the US-China Business Council, Robert A. Kapp will leave his position in fall 2004.*

## Dear Successor,

It's time to begin wrapping up 10 years of fascinating work at the US-China Business Council and to leave a few pointers behind for you.

You will lead a wonderful organization, with a strong base of several hundred US companies and firms ranging from 30-year veterans to companies new to China. They will expect thoroughness and extremely high competence levels from the Council and will provide you with invaluable support. You have in the Council the resources with which to serve your member companies well.

You will lead an organization whose reputation for commitment to the enhancement of US-China economic and commercial ties is unparalleled. You will find many warm welcomes in China from the Council's wide network of US and Chinese business friends and counterparts.

In Washington, you will enter a dense network of political figures, civil servants, policy researchers, nongovernmental representatives, journalists, and polemicists who know the Council well and respect its voice even when they do not share its views. You will also meet those who do not wish you well.

As you prepare to settle in, let me offer a few observations for you, and a few recommendations as well.

**1 Observation:** Commercial interaction with China is the core of the US-China engagement, but it cannot and should not always be isolated from other dimensions of US-China relations.

**Recommendation:** You must master the larger themes in US-China relations if you are to advance the ideas and the concerns of the American companies whose interests the Council exists to advance.

Business issues often need to be seen exactly as that, and not loaded down with the baggage and the sensitivities attending other aspects of

the US-China encounter. This is business's traditional (and often valid) response to other voices demanding the linkage of trade and non-trade questions, for example in trade agreements.

But in the end US-China trade and business relations are inherently political, in both countries. Especially as China's economic and political footprint continues to grow, the nature of our politics ensures that trade and non-trade policy matters relating to China will often be entangled. Business needs to hone its skills in that complex environment, in both the United States and China.

**2 Observation:** In the United States, an active political constituency dedicated to stronger US-China relations does not exist. This is especially important in regard to the Congress, where members cluster together around shared interests in good ties with many countries and regions, but not with China. There is nothing, for example, comparable to the House Taiwan Caucus, with its more than 120 members.

**Recommendation:** Your job will be to assert and defend your community's interest in a calm and productive US-China relationship in an environment devoid of permanent political allies within the US political system.

The task will require constant engagement with literally hundreds of people in the policy arena, friendly and unfriendly, either directly or through Council staff. It may also, on occasion, require strenuous advocacy in the face of inflammatory criticism or an assault on the foundations of US-China relations from non-business quarters.

The stream of criticism and invective directed at China by politically active groups in the organized labor community, the "China Threat" community, and their friends in Congress, will



continue far into the future. Judicious legislators willing to grapple soberly with the complexities of China's situation and of America's relations with China are few, and their ranks are not increasing.

On the other hand, a large and growing community of American companies requires a stable, civil, and productive relationship between the United States and China. In institutions of higher learning and research, similar bonds of cooperation are forming.

American businesses do not like to stand up on political issues outside of the most directly commercial ones, lest they be blasted for interfering in matters they should not enter, or be deemed unpatriotic or amoral. You will need to help business find its voice on questions that do not naturally evoke corporate expressions of opinion.

**3 Observation:** The perspectives and interests of US business, sometimes articulated directly to a China increasingly willing to listen and to hear what we have to say, and often directed to a US government committed to the defense of our economic interests with China, have helped to form the templates with which China's leaders are building their country's new economy.

**Recommendation:** Work to articulate to China and to our own government the best of what American companies can envision, and the most responsible portrait of what they legitimately expect as they work to succeed in China.

US business with China, conducted by our member companies, is part of a truly historic 25-year process of Chinese economic transformation and global integration whose full significance cannot yet be known by anyone. But there can be little doubt that US business, by its examples, its accessibility, its practices, and its demands for change in the Chinese commercial and legal environment, has contributed to China's vision of what the PRC can become.

Has American business "caused" China to develop as it has to the present? Of course not: for one thing, the United States accounts for less than 10 percent of total foreign direct investment in the country.

But the patient and vigorous articulation of American business perspectives, combined with US companies' efforts in corporate social responsibility, will continue to generate interest among Chinese policymakers and economic figures. The Council's role in this regard should grow.

**4 Observation:** When it comes to business with China, the American public perception is mixed. The announcement of China's arrival on the world economic stage has sounded; the American public has taken notice, but China remains an abstraction for most Americans.

**Recommendation:** As the new leader of the US-China Business Council, you will need to articulate in a thousand venues the value of your member companies' progress in China for audiences outside those companies. This is not an easy task. There are plenty of voices eager to show why your member companies' progress in China is bad for Americans. You will need to be honest but creative in affirming the positive meaning of this now-huge commercial engagement.

Americans like entrepreneurship, and they love success. But they often fear bigness—big government, big business—and its perceived dehumanizing power over ordinary people.

Some fear that companies, pursuing profits, will ignore higher ethical or moral principles, particularly those that exist to protect the disadvantaged.

Thus, the normal desire for economically priced consumer goods does not translate into a public conviction about the benefits of Chinese imports. The fact that China's purchases of huge amounts of US Treasury paper help to keep interest rates low, at a time when US federal budget profligacy and low household savings rates might otherwise have more disruptive economic effects, does not register on the public consciousness. The up-sides of US-China economic engagement need responsible articulation in the United States, and the US-China Business Council must continue to provide it.

**5 Observation:** In the United States and China alike, the media have much to do with an organization's success, whether it be a company or a nongovernmental organization.

**Recommendation:** Work with the media. Encourage business engagement with them. Strive to maintain and enhance the Council's reputation for responsiveness and accuracy in serving media needs for information, often on short notice. But work with your interviewers to be sure that you understood what was asked and that your responses have been understood as they were intended. Fight for corrections when the media distort your points. Never put words or thoughts for the media into the mouths and minds of those whose real thinking you don't know.

Respected American reporters and producers should receive the fullest possible assistance from the US-China Business Council. But never allow yourself or the Council to be hostages to media agendas, and never let serious media misrepresentations of the Council's views go unchallenged.

**6 Observation:** US-China matters are seldom as totally positive as we might hope, and seldom as dire as we might fear. They don't often end definitively. In fact, most of them don't end at all.

**Recommendation:** Expect to revisit old issues and repeated themes, but don't mistake the recurrence of old questions for the utter absence of change or of progress. Distinguish the major milestones from the momentary excitements.

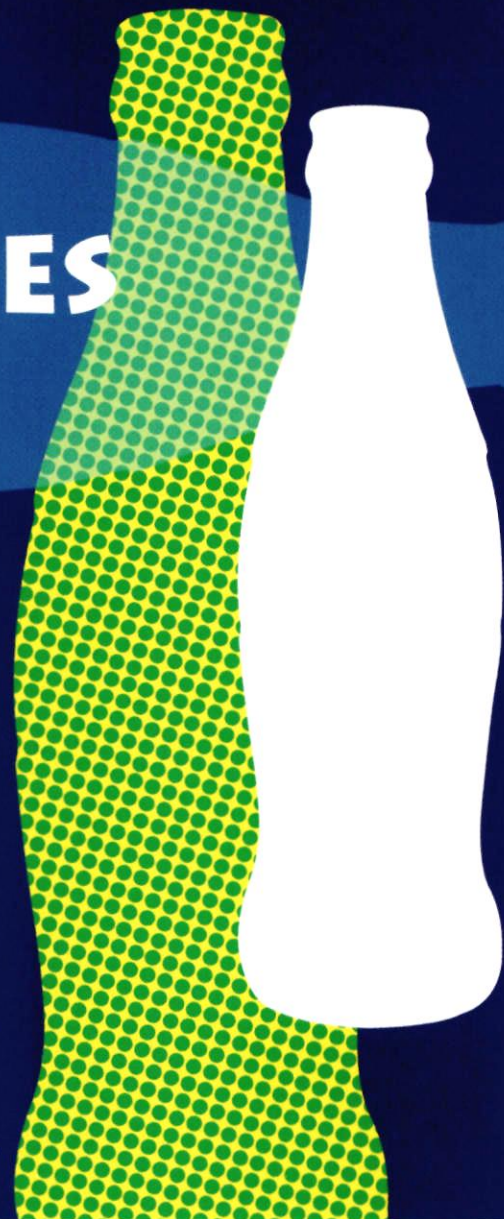
Will the United States and China have problems over intellectual property rights (IPR) protection again and again? Very probably. Does this mean that there is never progress on IPR protection? No. Will China and the United States snarl at each other over antidumping or other market-closing actions by one side or the other? It's a safe bet. Does it mean that US-China trade is not also progressing nicely? No.

The Council lives partly in a world of crisis and press release, partly in a world of megatrends. Every press release, by definition, is "news." The question is, for how long? As president of the Council, you must know and interpret the day's events, good or bad, but also measure the megatrends, soothing or disconcerting. And so: Never sugarcoat, but never hit the panic button. This work is long term, challenging, and occasionally it can really make a contribution to something bigger. That's the best part.

Those are a few thoughts for the new incoming leader of the US-China Business Council this fall. 完

# WHAT IT TAKES TO CREATE A SUCCESSFUL BRAND

**HINT:  
IT'S NOT  
JUST  
ABOUT  
THE  
PRODUCT**



## **George Crocker and Yi-Chung Tay**

### **George Crocker**

(gcrocker@monitor.com) leads Monitor Group's marketing and branding practice in Greater China.

### **Yi-Chung Tay**

(ytay@monitor.com) is a consultant and project leader based in Monitor Group's Shanghai office.

Monitor Group is a global strategy consulting and merchant banking group with China offices in Beijing, Shanghai, and Hong Kong. Over the past 10 years, Monitor ([www.monitor.com](http://www.monitor.com)) has worked with major multinational and Chinese companies to help them develop and expand their brands in China.

**T**wo decades ago, foreign companies penetrating the China market faced little competition in many product areas, but enormous obstacles in production and distribution. A decade ago, both firmly and newly established foreign manufacturers in China began to feel the heat from lower-priced domestic competition, though the foreign manufacturers maintained a significant quality advantage.

In today's China, brand competition is intensifying—foreign and joint-venture brands, local copycats, and increasingly enticing domestic brands, both national and local, all crowd the market. In this environment, foreign brands must vigilantly



Giant bicycles are catching on in China.

Photograph: Catherine Gelb

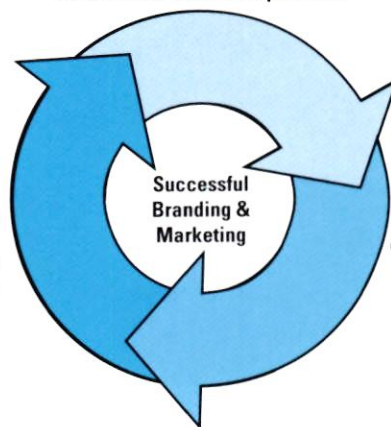
watch both for up-and-coming local brands and for counterfeit goods that dilute brand equity.

Domestic firms, though lagging in general marketing sophistication, are nonetheless rapidly learning how to market and brand with greater skill. Government relations, product quality, pricing, distribution, advertising—all are factors in the competitive calculus.

### Brand-new brand: A Giant success story

Giant Bicycle Inc., the Taiwan bicycle maker with a retail presence throughout urban China, illustrates the rewards awaiting successful brand and marketing strategies. Once an original equipment manufacturer (OEM) producing in China mostly for export, Giant has captured about 5 percent of the mainland domestic market, which is estimated at about 30 million bikes per year. Though not exactly a domestic company, most local Chinese accept the ubiquitous Giant brand as one of their own. This in itself is a branding accomplishment.

Aligning all activities to deliver the desired customer experience



Creating targeted and compelling value propositions that encompass the entire customer experience

Acquiring deep customer insights

Chinese customers search high and low for a good value proposition.

## Can Industrial Brands Be Far Behind?

Different in form from successful retail brands, strong industrial brands nonetheless are similar in substance. To date, few Chinese companies have successful industrial brands along the lines of Caterpillar, Ryder trucks, or Gore-Tex fabric. Semiconductor Manufacturing International Corp. (SMIC) harbors aspirations of becoming China's Intel Corp.; other brands such as Baosteel, CNOOC, and Huaneng Power work successfully in the business-to-business (B2B) sector. On the whole, however, as with consumer goods in the early 1990s, opportunities abound in numerous product and service areas for B2B brands capable of adapting and applying competitive strengths to an accurately targeted customer base.

—George Crocker  
and Yi-Chung Tay

Photograph: Dennis Chen

Giant offers a range of models in China, most of which are priced well above the basic Forever and Phoenix models that many Chinese in smaller cities still rely on for routine transport. Instead of drawing customers solely with low prices, Giant targets customers' aspirations, luring those who ride for fun, adventure, and exercise. Giant bikes are more appealingly designed than most local models, but are not as expensive or impractical as foreign racing bikes. Branded stores and kiosks offer brightly lit colored displays. Giant sales personnel are themselves bike enthusiasts with more technical savvy than competing sales personnel. And Giant actively promotes and supports recreational biking clubs of the kind popular in Europe and North America.

Giant's success in China, as with successful brands in any market, reflects certain market, industry, and company specifics. But the company's successful, three-part brand and marketing strategy is applicable to any product and industry in any market.

- First, firms must acquire deep consumer insights: not simply what people buy, but *which* segments of consumers buy *what* goods and *why*.
- Second, firms must create a value proposition for each group of target customers. The value proposition—the primary, essential benefit a product gives consumers—must go beyond just products, to encompass the entire customer experience with the brand.
- Third, firms must align all company activities toward providing the desired customer experi-



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Other brands have cottoned on to Yue Sai Kan's techniques.

Photograph: Catherine Gelb

ence. Although this approach will be familiar to experienced marketers, only a tailored approach will succeed in China.

### Getting to know your customers

With a dramatic variety of terrain, dialect, custom, and cuisine, China is as fragmented and diverse as Europe from virtually any marketing standpoint. Best-selling commentaries bemoan the homogenizing tendencies of modernization. But China, in many respects, has become more diverse in the Open Door era. The once-ubiquitous Mao jacket has given way to a variety of traditional and modern styles of local and international design.

Important as geography may be, it is insufficient to provide meaningful insights into China's consumer classes. With growing economic differences between and within regions, China today is as stratified as it is fragmented. Demographic factors, therefore, are increasingly important. Teenagers in Shanghai and in Xi'an, Shaanxi, may approach mobile phone displays with similar budgets and aspirations. Yet their respective parents will purchase household appliances in decidedly different ways. Obviously differences in wealth levels will influence the price ranges considered. But differences in beliefs and attitudes will often drive Shanghaiese to focus more on the emotional benefits of brands, styles, and products while consumers in Xi'an will tend to focus more on the functional benefits of their purchases.

Similarly, however, demographic categories alone are too broad to explain different consumer behaviors fully. A more structured and comprehensive approach is required. Geography and demographics must be considered as part of the broader physical, mental, and emotional context of the consumer and purchaser. Importantly, these factors must be able to explain not only how consumers behave, but why they behave as they do.

Is it possible to amass sufficient quantity and quality of relevant consumer information in today's China?

Certainly, it is far easier to obtain meaningful insights today than ever before. But there is little reliable, current, and comprehensive secondary data to inform the process (see the *CBR*, May–June 2004, p.54). Therefore, it is critical to integrate a wide range of sources and to triangulate where there are information gaps or conflicts. Marketers must formulate highly targeted market research to fill crucial data gaps; China is too big and too complex a market for an unfocused, "boil the ocean" approach.

This challenge of obtaining customer insights shines an interesting spotlight on the battle between global and local brands. Yes, foreign brands generally have greater marketing sophistication and firepower. But successful local firms, such as Cixi Zongshen Motorcycle Group, Guangdong Xizhilang Group Ltd. Co.—a leading fruit jelly snack brand—and China Merchant's Bank Co. Ltd., for example, exhibit an intuitive knack for obtaining customer insights, identifying promising segments, and building brand identities on the fly.

### A case in counterpoint: P&G and the China dream

Once upon a time, China's consumer markets were virgin territory. It was feasible, in theory, for ambitious, versatile global brands to seek and obtain large market share in the world's fastest growing market. If any foreign company actually experienced that dreamlike success, it was the Procter & Gamble Co. (P&G) through the 1990s in China.

An early, aggressive, and deep-pocketed entrant into the home goods market, the P&G family of brands has become ubiquitous in Chinese stores and homes, rivaled only by British-Dutch Unilever plc in market share across a broad product portfolio. Investing a cumulative total of \$1 billion, P&G established Rejoice, Pampers, and Safeguard as three of China's best-selling, most-trusted brands, with 50 percent market share at their peak.

In recent years, however, many P&G and Unilever products have faced new challenges. Counterfeit goods

have clearly nibbled away at brand equity. But legitimate local competitors have made inroads as well, creating effective products, brands, distribution networks, in-store displays, and product promotions. China's Masson Ltd. Co., for example, has taken on the global toothpaste brands Colgate and Crest with the nationally marketed CCP Calcium. And locally branded shampoos, such as Shu Lei and La Fang, owned by C-Bons Group and La Fang Group, respectively, are quickly gaining on P&G's Rejoice and Head & Shoulders.

In China's consumer markets today, it is doubtful whether any brand, foreign or local, can achieve the same degree of rapid, sustained growth that P&G and Unilever enjoyed during the past decade. In that period, successful production and distribution contributed substantially and enduringly to penetration and profitability in the wider market. Competitive successes today are occurring in smaller and more precisely defined consumer groups through more targeted strategies and execution.

### Value propositions: Striking a chord, not simply a bargain

If customer insight is the foundation of any strong brand strategy, then value propositions are the plumbing, wiring, and lighting that bring the brand to life. In consumer products, for example, these propositions transcend price and quality comparisons. Successful brands are at work when customers reach across comparable but lower-priced alternatives for the familiar favorite, or turn to a whole new product category for a more enjoyable customer experience.

Yue Sai Kan Cosmetics, recently acquired by L'Oreal, provides a unique window on the strength of a winning value proposition. Founded 12 years ago by the famous Chinese television personality, Yue Sai Kan, this firm helped persuade Chinese women of the propriety of cosmetics after a 30-year absence from Chinese stores and bathrooms alike. Using only Chinese models in advertising, displays, and packaging, the firm convinced Chinese women to stop imitating hair and makeup styles of the Western blondes commonly featured in the Chinese advertising of the day. Perhaps most important, the firm trained sales associates to explain and demonstrate proper use of products right at the sales counter.

Yue Sai presented its customers with an ambitious value proposition: regain a sense of feminine Chinese beauty through these products. The customer experience began with the advertisements, continued through the "education process" conducted at every point-of-sale, and product use, and finally to the feelings of confidence and satisfaction gained by using Yue Sai products. For a time, it was a winning proposition, and Yue Sai was one of China's

best-selling cosmetics brands, easily rivaling global brands in China. Then the floodgates of competition opened. Today, thousands of branded products compete for customer attention at cosmetics counters throughout urban Chinese department stores and shopping malls.

Of course, few uncontested product categories remain in China today. But some categories, such as sporting goods, seem appealingly far from saturation. As urban affluence increases, and the 2008 Olympic Games approach, the urban Chinese appetite for sports and recreation continues to grow. Top-end foreign brands, such as Nike and Adidas, already have a substantial presence in China's prosperous cities and shopping districts. Li Ning Sporting Goods Co.,



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## UNEXPLOITED OPPORTUNITIES IN THE MID- TO UPPER-MID PRICE AND QUALITY RANGES STILL EXIST. TO STAKE OUT THESE TERRITORIES, COMPANIES NEED VALUE PROPOSITIONS THAT STRIKE—AND HOLD—AN APPEALING NOTE WITH A CLEARLY DEFINED TARGET AUDIENCE.

founded by the famous Chinese gymnast of the same name, has achieved some success as a fast follower with a broadly similar offer but lower price levels. Li Ning exploited uncovered, mid-priced territory in the market and established a firm position by doing so. Li Ning also benefits from “brand nationalism”—many Chinese consumers prefer to buy Chinese products when possible. Yet unexploited opportunities in the mid- to upper-mid price and quality ranges still exist. To stake out these territories, companies need value propositions that strike—and hold—an appealing note with a clearly defined target audience.

### Ensuring the best customer experience

Delivering a compelling customer experience is sometimes misperceived as simply creating an appealing point-of-sale environment. In fact, companies must orient the entire manufacturer-to-consumer value chain (including product design, distribution, marketing, advertising, sales, and after-sales support) toward this desired outcome. Companies with successful global brands execute seamlessly across channels (IBM Corp., DaimlerChrysler Corp., and Sony Corp.) and even seemingly disparate product categories (Virgin Group and Apple Computer Inc.). Some local Chinese brands are also beginning to align activities well enough to deliver a consistent brand identity.

Haier Group, the white goods manufacturer, has become an internationally recognized brand synonymous with value, customized models, and acceptable if not (yet) outstanding product quality. Internationally, it is less well known that the linchpin of Haier’s success in China lies less in production than in after-sales service.

Haier has been one of the pioneers in reconstructing service quality in China. With a nationwide network of call centers and service centers, Haier advertises its commitment with the phrase “all you do is call, and Haier does the rest.” Its call centers maintain a detailed customer database, dispatching technicians from in-house service centers or a nationwide contractor’s network. Haier technicians are well known and appreciated in China for wearing shoe covers, protecting furniture, and vacuuming after completing repairs. It all adds up to a distinctively satisfying customer experience. And whether the com-

pany lives up to its service motto 100 percent of the time or not, there is little question that Haier (in white goods) and Changhong Group (in electronics) have surpassed foreign firms in service reputation and standards in China.

This degree of focus on the customer experience benefits branded goods and services in any market. But payoffs in China are particularly rewarding. Retail shopping is a form of recreation and entertainment in a society that two decades ago coped with shoddy goods and sneering service. Spacious, well-lit malls and shopping streets provide a welcome respite from small apartments in many Chinese cities. Helpful sales attendants still elicit looks of surprised skepticism from many grizzled shopping veterans. And the snarl of traffic in the street means that added conveniences are greatly valued. In China, for example, many cities still require new bicycles to be registered with the municipality. At Giant bicycle stores, the staff registers new bicycles on behalf of customers for no extra charge.

Branded one-stop shopping has also begun to take off, exemplified by the success of full-service household appliance stores such as Dazhong, Yongle, and Guomei. These stores offer greater product variety, more comparative information, better-trained sales staff, and higher-quality, store-backed guarantees. These features together deliver a much more satisfying customer experience than Chinese consumers could have dreamed possible a few short years ago.

### May the best brands win...

The best brands will win out over the next decade in China, as top-tier cities become world-class hubs and growth continues to spread inland to second- and third-tier cities and towns. As discussed, however, these winning brands may not be global household names or firms commanding top market share today. Instead, brand victors will be companies, foreign or local, large or small, that implement artful brand and marketing strategy through three critical domains—customer insight, customer experience, and coordination of all firm activities that engage the customer. Their victory spoils will be measured not in billions of consumers, as many in China have long hoped, but by customer loyalty, brand equity, and sustained market share—indicators of lasting value creation and long-term competitive advantage. 完





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# QUICK SERVICE HITS CHINA

THE FOOD  
MAY VARY  
BUT THE  
RECIPE FOR  
SUCCESS IS  
THE SAME

**Paula M. Miller**

China entered the modern fast-food era in November 1987 with the opening of the first KFC outlet in Beijing. Perhaps because KFC Corp., a subsidiary of Yum! Brands, Inc., was the first Western fast food company to enter the country and because chicken is popular in China, KFC remains the top quick-service restaurant (QSR, as the industry describes itself) in China today—in terms of sales and number of outlets. KFC now has more than a thousand outlets in the country, located in all provinces and autonomous regions except Tibet, which KFC may enter soon. The outlets serve more than 2 million Chinese each day.

**Paula M. Miller**  
is assistant editor of the  
*CBR*.

But what about the QSRs serving food less familiar to Chinese tastes? What strategies are these providers using? I interviewed dozens of foreign QSR companies and industry specialists about their experiences in China to find the answers to these questions. Most interviewees voiced common views on strategies to follow and problems to avoid. Although many of the pointers are pure common sense, some foreign companies have ignored them—and paid the price.

## China's quick-service scene

Chinese and foreign QSRs are well established in China's large and mid-sized cities. In 2000, more than 20 percent of quick-service operators in China were foreign. Western-style fast food accounted for roughly one-third of China's total quick-service business volume.

The menu is not the only difference between foreign and Chinese QSR companies—marketing strategies and business operations also differ. According to the All China Marketing Research Co. Ltd., many Western-style QSRs target youth and families while Chinese-style QSRs generally aim for customers between 25 and 44 years old. In fact, the older the Chinese customer, the

more likely he or she is to dine at a Chinese restaurant. When Western fast food restaurants first entered China, they focused on taste, presentation, speed, and efficiency; Chinese restaurants concentrated primarily on taste. Western companies, which generally have more mechanized production, tighter management, and more modern marketing techniques than their Chinese counterparts, average higher daily sales than Chinese companies.

China's QSR market has changed since KFC and McDonald's Corp.—the second major Western fast food company to enter China—opened their doors (see below and p.20). One global change occurred when many fast food companies switched to the quick-service food model which, instead of speed, emphasizes quality and freshness, and which customizes orders and targets a slightly older crowd. KFC and McDonald's recognized early on that children, young adults, and families were key to their success in China. But now that China's emerging middle class craves high-fashion items, luxury QSRs are also in high demand. Though most people would agree that the taste of the food is the most important part of a restaurant visit, the overall dining experience plays an increasingly



## Yum! Brands, Inc. in China

Yum restaurants, located in more than 240 Chinese cities, include 1,100 KFCs, 130 Pizza Huts, and one Taco Bell Grande. The company also runs six KFC D&Ds (drinks and desserts) and nine Pizza Hut Delivers—both of which are independent from the other restaurants. Yum opens more than 200 outlets per year in China. Mainland China accounted for roughly 13 percent of Yum's operating profits and one-third of its international business in 2003.

### KFC Corp.

Yum tailors its restaurants' menus to suit individual countries. Before changing products, the company conducts research and development surveys and product sampling and organizes focus groups. Because Yum's research revealed that, for instance, Chinese customers prefer dark meat, KFC now uses dark leg meat instead of white breast meat for its chicken burgers in China. The company also serves the Dragon Twister—a wrap with Peking duck sauce, onions, and fried chicken strips instead of Peking duck. KFC removed coleslaw from the menu when it did not sell well and replaced it with Chinese-style salads whose vegetables—including broccoli, cauliflower, carrots, mushrooms, and bamboo shoots—vary with the seasons. Last year KFC launched more than 20 new products—most for the short term.

KFC's primary customers are young children, young adults, and families. To better capture the children's market in Asia, KFC introduced "Chicky," a fluffy chicken mascot that hosts children's birthday parties. To capture China's new drivers, in 2002 KFC opened its first drive-through restaurant in Beijing's Asian Olympic Village district.

### Pizza Hut, Inc.

When it opened in 1990, Pizza Hut became the first large foreign company to introduce pizza to China. Pizza Hut's primary customers are white-collar professionals aged 35 and younger; its driving force consists of young adults aged 19 to 29 and children aged 8 to 12. Pizza Hut offers classic pizza toppings but also introduced toppings from around the world, including smoked salmon, wasabi dressing, German sausages, and, during Christmas, ostrich. The restaurant's current menu includes seafood pizza toppings such as prawns, crab sticks, and squid. Green tea ice cream makes for a cool dessert.

### Taco Bell Grande

China's first Taco Bell Grande opened in Shanghai in May 2003. The restaurant's interior resembles a Chi-Chi's (or even a TGI

Friday's) more closely than a Taco Bell in the United States. There is no counter—it is a sit-down, full-service restaurant complete with Mexican music and employees dressed in Mexican garb. And the China menu is quite different as well—there are no refried beans, hard-shell tacos, or sour cream in Shanghai. Kidney beans substitute for refried beans, and the food generally contains less spice and less rice. But Taco Bell Grande serves tortilla chips and salsa when customers are seated and offers cheesecake and Mexican flan for dessert. Qun Wang Jamieson, public affairs director of Yum Greater China, explains that the company invested almost two years experimenting and learning from other markets and is still fine-tuning the Taco Bell concept. Yum plans to expand the operation by the end of the year. Wang Jamieson added, "Taco Bell brings a very new flavor to China, and has attracted many adventurous people—it's a different demographic than KFC and Pizza Hut."

She concluded, "Even though Yum is a market leader in China, there is still room to improve. China is not an easy market, and the learning curve for foreign brands is steep. It has taken Yum years to learn what it knows, and it must be difficult for new companies that enter the market. If a company is wise, it will learn fast."

## McDonald's Corp. in China

After its 1990 entry into Shenzhen, McDonald's opened its largest restaurant in the world in Beijing in 1992. The first Beijing restaurant held 700 seats and 29 cash registers and served roughly 40,000 customers on its first day of business. Today McDonald's has more than 580 restaurants in China, located in 99 cities, and the company plans more than 1,000 outlets by 2008. China is the company's eighth-largest market.

The typical McDonald's customers in China are young adults, mothers, and their children. Shantel Wong, chief mar-



Photograph: Paula M. Miller

keting officer for McDonald's China Development Co., explained that the company offers a number of products that are unique to China. Each new product goes through taste tests by focus groups as well as "operation" tests. The goal is not only that customers will like the product but also that "the product's launch will be publicized with relevant and adequate marketing initiatives."

Regarding the importance McDonald's places on staff and supplier training to provide the best quality, service, cleanliness, and value to customers, Marina Leung, senior director of corporate relations for McDonald's China Development Co., commented that in the case of the restaurant's French fries, "Our suppliers had to start identifying the right fields and seeds for Shephody potatoes almost eight years before we began harvesting the potatoes for the fries." McDonald's also established a hamburger university in Hong Kong to provide training in Mandarin for its staff.

The company's current global "I'm lovin' it" advertising campaign helps target the Chinese youth market. And McDonald's will score more points with young Chinese customers for recruiting NBA superstar Yao Ming as spokesperson and for its future sponsorship of the Beijing 2008 Olympics.

important role in China. Especially in urban areas, it is now important for affluent customers to be seen sipping a latte in a Starbucks (see p.21). And Häagen-Dazs, a subsidiary of General Mills, Inc., has become an integral player in China's dating scene (see p.22).

### Winning strategies

Perhaps the two most important strategies that successful foreign QSRs in China follow are, first, to learn what customers want and deliver it and second, to market their company and products well. The approach seems simple, yet many companies either conduct inadequate market-entry research or stop researching shortly after opening for business. And some companies make basic marketing errors in selecting a Chinese name for their brand or failing to take steps to introduce their brand in China.

#### ● Know what customers want and deliver it

Learning what customers want from a restaurant involves not only studying what customers want to eat, but also how they prefer to be served and what overall dining experience they expect. Many foreign QSR companies in China discover through market research that they must alter their menus to suit local tastes, provide full service instead of counter service, and present a more upscale image than they do at home. For example, Pizza Hut restaurants in China, which have altered their menus to better suit local tastes, are full-service dinner houses. Qun Wang Jamieson, public affairs director of Yum Greater China, elaborated, "Pizza Hut and KFC have become more upscale over time. Yum pays a lot of attention to décor and the whole dining experience. A positive, sit-down dinner environment is crucial to our brand image."

It is often said that China is as large and diverse as Europe. But China's food preferences do not just differ by province, they differ within each province. Companies should thus prepare to adjust products to suit local tastes and, when appropriate, should ask themselves questions such as: Will my customers appreciate cold deli sandwiches, or do they need hot sandwich options? Is that doughnut recipe too sweet? Should I also offer a savory baked good?

KFC and McDonald's have adapted their menus well. In addition to its traditional fare, KFC has offered congee (rice porridge) for breakfast and egg, tomato, and spinach soup. During the recent bird flu scare, it even created a pork burger. McDonald's has offered regular and spicy hash browns for breakfast, spicy chicken-filet burgers, fish soup, and red bean paste pies.

Foreign fast food company headquarters (HQs) that expect their overseas franchises to follow the established franchise model strictly will likely run into trouble. Jeff Smith, Hill & Knowlton (China) Public Relations Co. Ltd.,

### Top Chain Catering Enterprises in China, 2002

Enterprise	2002 Sales (\$ million)	% Change over 2001	No. of Outlets
1. Tricon (China) Investment Co., Ltd.*	880.12	33	902
2. Beijing McDonald's Food Co. Ltd.	103.07	2	88
3. Shenyang Xiao Tudou Restaurant Co. Ltd.	96.02	4	142
4. China Beijing Quanjude Group Co. Ltd.	84.78	6	47
5. Tianjin Dicos Food Development Co., Ltd.	84.18	16	246
6. Chongqing Little Swan Catering Co., Ltd.	81.87	38	171
7. Beijing Dong'an Catering Co.	67.63	6	99
8. Chengdu Tanyutou Investment Shareholding Co., Ltd.	62.56	17	98
9. Chongqing Caigexiang Custom Restaurant Co., Ltd.	62.56	19	68
10. Chongqing Dezhuang Food Culture Co. Ltd.	61.59	135	158
11. Malan Hand-Pulled Noodle Fast-Food Chain Co. Ltd.,	54.65	5	436
12. Chongqing Taoranju Flavor Food Culture Co.	44.44	31	48

\* Now called Yum Brands, Inc., which includes KFC, Pizza Hut, and Taco Bell in China. Source: China Chain Store and Franchise Association

**FOREIGN FAST FOOD  
COMPANY  
HEADQUARTERS  
THAT EXPECT THEIR  
OVERSEAS FRANCHISES  
TO FOLLOW THE  
ESTABLISHED  
FRANCHISE MODEL  
STRICTLY WILL LIKELY  
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managing director for China, explained, "A foreign company would be foolish to think that the limited number of foreign customers in China can keep the company in business—and this is what it looks like the company expects if it keeps its US and China menus the same. If China's growing middle-class market is a company's target consumer but there aren't many of these customers in the restaurant, then the company isn't reaching out to the consumer group and isn't giving them a reason to visit the restaurant. Fast food companies need to send a clear message to consumers, 'You should come here, and here's why.' This frequently involves offering the restaurant's classic items *and* adapting the menu to suit local tastes."

Along with food items, a restaurant's atmosphere is critical—and atmosphere is affected by the restaurant's service. Many QSRs debate whether to provide customers with counter service or full service in China, though most companies realize it would be unpopular to ask customers to clear their own tables when they are finished eating. When Papa John's International Inc. opened in Shanghai in 2003 it made one key change to the traditional Papa John's formula—the company created a sit-down, full-service section in their largest restaurant, thus offering another option to take-out and delivery (see p.24). Yvonne Wang, executive deputy general manager of Papa John's

**Starbucks Corp. in China**

Starbucks first entered China in 1999 and, as of June 2004, operates 98 coffee shops in 10 cities in China: Beijing; Guangzhou; Hangzhou and Ningbo, Zhejiang; Nanjing, Suzhou, and Wuxi, Jiangsu; Shanghai; Shenzhen; and Tianjin. A Starbucks kiosk is now located at the Forbidden City in Beijing and a stunning two-story Starbucks on Hangzhou's West Lake is designed with glass doors that open out onto the lake.

Pedro Man, president of Starbucks Coffee International, Asia Pacific, describes Starbucks as "the 'third place'—a place between home and work where customers can chat, meet with friends, or simply relax." Though the company does not provide demographics on customers, it says its China stores have a good mix of Chinese and foreign customers that include students, workers, businesspeople, and mothers.

Man continued, "While the coffee remains the same worldwide, our food offerings and merchandise are localized to enhance the customer experience. For example, in Shanghai and Beijing, Starbucks created coffee mooncakes as a special food item to accompany and complement coffee for the Mid-Autumn



Festival." Starbucks' best-selling beverage throughout China is its latte (steamed milk and espresso), and though China is a tea-drinking nation, the company provides fewer tea options than in the United States. Starbucks provides detailed coffee training to its employees and supplies its stores with several pamphlets in Chinese to further local customers' knowledge of coffee and the company.

Shanghai, explained, "Most Chinese want to be served when eating. And because our motto is 'Better ingredients. Better pizza.' we knew we should offer better service in China as well."

When planning a restaurant's atmosphere, many successful QSRs market themselves as either fun, fashionable, or both. Victor Yuan, chair of Horizon Research Group Inc., notes, "Fast food is successful not so much because of the food, but because of the fun. The food isn't necessarily better than the food in other restaurants but the experience is more fun, and because it is designed for kids, many fast food companies succeed." Charles Oliver, partner at market research consultancy GCIS in Shanghai, commented on QSRs that cater to the rising middle class, "Mister Donut [a subsidiary of Japan's Duskin Co. Ltd.] is more analogous to the Chinese teahouse experience than to a simple doughnut store—people order drinks, hang out, and are seen. The company provides an experience rather than just food" (see p.26).

Of the stores I visited in China, Häagen-Dazs stands out as the company that has mastered the luxury food market most impressively. For China's Mid-Autumn Festival, Häagen-Dazs sells novelty ice cream mooncakes in boxes that, depending on the size and quantity of moon-

## Häagen-Dazs in China

Häagen-Dazs, the high-end ice cream seller owned by General Mills Inc., first entered China in 1996 with a shop on Shanghai's Nanjing Road. The operation is a nonfranchising, wholly foreign-owned enterprise in China that operates 34 shops in coastal China. On average, the company opens one store per month. Gary Chu, vice president and managing director of General Mills China, commented, "Häagen-Dazs is very careful when selecting shop locations—the shops must be in fashionable, primary spots. We follow a city for several months to a year and analyze official government data, independent data, and consumer index data on sugar, fashion, and brand names. In Shanghai, Häagen-Dazs is a food and a fashion brand." The company also stocks more than 2,500 Häagen-Dazs freezers in different retail



shops, including hyper- and supermarkets, cinemas, night clubs, golf clubs, convenience stores, tourist attractions, and 7-Eleven stores in Shenzhen and Guangzhou.

Most Häagen-Dazs customers are young professionals and upper-middle-class, white-collar workers; roughly 60 percent of customers are young women. Chu remarked, "The majority of Häagen-Dazs customers are Chinese. We targeted the Chinese consumer from the beginning of our operations and never designed China-based Häagen-Dazs shops specifically for expatriates. Many Chinese are okay with our [relatively high] prices because we are selling food,

brand, fashion, and indulgence."

Häagen-Dazs has created new products for the China market. It serves green tea ice cream, and lychee and red bean flavors are on the way. Since hotpot (*huoguo*) meals are a familiar food in China, it was fairly easy for the company to introduce ice cream-and-sauce fondue, which makes up 28 percent of the store's business in the wintertime and is an especially hot product for couples on Valentine's Day. Häagen-Dazs created chocolate-covered ice cream mooncakes for China's Mid-Autumn Festival that came complete with a round, mango sorbet center in place of the traditional egg yolk. The company also sells ice cream drinks and cakes.

For marketing, the company has more than 50,000 VIP club customers in China that it contacts regularly with newsletters and e-mail promotions. It also advertises in high-end movie theaters and specialty women's and airline magazines.

According to Chu, some of the biggest challenges for Häagen-Dazs in China include training staff, obtaining fresh milk, and logistics. New employees receive detailed training manuals with sections on service, efficiency, and hygiene. Häagen-Dazs also runs a school for service training, and mystery shoppers (unidentified "shoppers" hired to rate their Häagen-Dazs experience) visit and rate stores. Finding a steady supply of fresh milk is difficult because China has strict rules for importing dairy products but lacks a strong domestic supply. China's freezer standards are also a problem. Häagen-Dazs imports all of its freezers from Europe and operates its own freezer container trucks. Chu concluded, "It is not easy to sell ice cream in China. Foreign companies must make large investments, establish brands, and maintain seasoned management. Local companies have many advantages—some pay far less tax and far lower employee wages and spend less for a lower quality product. Interestingly, since SARS hit China, customers have become more concerned about hygiene and food quality. People are beginning to see the differences between brands."

**MISTER DONUT MUST  
CONVEY THE  
DIFFERENCE BETWEEN  
BREAD AND  
DOUGHNUTS,  
SCHLOTZSKY'S DELI  
MUST EXPLAIN THE  
DIFFERENCE BETWEEN  
SANDWICHES AND  
HAMBURGERS, AND  
SUBWAY RESTAURANTS  
MUST DEFINE  
SUBMARINE  
SANDWICHES.**

cakes, range between ¥198 (\$24) and ¥618 (\$75). Even with this high price, the mooncakes draw huge lines of customers. And this past February, to help couples celebrate Valentine's Day, Häagen-Dazs offered heart-shaped ice cream fondue. Starbucks, which offers a coffee mooncake for the Mid-Autumn Festival, and Mrs. Fields Cookies, which has launched basket promotions (see p.26), also use special techniques to draw in the luxury goods crowd.

### ● Marketing matters

Though some big-name, long-established, foreign QSRs in China may focus primarily on how to reach their target audience through promotions, other companies must focus on educating the public about their company and the products they sell. Mister Donut must convey the difference between bread and doughnuts, Schlotzsky's Deli (see p.28) must explain the difference between sandwiches and hamburgers, and Subway Restaurants must define submarine sandwiches. Most companies print full-color brochures, in Chinese, that describe their products and the company's history.

Another basic but vitally important marketing step for foreign companies is to make certain the company's Chinese name is meaningful and free of bad connotations. Foreign restaurant

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## Papa John's International Inc. in China

Papa John's opened its first pizza outlet on the mainland in Shanghai's Pudong district in October 2003 and opened its second outlet in Shanghai's Gubei district in January. The company will launch its first Beijing restaurant in September. Within the next 10 years, Papa John's plans to establish 200 outlets in Shanghai and neighboring cities and more than 75 in Beijing and the surrounding cities. Over time the company hopes China will become its largest market outside the United States.

Yvonne Wang, executive deputy general manager of Papa John's Shanghai master franchisee, notes, "Papa John's decided to set up in Shanghai first for many reasons. Shanghai is fashionable, and its large population already knows and loves pizza. We are also well known to many of the foreigners who want pizza delivery. Though business is strong in the two Shanghai restaurants now, the Pudong restaurant has stronger business because it has been there longer, it has a more central location, and there are more target customers. We need to advertise more for the second restaurant, which is the first Papa John's in the Asian market to offer a full-service dine-in option in addition to delivery and carry out."

Though it varies by restaurant location, typical Papa John's customers in



Shanghai are foreign kindergartens, middle-school children, families, and companies. Wang continued, "We really want to introduce Papa John's to Chinese customers, who frequent the second restaurant in higher percentages than the first."

The Papa John's China restaurants offer smaller pizza pies than in the United States—there is no demand for the large sizes offered in the United States. To suit local tastes in Shanghai, the company has added pizza toppings such as crab, corn, green peas, shrimp, and pickles. Similar toppings will be featured in the Beijing restaurants. The company offers free delivery to customers within 2.5 km.

To date, Wang sees the company's greatest challenges as finding ideal real estate locations, working with PRC government regulations on establishing food outlets in residential compounds, and keeping costs, which are high because of imported ingredients, down.

names that are transliterated only to approximate the sound of the foreign name will be less effective than those that also convey the product or company image. The Coca-Cola Co.'s Chinese name (*Kekou Kele*), which, generally translated, means "to let the mouth be happy" or "happiness in the mouth," is usually cited as an ideal translation. And sometimes a company's branding is not as strong as the MNC thinks. The company assumes it is well known in China but customers, in fact, are unaware of the brand.

### Top problems to conquer

Although countless problems can prevent foreign companies from achieving success in China's QSR industry, four main challenges are most common.

**1 Finding, and paying for, the right location**  
Finding the right location for any business is critical, and QSRs are no exception. Some foreign QSRs are more dependent on foreigners, businesspeople, and trendy urbanites than others. This dependency unfortunately costs them dearly in rent. Häagen-Dazs pays extremely high rent for prime locations, and Schlotzsky's Deli has had to move a few times in search of better locations. Companies must then decide how to offset these high costs.

**2 Training staff**  
Paul Y. Gao, CFO and master franchisee (an individual or corporation that commits to develop a franchisor's company and sell subfranchises, in a region or whole country) of Mrs. Fields China, planned ahead for Mrs. Fields's future expansion: "We have more staff than we need now for our Shanghai operations but this is okay—they are in training for future stores." Pedro Man, president of Starbucks Coffee International, Asia Pacific, remarked, "Starbucks focuses on providing employees with intense coffee training classes. For example, each barista goes through two to three weeks of training before they are able to serve behind the bar." After all, not many people in any country know how to make a short, double-shot, soy milk, no-foam, macchiato.

**3 Logistics**  
Because many foreign QSRs still import a large percentage of their food and equipment, logistics costs can be high and efficiency can be low. Schlotzsky's Deli imports almost everything needed for its restaurants. Papa John's uses local vegetables and toppings but must import cheese, dough, sauces, and oils. Ice cream companies that require a fresh milk supply for their ice cream—instead of milk powder—have a notoriously tough time because China lacks the fresh milk they need. These ice cream companies suffer heavily from the transportation and duty

### Preferred Fast Food, 2001

Food	Beijing % of Times Selected	Guangzhou % of Times Selected	Shanghai % of Times Selected
Chips	2.26	1.55	1.79
Chinese-style chicken	1.81	0	1.79
Chinese noodles	5.43	5.81	7.50
Chinese snacks	12.22	10.47	19.29
Dumplings, wontons & other wheaten food	6.34	8.53	12.14
Hamburgers	39.82	18.22	28.93
Others	5.43	3.10	1.43
Pizza	1.36	2.71	1.07
Rice meals	16.29	45.74	16.79
Western-style chicken	8.15	3.49	8.21

Multiple-choice questions; totals exceed 100 percent.  
Source: All China Marketing Research Co., Ltd.





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## Mrs. Fields Cookies in China

Though Hong Kong has 13 Mrs. Fields cookie stores, the company is new to the mainland, having opened its first two stores in Shanghai in 2003. Paul Y. Gao, CFO and master franchisee of Mrs. Fields China, plans to open three more Shanghai stores in 2004. The first store (in the Lippo Plaza) is 100 m<sup>2</sup>, which is enormous compared to the typical Mrs. Fields store. Gao explained, "Knowing that it is popular for Chinese customers to relax in café-style environments, we wanted to create a large, well-designed seating area to see if customers would come in to drink coffee, which is when we would give out sample cookies." The second store (in the Shanghai Center) is only 10 m<sup>2</sup>. Except for an umbrella table there is no seating, yet the store is busy because of its prime location. The larger store has two ovens and delivers the baked goods to the ovenless smaller store. Gao remarked, "We now know that all stores need ovens—especially for the good 'fresh baked' smell that attracts customers. New stores will be medium-sized with ovens, counters, and small seating areas in selective, high-income, high-traffic locations."

In China, Mrs. Fields targets women aged 20 to 35; to date roughly 70 percent of customers are foreign. The cookie giant is also tapping into the children's market by delivering cookies with names inscribed on them for children's birthdays, by catering events at foreign schools, and by donating cookies for fundraising auctions.

In Shanghai, Mrs. Fields currently sells the same products as in the United States. With Mrs. Fields approval, it may regionalize the menu in the future (the Singapore Mrs. Fields bakes green tea cookies). The Shanghai stores serve a wide variety of coffee and cold beverages, including American coffee, espressos, cappuccinos, lattes, mochas, and iced cappuccinos. Gao remarked that foreigners usually already know what they want to order when they come in but Chinese customers, who usually prefer less sugary foods than Westerners, often order brownies—perhaps not realizing that plain cookies and muffins are less sweet than brownies.

The store experiments with various marketing promotions, including free nibbler cookies with in-store purchases, coupons, joint promotion programs with local companies, basket promotions, corporate sales, and gift items.

Gao listed two main challenges that the company faces in China: "Once Mrs. Fields has more China stores, we may be able to obtain a domestic dough supplier—right now our dough is imported so costs are high. Finding suitable locations for stores is also difficult. Because we are the only foreign MNC that makes fresh cookies in China, we don't have much competition. This is good and bad—bad because we have to educate the public about fresh cookies on our own."

## Mister Donut in China

There are roughly 1,400 Mister Donut outlets in Japan, more than 1,000 in the Philippines, more than 300 in Thailand, and 10 in mainland China. The doughnut chain will enter Taiwan in October 2004. Mister Donut, which in Asia has been owned by the Japanese firm Duskin Foods Co., Ltd. for decades, opened its first outlet in Shanghai in 2000. The master franchisee company plans to open more stores in other parts of Shanghai soon.

Roughly 40 percent of Mister Donut's Shanghai customers are aged 21 to 25, about 85 percent are under 35, and around 65 percent are female. Many customers are students and financially well-off young adults. Peng Guorong, store development department manager of the joint venture Shanghai Marujin and Duskin Foods Co., Ltd., says, "In the beginning most of our customers were foreigners—but the percentage varies depending on the store's location. The Huaihai Road store receives many Japanese customers because they are already familiar with Mister Donut and there are many Japanese in this area."



In Shanghai, Mister Donut offers traditional Western-style doughnuts such as honey dipped, old fashioned, chocolate old fashioned, and French crullers. It also offers doughnuts developed for Japanese and Chinese customers, such as red bean, curry, and the sesame cruller stick. Mister Donut developed savory baked goods for the Asian market, such as its curry and chicken pies. The company sells specialty coffees, soup, ice cream sodas, flavored ices, and soy milk drinks. To confirm which products customers like most, the company conducts in-store and door-to-door surveys.


According to Peng, Mister Donut's main challenges are expensive real estate, staff training, the need to cut prices, and the need to educate customers about its products.

Photograph: Paula M. Miller

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## Schlotzsky's Inc. in China

Schlotzsky's Deli is a medium-sized business that defines itself as a fast, casual, upscale sandwich restaurant that serves made-to-order hot sandwiches on specialty breads, sourdough crust pizza, soups, and salads. The first Schlotzsky's Deli in China opened in Beijing in 1998. Over the last few years, five have opened in Beijing (all were franchises), though three closed mostly because of poor location. The larger of the two remaining restaurants in Beijing receives the most customers and occupies a whopping 235 m<sup>2</sup>; the smaller deli is 110 m<sup>2</sup>. A new 200 m<sup>2</sup> restaurant will open in Shanghai at the end of 2004. Because the deli rarely advertises, it relies primarily on word of mouth and must be located near business centers with ample foreigners, office workers, and young people.

Morris Sun, general manager of Schlotzsky's Deli China, estimates that 60 percent of its customers are foreigners

and 40 percent are Chinese, though many of the Chinese customers accompany foreigners. "Over time, we've seen an increasingly higher percentage of Chinese customers, but change is slow," Sun said. Schlotzsky's Deli targets high-end consumers—especially young, white-collar women. Sandwiches sell well among foreigners, while Chinese customers tend to order pizza. Generally speaking, women prefer salads. Sun continued, "Schlotzsky's emphasizes high-quality food and is one of the very few sandwich restaurants in China that offers hot sandwiches."

According to Sun, one of Schlotzsky's biggest challenges will be to lower food costs—which are high because almost everything is imported into China—so it can lower prices.

Schlotzsky's Deli also delivers and caters—it has even catered events in Beijing's Palace Museum and at the Great Wall.

expenses involved in importing dairy products—never mind investments in cold storage trucks and in-store freezers.

### 4 Communication between corporate headquarters and franchisees

Because not all foreign fast food companies maintain China headquarters, or even Asia headquarters, open communication between corporate HQs in the United States and their franchisees or chains in China is critical. If a company has no corporate management on the ground in China, headquarters may be unaware of China's restaurant realities. Management in

China must communicate clearly and frequently with corporate HQs to avoid misunderstandings and unrealistic expectations at HQ.

### Fast forward

Though even QSRs with careful marketing strategies will undoubtedly continue to face problems in China, their future looks bright. After all, a country's fast food industry frequently grows together with its economy, and China's QSR scene will likely charge ahead as its citizens become wealthier.

And with time the Chinese regulatory environment will become more conducive to franchising by foreign companies. Under China's World Trade Organization commitments, all franchising restrictions are to be lifted by December 11, 2004; China's Regulations on Management of Foreign Investment in the Commercial Sector, which took effect June 1, grant greater distribution rights by removing geographical restrictions and lowering registered capital and investor qualification requirements. Commercial franchising regulations that clarify legal structures are expected by the end of the year. Ultimately the regulations should reduce legal risks and operating costs.

Even as Chinese consumers become more health conscious and watch their diets carefully, US-based QSRs should be fairly well prepared to adapt to consumer demands—having already experienced pressure to offer healthier foods in the United States. Foreign QSRs may have another advantage in China: During the 2003 and 2004 SARS outbreaks, many Chinese customers preferred to eat at Western QSRs, believing that these restaurants maintained more sanitary conditions than the average Chinese restaurant.

But no matter what advantages foreign QSRs may have today, their success will depend on how well they serve a market that could soon dwarf that of any other nation. 完

### Why Chinese Consumers Choose Western-Style Fast Food Restaurants, 2001

Consideration	Beijing		Guangzhou		Shanghai	
	Times Selected	%	Times Selected	%	Times Selected	%
Good taste	234	57.5	264	53.5	299	62.0
Cleanliness	186	45.7	184	37.3	223	46.3
Close location	178	43.7	165	33.5	202	41.9
Convenient & quick	155	38.1	140	28.4	159	33.0
Good services	61	15.0	105	21.3	141	29.3
Reasonable price	46	11.3	63	12.8	101	21.0
Special display in restaurant	35	8.6	46	9.3	54	11.2
Special activities (e.g., birthday party)	21	5.2	21	4.3	17	3.5
Other	12	2.9	12	2.4	2	0.4

Notes: Multiple-choice questions; totals exceed 100 percent. Beijing survey N = 407; Guangzhou survey N = 493; Shanghai survey N = 482. Source: IMI Consumer Behaviors and Life Patterns Yearbook, 2002–2003

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# CHINA'S YOUTH DEFINE "COOL"

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CAPTURE THE  
HEARTS, MINDS,  
AND WALLETS OF  
CHINESE YOUTH**



## **Jeff Smith and Jean Wylie**

### **Jeff Smith**

is managing director at Hill & Knowlton (China) Public Relations Co. Ltd. in Beijing.

### **Jean Wylie**

is business development director and deputy regional director of marketing communications at Hill & Knowlton in Shanghai.

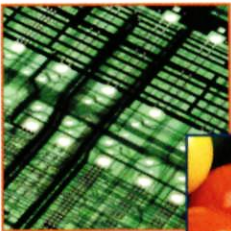
Imagine a population roughly the size of the Netherlands', made up of a generation of only children. Add the words "newly rich," "fashion-savvy," and "young," and you have just described China's millions of university students. To tap into this lucrative market, companies must first discover what these students want and how they think.

A recent survey conducted by Hill & Knowlton (China) Public Relations Co. Ltd., in conjunction with *Seventeen* magazine (China) and Sinomonitor

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## Facts and Figures on China's Youth

China's teens and twenty-somethings are a powerful demographic. The numbers help put their current and potential influence into perspective:

- China has roughly 200 million citizens aged 15 to 24. Twenty million young people enter adolescence each year, a population that is reaching sexual maturity four or five years earlier than in the 1970s.
- Young people account for 35.9 percent of China's 21.9 million Internet users, logging on an average of eight hours per week.
- Compared to 29 percent of people aged 25 to 39, 36 percent of 15- to 24-year-olds "often" spend money on nonessential items.
- In China, 43.5 percent of 18- to 24-year-olds have more than 14 years of education, compared to 34.4 percent of people aged 25 to 39.
- In China, 26.3 percent of 18- to 24-year-olds have mastered at least one foreign language, compared to 13.4 percent of people aged 25 to 39.

Sources: Sinomonitor International, 2004 China Marketing and Media Study/China Target Group Index; and Xinhua News Agency

International, set out to uncover students' dreams and aspirations, their role models and preferences, and their definition of "cool." The April 2004 "China Cool Hunt" survey polled 1,200 18- to 22-year-old students from 64 universities in Beijing and Shanghai about the who, what, and why of cool. Half of those surveyed were from Beijing and half from Shanghai; the gender split was also 50-50. The surveyed students majored in 97 different subjects—though English was the most common—and came from 229 cities in 27 provinces.

### Student traits, beliefs, and role models

The China Cool Hunt survey found some expected, but also unexpected, views among students. When asked to describe their personality traits, survey participants defined themselves as honest, friendly, and easy-going. Yet Chinese students also displayed a remarkable independent streak—26 percent defined themselves as individualistic and 76 percent described themselves as entrepreneurial. These students also know what they want—including independence within the workplace. Almost two-thirds agreed that, "Sooner or later it would be better to work for myself than be employed by a company."

China's university students are optimistic, full of confidence in themselves and their judgment, and believe they can achieve their goals. Seventy-two percent of the survey participants—young men and women scored nearly the same—are optimistic about their future. Just over half of the students surveyed agreed with the statement, "I usually manage to get what I want." And according to the survey results, students also do not seek guidance—they are happy to make their own decisions and follow their own ideas.

Along these lines, the survey queried students on their role models. More than one-third of respondents report that their parents—not celebrities, businesspeople, or government leaders—are their role models. This is especially true for young women, of whom 41 percent considered their parents as role models, compared to 28 percent of young men. But like young people everywhere, Chinese students do not always listen to their parents. About 83 percent of those surveyed agreed, "It's better to follow my own ideas than to do exactly what my parents want me to do." A mere 5 percent disagreed.

When students were polled on dating, the survey found that nearly 70 percent of those surveyed dated during high school or college. This marks quite a change from only a few decades ago, when Chinese society frowned on dating, and even picking one's own mate was uncommon. At the same time, a full two-thirds reported that they would not allow a relationship to compromise their studies.

### "Cool" defined

In an unprompted and open-ended question on what brands students view as cool, the Nike brand was the clear winner, making 30 percent of students' lists.

Yet a closer look at the students' lists of the top 10 global brands reveals that no single industry dominates—not fashion, sports, or technology. The list covers two athletic companies, Nike and Adidas; four technology firms—Microsoft, Samsung, Nokia, and IBM; and two fashion clothing and accessory brands, Christian Dior and Only (a subsidiary of Bestseller A/S). Just two Asian brands, Samsung and Sony, made the list.

Because so many of the chosen brand names were not consumer products, we wondered what Nike, Microsoft, and Nokia had in common with BMW, Coca-Cola, and IBM, which all ranked among the coolest brands in the world on the students' lists (see p.34). To find out, we asked the students, "In one sentence please describe what you mean by 'cool.'" Just under half of male and female respondents in both Beijing and Shanghai indicated that individuality and innovation make a company cool. As might be expected by students' descriptions of themselves as individualistic, they recognize, and bond with, brands that are unique and that show an individual style. Students seek products that help them stand apart from the crowd.

The survey results revealed a few surprises about how students perceive Chinese brands. Fifty-one percent of respondents stated that China does not have any cool brands. Thus, for many respondents, Chinese companies do not even register on the global scale of cool. If the perceptions of the surveyed students are any gauge, "China Inc." has far to go to develop a cool image, regardless of its impressive business success.

Though Chinese brands may not be cool on a global scale, they are not completely out of the running. When asked specifically about cool Chinese brands, Haier topped the list. Who would have thought that a white goods manufacturer would be the trendsetter for a whole new generation of Chinese students? The presence of computer-maker Lenovo (formerly Legend) and sports gear maker Li Ning on students' lists is perhaps less of a surprise. But there is a strong point to make here: Haier, Lenovo, and Li Ning all have dynamic and inspirational leaders—and have received loads of good publicity.

Interestingly, fashion items (in the Western sense) did not score particularly high in the cool stakes—only Christian Dior and Only made the top 10. When students were asked to name their top three favorite fashion brands, Nike was the clear leader but three technology companies—Sony, Nokia, and Samsung—also made the list.



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Li Ning was again the only Chinese brand. The results demonstrate that a company does not have to be a fashion brand per se to be perceived as one. In China, fashion is about lifestyle, so any product has the ability to become a fashion brand.

Though foreign brands scored near the top in many survey categories, music is one area where they fell short. Asian, not Western, musicians are viewed as cool by this generation. No international pop stars were among students' top 10 favorites. China's Wang Fei was the most popular singer, with 17 percent of the votes. Though language may play a factor in music selection, culturally, Chinese pop music is preferred to Western.

### Spending power

But the million-dollar question is: Do students have money to burn, or at least to spend? The answer is a resounding yes.

More than 60 percent of the students interviewed spend more than ¥500 (\$60.38) per month—a huge sum considering that in 2002, Beijing's per capita annual income was ¥13,252 (\$1,600) and Shanghai's was ¥14,396 (\$1,739). Ten percent of these students spend more than ¥1,000 (\$121) a month. Female students in Beijing and Shanghai have similar disposable income levels—roughly ¥300 (\$36.23) per month. But there are some exceptions. While more than three-quarters of the male students polled in Shanghai have more than ¥500 to spend per month, less than half of male students polled in Beijing have more than ¥500 to spend each month.

Students were also polled about how they would spend their money if they became successful entrepreneurs. When respondents were asked which brand of car they would buy if they earned ¥1 million (\$120,773) per year, respondents mentioned 75 brands and models. Initially it seemed that German cars made a clean sweep—31 percent of university students would buy a BMW, followed by a Mercedes-Benz, and then a Volkswagen. But on closer examination a more complicated trend emerged: Students chose a range of cars that were either backed by companies with strong corporate reputations or that possess a distinct style, such as Ferrari.

### Translating cool into profits

Today's students perceive brands and companies in a similar way. Brand names and corporate reputation overlap. Common themes that the top-rated global cool brand Nike and the top-rated Chinese cool brand Haier share are individualism and inspiration. Nike symbolizes empowerment because it encourages individuals to believe in themselves and that they can "just do it," while Haier's CEO is a charismatic, inspiring figure who leads by example and stands out from the crowd. Possessing a unique product may give students a sense of empowerment. So for companies to build strong consumer brands in China, and to reach China's youth, they must also build strong corporate reputations. Corporations seeking to succeed with this group of Chinese consumers, then, must work to embody and project an image of individualism, entrepreneurship, and empowerment. 完

## China Cool Hunt Survey Questions

### What Are the Coolest Three Brands in the World?

Company/Brand	Beijing Percent of Votes	Shanghai Percent of Votes
Nike	31.7	29.9
Sony	18.7	13.1
Adidas	18.6	11.5
BMW	10.8	9.4
Microsoft	12.3	5.9
Coca-Cola	12.2	5.4
IBM	7.6	8.7
Nokia	8.4	6.0
Samsung	6.0	4.2
Ferrari	6.2	3.9
Christian Dior	3.4	1.6
Only	3.0	3.1

### Please Name Your Top Three Fashion Brands

Company/Brand	Percent of Votes
Nike	25.2
Adidas	12.6
Sony	9.2
Only	7.9
Elle	5.3
Nokia	4.3
Li Ning	4.2
Samsung	3.9
Christian Dior	3.7

### What Are the Coolest Brands in China?

Company/Brand	Percent of Votes
Haier	37.1
Lenovo	17.7
Li Ning	16.1
TCL	6.2

Notes: University students polled=1,200; Beijing=600; Shanghai=600  
Source: China Cool Hunt survey, April 2004; administered by Hill & Knowlton (China) Public Relations Co. Ltd., *Seventeen* magazine (China), and Sinomonitor International

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### PAULA M. MILLER

IKEA Group, a franchisee of Inter IKEA Systems BV, entered China in 1998 when it opened its first store in Shanghai. IKEA's mainland China stores belong to the IKEA Group and operate as joint ventures. (IKEA Hong Kong and IKEA Taiwan are separate franchisees.)

A new, redesigned Shanghai store opened in 2003, replacing the original outlet. At 33,000 m<sup>2</sup>, the two-story Puxi district outlet is four times larger than the first store and is now IKEA's second-largest in Asia, after the one in Kuala Lumpur, Malaysia. Shanghai's new IKEA, which attracted roughly 80,000 visitors on its opening day, offers more than 7,000 products and features a 170 m<sup>2</sup> children's playground and a 500-seat restaurant.

IKEA opened its first Beijing store in early 1999. A second Beijing store is currently under construction in the city's northern Chaoyang district, and the company plans to enter Shenzhen after 2005. IKEA expects to have 10 large stores up and running in China by 2010.

Important to this physical expansion, of course, is revenue expansion. After lowering

prices nearly 10 percent, IKEA's China sales rose 35 percent in 2003. Sales were up 50 percent in the first three months of 2004 alone.

In fiscal year 2003, PRC factories produced nearly a quarter of IKEA's goods; the company aims to produce more than a third of its goods locally in the next four years. In early 2004, 66 percent of the company's merchandise was produced in Europe, 31 percent in Asia (mainly Vietnam), and 3 percent in the United States. In China, IKEA currently uses 362 suppliers and employs several hundred thousand employees, directly and indirectly.

### Who shops at IKEA?

Ulf Smedberg, marketing manager of IKEA China, described IKEA's mission as "to provide smart solutions for homes by implementing three criteria: good design, functionality, and low price." But, he explained, "When IKEA first entered China, the store was considered too expensive for its target consumers—young, professional couples—and the company lowered its

### PAULA M. MILLER

is assistant editor of the *CBR*.

prices. The store's prices are now considered mid-range in Shanghai." A typical IKEA customer earns about ¥3,300 (\$399) per month—the national average is ¥1,000 (\$121)—and buys ¥300 (\$36) of merchandise per visit.

Most of IKEA's China customers are 20 to 35 years old, but the stores now attract an increasing number of customers closer to age 45, most likely a result of the store's market repositioning. Many customers are families with children or are double-income, well-educated couples with no children. IKEA's customers are generally better educated, earn higher incomes, and travel more than the average Chinese. And, as is true in IKEA shops around the world, roughly 70 percent of IKEA customers are women.

### Adapting products and services

IKEA offers the same product range in all countries—8,000 to 10,000 products depending on the store's size. But the company adapts the layout of the store, presentation of the goods, home solutions offered, and prices according to national economic and cultural conditions. In China, the store layouts reflect the layout of many Chinese apartments, and since many Chinese apartments have balconies, the stores even include a balcony section.

Smedberg, who has worked for IKEA for nine years, says that Chinese tend to spend most on their living rooms, which he terms the heart of the home where many people "show off" and entertain. Many Chinese living rooms contain a dining table as well, so dining room purchases are also common. Because Chinese kitchens are generally small, customers spend less on them. At one time, bedroom furniture and decorations were the least popular purchases in China, perhaps because the room is the most private and thus least visible place in the home. But IKEA has recently witnessed an enormous increase in bedroom sales—especially in Shanghai. Next year, the company plans to launch a global campaign that targets the complete bedroom.

"In terms of housing, the average square meters per person in China has been increasing considerably. Until recently, apartments averaged 40 m<sup>2</sup>; now Beijing and Shanghai apartments average 80 m<sup>2</sup>. This means several things: Chinese residents need more furnishings and, because consumers are buying more gadgets, they need more storage containers and facilities. It also means IKEA needs to keep its home-life study up-to-date because change happens so fast," says Smedberg.

IKEA alters products to suit the needs of Chinese consumers. "When IKEA first began operations in China, it sold Hong Kong-sized beds, which are shorter than standard-sized beds. But we quickly realized the beds were too short for mainland China and switched to selling standard beds," Smedberg adds. Many countries require slight product modifications; for example, consumers in the United States generally prefer larger items.

IKEA also had to adapt its location and do-it-yourself (DIY) assembly concept to China. IKEA has built its PRC stores near public transportation lines, offers local home delivery and long-distance delivery to major cities

## THE SWEDISH FURNITURE RETAIL GIANT IS BRINGING ITS UNIQUE STYLE—AND SALES MODEL—TO CHINA



Photographs provided by IKEA

in China for a fee, maintains taxi lanes, and offers fee-based assembly services. Smedberg explained, "Usually IKEA stores open relatively far out in the suburbs, but we knew China had to be different since, for example, only 20 percent of visitors in Shanghai have cars. But the stores also need ample parking so that people can visit with their own cars in the future. The Shanghai store has almost 1,000 parking places." Smedberg also commented that IKEA's DIY products are appreciated in the West, because customers know they save money by assembling products themselves and because many customers actually enjoy assembling the furniture. But in China, where labor is cheap, the DIY notion has not taken hold, so Chinese customers use IKEA's assembly services more than customers in other countries.



China with plants, drying laundry, and a newspaper. But the man is sitting in a red, modern, upholstered IKEA chair—one that is currently on sale.

## Trials and tribulations

According to Smedberg, IKEA faces three main challenges in China: pricing, high duty rates, and the PRC bureaucracy. It has been difficult for the company to set prices at a level that is good for both customers and the company. IKEA has been hit with heavy import taxes in China, though the company aims to relocate production of many items to China to solve this problem. The country already supplies glass,

timber, textiles, hardware, plastic, and almost anything else the store needs. IKEA faces strict quotas and has difficulties importing food to its Swedish restaurant. The company now has a food-import agent that handles all related issues, including labeling.

IKEA's China distribution center is in Shanghai. Next year, a new distribution center will open in Shanghai that will distribute to China and Japan.

What about IKEA's competition in China? UK-based B&Q, the largest DIY retailer in Europe and the third-largest in world, has several stores in China. But IKEA's biggest worries may be the many international and Chinese chains and companies that counterfeit IKEA products. Smedberg remarked, "The more popular IKEA becomes, the more competition we have. Of course healthy competition is good—it makes home furnishings more popular. But it's bad that increasingly more companies copy our products." He believes more products are copied now because more IKEA products are made in China, and some of their suppliers also supply other furniture and home design companies. IKEA's online catalogue also makes products easy to view and copy. Smedberg continued, "Some furniture stores keep IKEA catalogues in their store and tell customers that they can reproduce the furniture at a lower price. Stores try to copy the IKEA concept and products, slightly change the name, slightly lower the price, and suddenly, home furnishing stores in China are blue and yellow as well. But if we spent the time, money, and energy required to chase copycats there would be no time to focus on anything else. We need to focus on other aspects of IKEA."

IKEA's China sales seem certain to boom, but for die-hard IKEA fans, there is bad news and good news about the multinational corporation's current China operations. The bad news is that shoppers will not find IKEA's famous Swedish cinnamon rolls in any of the China stores. The good news: The rolls are scheduled to arrive shortly.

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## Research, education, and marketing

To better understand people's lifestyles and their home aspirations and frustrations, IKEA conducts home visits, surveys, and focus groups. The company also conducts an annual "Market Capital" tracking study in each continent. The study asks customers in the stores and in the surrounding areas about IKEA's product range and price and service levels. It also provides helpful information on IKEA's target consumer groups.

To help Chinese customers understand the IKEA concept, the company posts in-store instructions and design advice, publishes brochures and catalogues, and operates a detailed website. For example, one in-store sign portrays an older couple whose child just moved away from home to attend college. The couple discusses how IKEA helped them to convert their son's former bedroom into a new room for their use. The store's room settings are full of furnishing and decor ideas. The IKEA catalogue, which is distributed in the store and through the mail, is IKEA's main promotional tool. IKEA also produces brief TV spots that show living areas before and after IKEA's magic touch.

Charles Sampson, CEO of Saatchi & Saatchi China, the advertising firm that creates IKEA's print ads in China, explained, "Many Chinese consumers follow an 'all or nothing' approach to interior design. If they want to redesign their living room they will either completely redo everything or do nothing. IKEA wanted to convey that change can be easy, and that it is okay to make small changes, step-by-step." Saatchi & Saatchi's "Small changes, a refreshing new life" advertisements help to convey this message. One advertisement shows an old man sitting on his balcony in his shorts and undershirt, while holding a bird cage and whistling to his bird. The balcony looks like a typical cement-and-tile balcony in



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**TRADE**

# The Emerging Asian Union

**Edward Gresser**

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**F**ew topics received more attention in Washington, DC, in early spring 2004 than China. Last winter, the Bush Administration's Commerce and Treasury secretaries made pilgrimages to Beijing to deposit long lists of appeals, petitions, and protests. China is charged with delinquency in its World Trade Organization (WTO) commitments; the Bush Administration is charged with weakness in enforcing them. And lawsuits were flying: the AFL-CIO filed a case against Chinese labor abuses with the US Trade Representative (USTR) in March, and a group of manufacturers is said to have prepared one against Chinese currency policy. Rejecting both, the USTR itself has protested Chinese computer chip taxes at the WTO.





# China Trade, Asian Investment, and a New Competitive Challenge

The sheer number of complaints is striking. But equally striking is the fact that few of them are new. China's labor record has not notably improved in recent years—but neither has it deteriorated. China's currency rates have not changed since 1994. And while China's implementation of WTO commitments has gaps, with chips a high-profile dispute and intellectual property rights perhaps even more so, the Chinese economy is more open than ever before and sucking in imports at an extraordinary pace.

With little attention in the United States, the twenty-first century has brought rapid integration of the Asian economy and the emergence of what can be termed an informal "Asian Union." For the first time, China's manpower and low costs are united with the money and technology of Japan, South Korea, Taiwan, Hong Kong, and Singapore. China's emergence as America's most visible source of goods thus reflects a structural change in the Asian economy more than it reflects new Chinese trade or labor policies. This development offers economic and security opportunities, carries with it potential sources of risk and financial instability, and also means a powerful new competitive challenge.

Demographic realities mean that Asia's new competitive advantages are unlikely to last forever. But in the next decade American business, labor, and government may find themselves adjusting to a much more challenging environment.

## Economic integration

One might begin with a single fact: last year Japan exported more to "Greater China" than to the United States. Japanese firms sent cars, computer chips, televisions, and other goods worth 13.7 trillion yen west to mainland China, Hong Kong, and Taiwan in 2003; and only 13.6 trillion yen worth of goods east to America.

Setting aside the World War II years as anomalous, one must go back to 1873 to find Japanese statisticians recording 4.3 million yen worth of exports to China and 4.2 million to the United States. By 1874, the United States had passed China to become Japan's major export market and did not trail again in peacetime for 130 years.

Trends are similar in South Korea, Taiwan, Hong Kong, and much of Southeast Asia, with China first passing Japan and now approaching the

United States as Asia's main export market. Their experience, like that of Japan, reflects a series of Asia-Pacific milestones passed in the 1990s. Some got little attention in America, but together they leave China more secure and more integrated into the Pacific economy than at any time since the early 1800s:

- In 1992, China normalized diplomatic relations with South Korea. Since then, the wealthy South Korean economy has been rapidly merging with the North China industrial complex around Beijing and Tianjin.
- In 1997, pursuant to the Sino-British lease agreement of 1898, Hong Kong returned to Chinese sovereignty; smaller Macao followed in 1999. Hong Kong investment in China has boomed for a decade and will become even larger as the mainland government and Hong Kong implement the Closer Economic Partnership Arrangement.
- Between 1996 and 2001, Taiwan governments relaxed post-revolutionary bans on mainland investment, bringing Taiwan manufacturers and high-tech firms to Shanghai, Fujian, and other sites around China.
- And in 2001, China joined the WTO. To previous openings to investment and trade, this added financial services, telecom and distribution liberalization, intellectual property law reform, trading rights, and at least legal guarantees against extraction of technology from investors.

**Table 1:**  
Foreign Direct Investment in China, 2000 and 2002

Source	No. of New Projects		Annual FDI Flows (\$ billion)	
	2000	2002	2000	2002
<b>Total</b>	<b>22,500</b>	<b>34,200</b>	<b>40.8</b>	<b>52.7</b>
Hong Kong	7,100	10,800	16.2	17.8
Offshore Islands*	1,500	2,700	4.4	8.2
United States	2,600	3,400	4.4	5.4
South Korea	2,600	4,000	1.5	2.7
Japan	1,600	2,750	3.2	4.2
Taiwan	3,100	4,900	2.4	4.0
Europe	1,100	1,500	4.7	3.7
ASEAN	1,000	1,700	2.8	3.2

Source: Progressive Policy Institute (PPI)

\* Tax havens such as the Virgin Islands, Samoa, and the Bahamas

**Table 2:**  
**American Imports from China, 1999–2003**

Product	1999	2003	Growth 1999–2003
<b>Total (by value)</b>	<b>\$82 billion</b>	<b>\$152 billion</b>	<b>87%</b>
Electric toothbrushes	767,000	55.8 million	7,380%
Child safety seats for autos	134,000	3,813,000	2,850%
Perfume	22,000 kg	1.97 million kg	890%
Wooden beds	584,000	3.2 million	650%
Television sets	3.6 million	13.3 million	470%
Shoes	1.25 million pairs	1.64 million pairs	31%
Dolls	460 million	454 million	-1%

Source: PPI

The consequence is a wave of investment in the mainland. American debate has focused intently on the “outsourcing” of American companies. But most investment in China comes from Asia’s five rich economies: Japan, South Korea, Taiwan, Hong Kong, and Singapore. This investment is blurring Asia’s economic borders, uniting the financial and technological power of Japan and the ex-tigers with China’s low costs and vast manpower reserves.

This is a healthy and long-delayed shift. In retrospect, Asian economic integration should have happened after World War II. But in the years when Europe began its long and slow union, the Chinese revolution and the Korean War prevented a similar evolution in Asia. The evolution is now, however, proceeding at extraordinary speed. One can think of the result as an informal Asian Union—an integrated economy roughly the same size as its \$11 trillion European counterpart, though without its elaborate legal framework and policy coordination among governments.

**Table 3:**  
**American Imports from East Asia, 2000–03 (\$ billion)**

Source	2000	2003	Change 2000–03
East Asia	\$348	\$357	+\$9
Mainland China	\$100	\$152	+\$52
Wealthy Asia	\$258	\$211	-\$47
Japan	\$147	\$118	-\$29
South Korea	\$40	\$37	-\$3
Taiwan	\$41	\$32	-\$9
Singapore	\$19	\$15	-\$4
Hong Kong	\$12	\$9	-\$3
Other ASEAN	\$69	\$67	-\$2

Source: PPI

## Asian investment trends

Since the late 1990s, China has received \$40 billion to \$50 billion a year in direct investment: factories, research stations, sales offices, and so on. Between 2000 and 2002 (complete 2003 statistics are not yet available), foreign firms opened 83,000 new projects in China. The Chinese government characterizes about three-quarters of them as manufacturing facilities.

In other words, foreign firms set up roughly 60,000 new plants on the mainland in the first three years of the twenty-first century. This may overstate the total to some extent, as definitions of “manufacturing” and “foreign-invested facility” can be blurry. But nonetheless the total is very high. For context, the *total* number of manufacturing plants in the United States is about 350,000.

Some investors are Americans, adding Chinese plants to existing American and international facilities or moving to China altogether. But as Table 1 shows, American investment is only a small fraction, and maybe not a growing one, of total investment in mainland China.

So excluding those financed from offshore islands, about 80 percent of the new projects are Asian rather than western. The actual ratio is probably closer to 85 percent, since most offshore island projects are thought to involve Taiwan firms avoiding Taipei government scrutiny and mainland Chinese firms hoping to get incentives meant for foreign investors.

Why are they coming? For one thing, China’s government tries enthusiastically to lure them. Discriminatory taxes on foreign-made goods as opposed to locally produced counterparts are an example. The Bush Administration’s recent filing of a WTO case over semiconductor taxation highlights an especially objectionable case. Other incentives range from tax rebates for exporters to the wine-and-dine sessions common worldwide. But the realities of geopolitics, economic comparative advantages, and demography mean that investment promotion policies simply accent a phenomenon that would happen in any case. To list these realities briefly:

- China’s economy has opened up through domestic reform and WTO membership.
- China’s diplomatic situation has improved, through stable relations with Japan, peace with South Korea, and renewed sovereignty over Hong Kong.
- China has an almost unique combination of big-country, poor-country, rich-country, and regional-country advantages for Asian investors: hundreds of millions of workers at relatively (though not spectacularly) low wages, high literacy rates, good infrastructure, and cultural compatibility with its neighbors.

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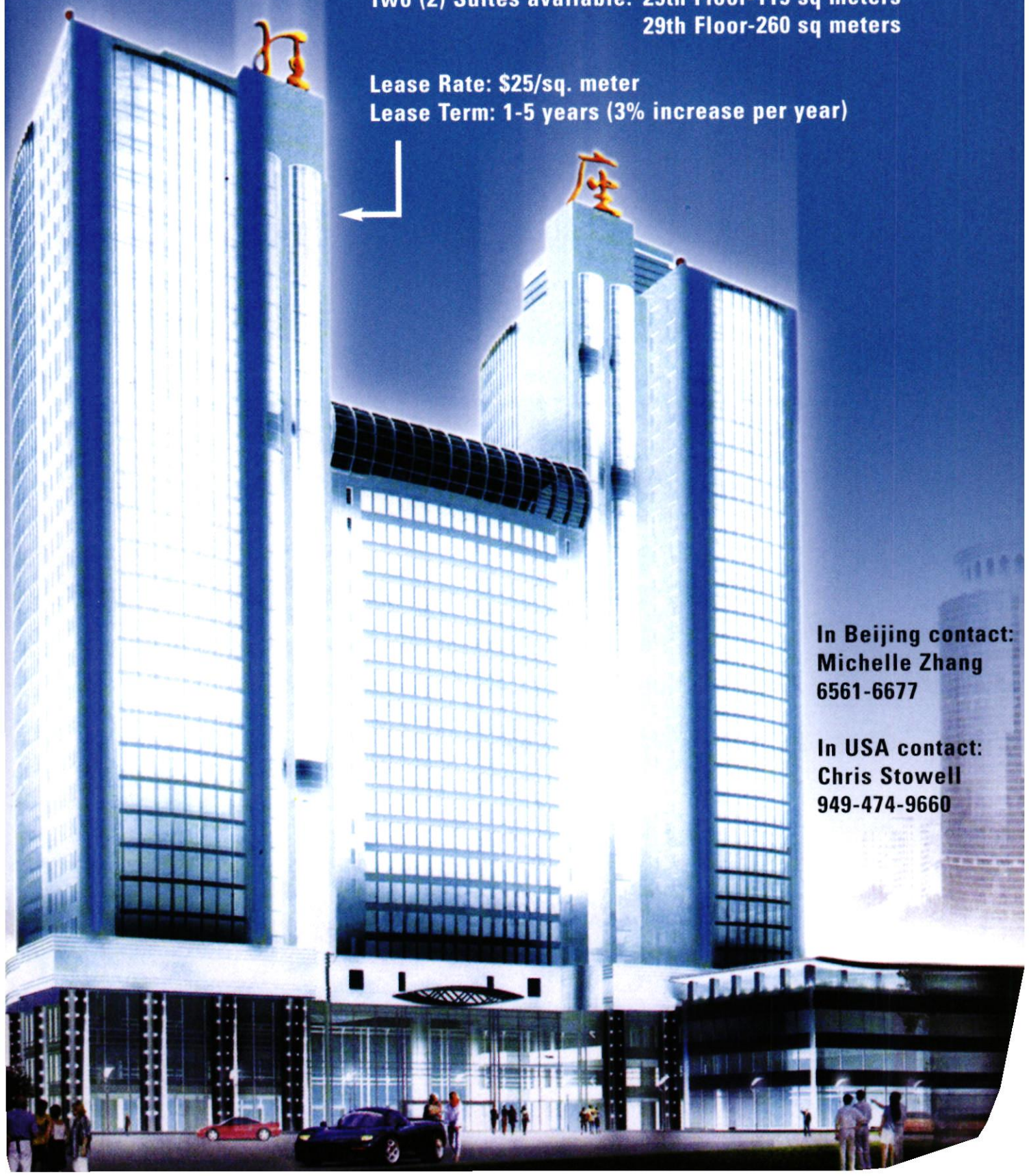
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## China as exporter

The consequences are big enough to numb. Most visible in the United States are imports from China. As Japanese, South Korean, Taiwan, and other plants start production, "Chinese" exports to the United States boom. Between 2000 and 2003, such exports rose from \$100 billion to \$152 billion and accounted for all of America's net import growth.

With most of these imports still concentrated in consumer goods, the phenomenon is even more visible and has a more powerful psychological impact than the numbers alone would suggest. But "Chinese" exports are diversifying as well as booming.

Three popular consumer goods—clothes, shoes, and toys—accounted for nearly half of American imports from China in 1993. By 1999, these products made up only a third of the total, and by 2003 were less than a quarter. As Table 2 shows, the fastest-growing imports from China are now sophisticated, capital-intensive goods like TV sets, perfumes, and child safety seats. More is on the way—Taiwan firms, for example, are already reported to be building 19 state-of-the-art semiconductor plants around Shanghai, and firms from Malaysia, South Korea, and the United States are not far behind.

America's direct imports from wealthy Asian countries, meanwhile, have plummeted. Table 3 shows how falling imports from Japan and the other four wealthy Asian economies almost precisely offset new purchases from China. This is actually a bit too precise—it reflects the fact that information technology imports have dropped as well as shifts of production to the mainland—but illustrates the fact that "Chinese imports" might more accurately be termed imports from an integrated Asian regional economy.

## China as importer

The other half of the ledger shows an equally striking trend. China is also emerging rapidly as one of the world's most enthusiastic importers.

American exports to China, for example, have more than doubled in four years. The \$13 billion exported in 1999 reached \$28 billion last year. This is faster export growth than we see with any other major country and accounts for more than half of America's worldwide export growth over the past four years. Though the absolute totals are lower, the rate of export growth to China is actually a bit higher than the rate of growth of imports from China.

Even these statistics may understate the success of America's exporters. From the reopening of trade during the Nixon Administration to the late 1990s, America's main exports to China consisted of government purchases of grain and airplanes. Such purchases were often concluded for political reasons. But as Table 4 shows, American export growth since then has been concentrated in a long list of new products for which Chinese demand must be mainly commercial.

Chinese purchases of aircraft remain an important part of the trade relationship, but have not noticeably grown since the 1990s. Grain exports, meanwhile, (except soybeans) plunged in the mid-1990s and have not recovered. But exports of American computer chips have tripled since 1999. Some other industrial inputs, including older products like textiles and steel, have done even better. And so have a long list of other goods, from auto parts to fish, cars, refined copper, spectacles, and oranges.

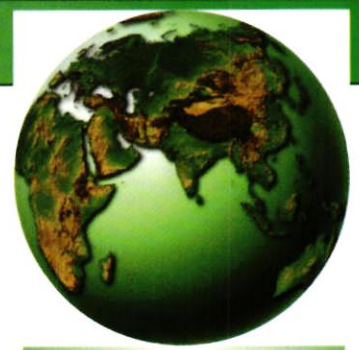
Only a global perspective, however, shows the true scale of China's import boom. Since 1999, America's imports have grown by about a \$100 billion. Japan's have grown by about \$70 billion, and Europe's by about \$100 billion. None of these are small figures. But China's imports have grown by nearly \$250 billion—accounting for a quarter of the world's import growth since 1999, and nearly as much as the European Union, the United States, and Japan combined.

As successful as American exporters may have been, the businesses of most other countries have done better. Filipino exports to China are typical, quadrupling from \$500 million to \$2 billion (plus another \$1.5 billion to Hong Kong) in four years. Other mid-income Southeast Asian countries, such as Thailand and Malaysia, now supply Chinese factories with everything from rubber to chips. Turkish exports to China have grown tenfold, led by steel and auto parts. Pacific-basin natural resource exporters—Peru, Chile, and Russia—have similar records, with China's purchases large enough to raise world prices for lead, iron ore, and other raw materials. Even the profitability of Panama Canal operations has jumped, as ships arrive from China

**Table 4:**  
**US Exports to Mainland China 1999–2003**

Product	1999 Exports	2003 Exports	Growth
<b>All goods</b>	<b>\$13.1 billion</b>	<b>\$28.4 billion</b>	<b>117%</b>
Refined copper	\$1.0 million	\$157.0 million	10,000%+
Oranges	\$0.1 million	\$16.0 million	10,000%+
Spectacles	\$0.2 million	\$1.1 million	540%
Steel	\$73.0 million	\$452.0 million	520%
Semiconductors	\$0.7 billion	\$2.4 billion	340%
Textile yarn & fabric	\$79.0 million	\$250.0 million	220%
Auto parts	\$151.0 million	\$325.0 million	115%
Fish	\$90.0 million	\$175.0 million	94%
Airplanes	\$2.1 billion	\$2.2 billion	4%
Wheat, rice & corn	\$49.0 million	\$36.0 million	-27%

Source: PPI



**Table 5:**  
**World Exports to Mainland China**  
**1999–2003 (\$ billion)**

Country	1999	2003	Change
Turkey	\$0.04	\$0.4	990%
South Africa	\$0.24	\$1.6	767%
India	\$0.5	\$3.1	520%
The Philippines to Mainland (To Hong Kong)	\$0.6	\$2.1	250%
Peru	\$0.2	\$0.66	209%
Russia	\$3.5	\$10.0	185%
South Korea	\$13.7	\$39.0	180%
Japan	\$23.5	\$57.0	142%
United States	\$13.0	\$28.4	117%
European Union	\$20.6	\$38.0	84%
<b>World</b>	<b>\$166.0</b>	<b>\$410.0</b>	<b>147%</b>

Source: PPI

carrying clothes and bringing away ores and capital goods.

Nor does this seem enough. In January, in an amusing echo of America's steel-tariff debates, Chinese manufacturers and construction firms were appealing to their government to lift antidumping penalties on Russian, Taiwan, Ukrainian, and South Korean steel. The South Korean government, meanwhile, imposed emergency *export* restraints on steel to avoid a supply crisis in the domestic Hyundai and Daewoo plants.

### Some cautionary points

What does all this mean for American debates on US-China trade?

The total picture certainly includes unfair trade practices, objectionable tax policies, investment promotion schemes and so on. A new generation of trade policy can usefully tackle them. But they are relatively small parts of a phenomenon that is much bigger and has little to do with concepts of fairness and unfairness. Economic integration means Asia can suddenly make high-quality goods at lower costs. Americans, in business and labor as well as government, need to respond appropriately.

But we should remember that Asia has vulnerabilities and eroding areas of advantage as well. Three in particular are important to remember: the risk of unexpected political events and financial overheating; little-noted labor force trends in China; and larger demographic trends.

#### ● Unexpected events and asset bubbles

Rapid security or financial shifts, of course, can derail or delay trade flows and economic integration alike. Sudden security crises in the

Taiwan Strait or on the Korean peninsula are entirely possible, as recent electoral results from Taipei and the slow pace of negotiations on North Korea's nuclear program remind us. Either would put predictions for Asia's future in the trash basket.

Financial trends also provide grounds to expect a slowing, or even a sharp break, in China's growth and Asia's mainland investment.

Observers in the West and the Chinese government both note fears of credit-fueled booms and asset bubbles. Guo Shuqing, director of China's foreign-exchange bureau, hinted at this in a press release quoted by the *Washington Post*, stating that "the inflation rate is rising and the asset bubble problem is starting to get worrying." China finance expert Nicholas Lardy likewise noted last year that outstanding credit more than doubled between 2002 and early 2003, rising from ¥0.9 trillion to ¥1.9 trillion. This, he argues, probably implies growth in bad loans and poor investment, together with potential for rising inflation and excessive investments in real estate and manufacturing like those that presaged the financial crises of 1997–99.

Trade figures tend to support the hypothesis that the Chinese economy is overheating. In 2003, China's imports grew by 40 percent, and exports by perhaps 35 percent. In US history, such rates of trade growth occur only in anomalous periods. The leading examples are 1866, the year after the Civil War; 1919, the year after the World War I; 1942, as the Lend-Lease program kicked into gear; and 1946, the year after World War II. By January 2004, annualized import growth seems to have been 77 percent—well beyond anything in modern American history.

Obviously such comparisons are not perfect. China's economy is very different from that of the United States, and its rapid integration into the global economy may mean these figures are more benign than they would be in America. But the odds are that such trends are not wholly healthy. China is probably investing, buying, and borrowing too much, and Asia as a whole may pay a substantial price for the boom in coming years.

This leads back to the potential for political shocks. Most countries hit by the financial crisis in 1997 were healthy again by the turn of the century. But it is interesting to note that of the three Asian countries hit hardest by the crisis, the two that recovered best were the democracies: Thailand and South Korea. The authoritarian Indonesian system, in contrast, collapsed under the strain and the country continues to struggle today. China might have more in common with Indonesia than with the other two.

#### ● Rising costs

Asia's current advantage is its pairing of China's low labor and land costs with the wealth and technology of its neighbors. But land costs

**Of the  
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**Table 6:**  
**China's Baby Bust**

Country	Median Age, 1975	Median Age, 2000	Median Age, 2025
Japan	30	41	50
Europe	32	38	45
China	21	30	39
United States	29	36	39
World	22	27	32

Source: PPI

are rising fast in China's coastal cities, and labor costs may also rise rapidly in coming years.

Repression of labor rights is a dismal fact of Chinese politics. But anti-union policies and immigration restrictions may not be enough to overcome the power of labor markets. Wage data is notoriously tangled and politicized, but several sources seem to show that Chinese wages and overall labor costs are rising. This is especially clear in the coastal urban areas that attract most foreign investment and produce most of China's exports. To cite a few anecdotal points:

- ▶ The International Labor Organization's wage database indicates rapid wage growth for city residents as rural incomes stagnate. These figures show real manufacturing wages in China nearly doubling in the last decade, from ¥280 to ¥502 in real terms per month.
- ▶ The 2002 White Paper released jointly by the Beijing and Shanghai American Chambers of Commerce asserted that urban wages for employees of American companies grew nearly 9 percent per year from 1998–2001, and that skilled jobs commanded even higher salary jumps of up to 20 percent.
- ▶ China's own statistical data likewise reports general labor cost increases of 16–18 percent per year in export centers like Guangzhou and Shanghai, even as rural incomes stagnate and hold down national averages.

If such trends continue, one of Asia's major advantages relative to the United States and some of its neighbors may erode sooner than most people predict.

Bolstering this hypothesis are China's low fertility and immigration rates. The World Bank projects that over the next 10 years China's labor force will grow barely half as fast as that of the world as a whole (1.4 percent per year for the world, 0.8 percent for China), and even more slowly than the 0.9 percent annual rate projected for America. The result is likely to be a mild labor shortage in the next decade.

Slow overall labor-force growth, of course, can still allow urban labor and therefore manufacturing industry to grow rapidly, as rural workers move to cities. But as time passes, coastal export platforms like Guangdong and Shanghai might find the sup-

ply of cheap workers running out. Thus they would come to look more like Taiwan and South Korea than like low-wage manufacturing parks. Strong education and capital investment would continue to spur growth, but wages and labor costs would likely begin converging with those of long-industrialized countries.

## ● Aging China

Finally, and perhaps most important, China is getting old.

China is now by far the "youngest" of the great powers. Its median age is about 30, well below those of the other seven countries participating in the G-8, the UN Security Council, or both. The United States is second "youngest" with a median age of 35, while the others range up to the early forties for Italy and Japan. By the mid-2020s, China will catch the United States at 39 and age much more quickly afterward.

The number of Chinese children has already dropped by 50 million since the 1970s and is continuing to fall. So the new factories now opening each week may, sooner than one expects, begin to encounter labor shortages. This may push the cost of labor up even faster than economic growth and productivity might suggest.

Meanwhile, as there are fewer Chinese children there are also more elderly. By 2025, more than 200 million Chinese will be over 65. This means an extraordinary housing, health, and pension challenge—consider the fact that 200 million is more than two-thirds of the total US population.

Even if this does not lead to the dire consequences a recent Central Intelligence Agency paper suggests—"China could confront slower growth, increased political instability, and perhaps even pressure for significant cultural change, given the lack of sophisticated pension systems, health facilities and capital markets"—it means that absent a new demographic shift, one of China's (and therefore East Asia's) principal sources of comparative advantage will probably erode over the next two decades.

## Benign challenge

An Asian Union has some powerful competitive strengths. But a competitive challenge is a benign challenge. For most of the twentieth century, China posed a very different set of questions for the United States: questions that related not to jobs and adjustment, but to Asia's political stability, the spread of radical ideologies, and in some cases war. For instance, the Korean War would have been improbable without a radicalized China, and the Vietnam War impossible.

An economic challenge, by contrast, threatens no lives and can be met by peaceful negotiations abroad and reform at home. This is of course no reason to be complacent or dismiss the importance of economics. But it is a reason to keep the trade debate, as heated and controversial as it may be, in a healthy perspective. 完

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# PRIVATE EQUITY IN CHINA: RISK FOR REWARD

Richard Daniel Ewing

**The struggles  
and rewards  
of private  
capital in  
China**

**Richard Daniel Ewing** is a nonresident fellow of Chinese studies at the Nixon Center in Washington, DC, and will begin working as a consultant at McKinsey & Co. in October.

**P**ivate equity managers today see opportunities in vast sectors of the PRC economy that have no dominant industry leader, and in research labs that are percolating with innovations. Global private equity firms are rapidly opening offices in China and raising hundreds of millions of dollars to invest in the country. As Jim Hildebrandt, managing director at Bain & Co., noted at a recent private equity panel sponsored by the Wharton School of the University of Pennsylvania: "China is the most important growth market for private equity."

China's leaders recognize that they must build a vibrant private sector and that private equity plays an important role toward this end. China Venture Capital Association Chair Chang Sun maintains that China's World Trade Organization entry is releasing a groundswell of Chinese entrepreneurship and that private equity can supply the capital those businesses need, accelerating economic growth and raising employment.



Figure: Total Venture Capital Investment in China (\$ million)



Source: Warburg Pincus LLC; www.zero2ipo.com.cn

## Minding the gap between banks and stock markets

Despite the importance of the small business sector, China's financial markets are poorly equipped to fund its growth. Chinese banks loan much of their money to state-owned enterprises (SOEs) and lack the tools to analyze the credit risk of new firms with unproven technology. Besides, most start-ups lose money for years before becoming profitable, making fixed-debt payments difficult to bear. New listings on the Shanghai and Shenzhen stock exchanges were frozen for the past several years, effectively closing the initial public offering (IPO) capital window to private firms (although there are signs of a potential thaw). This means that private equity investors are often the only ones with money to fund entrepreneurial companies.

Private equity investors dream of discovering China's new Microsoft, Amazon, or FedEx. These diamonds-in-the-rough exist, but are hard to find. Many private equity investors compare China today to the United States in two earlier periods. The first comparison is with America's technology boom in the 1970s, when investment surged into Silicon Valley. Investors argue that the United States had a successful mix of talent, university research, and capital. China has the first two, but lacks capital and sophisticated investors to direct investments accurately into next-generation technologies. A second parallel exists between America's leveraged-buyout boom in the 1980s and China's need to restructure SOEs. In the 1980s, many large, poorly managed US conglomerates were dismantled to release value trapped in smaller divisions. Whatever the comparison, opportunity currently abounds for private equity in China.

Already, there have been some notable successes. In March, Semiconductor Manufacturing International Corp. (SMIC) launched a \$1.8 billion IPO on the New York Stock Exchange. SMIC's early investors, such as Goldman Sachs Group, Inc. and Walden International Investment Group, cashed out handsomely.

Other Chinese firms have had similar success (see Table 1). Ctrip.com International Ltd. raised \$75 million on Nasdaq last year, while Alibaba.com Corp. recently netted \$82 million in a private financing round from Softbank Corp. and other investors. Although investor enthusiasm over recent Chinese IPOs may have softened, the long-term perspective on Chinese listings is still bullish.

## Private equity's new heartthrob

The first private equity firms in China began operating in the early 1980s. Local governments sponsored private equity funds to support new businesses. One of the first was China New Technology Venture Investment Co., founded in November 1985. Foreign firms soon followed. International Data Group (IDG) formed the first foreign venture fund to operate in China in the early 1990s and became an immediate force in the industry. Additional waves of private equity followed over the next decade.

Private equity in Asia has closely followed the regional economy, growing steadily in the late 1990s, though still at lower total figures than in North America. Private equity investments in Asia shrank in 2002, but rebounded strongly the next year, rising 90 percent in 2003. Japan and South Korea dominate Asia's private equity market. China accounted for less than one-tenth of the private equity invested in Asia last year (see Table 2). Notably, despite China's clear lead in attracting foreign direct investment, India attracted more private equity annually until 2003. India's predictable laws, multiple stock exchanges, and entrepreneurial history are a strong draw. But global investment firms are reacting positively to new PRC regulations and perceived openness to private business. According to the *Asian Venture Capital Journal*, China attracted roughly \$1.3 billion in private equity in 2003, compared with a fraction of that amount the year before. As much as \$1 billion of that capital

## An Overview of Private Equity

"Private equity" refers to privately transacted equity investments in firms, typically small, growing companies. Private equity investments cover a wide range of deals and include seed, expansion, and pre-offering financing rounds. It also includes buyouts and turnaround investments. While private equity encompasses all of these transactions, venture capital (VC) only refers to funding provided in early stages. High risks and large potential rewards define VC deals. For each successful investment there are many failures.

In exchange for helping to add value to these firms, private equity investors typically demand large ownership claims and direct control over management. They are active investors, usually appointing directors and exercising strict oversight during the invest-

ment period. These firms often bring reputation and credibility to their business partners, supplying experienced management and industry contacts that young entrepreneurs lack.

Private equity serves a critical role in corporate development and in the economy. It fills the void between entrepreneurs and the public capital markets. New firms with unproven technology are too small and risky for capital markets or banks to identify, evaluate, and fund. These firms would likely remain unfunded if not for private equity. VC investors help promote growth in the most innovative and promising sectors of the economy. As Harvard University business professor Paul Gompers noted in a recent paper: "The importance of small business in any economy

makes venture capital a central part of any future economic growth."

Private equity can come from a wide range of investors (see Table 3). Some, like the Carlyle Group, are pools of capital from high net worth individuals or pension plans. Other sources are large corporations such as Intel Capital, investment banks such as Goldman Sachs Group, Inc. and CITIC Capital, local governments, or even multilateral institutions such as the Asian Development Bank. The World Bank's International Finance Corp., a major private equity investor in emerging markets, is seeking to improve corporate governance and the financial services industry in China through investments in high-quality corporations.

—Richard Daniel Ewing

**Table 1: A Sample of Venture Capital Results in China**

Company	Year	Business Sector	Select Venture Investors	IPO Raised (\$ million)	Exchange
Heng'an International Group Co. Ltd.	1998	Personal hygiene products	NA	90	HKSE
Chinadotcom Corp. Ltd.	1999	Enterprise solutions, software, and outsourcing	ChinaVest	84	NASDAQ
Eagle Brand Holdings Ltd.	1999	Ceramic sanitary wares and tiles	Walden International Investment Group, Government of Singapore	43.7	Singapore Stock Exchange
AsialInfo Holdings Inc.	2000	Telecom networks	Intel Pacific Inc., Fidelity International, Ltd., Warburg Pincus LLC, NewMargin Venture Capital, Chengwei Ventures LLC, Vantone International Group	120	NASDAQ
UTStarcom Inc.	2000	Wireless and IP switching solutions	Softbank China Venture Capital	18	NASDAQ
Sohu.com Inc.	2000	Holding company, Chinese portal	Dell Ventures, Crystal Internet Ventures Funds LP, Robertson Stephens, Inc., Walden International	68	NASDAQ
Kingdee International Software Group Co. Ltd.	2001	Software	IDG Ventures	9	HKSE
Ctrip.com International Ltd.	2003	Online travel agent	Carlyle Asia Venture Partners	75.6	NASDAQ
Semiconductor Manufacturing International Corp.	2004	Semiconductor manufacturer	Goldman Sachs Group, Inc., Walden International, Motorola, Inc., Oak Investment Partners LP, Vertex Venture Holdings	1,800	NYSE
Linktone Ltd.	2004	Wireless content and applications	Fidelity Investments, AsialInfo Holdings Inc., Goldman Sachs, Odyssey Capital Group LP*	86	NASDAQ
Shanda Interactive Entertainment Ltd.	2004	Online computer gaming	Softbank Venture Capital	152	NASDAQ
Ping An Insurance Co.	2004	Life insurance	Morgan Stanley, HSBC, Goldman Sachs	1,500 (est.)	HKSE

Note: \*These four invested in Intrinsic, Linktone's parent company. HKSE = Hong Kong Stock Exchange; NYSE = New York Stock Exchange; NA = not available. Sources: Warburg Pincus LLC, Richard Daniel Ewing

came in the form of venture investments (see Figure).

And much more capital is on its way. In 2002, for example, Warburg Pincus Asia LLC only had about \$100 million at work in China, as opposed to \$300 million in South Korea and \$600 million in India, but is committed to greatly increasing its PRC position. According to Managing Director Xiang-Dong Yang, Carlyle Asian Ventures is planning to invest between \$750 million and \$1 billion in China over the next two years.

### The search for investment targets

Private equity investors are directing their capital at three categories within China's many potentially dynamic investment sectors. First, hundreds of SOEs are considering selling, restructuring, or privatizing portions of their assets. This attractive category, however, is dominated by insiders and is difficult for foreign firms to penetrate, although the State Asset Supervision and Administration Commission is installing transaction centers and experimenting with opening up the sale of SOE assets and equity. Established private businesses are also attractive. These firms typically manufacture either for export or for the domestic market. Entrepreneurs starting new businesses also provide fertile soil for sophisticated investors. Foreign funds generally target Chinese private firms and start-ups, as these firms are most similar to their typical investment targets.

Private equity investors in China also tend to favor information technology, telecom, and biotechnology. China's world-

class universities, talented scientists, and strong research programs provide technical staff and knowledge; international private equity firms can provide global experience and management skills. Commercial banking and insurance sectors also have high potential.

Rapid changes in China's economy and social structure are, meanwhile, fostering new areas for investment. Chief among those changes are mass urbanization, privatization of state assets, large-scale infrastructure construction, and Chinese baby boomers retiring without the accumulated wealth of their Western counterparts. These trends will fuel sustained growth in areas from construction materials and equipment to telecom equipment and life insurance. Private equity firms are busy trying to identify and develop the companies that will lead these sectors.

Each private equity fund develops its own strategy to target firms. Some focus on seed-round technology investments, while others target turnarounds. Each approach requires unique expertise. For example, Hong Kong-based investment bank CITIC Capital takes a two-pronged approach, investing in mature businesses or medium-sized enterprises with an eye to bringing them to IPO, while also investing to capitalize on the relocation of manufacturing into China.

### And then there's the local competition

Despite the allure, a combination of developing legal systems, opaque regulations, and unpredictability makes the

Chinese private equity market treacherous. "There are a lot more 'X' factors across all fronts," says Eric Wei of Gilbert Global Equity Partners. Private equity investors encounter challenges at every stage in the process—from identifying companies and performing due diligence to negotiating terms and finally exiting their investments.

The first major problem is sourcing the right deals. Fund managers look at hundreds of opportunities but only select a few. In the United States, only 1 percent of proposed deals are chosen. Although China is described as a "target-rich environment," it is also a fractured landscape of multiple, distinct markets. Each region, province, or industry requires different resources.

Second, negotiating the deal can be extremely difficult. To start, Chinese entrepreneurs and experienced venture capitalists often don't agree on company valuations. Chinese entrepreneurs frequently benchmark high valuations based on similar firms in America. Venture capital (VC) firms in China, on the other hand, stress the differences and country-specific risk. Making matters worse, there is no standard methodology for valuing a company. One example of a possible friction point: Because national growth rates are an important component of a firm's total valuation, valuations for Chinese firms may be boosted disproportionately by China's optimistic growth prospects.

Next, gaining control in a corporation can be difficult for investors in China, and entrepreneurs can be unyielding. John Ying, managing director at iVentures, calls this the "head honcho problem" (*dalaoban wenti*). Frequently a start-up's founding members will refuse to give up control of the company and accept a minority ownership stake (a common condition for many start-ups in exchange for VC funding). Even in larger companies, major investors find it difficult to gain board seats and minority shareholder rights are widely disregarded. Commercial banking is particularly restricted, with the People's Bank of China capping aggregate foreign ownership at 24.9 percent (see the *CBR*, July–August 2003, p.18). A combination of disagreements over valuation and unwillingness to cede large ownership claims can easily prolong negotiations or frustrate a deal, as Newbridge Capital LLC's prolonged acquisition of a controlling 18-percent stake in Shenzhen Development Bank Co. Ltd. demonstrates.

The fourth major problem is finding and keeping a strong management team. Building a new business requires a tremendous amount of talent, sweat, and leadership. Private equity firms will often work with the same seasoned managers on numerous deals over many years; conversely, firms will not

enter a deal with personnel they do not trust. At a premium now are Chinese-born, American-educated entrepreneurs who understand the concept of shareholder value and who are returning home to start new companies. As Derek Sulger, founder of Linktone Ltd., argued at an Asia Society private equity conference, "Instituting a culture of transparency, corporate governance, and managerial accountability is critical."

Finally, the channels for exiting investments are narrow. The Shanghai and Shenzhen stock exchanges almost exclusively list SOEs, closing that option to private firms. Moreover, founder shares become nontradable legal-person shares when listed domestically, eliminating this venue as a liquidity source. Thus, firms and venture capitalists often look to strategic buyers to liquidate their positions. These buyers, typically corporations looking to acquire new capabilities, snap up smaller, innovative firms. Foreign stock exchanges offer another potential exit. Ironically, the Hong Kong and New York exchanges are more accessible to good local firms than those in Shanghai and Shenzhen. Many of these firms seek to list on Nasdaq, because as Sulger explained, "that's where investors know how to value their businesses."

Global private equity firms are increasingly meeting stiff competition from domestic funds. These local firms are nimble, have better contacts, and are quick to strike deals. China's super-rich, leading corporations, and local governments are backing new domestic funds. Domestic funds can move rapidly because they are not bound by the strict due diligence requirements of their foreign competitors, and they are less worried about currency controls, taxation, and exit strategies. For example, one foreign fund manager told a potential partner that he needed several months to perform due diligence, only to lose the investment to a local fund willing to provide funding immediately. Local funds have begun to dominate certain sectors, inspiring this foreign competitor to compare them to the "warlords of early twentieth century China."

## Room to grow

Despite these many hurdles, the private equity market in China has been improving. In June 2002 a collection of private equity firms founded the China Venture Capital Association ([www.cvca.com.hk](http://www.cvca.com.hk)) to boost bargaining power and promote entrepreneurial rights. Headed by Chang Sun, managing director

*Continued on page 66*

**Table 2:**  
Private Equity  
Invested in Asia, 2003

Country	Invested Private Equity (\$ billion)
Japan	7.7
South Korea	3.1
Australia	2.1
China	1.3
India	0.8
Other	2.8
<b>Total</b>	<b>17.5</b>

Sources: *Asia Venture Capital Journal* and *Financial Express*

**Table 3:**  
Leading Private Equity Investors in China (in alphabetic order)

Foreign	Domestic
Baring Private Equity Partners	Beijing High Technology Venture Capital Co., Ltd.
Carlyle Asia Venture Partners	Beijing Venture Capital Co., Ltd.
ChinaVest	Canton Venture Capital Co.
H&Q Asia Pacific	Guangdong Technology Venture Capital Group
IDG Technology Venture Investment	Legend Capital Co.
Intel Pacific Inc.	Millennium Ark Investment Co., Ltd.
Softbank China Venture Capital	NewMargin Venture Capital
Vertex Venture Holdings	Shandong High-tech Investment Corp.
Walden International Investment Group	Tsinghua Venture Capital Co., Ltd.
Warburg Pincus LLC	Shenzhen Capital Group Co. Ltd.

Source: [www.zero2ipo.com.cn](http://www.zero2ipo.com.cn)

# Beijing Olympics 2008:

## Opportunities for Foreign Firms

Gilbert Van Kerckhove

*Gilbert Van Kerckhove (gilbert@strategy4china.com), managing director of Beijing Global Strategy Consulting Co. Ltd. (www.strategy4china.com), served as an adviser to the Beijing Municipal Government on the planning and awarding of contracts for the 2008 Olympics. He recently discussed with CBR Editor Catherine Gelb whether opportunities for foreign firms to participate in Olympics-related projects still exist.*

**Q:** As of spring 2004, at what stage are the specific preparations for the Olympics, apart from the many efforts to modernize Beijing as a whole?

**A:** I think most of the major venues have been decided, especially for the seven large ones that take time to build. Construction has started on the National Stadium, the National Swimming Center and others. Most of the venues have to start [construction] this year.

Of course, there are 30 venues in Beijing, and people tend to forget that there are also 59 training venues. Training venues vary in size and investment levels and may offer fewer business opportunities.

**Q:** What remaining areas would you say are the most promising for foreign companies?

**A:** If you look at [Beijing] modernization issues, a company may still have a chance to grab a power plant or a subway line, but these are more or less exceptional projects. We still see a number of opportunities in subcontracting to the winners of the major venues. There is one development that is separate from the Olympics and from the modernization of the city but is still part of the larger story: The government is currently disposing of many state-owned assets. This is a very interesting process actually. [The government has set up] equity exchanges, where there is going to be massive trading of state-owned assets of all kinds that can even include software, land use rights, name rights, and of course parts of companies.... Now this is quite important because if a [foreign] company says it wants to join this modernization drive of Beijing, and decides it needs to set up a company to do some manufacturing, and take this opportunity to jumpstart production in China and tackle the whole

market, it can also go and look in this portfolio of companies that are coming on the market, some of which are bankrupt.

Actually one American company has been doing this in the food sector, where it bought a more or less bankrupt company to make chicken wings or similar products. Even for the bigger players, there are some interesting opportunities that actually have nothing [directly] to do with the Olympics.

And then there are a lot of niche players. Often you see small companies that work in China. You don't read about them in the newspaper, but they're doing their stuff, and it's quite amazing. You see a lot of these small companies from California, for example, high-tech companies selling specialized equipment within the IT/telecom world, or other small companies working in catering, logistics. Logistics is also important because it involves storage and transportation. For example, in the food sector, you need control over quality. Athletes want to eat their own food—they don't want to eat local food. They are very, let's say, demanding. Even the horses—the horses that come to China cannot eat the grass from China, they want their own fodder.

In all of these smaller niches, the market is actually changing at a dramatic pace. Quality for the Chinese is becoming more important day by day. And, yes, Chinese companies are able to deliver certain things, but it's becoming clear that if a foreign company can provide top-of-the-line goods or services, it has a chance to survive, and to do very well.

**Q:** Are there particular risks associated with Olympics projects, as opposed to the standard risks of doing business in China?

**A:** I would say you do have the same risks that you have overall in China—the very particular risks from the Olympic projects are related basically to the huge competition you're facing—very high competition, narrow profit margins.... Unfortunately a lot of the projects...will be money-losers for most of the companies because of the competition. Some companies that looked at their options very coldly have asked, "Why should we lose time and money with these projects? We can just look at another."

For example, I visited a large Singaporean real estate developer two years ago and asked if the company wanted to bid for the Olympic Village project. The company officials said to me,



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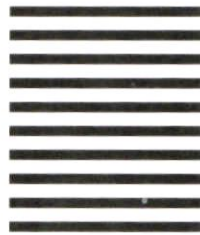
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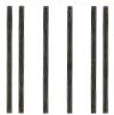
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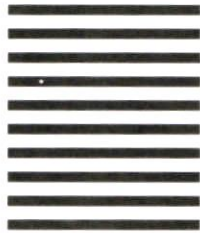
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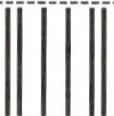
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## The most important advice I can give to everybody is: be careful and do your homework.

“Gilbert, we don’t want to, because it’s too complicated, there are one million rules to follow from the government, from the Olympic committee, and others.” What they had already done was very clever. They had looked at the Olympic Green area and had already bought up all of the surrounding land and real estate projects to develop as they wanted. This is the kind of strategic decision that needs to be made by each individual company.

**Q:** What advice would you give companies, particularly smaller and medium-sized companies, that are interested in Olympics opportunities that may still arise in the next couple years?

**A:** I think that the most important advice I can give to everybody is: be careful and do your homework. Don’t jump into the market blindly. There are a lot of tools available. You have organizations like the US-China Business Council [the publisher of the *CBR*] that can give a lot of information, the American Chamber of Commerce can give information, and of course there is the US Commercial Service. And there is the Internet.

There are several ways for smaller companies to do their homework, because the very big surprise for a lot of these companies is that they have completely misunderstood the cost of doing business in China. People look at China as a country where inexpensive microwave ovens and coffee machines come from. And then they go to China and discover that the minimum rent for a small office is \$1,000-\$2,000 a month. Then the foreign China representative for the company sets up an apartment with his family, has one or two kids, and oh boy, there goes the budget through the roof because the lease on the apartment is at least \$2,000 a month. If he needs to put his kids in the American school, it’s going to cost him \$15,000, \$20,000 a year. People don’t expect this.... They have to be very cost conscious. They have to make up their mind how they’re going to go into the market. These small companies cannot understand the market after a one- or two-week visit. They really have to do whatever they can to study.

Also, many companies try to save money on lawyers, because they think they know enough about business, or

they use a lawyer they know from California, or from Washington, but those people do not know the fine print of the legal environment in Beijing. It’s going to be very different from the legal environment in Shanghai. I’m not saying a company always has to spend tons of money on lawyers, but do at least protect yourself with good legal advice. At least make sure your lawyers advise you on any contract content and intellectual property protection. You have to see whether or not it makes sense to try to apply for patents, license technology for royalties, etc.

**Q:** How does a foreign company find out which government entities or which Chinese companies to approach? How do they find out who has the contracts, for instance, and who might have an opportunity for them?

**A:** Well, this has been the major problem today in Beijing. Of course people go to their embassy and to other organizations to figure it out. I see all the embassies fighting with it. Sometimes I talk to the small embassies and they say, “We are a small embassy, and we don’t have the muscle of the British or the Germans or the Americans.” But then you go to the Germans, the British, and the Americans, and they say they still have no clue how to deal with some issues. There is no magic solution there. Our company is working on setting up a website, with information that would be all-encompassing, that would cover all the different business sectors.

In the meantime, it is important for companies to realize that by the time a tender is issued in China, it is often too late to prepare a competitive bid. It is important to have people in Beijing lobbying the government, the customers, trying to find out which projects are in the pipeline so that the company can be informed of the tender deadlines. Often a government ministry will just send a prequalification notice to a list of companies with which it is familiar—even if, say, the world leader in a particular sector is not among those companies listed. When I have asked the Chinese side about this, they say, “We haven’t heard from anyone at that company.” 完

# CRITICAL EYE ON HEFEI



**Adam Ross**

**A** surge of foreign investment has driven growth in China's east coast for more than a decade. But as prime investment destinations become more crowded and more expensive, investors are steadily moving inland toward places like Hefei, capital of Anhui province. Compared to Shanghai and surrounding cities in Jiangsu and Zhejiang, Hefei offers lower labor costs, proximity to raw materials, and better access to China's inland markets. Investors are taking notice.

## An inland city lures investors from the coast

**Adam Ross**

is a research associate at the US-China Business Council in Shanghai.

### Strong local economy

Hefei's real GDP grew at a brisk 13.3 percent last year, fully two percent ahead of Anhui's already strong growth. Exports from Hefei rose 21.1 percent in 2003 and accounted for an eye-opening 59 percent of Anhui's total exports. Imports into Hefei, which jumped 50.8 percent, accounted for 42 percent of all imports into the province.

The Hefei metropolitan region is known nationwide as a production base for raw materials, energy resources, and household appliances. Maanshan Iron and Steel Co. Ltd., in eastern Anhui, is one of China's top 10 steel makers, reporting 2003 profits of more than ¥2.5 billion (\$302.4 million). Hong Kong-listed Anhui Conch Cement Co. Ltd. is a large producer based in the nearby city of Wuhu. And Hefei Rongshida Group is one of the nation's largest electrical home appliance manufacturers.

A short walk through central Hefei reveals that stores are filled with national brands of

clothing, appliances, and motorcycles—as well as shoppers. Local residents are clearly spending enough money to please consumer goods makers and to keep turnover brisk. Though Hefei retail centers are not yet comparable to those of Beijing and Shanghai, consumer markets are clearly developing quickly. The city is an example of China's growing inland markets, which are claiming larger shares of wealth and spending as China's economy continues to speed ahead.

### Attracting investment

In addition to the strong economic base in Hefei, local government has stepped up efforts to attract outside investment. Officials are proud to note that recent investment promotion events held in Shanghai, Beijing, Guangdong, and elsewhere in China have helped woo manufacturers to Hefei. Hefei also rewards individuals and organizations that successfully bring investment into the city with cash. The provincial government



has arranged trips to Japan and South Korea for local businesses seeking foreign partners. Local officials report that overall, new investors are most strongly swayed by Hefei's low labor costs compared to more-developed coastal regions.

Greater Hefei has two national-level economic development zones. The Economic and Technological Development Area, founded in 1993, is home to a range of heavy machinery and consumer goods manufacturers. The New and High-Technology Industrial Development Zone, launched in 1997, focuses primarily on serving electrical appliance manufacturers.

Foreign investors with significant Hefei investments include ABB Inc., the Coca-Cola Co., Mitsubishi Heavy Industries Ltd., Sanyo Electric Co. Ltd., Unilever plc, and Uni-President Enterprises Corp.

### Transport links and other difficulties

To support sustained economic growth, government at all levels will need to spend more on transportation infrastructure. There is currently no true highway between Hefei and Nanjing, the capital of neighboring Jiangsu. Since Nanjing is a major port for Hefei imports and exports, and the site of the closest international airport, it is an important link for foreign investors. Yet the 150-km trip can take a painful seven hours in traffic, and with no direct rail line between the cities, trains are no more convenient.

The railway situation should improve markedly in a few years, as construction moves forward on the Nanjing-Xi'an railroad. The two-track Nanjing-Hefei section of this line, which is targeted for completion by 2007, will reduce rail travel times between the cities to as little as 45 minutes.

Most foreign trade into and out of Hefei is processed through Shanghai or Nanjing. Foreign manufacturers in Hefei report customs disputes with officials in Shanghai, who tend to treat Hefei-based manufacturers as lower priority than Shanghai-based producers. Companies tend to have fewer problems when filing customs registrations in Hefei itself, but these kinds of procedural issues, common throughout inland China, remain a concern for foreign investors.

### Hefei and the Yangzi River Delta

Hefei would like to reap the benefits of Yangzi River Delta (YRD) growth as much as possible, but it is really only a satellite city in the region. At nearly 500 km from Shanghai (about the distance from New York City to Buffalo), the trip is not a viable commute. With such geographical limitations, government and industry leaders view the YRD primarily as a downstream

## Hefei and Anhui Economic Indicators, 2003

	Hefei		Anhui		Hefei as % of Anhui
	Amount	% change over 2002	Amount	% change over 2002	
Population	4.57 million		64.1 million		7.1
Real GDP	¥47.78 billion	+13.3%	¥397.32 billion	+11.3%	12.0
Exports	\$1.82 billion	+21.1%	\$3.06 billion	+24.9%	59.5
Imports	\$1.20 billion	+50.8%	\$2.88 billion	+66.5%	41.7

Source: Hefei Municipal Government and Anhui Council for the Promotion of International Trade

market for local goods and a continuing source of investment into Hefei.

Perhaps equally important to firms already set up in the YRD, Hefei is establishing itself as a major gateway to the 64 million people of Anhui—and to other inland locales. Present cost and geographical fundamentals support such a role, and Hefei's rich history as an economic and political center also bodes well. With continued government support, especially in boosting transportation infrastructure and in fostering free-market conditions, Hefei will become increasingly visible as a hub in the heart of China. 完

### Hefei Infrastructure Spending, 2003

Transportation Infrastructure	¥10.54 billion
Electronic Machinery and Equipment	¥10.50 billion
Telecom and Electrical Infrastructure	¥6.10 billion

Source: Hefei Municipal Government

### Anhui FDI, 2003

Contracted FDI	\$1,023.67 million	+15.4%
Utilized FDI	\$390.51 million	+4.1%

Source: Anhui Council for the Promotion of International Trade

### Hefei Links

**Hefei Development and Planning Commission**

[www.hftz.hfic.gov.cn](http://www.hftz.hfic.gov.cn)

**Hefei Information Net**

[www.hfic.gov.cn](http://www.hfic.gov.cn)

**Anhui Investment Info Net**

[www.china-anhui.com](http://www.china-anhui.com)

**Anhui Bureau of Commerce**

[www.ahmotec.gov.cn](http://www.ahmotec.gov.cn)

**Anhui Statistics Bureau**

<http://ahtj.ah.gov.cn>

### Top Five Sources of Foreign Investment, 2003 (\$ million)

Hefei		Anhui	
1. Hong Kong	\$139.60	1. Hong Kong	\$424.77
2. Virgin Islands	\$38.78	2. United States	\$114.94
3. United States	\$32.33	3. United Kingdom	\$87.78
4. Australia	\$7.79	4. Virgin Islands	\$80.73
5. Canada	\$7.65	5. South Korea	\$67.90

Source: Hefei Municipal Government and Anhui Council for the Promotion of International Trade

# SELLING CHINA

FOREIGN DIRECT INVESTMENT  
DURING THE REFORM ERA



YASHENG HUANG

## Selling China: Foreign Direct Investment during the Reform Era

by Yasheng Huang.

New York, NY: Cambridge University Press, 2003. 383 pp. \$50 hardcover.

China, since its opening up in the late 1970s, has been the greatest recipient of foreign direct investment (FDI) among developing countries (\$446 billion from 1979 to 2002) and, since 1993, has been the second-largest recipient of FDI in the world after the United States. These fascinating figures depict China as one of the most popular investment destinations in the world. While many celebrate China's large FDI absorption as an unprecedented achievement, a lone voice asks: what causes such substantial FDI inflows? What is the role of FDI in the Chinese economy? Why would expanding opportunities created by China's rapid economic growth and political stability appeal to foreign investors more than to domestic firms?

These are the questions raised in *Selling China: Foreign Direct Investment in the Reform Era*. The author, Yasheng Huang, a Harvard Business School professor, proposes an unconventional perspective on FDI in China: high levels of foreign investment result, in part, from the weaknesses rather than the strengths of the Chinese economy. Under identical macroeconomic conditions, such as market size and low labor costs, he argues, whether a country receives more or less FDI relative to domestic investments is a function of the relative competitiveness of foreign firms versus domestic firms. Based on this insight, Huang's central claim is that FDI flows into China because of the uncompetitiveness of Chinese firms rather than the competitiveness of foreign ones.

Huang uses what he calls an "institutional foundation framework" to explain unusual Chinese FDI patterns. These patterns include an unusually high depen-

dency on FDI, a sharp rise in FDI inflows versus a precipitous drop in contractual alliances including export processing and assembly, FDI's dominance in China's labor-intensive and export-oriented industries, and the ubiquitous presence of foreign-invested enterprises (FIEs) across China.

Huang's institutional foundation framework emphasizes institutional imperfections that attract huge FDI inflows. These imperfections come from three fundamental problems in China's economy. First, China's financial system allocates China's financial and economic resources to the least efficient firms—state-owned enterprises (SOEs)—while denying the same resources to China's economically most efficient firms—private firms. Entrepreneurs have to resort to FDI for capital, which partially contributes to the heavy reliance on FDI. Second, China's political and legal systems offer poor protection to private enterprise. Therefore, private firms may seek to become FIEs to obtain better legal protection. And third, China's economy is substantially fragmented, a direct result of the political hierarchy among firms, which places SOEs at the top and domestic entrepreneurial firms at the bottom. This fragmentation reduces domestic capital mobility across regions and constrains the growth and investment options of domestic firms, thus providing opportunities for FDI across China.

The cumulative effect of the economic and legal discrimination against efficient and entrepreneurial domestic firms is a pervasive lack of competitiveness in China's corporate sector: SOEs are beset with internal inefficiencies while private

firms lack resources and property rights security.

Interestingly, while entrepreneurial domestic firms have to cede part of their equity control in exchange for venture capital and legal protection in the form of FDI, the assets that inefficient SOEs have built up over the years are ideal targets for foreign investors. As a result, some FDI has financed the ownership transfers of existing assets from Chinese control to foreign control—a de facto privatization process. This is no doubt the meaning of the book's title—that the "selling" of China is the unwitting outcome of SOEs' failure to capitalize on their privileged treatment.

Huang admits that FDI inflows bring benefits to China, but claims, "FDI is not the only option to achieve economic growth and reforms." He then posits, "If privatization of SOEs had been politically feasible, or if private entrepreneurs could have obtained financing to fulfill export contracts, many of the benefits currently associated with FDI could have been realized with a lower level of FDI." Huang recommends that "a better economic strategy" would be to privatize SOEs and remove constraints on private firms.

Huang further suggests that China's gradualist reform strategy, while positive overall, could be more efficient with faster privatization. He suggests that Chinese policymakers have not endorsed a large-scale privatization strategy because they want to preserve, not dismantle, socialism. The ideology that private entrepreneurs and capitalists change the color of the socialist state may hamper further action. The solution, hinted at by Huang, is to take Deng Xiaoping's famous aphorism—"it does not matter

# Beyond Tiananmen: The Politics of U.S.-China Relations, 1989-2000

by Robert L. Suettinger.

Washington, DC: The Brookings Institution, 2003, 556 pp. \$39.95 hardcover.

## Beyond Tiananmen

THE POLITICS OF U.S.-CHINA RELATIONS 1989-2000

ROBERT L. SUETTINGER

A professor once described to me that US-China relations are like “a snake in a bamboo tube.” The snake continuously slides through, while every now and then squeezing itself through inevitable tight spots. There couldn’t be a better analogy to describe bilateral relations as portrayed in Robert L. Suettinger’s *Beyond Tiananmen: The Politics of U.S.-China Relations, 1989-2000*. He begins by recounting the events leading up to the Tiananmen Square massacre on June 4, 1989, when “the United States and other Western countries recoiled from China in horror and disgust.” He then takes the readers through each important turn in US-China relations from that fateful day until the end of the Clinton Administration, relating how many US and PRC policy decisions were the outcomes of complex intragovernmental processes.

Suettinger also details the two countries’ inveterate dance between estrangement and détente. President George H.W. Bush initiated contact with China immediately following Tiananmen, and after receiving an agreement from China, sent a secret envoy of US diplomats to Beijing while the rest of the United States was

outraged. A few years later, the Clinton Administration’s hard line on human rights threatened to revoke China’s Most Favored Nation status in 1994. In 1996, Beijing reacted intensely when Taiwan President Lee Teng-hui visited the United States, and began People’s Liberation Army navy and air force drills on an island in the Taiwan Strait, 75 miles from Taiwan. President Jiang Zemin was the first Chinese president to make a state visit to the United States in 1997 following a 12-year gap. These are only a few of the complex and consequential developments in US-China relations detailed in the book.

The lack of transparency surrounding government decisions in China impedes a completely balanced look at diplomacy. Although we do not know the Chinese government’s exact decisionmaking process, Suettinger provides strong analysis from available resources to give a fair account of the each country’s perspective.

*Beyond Tiananmen* satisfies the curiosity of readers interested in the politics behind weapons sales to Taiwan, human rights in China, Clinton’s campaign finance scandal, the bombing of the Chinese embassy in Belgrade, intellectual

property rights, and just about any other topic related to US-China relations. Suettinger himself occasionally surfaces to share a behind-the-scenes look at diplomatic relations with China from his days at the National Security Council, where he worked as an intelligence officer for three-and-a-half years. Including more of his personal experiences would have been intriguing, but doing so would have skewed coverage of the central issues that defined the US-China relationship.

Aside from giving us an insightful and clear look at the not-so-black-and-white issues of diplomacy between the United States and China, Suettinger argues that conflict between the two countries is not inevitable—even better prospects for the twenty-first century’s single most important bilateral relationship lie ahead. Currently, the US-China relationship is the best it has been in years. Is the snake nearing the end of the bamboo tube, or are we just sliding smoothly into the next tight spot?

—Doris Grage

Doris Grage is research assistant at the CBR.

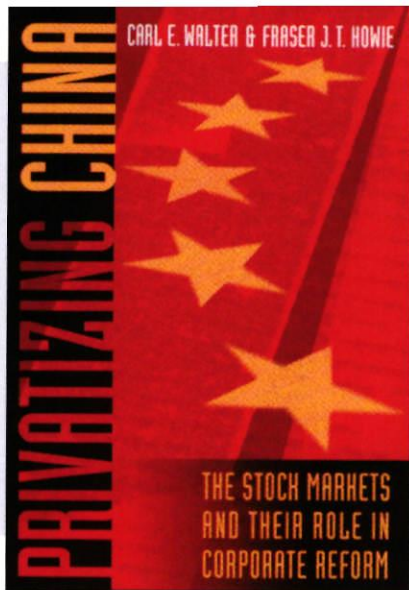
whether the cat is white or black, as long as it catches mice”—and apply it to firm ownership.

*Selling China* should be recommended to scholars and practitioners interested in China’s political economy. It provides an innovative and rigorously argued analysis with important implications both for scholars and policymakers concerned

with China’s continued economic reform efforts. Such a thought-provoking book will surely spark hot debate over China’s reform model as the country fulfills its commitments to the WTO.

—Ying Huang

Ying Huang is a doctoral student at Michigan State University.



## Privatizing China: The Stock Markets and Their Role in Corporate Reform

by Carl Walter and Fraser Howie.

Singapore: John Wiley & Sons (Asia) Pte Ltd., 2003. 296 pp. \$27.95 softcover.

One of the key ingredients of corporate reform in China has been the development of a securities market. Here individuals, and institutions such as pension funds and insurance companies, can invest their funds for long-term returns, and listed companies can provide an exit strategy for investment bankers or raise capital to expand their operations.

Except for a few months in the early 1950s, China had no stock market to provide capital to Chinese enterprises until 1990. Once the post-1978 Chinese financial reforms began, however, the need for capital grew, particularly for the large state-owned enterprises, but also for new enterprises started in the wake of these reforms. Thus in 1990, stock markets were established in Shanghai and Shenzhen, and China started listing companies overseas in 1992.

Chinese stocks have been immensely successful, raising more than \$60 billion in international stock offerings and \$85 billion in China's two domestic stock markets. But China's listed companies and markets, like other recent Chinese financial reforms, developed with "Chinese characteristics" that set them apart from the experiences of most other stock markets in the world. Just how far apart is skillfully analyzed and thoroughly documented by Carl Walter and Fraser Howie in their new book on China's stock markets, *Privatizing China: The Stock Markets and Their Role in Corporate Reforms*.

Both Walter's and Howie's decade-long experiences working with financial institutions in China enabled them to locate and marshal hard-to-find sources

to develop their analysis of stock market development in China. They also gathered information from Chinese research groups and from the Western-educated Chinese innovators who pushed to establish China's stock exchanges in Shanghai and Shenzhen.

This book should be required reading for any potential investor or fund manager interested in the "China concept" (and who could not be interested, as China fast becomes one of the world's economic powerhouses?). Walter and Howie describe "privatization with Chinese characteristics" and show what China's markets lack: truly privatized companies, large numbers of private individual investors, and freedom from the kind of misinformation and manipulation that often characterizes newly established markets.

The core of their book, a revision of their 1990 work on the experimental state of China's stock market, *To Get Rich is Glorious*, gives step-by-step and in-depth answers to the various questions that an inquiring investor should ask: How did China's stock markets develop? What is the role of regulators? How are share ownerships defined? How are stock offerings packaged? How are the listed companies chosen? How many retail investors are buying Chinese shares? How are China's markets segmented? What are the factors that created a 10-year-long bull market? And, what may happen over the next 10 years, particularly in light of China's World Trade Organization (WTO) entry?

Some of the areas not covered by the authors include stockholder rights in company governance, a fuller explanation

for China's bull markets, and more detailed discussion of how Chinese characteristics could possibly cause China's financial markets to fail in the future.

Yet the information Walter and Howie provide is invaluable, including a detailed chronology of the development of China's stock markets, a set of useful tables, and definitions of the alphabet soup of agencies and policies associated with Chinese stock markets.

Potential retail investors in Chinese B shares, or managers of foreign funds planning to become "qualified foreign institutional investors," will find this excellent book indispensable. We hope the authors will update their book in another four years to show the effects China's WTO entry has had on China's stock markets.

—Stephen C. Thomas and Chen Ji

Stephen C. Thomas teaches Chinese Politics, and Chen Ji teaches Finance in the College of Business, at the University of Colorado at Denver.

# BEING CHINESE

*Voices from the Diaspora*



WEI DJAO

## Being Chinese: Voices from the Diaspora

by Wei Djao.

University of Arizona Press: Tucson, Arizona, 2003. \$22.95 paper. 240 pages.

**W**hy do ethnic Chinese consider themselves Chinese no matter where they were raised?

Shanghai-born Wei Djao, professor of Asian Studies at Northern Seattle Community College, probes the resilience of Chinese ethnic identity among the interviewees despite their being raised in vastly different cultures. Djao writes of the global search for identity within the Chinese diaspora. Her book is an insightful glimpse into the lives of 22 *huayi*, or people of Chinese descent, living in countries from Australia to Zimbabwe. Djao's portrayal explores how the *huayi* conceptualize their Chinese identity and its independence from ethnic grouping. Djao's use of the word "identity" is not to be taken in the strict academic sense; rather she uses it to encompass what she terms "the emotional richness" of being Chinese. She finds that this richness has roots interwoven in the ethnic, political, and cultural dimensions of being Chinese, yet this identity incorporates selective aspects of Chinese culture and is thus highly individualized.

The book opens with a comprehensive history of emigration from mainland China and looks into the political, economic, and religious reasons for the exodus. The second part of the book, entitled "Voices from the Diaspora," features a series of interviews with people descended from Chinese who emigrated between the Opium War (1842) and the establishment of the People's Republic in 1949. In the third part of the book, Djao examines the overlapping of the cultural, ethnic, and political dimensions of being Chinese in

the diaspora, and concludes that ethnic identity, as evidenced in her subjects, is an issue that defies concise classification.

Djao's interviews reveal the dichotomy between how people actually live ("real" culture) and how they feel they ought to live ("ideal" culture). She allows her subjects to define what it means to be Chinese—whether through ethnicity, language, or social position. Djao explains that for many of them, Chinese identity is a selective one at best. She explains that, "...being Chinese is a state of mind and a feeling. The sentiment is at times vigorous, at other times fragile, and quite often deeply sustaining to those who feel it. Such a feeling is not jingoistic nationalism, for it transcends political allegiance." Many of the book's vignettes point to continual use of the Chinese language, filial piety, a strong work ethic, and belief in fate, *feng shui* (geomancy), and traditional medicine as distinct markers of their ethnic identity.

One of the most fascinating profiles is that of Fay Chung, a Zimbabwean-born Chinese, who currently works as the director of education for the United Nations Children's Fund. She speaks of her break with traditional expectations and stereotypes of Chinese women to pursue her education. Chung says that while she considers herself more culturally Zimbabwean than Chinese, she feels that the Chinese moral values and strong work ethic her parents imbued in her have contributed to her successful career.

Several of the *huayi* Djao features are of mixed ancestry, and some are a few generations removed from China. Yet many of them define their social identity as Chinese. Laileen Springgay of India

explains that despite the fact that her great-grandmother was not Han Chinese, she was from China and Chinese in that all of her descendants used Chinese kinship terms. Natascha Chinque of Canada points to her interest in *feng shui* and Chinese philosophy as stemming from the fact that she is three-eighths Chinese.

*Being Chinese* is a good sociological overview of some of the aspects of Chinese culture that have endured despite the changing cultural circumstances of the subjects. The most poignant aspect of the book is the individual examination and interpretation of what being Chinese means to each person profiled. *Being Chinese* is an informative introduction to diaspora studies for academics and students of Chinese culture.

—Shannon Conrad

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

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.

## Accounting

### CHINA'S IMPORTS

#### SunSystems Union Holdings Ltd. (UK)

Selected by Sino Life Insurance Co. Ltd. to provide financial management. 05/04.

## Agriculture

### CHINA'S IMPORTS

#### Elders Ltd. (Australia)

Won order from Xuzhou Vv Group to supply 3,000 dairy cows. \$4.7 million. 04/04.

### CHINA'S INVESTMENTS ABROAD

#### Xinjiang Chalkis Co. Ltd.

Bought 55% of Conserves de Provence SAS in France from its parent company, Le Cabenon, and will supply the resulting joint venture with preserved tomatoes for packing and distribution in Europe. 04/04.

### OTHER

#### Bourgoin SAS (France)/Shandong Laidong Diesel Co. Ltd.

Signed letter of intent to form a joint corn-picker production company aimed at China's domestic market. 05/04.

## Architecture, Construction & Engineering

### INVESTMENTS IN CHINA

#### CSR Ltd. (Australia)

Signed four-year lease with Nanning Glass Factory for use of its fiberglass insulation manufacturing plant in Nanning, Guangxi. 04/04.

## Automotive

### CHINA'S IMPORTS

#### BASF Shanghai Coatings, a division of BASF AG (Germany)

Chosen by Dongfeng Motor Co., Ltd., a joint venture between Nissan Motor Co., Ltd. and Dongfeng Motor Corp., to supply primers, basecoats, and clearcoats for car bodies and bumpers for the joint venture's new plant in Guangdong. 04/04.

### INVESTMENTS IN CHINA

#### Kia Motors Corp. (South Korea)

Will invest in the construction of a car plant in Jiangsu through its joint venture, Dongfeng Yueda Kia Motors, to produce sport-utility vehicles, cars, and sedans. \$645 million. 05/04.

#### Ferrari SpA (Italy), Wo Kee Hong (Hong Kong)/Poly Technologies Corp. (Beijing)

Formed joint venture, Ferrari Maserati Cars International Trading, to import, market, distribute, and provide technical support for Ferrari and Maserati cars. 04/04.

#### Hino Motors Ltd. (Japan)/Jiangsu Chunlan Group

Established joint venture to make trucks in Nanjing. (Japan:50%-PRC:50%). \$132.9 million. 04/04.

#### Key Safety Systems, Inc. (US)/Yanfeng Visteon Automotive Trim Systems Co., Ltd. (Shanghai)

Formed joint venture, Yanfeng Key Automotive Safety Systems Co. Ltd., to design, develop, and supply safety system products. 04/04.

#### Piaggio Group (Italy)/Chongqing Zongshen Motorcycle Group

Formed joint venture, Foshan Zongshen Piaggio Motorcycle Co. Ltd., in Guangdong, to make scooters and high-end motorcycles. \$29.8 million. 04/04.

#### Sherwin-Williams (US)/Shanghai Kinlita Chemical Co.

Formed joint venture, Sherwin-Williams Kinlita Co., Ltd., to make auto paint. \$8 million. 04/04.

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; CBRC: China Banking Regulatory Commission; 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; DSL: Digital Subscriber Line; ETDZ: economic and technological development zone; GSM: Global System for Mobile Communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquefied natural gas; MII: Ministry of Information Industry; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; 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; 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

**Sumitomo Electric Industries Ltd. (Japan)/China Dongfeng Motor Corp. (Hubei)**

Formed joint venture in Huizhou, Guangdong, to make wire harnesses for carmakers. (Japan:51%-PRC:49%). 04/04.

**Vantec Corp., Sumitomo Warehouse Co. (Japan)**

Will form joint venture in Wuhan, Hebei, to offer auto parts distribution services. 04/04.

**Behr GmbH & Co. KG (Germany)/China Dongfeng Motor Corp. (Hubei)**

Formed joint venture, Dongfeng Behr Thermal Systems Co. Ltd., in Wuhan, to produce and market copper/brass and aluminum radiators for trucks. (Germany:50%-PRC:50%). 03/04.

**Eaton Corp. (US)/FAW Jiefang Automotive Co. Ltd., a subsidiary of China FAW Group Corp. (Jilin)**

Formed joint venture, FAW Eaton Transmission Co. Ltd., to produce transmissions for commercial vehicles and buses. 03/04.

**Toyota Motor Corp. (Japan)/China FAW Group Corp. (Jilin)**

Established an engine manufacturing joint venture, FAW Toyota Changchun Engine Co. Ltd., in Changchun, Jilin. (Japan:50%-PRC:50%). \$85 million. 03/04.

**TRW Automotive JV LLC (US)/FAWER Automotive Parts Co. Ltd., a subsidiary of China FAW Group Corp. (Jilin)**

Formed joint venture, TRW FAWER Commercial Vehicle Steering (Changchun) Co. Ltd., to manufacture and sell steering gears for the commercial vehicle market. 03/04.

**OTHER**

**DaimlerChrysler AG (Germany)/Beijing Automotive Industry Holding Co. Ltd.**

Signed a project proposal to manufacture Mercedes-Benz C-Class and E-Class sedans in Beijing. 05/04.

**Cummins Westport Inc., a joint venture between Cummins Inc. (US) and Westport Innovations Inc. (Canada)/Dongfeng Cummins Engine Co. Ltd., a joint venture between Dongfeng Motor Corp. and Cummins Inc. (US)**

Signed MOU to manufacture natural gas engines in Xiangfan, Hubei. 04/04.

**Fuji Heavy Industries Ltd. (Japan)**

Signed distribution agreement with Ji-Dong Trading Group Ltd. in Tangshan, Hebei, and Shanghai Automotive Industry Sales Corp. to sell its Subaru-brand passenger cars. 04/04.

**Volvo Group (Sweden)/China National Heavy Truck Corp. (Shandong), China FAW Group Corp. (Jilin)**

Signed agreement to jointly own engine producing plant. (Sweden:52%-PRC:48%). \$200 million. 03/04.

**Aviation/Aerospace**

**CHINA'S IMPORTS**

**Airbus SAS (France)**

Received order from China Southern Airlines Co. Ltd. for 15 A320s and six A319s. \$1.2 billion. 04/04.

**Pemco Aviation Group, Inc. (US)**

Chosen by Hainan Airlines to convert 10 passenger planes to cargo planes. \$24 million. 04/04.

**CAE Inc. (Canada)**

Received order from China Southern Airlines for Embraer ERJ 145 flight simulator. \$12.6 million. 03/04.

**OTHER**

**Deutsche Lufthansa AG (Germany)/Shanghai Airlines**

Formed codesharing partnership for cooperating on frequent flyer miles. 04/04.

**Banking & Finance**

**CHINA'S IMPORTS**

**Credit Suisse First Boston (Switzerland)/CITIC Securities Co., Ltd., China Credit Trust Co., Ltd., ICBC**

Signed agreement to securitize portfolio of \$314 million in nonperforming and poorly performing loans. 04/04.

**Deutsche Bank AG (Germany)/Merrill Lynch & Co. (US)**

Hired along with China International Capital Corp. to underwrite \$1 billion share offering for Hubei-based Dongfeng Motor Corp. 04/04.

**eBworx Bhd (Malaysia)**

Won contract from Huaxia Bank in Beijing to install digital credit management system. \$1.58 million. 04/04.

**Merrill Lynch & Co. (US)**

Hired to underwrite the initial Hong Kong stock offering of China Power International Holding Ltd. 03/04.

**INVESTMENTS IN CHINA**

**Hang Seng Bank (South Korea)**

Acquired 16% of Fujian-based Industrial Bank Co. Ltd. \$208.5 million. 04/04.

**US Principal Financial Group Inc. (US)/China Eagle Securities Co. Ltd. (Shenzhen)**

Set up joint fund management company. \$100 million. (US:33%-PRC:67%). 03/04.

**OTHER**

**Shinsei Bank, Sumitomo Trust & Banking Co., Marubeni Corp (Japan)/CITIC Group**

Set up investment fund to help Japanese companies enter the Chinese market. 05/04.

**Asia Payment Systems, Inc. (US)/Beijing Sunkart Investment Management Co. Ltd.**

Signed MOU to investigate commercial, technical, and legal issues related to launching a VIP card service for credit card market. 04/04.

**The Carlyle Group (US)**

Opened an office in Shanghai. 04/04.

**Standard Chartered Bank (UK)/China Export & Credit Insurance Corp.**

Signed agreement to offer exporters credit insurance coverage and trade financing services. 04/04.

**American Express Co. (US)/ICBC**

Agreed to issue American Express credit cards in China. 03/04.

## Chemicals, Petrochemicals & Related Equipment

### CHINA'S IMPORTS

#### Lurgi AG, a subsidiary of MG Technologies AG (Germany)

Won contract from CNOOC-Kingboard Chemical Ltd., a joint venture between CNOOC, Hong Kong-based Kingboard Chemical Ltd., and the China National Technical Import and Export Corp., to build a methanol plant in Hainan. \$90 million. 05/04.

### INVESTMENTS IN CHINA

#### BP plc (UK)/SINOPEC

Signed agreement to build an acetic acid plant in Nanjing, Jiangsu. (UK:50%-PRC:50%). 05/04.

#### Borden Chemical, Inc. (US)/UVITech (Hong Kong)

Formed joint venture, Borden UV Coatings (Shanghai) Co., Ltd., to manufacture and market coatings and adhesives for fiber optics, digital media, and other applications. 04/04.

#### Borden Chemical, Inc. (US)/Asia Dekor Holdings Ltd. (Hong Kong)

Formed joint venture, Asia Dekor (Hong Kong) Borden Chemical Co. Ltd., to build a formaldehyde and derivative resins manufacturing facility in Guangdong. 04/04.

#### Milacron Inc. (US)/Jiangnan Mould & Plastic Technology Co. Ltd. (Jiangsu)

Formed joint venture, Milacron Plastics Machinery (Jiangyin) Co., Ltd., to manufacture and sell injection-molding machines for plastic components. (US:70%-PRC:30%). 04/04.

#### Mitsubishi Chemical Corp., Mitsubishi Corp., Itochu Corp. (Japan)/CITIC Group

Will form joint venture in Zhejiang to produce terephthalic acid for polyester textiles. (Japan:90%-PRC:10%). \$108 million. 03/04.

#### Mitsui Chemicals, Inc. (Japan)

Established subsidiary, Mitsui Chemicals Plastic Compounds (Zhongshan) Co., Ltd., in Guangdong, to produce and sell polypropylene auto materials. 03/04.

#### Mitsui Chemicals Inc. (Japan)/SINOPEC

Signed agreement to build a plant in Shanghai to produce bisphenol A for polycarbonate plastic manufacturing. 03/04.

### OTHER

#### Degussa AG (Germany)/Changchun Jida High Performance Materials Co. Ltd. (Jilin)

Signed agreement to develop, produce, and market high-temperature polymers. 05/04.

## Distribution, Logistics & Related Services

### INVESTMENTS IN CHINA

#### ProLogis (US)/Shanghai Northwest Logistics Park Co. Ltd.

Formed joint venture developing a distribution facility in Shanghai. 04/04.

#### Mitsui OSK Lines, Ltd. (Japan)/Sinotrans Ltd. (Beijing)

Established joint venture, Sinotrans-MOL Shipping Co., Ltd., based in Guangzhou, to transport cars. (Japan:49%-PRC:51%). \$8 million. 03/04.

### OTHER

#### Road King Infrastructure Ltd. (Hong Kong)/Government of PRC

Signed an agreement to manage and operate the Tangshan-Tianjin Expressway in Hebei. (Hong Kong:46%-PRC:55%). 91.8 million. 03/04.

## Education

### CHINA'S IMPORTS

#### Obducat AB (Sweden)

Received orders for nanoimprint lithography systems from Jilin University and Beijing University. 03/04.

### INVESTMENTS IN CHINA

#### Times Publishing Ltd., a unit of Fraser and Neave Ltd. (Singapore), Hong Kong Infomedia Capital Group Ltd./China Universal Press & Publication Co. (Beijing)

Formed joint venture, Beijing Universal Times Culture Development Co., to explore opportunities for development and production of cultural and educational books and materials for sale in China. 05/04.

#### University of Nottingham (UK)/Wanli Education Group

Formed joint venture university in Zhejiang. 04/04.

## Electronics, Hardware & Software

### CHINA'S IMPORTS

#### Tandberg Television (Norway)

Secured contract with Shanghai Interactive TV to provide digital cable and video equipment. 03/04.

### CHINA'S INVESTMENTS ABROAD

#### Flextronics International (Singapore)/Hisense Co. Ltd. (Shandong)

Formed joint venture to assemble color TV sets in Hungary. 04/04.

### INVESTMENTS IN CHINA

#### Global eXchange Services (US)/ChinaECNet

Will jointly develop and establish an electronic transaction exchange connecting electronics manufacturers to buyers in China and abroad. 03/04.

#### Interchance Ltd., a subsidiary of InvestNet, Inc. (Canada)

Agreed to acquire 100% of computer systems integration and business solutions company Shanghai DSI Computer Technology Co. Ltd. 03/04.

#### Sumitomo Microelectronics Co., Ltd. (Japan)/SVA Electron, a unit of SVA Group Co. Ltd. (Shanghai)

Formed joint venture, SVA Zhujin Microelectronics Co., Ltd. (Japan:70%-PRC:30%). \$27 million. 03/04.

### OTHER

#### Xybernaut Corp. (US)/Beijing CyberNet Institute

Will engage in joint research and marketing activities related to mobile/wearable computing, and will form a research and development institute concentrating on mobile/wearable computing solutions for the media, entertainment, and government sectors. 05/04.

#### Advanced Micro Devices Inc. (US)/Founder Group (Beijing)

Signed MOU to make and sell Founder-built computers based on AMD's 64-bit processors. 03/04.



**Motorola, Inc. (US)/Datang Mobile Communications Equipment Co. Ltd.**

Signed MOU to develop chipset solutions for the TD-SCDMA infrastructure market. 03/04.

**Oki Electric Industry Co., Ltd. (Japan)/China Electronic Systems Engineering Corp.**

Signed agreement to market and sell motion picture monitoring solutions to the Chinese market. 03/04.

**Energy & Electric Power****CHINA'S EXPORTS****The Electricity Co. 1 (Vietnam)**

Signed contract with Yunnan Electricity Co. to purchase 40 MW of power. 04/04.

**CHINA'S IMPORTS****Mitsubishi Heavy Industries, Ltd. (Japan)**

Received order from Chongqing Yuanda Environmental-Protection Group Co., Ltd. to design and supply components of two large-scale flue gas desulfurization systems to be installed at the Guixi Power Plant in Jiangxi. 05/04.

**Alstom SA (France)**

Won contract from the Three Gorges International Tendering Co. Ltd. to supply four turbines and generators. \$195.6 million. 03/04.

**Gamesa Corporacion Tecnologica SA (Spain)**

Received order for 12 wind turbines from Ningxia Electric Power Co. \$6.32 million. 03/04.

**GE Energy (US)**

Won contract to supply three turbine-generator sets for Lihong Hydropower Station in Sichuan. \$7.8 million. 03/04.

**Mitsubishi Heavy Industries, Ltd. (Japan)**

Received order from Datang Hancheng No. 2 Power Plant Co. Ltd. in Shaanxi for a flue gas desulfurization system. 03/04.

**INVESTMENTS IN CHINA****Universal Communication Systems, Inc. (US)/Jiangsu Yangtze Petrochemical Co. Ltd., a division of PetroChina**

Formed joint venture, Shanghai Gaochen Energy Technology and Development Co. Ltd., to market air/water machines and systems, and develop, sell, and distribute solar panels. 04/04.

**Greenwind Power Corp. (Canada)/China Link Industries Group Inc.**

Formed joint venture to develop and operate a wind farm on Daishan Island in Zhejiang. 03/04.

**Food & Food Processing****INVESTMENTS IN CHINA****Anheuser-Busch, Inc. (US)**

Acquired 36% stake in Heilongjiang-based Harbin Brewery Group Ltd. and will acquire majority stake, including SABMiller plc's 29.4% share. \$272.5 million. 05/04.

**Ajinomoto Frozen Foods Co., Life Foods Co. (Japan)/Xiamen Ideal Group Co. (Fujian)**

Formed joint venture to operate a frozen vegetable plant in Fujian. (Japan:70%-PRC:30%). 04/04.

**Sumitomo Corp. (Japan), Savola Edible Oil Co., Ltd. (Saudi Arabia)/Shandong Xiwang Group Co. Ltd.**

Formed joint venture, Shandong Xiwang Savola Oils and Fats Co. Ltd., in Shandong, to market and manufacture corn oil. \$8 million. 04/04.

**LSG Asia GmbH, a subsidiary of LSG Lufthansa Service Holding AG (Germany)/ Guangzhou Baiyun International Airport Co., Beijing Hua Zhuo Investment Management Co. Ltd.**

Formed joint venture catering facility, Guangzhou Baiyun International Airport LSG Sky Chefs Co. Ltd., in Guangzhou's Baiyun International Airport. (Germany:30%-PRC:70%). 03/04.

**Forestry, Timber & Paper****CHINA'S IMPORTS****Metso Paper, Inc. (Finland)**

Received order from Yanzhou Sun Paper Co. Ltd. in Shandong to supply a paper finishing line. \$49.1 million. 05/04.

**Metso Paper, Inc. (Finland)**

Received order from UPM-Kymmene (Changshu) Paper Industry Co. Ltd. in Jiangsu for papermaking machine parts. 04/04.

**Metso Paper, Inc. (Finland)**

Received order for a tissue production machine from Hengan Holding Co. Ltd. in Anhaizhen, Fujian. 03/04.

**Healthcare Services & Investment****CHINA'S IMPORTS****Center for International Health (US)**

Signed agreement with the government of Shanghai to provide training and technical assistance to upgrade the city's emergency medical response. 03/04.

**Machinery & Machine Tools****INVESTMENTS IN CHINA****Sullair Corp., a unit of Hamilton Sundstrand (US)/Ishikawajima-Harima Heavy Industries Co., Ltd. (Japan)**

Formed joint venture to design, manufacture, assemble, sell, and service centrifugal air compressors in Jiangsu for export. 04/04.

**OTHER****Wijaya Baru Global Berhad (Malaysia)/Changyuan Spraying Products Co. Ltd. (Guangdong)**

Signed MOU establishing a joint venture for a commercial and industrial filters business. 05/04.

**Media, Publishing & Entertainment****INVESTMENTS IN CHINA****Beijing Dentsu Advertising Co., Ltd., a subsidiary of Dentsu Inc. (Japan)/ Shanghai Film Group Corp.**

Formed joint venture, SFS-Dentsu Media & Entertainment Group, to provide operational support for a Shanghai movie channel. (Japan:49%-PRC:51%). 04/04.

**NHN Corp. (South Korea)/Searainbow Holding Corp. (Hainan)**

Formed online games joint venture, OurGame Assets Ltd. (South Korea:50%-PRC:50%). 04/04.

**Cheil Jedang Home Shopping (South Korea)/Shanghai Media Group**

Formed home shopping joint venture to develop 24-hour home shopping TV channel. (South Korea:49%-PRC:51%). \$20 million. 03/04.

**Viacom Inc. (US)/Shanghai Media Group**

Formed joint venture to produce Chinese-language youth and public health programming. 03/04.

**Viacom Inc. (US)/CCTV**

Signed agreement to offer youth programming and HIV/AIDS informative programming and events. 03/04.

**Medical Equipment & Devices****CHINA'S IMPORTS****Singapore Computer Systems Ltd.**

Won contract from Beijing Tongren Hospital to design and implement software and IT services, manage projects, and provide maintenance for their new wing. \$2.2 million. 04/04.

**INVESTMENTS IN CHINA****Bracco SpA (Italy)/Shanghai Sine Pharmaceutical Co. Ltd.**

Formed joint venture to produce and market diagnostic imaging systems such as X-rays, magnetic resonance, and ultrasound systems. (Italy:70%-PRC:30%). 04/04.

**Metals, Minerals & Mining****CHINA'S IMPORTS****Rio Tinto Iron Ore (Australia)**

Signed a 10-year iron ore supply contract of up to 7 million additional tons per year with Shanghai Baosteel Group Corp. 04/04.

**INVESTMENTS IN CHINA****Stellar Pacific Ventures Inc. (Canada)/Maying Gold Mines (Henan)**

Formed joint venture to acquire new mining properties and develop medium-sized gold mining projects. 04/04.

**Minco Mining & Metals Corp. (Canada)/No.2 Exploration Institute of the Gansu Bureau of Geological Exploration**

Formed joint venture to explore and develop gold projects in Gansu. 03/04.

**OTHER****Mechel Trading, a subsidiary of JSC Mechel Steel Group (Russia)**

Signed a protocol of intent with Zhejiang Material Industries Group for the long-term supply of steel, hardware, and iron-ore concentrate. 05/04.

**Oxiana Ltd. (Australia)/Yunnan Geology and Mineral Resources Co. Ltd.**

Formed gold exploration joint venture in southeastern Yunnan. 04/04.

**Canadian Silk Road Resources (Canada)/Gansu Qinqi Minerals Co. Ltd., a subsidiary of the Gansu Bureau of Geology Mineral Exploration and Development**

Signed an agreement to jointly explore gold prospects in Gansu. (Canada:70%-PRC:30%). 03/04.

**Petroleum, Natural Gas & Related Equipment****INVESTMENTS IN CHINA****Royal Dutch/Shell Group (the Netherlands)/SINOPEC**

Formed joint venture to develop service stations in Jiangsu. (the Netherlands:40%-PRC:60%). \$200 million. 05/04.

**OTHER****Energem Petroleum Corp. Ltd., a subsidiary of DiamondWorks Ltd. (Canada)/CNPC**

Signed MOU to form exploration and production joint venture in Africa. 04/04.

**Pharmaceuticals****OTHER****Medicines for Malaria Venture (Switzerland), Oxford University (United Kingdom), Sigma-Tau SpA (Italy)/Chongqing Holley Share Co. Ltd.**

Signed contract to promote new antimalarial medicine manufactured by Chongqing Holley Share Co. Ltd. in global markets. 03/04.

**Ports & Shipping****CHINA'S IMPORTS****See Hup Seng Ltd. (Singapore)/China National Fisheries (Group) Corp.**

Signed MOU to form joint venture to repair and maintain China National Fisheries' fishing and related support vessels. 04/04.

**Mitsui Engineering & Shipbuilding Co. Ltd. (Japan)**

Received orders from Dalian New Shipbuilding Heavy Industry Co. Ltd. and Shanghai-based Hudong Zhonghua Shipbuilding (Group) Co. Ltd. for six marine engines for 4,250-TEU container ships. 03/04.

**Mitsui OSK Ltd., a subsidiary of Mitsui & Co. (Japan)**

Signed 10-year contract with Maanshan Iron & Steel Co., Ltd. in Anhui to provide transport of 500,000 tons per year. 03/04.

**Mitsui OSK Ltd., a subsidiary of Mitsui & Co. (Japan)**

Signed 20-year contract with Shanghai Baosteel Group to transport iron ore from Brazil to China. 03/04.

**OTHER****Total Automation Ltd. (Singapore)/COSCO Shipyard Group Co. Ltd.**

Signed MOU to form joint venture, COSCO Shipyard Total Automation Co. Ltd., specializing in vessel repair and manufacturing and selling electronic vessel control systems. (Singapore:40%-PRC:60%). 04/04.

## Rail

### CHINA'S IMPORTS

#### **Singapore Technologies Electronics Ltd./Guangzhou Heartly TeamGo Information System Engineering Co. Ltd.**

Won contract from Guangzhou Metro Corp. to design, supply, install, and implement an automatic fare collection system for Guangzhou MRT Line 4. \$11.3 million. 03/04.

### OTHER

#### **Hong Kong MTR Corp./Beijing Infrastructure Investment Co. Ltd., Beijing Capital Group**

Signed MOU to develop a subway line in Beijing. 04/04.

## Retail/Wholesale

### INVESTMENTS IN CHINA

#### **Ito-Yokado Co. Ltd., York-Benimaru Co., Ltd. (Japan)/Beijing Wangfujing Department Store Group Co. Ltd.**

Established joint venture, Beijing Wang Fu Jing Yokado Commercial Co. Ltd., to develop supermarket operations in Beijing. (Japan:60%-PRC:40%). \$24 million. 04/04.

#### **President Chain Store Corp. (Taiwan)/Lizhu Group (Guangdong)**

Formed joint venture to establish mainland outlets of Taiwan-based COSMED, a cosmetics and pharmaceutical chain and subsidiary of President Chain Store Corp. (Taiwan:65%-PRC:35%). \$6.05 million. 04/04.

## Telecommunications

### CHINA'S EXPORTS

#### **Huawei Technologies (Guangdong)**

Won contract from Banverket Telenät in Sweden to expand local broadband networks. 04/04.

#### **Huawei Technologies (Guangdong)**

Won contract from Embratel Participações SA in Brazil to supply a next-generation network platform for local telephony and DSL access. 04/04.

#### **Huawei Technologies (Guangdong)**

Won contract from Ethiopian Telecommunications Corp. to construct its wireless CDMA2000 network in Addis Ababa and three other cities. \$10 million. 03/04.

#### **Huawei Technologies (Guangdong)**

Won contract from Algeria Telecom to construct and expand its wireless CDMA2000 network in northeast Algeria. \$40 million. 03/04.

#### **ZTE Corp. (Guangdong)**

Selected by Uzbekistan's East Telecom to deploy a national Internet backbone network. 03/04.

### CHINA'S IMPORTS

#### **Alcatel Shanghai Bell, a joint venture between Compagnie Financière Alcatel SA (France) and MII**

Won contract from Shanxi Mobile, a subsidiary of China Mobile, to expand and upgrade its existing networks in six cities in Shanxi. \$10 million. 05/04.

#### **UTStarcom, Inc. (US)**

Won contract from China Telecom Corp. to expand and optimize networks in Suzhou and Taizhou, Jiangsu. \$21 million. 05/04.

#### **LM Ericsson AB (Sweden)**

Signed agreement with Sichuan Unicom to expand its wireless CDMA network in low-density areas. 04/04.

#### **LM Ericsson AB (Sweden)**

Signed agreement with Sichuan Mobile to expand its GSM network and prepare the network for future 3G deployment. 04/04.

#### **Motorola, Inc. (US)**

Won contract from Tianjin Cable to deploy digital cable. 04/04.

#### **Siemens Information and Communication Group, a unit of Siemens AG (Germany)**

Commissioned by China Mobile to expand its network in Anhui, Shanghai, and Zhejiang. \$36.6 million. 04/04.

#### **UTStarcom, Inc. (US)**

Signed contract with China Netcom to expand its PAS network in Hebei. \$75 million. 04/04.

#### **UTStarcom, Inc. (US)**

Won contract from China Telecom Corp. to expand network and services to all of Jiangsu. \$40 million. 04/04.

#### **IBM Corp. (US)**

Signed a contract with Shandong Unicom, a unit of China Unicom, to provide business intelligence solutions and decisionmaking assistance. 03/04.

#### **Lucent Technologies (US)**

Won contract from Shanghai Metro to employ networking solutions for Line 4. 03/04.

#### **Motorola, Inc. (US)**

Won contract from Changchun CATV in Jilin, Kunming CATV in Yunnan, and Qiqihar CATV in Heilongjiang to supply broadband infrastructure technology. 03/04.

#### **Oy Nokia AB (Finland)**

Won contract from Nanjing Metro in Jiangsu to supply digital mobile radio equipment and provide implementation and training services for the urban rail system. 03/04.

### INVESTMENTS IN CHINA

#### **SK Teletech Co., Ltd., a unit of SK Telecom Co. (South Korea)/Xinjiang Tiandi Group Co.**

Will establish joint venture, SK Tiandi Telecom Co., Ltd., to produce mobile phone handsets. \$12.1 million. 03/04.

### OTHER

#### **i2Telecom International, Inc. (US)/China Unicom**

Formed partnership to sell i2Telecom voice-over Internet protocol products to small and medium-sized businesses. 04/04.

#### **Rocket Software OSS Unit (US)/Unihub China Information Technology Co. Ltd. (Beijing)**

Formed alliance to distribute and develop telecom and data-network software. 04/04.

#### **Syniverse Technologies, Inc. (US)/China Mobile**

Signed contract to improve roaming capabilities between China and North America. 03/04.

## Textiles & Apparel

### INVESTMENTS IN CHINA

#### Esquel Group (Hong Kong)/Zhejiang Institute of Science and Technology

Established ZIST Esquel Eco-Textile Research Center to research eco-textile production. 04/04.

#### Sanei International Co. Ltd. (Japan)/Ningbo Shanshan Group

Will form joint venture to establish apparel outlets and shops in Shanghai and other cities. (Japan:51%-PRC:49%). \$3.1 million. 04/04.

### OTHER

#### Lenzing Group (Australia)

Opened a branch office in Shanghai. 03/04.

## Tourism & Hotels

### CHINA'S IMPORTS

#### Marriott International, Inc. (US)

Signed agreement to manage the hotel of Shenzhen Minrong Investment Co. Ltd. in Shenzhen. 03/04.

### CHINA'S INVESTMENTS ABROAD

#### Henan Guoji Industry and Development Corp. Ltd./National Tourist Board of Sierra Leone

Signed joint venture agreement to construct a hotel in Freetown, Sierra Leone. \$266 million. 05/04.

### INVESTMENTS IN CHINA

#### Marriott International, Inc. (US)

Will build two hotels, the Ritz-Carlton, Beijing and JW Marriott Hotel Beijing, to be managed by Beijing Guohua Real Estate Co., Ltd. 04/04.

### OTHER

#### JAL Hotels Co., affiliated with Japan Airlines International Co., Ltd., (Japan)/Beijing Capital Tourism Co.

Formed joint venture, BTG Nikko International Hotel Management Co., to operate hotels in Beijing and other cities served by Japan Airlines International Co., Ltd. (Japan:50%-PRC:50%). 04/04.

#### Hilton International Co. Ltd./China Jin Mao Group Co. Ltd.

Announced management agreement for a resort on Hainan Island. 03/04.

## Private Equity in China: Risk for Reward

*Continued from page 51*

of Warburg Pincus, the association has about 50 members, including the Carlyle Group, Newbridge Capital, and Goldman Sachs.

Capital market regulation and the legal system are developing, making the landscape more predictable for investors. In January 2003, the PRC government clarified the Venture Capital Regulations, rules governing private equity investments (see the *CBR*, July–August 2003, p.24). Those changes promoted investment in high technology and addressed issues of capital formation, capital contribution, and application procedures. In addition, investors are optimistic that the gradual emergence of a professional managerial class will help private equity firms build new businesses.

Loosening capital controls and easing the ability of foreign investors to repatriate profits would be welcome changes. Additional positive steps, already under way with the approval of Shenzhen Stock Exchange's separate board for small and medium-sized enterprises, would be to loosen domestic listing requirements for high-growth firms. This would provide access to

capital for growing companies and create exit opportunities for VC investors.

### From high-risk plays to mature financing

For the private economy, VC investors perform the critical role of allocating capital to entrepreneurs who would otherwise be unable to develop their businesses. Entrepreneurial innovation, in turn, will strengthen the Chinese economy. Yet the "high risk, high reward" days of Chinese private equity may be numbered. Many managers see an eventual professionalization of the private equity market coming in a few years. The economy is modernizing and more global funds are rooting themselves in the country. Those forces will eventually create stability, mitigate risk, and reduce the opportunity for exceptional returns. Still, if private equity investors can avoid China's pitfalls, lucrative opportunities may abound. The recent string of deals and the pipeline of mainland companies seeking to list over the next year provide a strong indication that private equity will become increasingly critical to the Chinese economy. 完

## PAYLESS SHOESOURCE®

Payless ShoeSource is the largest family footwear retailer in the Western Hemisphere, selling more than 200 million pairs of shoes in 2003 to more than 128 million satisfied customers. Sales for 2003 were \$2.8 billion.

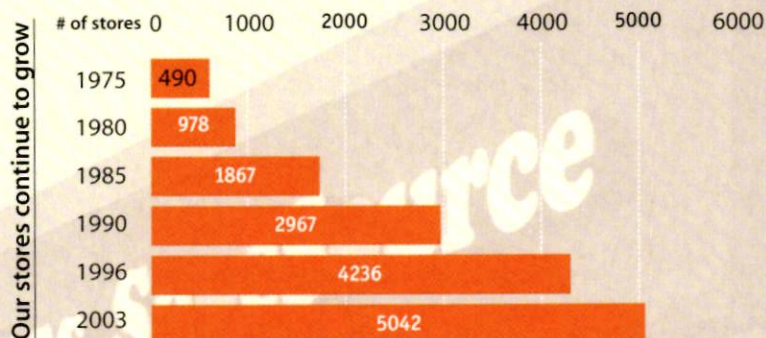
Payless® now operates stores in all 50 states and Puerto Rico, as well as over 500 stores in international locations including

Canada, the U.S. Virgin Islands, Central America and the Caribbean, South America, Guam and Saipan.

Payless will open a test store in Japan, its first expansion into an Asian market, in 2004.

Payless has been conducting sourcing operations in China since 1986, and currently exports more than 180 million pairs of shoes annually. Our longstanding successful relationship with China helps us accomplish our mission.

### Payless ShoeSource Growth Chart



NYSE Trading Symbol: PSS

**Payless  
Shoe  
Source®**

[www.payless.com](http://www.payless.com)

OUR MISSION: TO BE THE MOST  
SUCCESSFUL FOOTWEAR RETAILER  
IN THE WORLD.

<b>Amway China Co. Ltd.</b> .....	47
Amway (China) Co. Ltd. is a PRC-US cooperative joint venture engaged in manufacturing and distribution of daily-use products. Its Chinese partner is Global Star Investment Ltd., which invests and trades under the auspices of the Administrative Committee of the Guangzhou Economic and Technological Development District. <a href="http://www.amway.com.cn">www.amway.com.cn</a>	
<b>China International Fair for Investment &amp; Trade (CIFIT)</b> .....	13
CIFIT is sponsored by the Ministry of Commerce of the People's Republic of China, co-sponsored by the United Nations Conference on Trade and Development and the World Association of Investment Promotion Agencies. Held annually during September 8-11 in Xiamen, CIFIT is the sole nationwide international investment promotion event focusing on foreign direct investment. <a href="http://www.chinafair.org.cn">www.chinafair.org.cn</a>	
<b>China Shipping North America</b> .....	17
China Shipping Container Lines provides containerized ocean and inland transportation, including refrigerated services. The website provides company profile, sailing schedules, transit times, service maps, cargo tracing, tariff rates, and worldwide contacts. <a href="http://www.chinashippingna.com">www.chinashippingna.com</a>	
<b>COSCO Americas</b> .....	31
COSCO (China Ocean Shipping Company), a premier full-service intermodal carrier, utilizes a vast network of ocean vessels, barges, railroad, and motor carriers to link the international shipper with the consignee. <a href="http://www.coscon.com">www.coscon.com</a>	
<b>Exxon Mobil Corporation</b> .....	5
Exxon Mobil Corporation is the world's premier energy company. ExxonMobil operates in more than 200 countries and territories around the world engaged in petroleum upstream, downstream and chemical businesses. <a href="http://www.exxonmobil.com">www.exxonmobil.com</a>	
<b>IBS Logistics</b> .....	27, 70
IBS Logistics provides total logistics management of your entire supply chain, including freight forwarding, warehousing and distribution, inter-modal rail and trucking, and customs house brokerage. IBS, supported by the G-Log system, streamlines supply chains and increases efficiencies. <a href="http://www.ibslogistics.com">www.ibslogistics.com</a>	
<b>Lucent Technologies</b> .....	35
Lucent Technologies designs and delivers systems, services and software for next-generation networks. Backed by Bell Labs, Lucent's strengths in services, mobility, optical, software, and data/voice networking help customers quickly deploy and better manage networks. <a href="http://www.lucent.com">www.lucent.com</a>	
<b>Maersk Sealand</b> .....	39
Maersk Sealand is one of the largest liner shipping companies in the world, serving customers all over the globe. More than 300 container vessels and 950 containers ensure a reliable and comprehensive worldwide coverage. <a href="http://www.maersksealand.com">www.maersksealand.com</a>	
<b>Marger Johnson &amp; McCollom, P.C.</b> .....	70
Marger Johnson & McCollom, P.C. is a full-service intellectual property law firm relied upon by businesses across the United States and Asia, with expertise in prosecution, litigation, opinion and global IP work. <a href="http://www.techlaw.com">www.techlaw.com</a>	
<b>Mayfair Hotel Shanghai</b> .....	15
Mayfair Hotel Shanghai is the largest multi-use hotel complex consisting of 860 well-appointed guest rooms including 42 business suites with kitchenette, an extensive array of F&B outlets, 261 service apartments and a 20,000 m <sup>2</sup> shopping mall. <a href="http://www.mayfairshanghai.com">www.mayfairshanghai.com</a>	
<b>Mediterranean Shipping Company SA</b> .....	23
<b>MOL</b> .....	71
MOL is one of the world's largest multi-modal shipping companies, operating a diverse network of container shipping and logistics services around the globe. MOL is a founding carrier partner in GT Nexus, an e-logistics solutions company. <a href="http://www.molpower.com">www.molpower.com</a>	
<b>Monitor Group</b> .....	25
Monitor Group is a leading global strategy consultant, advising companies and government entities on addressing and defining responses to complex strategic problems. Monitor is dedicated to fundamentally enhancing the competitiveness of our clients through supporting the creation of innovative, winning, action-oriented strategies. <a href="http://www.monitor.com">www.monitor.com</a>	
<b>Payless ShoeSource</b> <a href="http://www.payless.com">www.payless.com</a> .....	67
<b>Scala North America, Inc.</b> .....	29
Scala Business Solutions has been successfully delivering connected supply chain (SCM) and enterprise resource planning (ERP) solutions to global companies in emerging markets such as China for over 25 years. <a href="http://www.scala.net">www.scala.net</a>	
<b>The Garden Hotel Guangzhou</b> .....	2
The Garden Hotel Guangzhou is comprised of 1,028 luxurious rooms and suites, 800 offices, a convention hall, 10 function rooms, and 12 different restaurants and bars. Other facilities include a health center, shopping arcade, bank, post office, taxi tour, and ticketing service. <a href="http://www.thegardenhotel.com.cn">www.thegardenhotel.com.cn</a>	
<b>UPS</b> <a href="http://www.ups.com">www.ups.com</a> .....	72
<b>WJS Stowell Company</b> .....	43
WJS Stowell Company (STOCO) is leading American trade company in petroleum and other equipment, established in 1971. STOCO has 5 offices and 30 staff in China. <a href="http://www.wjs-stowell.com">www.wjs-stowell.com</a>	
<b>World Economic Forum</b> .....	33
The World Economic Forum is the foremost global community of business, political, intellectual and other leaders of society committed to improving the state of the world. <a href="http://www.weforum.org">www.weforum.org</a>	

# A GANSU HOMECOMING

A once-sleepy province is waking up



Russell E. Kratzer

**W**hen I arrived at the Shanghai train station on a cold February day, it seemed that half of the city's 15 million people had gathered in front of the entrance, and everyone was struggling to be first through the gate. I was about to begin a 27-hour train ride, and I was in no mood to fight the crowds heading home for China's Spring Festival. I consoled myself with the thought that I was headed to the much less crowded Tianshui, Gansu, where I taught English as a Peace Corps volunteer from 2000 to 2002.

As the train approached the Tianshui station, my excitement grew. Nearly two years had passed since I left Tianshui, and I was looking forward to visiting old friends and seeing how much the city had changed. When the train finally arrived at the station, my basketball buddies Lei Tianbin (Chuck), Lu Duowen (Jimmy), and Li Wenjun (Lee) were waiting for me on the platform, warmly welcoming me back to Tianshui. Although it was already past midnight, we went downtown to eat roasted lamb, drink local beer, and remember the good old days.

My week in Tianshui was similarly filled with food and conversations with old friends. My former supervisor, Ma Xiangming, treated me to hand-pulled noodles and briefed me on his new projects at the university's international exchange department. My former next-door neighbor, Zhao Feiyi, discussed his doctoral research with me while his daughter bounced in his lap. She seemed wary of my blue eyes and red hair, but I tried to calm her fears by reminding her that I had held her the day after she was born. Jiang Bingsheng, an English department colleague, took me to a hot-pot restaurant. I had made certain to bring some American chocolate for his son, who is a big fan of Hershey bars.

Between meals and conversations with these friends, I took time to explore the downtown area and acquaint myself with the new Tianshui.

Like the young students I taught, Tianshui seems to be a young city growing into a confident adult and finding its place in the world. The second-largest city in Gansu, Tianshui has grown over the past 15 years from a poor backwater into a modestly prosperous city with a thriving middle class.

The changes just since my departure two years ago were immediately visible: Across from the city's main square, an upscale shopping plaza has replaced a run-down lot where miscellaneous vendors had set up shop. The city government also widened some of the streets and established clearer bike paths and sidewalks. It even installed exercise equipment on the sidewalks of Tianshui—while running errands, passersby can do a few pull-ups or run on a low-tech treadmill painted fluorescent

pink. All of these changes invoke a sense that the city is becoming more organized and is trying to provide a more comfortable environment for its citizens.

The government has also made significant improvements to Tianshui's transportation system. First, it added a traffic light to the busiest intersection in town. When I lived in Tianshui, there were only a couple traffic lights, and they were not necessarily at the busiest intersections. The government has also added timers and pedestrian crossings. Though many drivers and pedestrians are reluctant to obey the traffic signals, such additions demonstrate the government's commitment to improving traffic control. Now Tianshui even has highly visible street signs that contain *pinyin* so foreigners can easily navigate the streets.

Perhaps the most welcome change is to the bus system. In the city center, old poles with rusted signs marking the bus stops have been replaced by new bus shelters. The city also purchased a fleet of new buses, a very welcome change for me. At 6'3", I used to have to bend my knees and tilt my neck about 45 degrees to avoid hitting my head on the bus ceiling. But on the new and improved No. 2 bus, even when I stood on my tiptoes, I was in no danger of hitting my head. Now that's progress!

Cell phones have invaded the city. When I left Tianshui in the summer of 2002, mobile phones were few and far between. But upon my return, I stepped off the bus in the town's main square to find myself staring at China Mobile advertisements at each corner. These gigantic blue-and-white billboards loom over the citizens of Tianshui, urging them to buy cell phones or more minutes. Walking down the street, I lost track of the number of stores and kiosks selling cell phone recharge cards and accessories. Four years ago only wealthy Tianshui citizens would contemplate buying a cell phone; now even the cabbage-and-tomato vendor carries one.

There are still reminders that Tianshui has some catching up to do. Despite the ubiquity of cell phones and China Mobile kiosks, I was disappointed to discover that there was no way to add minutes to my phone, which I had bought in Shanghai. China Mobile only sells cards for local accounts in Tianshui. Perhaps this problem will be solved before I make my next trip to Gansu.


As I rode the train back east to Shanghai, I digested the sights and sounds of my trip and tried to imagine how much more Tianshui would change before my next visit. I hope that by then the city will have an airport, so I won't have to take another long train ride to find out. 完

Russell E. Kratzer is studying Chinese at Fudan University in Shanghai.

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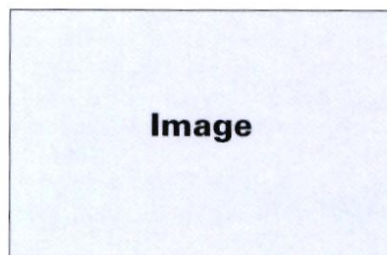
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