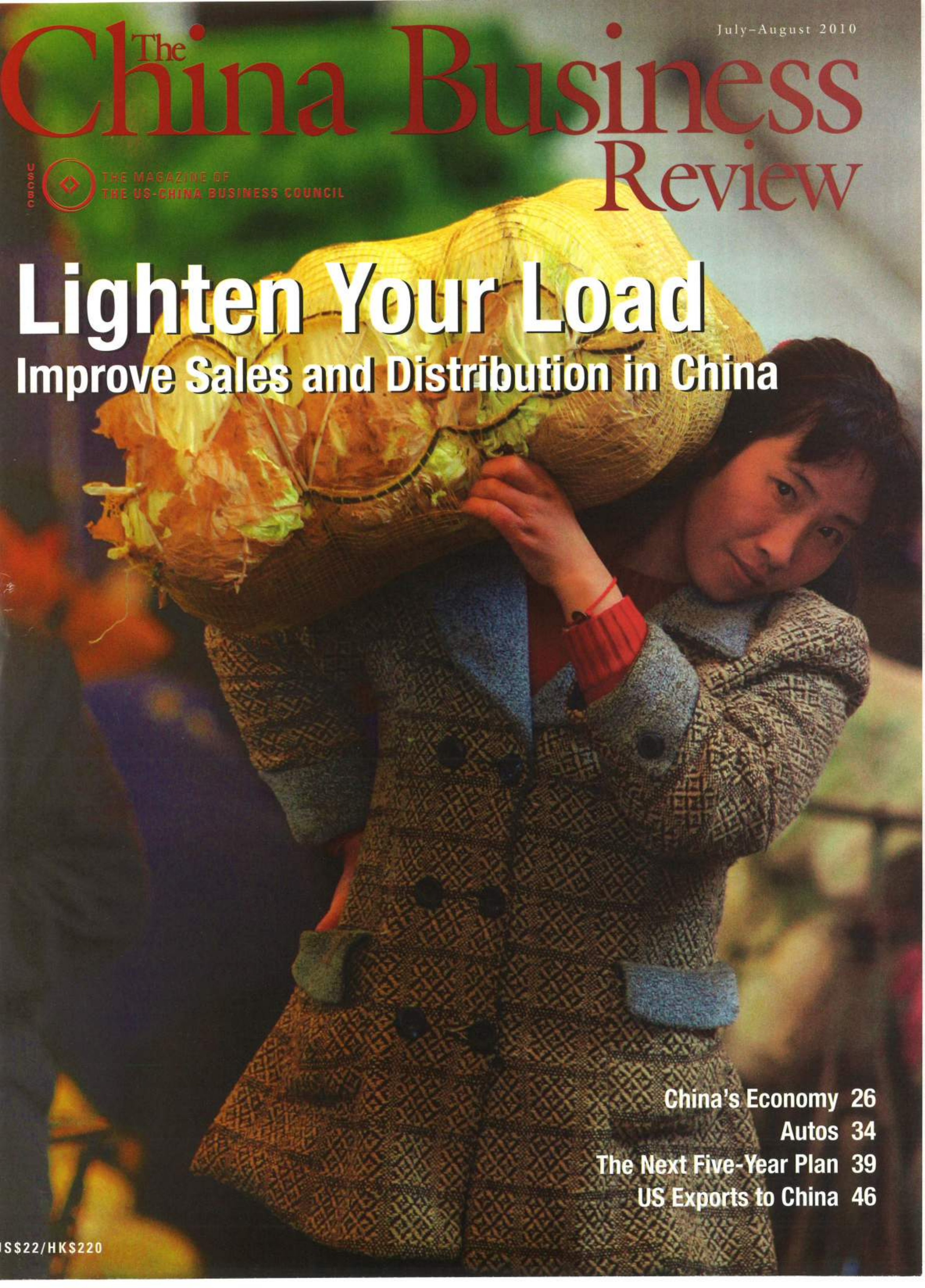
July–August 2010

The China Business Review

USCBC
THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL

Lighten Your Load

Improve Sales and Distribution in China



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Many cities restrict truck size in downtown areas, forcing distribution companies to use less efficient, smaller trucks.

The China Business Review

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Features

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Letter from the Editor

After nearly 12 years at the US-China Business Council (USCBC), the last four as editor of the *CBR*, the time has come for me to move on. It has certainly been an exciting decade to follow US-China commercial relations. Since I started at the USCBC on October 1, 1998 (China's National Day), the *CBR* has followed major US-China commercial events: the intense campaign, and final vote, for permanent Normal Trade Relations, negotiations over China's entry to the World Trade Organization (WTO), and China's final WTO entry agreement. Once China entered the global trade body, we pored over the agreement, putting together issues outlining China's commitments in various fields. For five years, we closely tracked China's progress in implementing its WTO commitments and opening sectors further to foreign investment.

Now that most of China's WTO commitments have been phased in, business is looking "beyond WTO" and urging China to liberalize sectors that still have restrictions for foreign investors. Accordingly, the *CBR* has covered a range of topics, from long-term issues like intellectual property and transparency to the latest developments in new policies that affect business, such as China's developing indigenous innovation policies.

In addition to business-related developments, the last decade has given those of us who focus on China a rollercoaster ride of ups and downs. On the upside, the 2008 Beijing Olympics, 2010 Shanghai Expo, and 2001's APEC meetings in Shanghai celebrated China's arrival as an accepted international player. On the downside, several incidents—such as the EP3 incident in Hainan and the US bombing of the PRC Embassy in Belgrade—heightened political tensions that occasionally spilled into the commercial realm. The 2008 Sichuan earthquake brought both tragedy and inspiring stories of survival and recovery, while the 2005 birth of Tai Shan, the panda at the National Zoo in Washington, DC, created a general feeling of goodwill.

So it is with mixed feelings that I take my leave—it is hard to imagine a job more in the thick of China events than one at USCBC. Nevertheless, I leave the magazine in the capable hands of Paula Miller, who has been my right hand on the magazine these last four years. I would like to thank Paula for all her support, as well as current assistant editors Julia Zhao and Daniel Strouhal. Thanks must also go to our designer Jon Howard, and advertising representatives Uhry and Associates and their China-based counterparts, Publicitas. Finally, I would like to recognize the many USCBC staff members who, over the years, have contributed ideas, articles, and introductions to outside authors.

We always welcome reader comments on any aspect of the magazine. If you have suggestions for stories or improvements to the magazine, please e-mail publications@uschina.org

Best wishes,

Virginia Hulme

The China Business Review

Editor Virginia A. Hulme, vhulme@uschina.org
Associate Editor Paula M. Miller, pmiller@uschina.org
Assistant Editors Daniel Strouhal, dstrouhal@uschina.org; Julia Zhao, jzhao@uschina.org
Administrative Assistant Mattie Steward
Art Direction & Production Jon Howard/JHDesign, Inc.
Research Assistants Jeffrey Genota, Joseph Luk

Inquiries and Subscriptions: publications@uschina.org
Web: www.chinabusinessreview.com
Reprints: For bulk custom reprints (min.100), call 1-800-259-0470 in North America and 717-481-8500 from other parts of the world, or e-mail Jackie Epler, jepler@reprintdept.com
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ADVERTISING
North America–Uhry & Associates
1117 East Putnam Avenue, PMB 306, Riverside, CT 06878

Northeast: Peter Uhry
Tel: 203-637-5478 Fax: 203-698-1725
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Northeast & Midwest: Ed Winslow
Tel: 203-838-7985 Fax: 203-838-9660
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Southeast & Mid-Atlantic: Ned Frey
Tel: 757-259-5907 Fax: 757-259-6804
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West & Southwest: John McCarthy
Tel: 818-706-8066 Fax: 818-706-8326
E-mail: johnmccarthy1@sbcglobal.net

China–Publicitas China
Beijing: Cindy Zhan
Rm 808, Fullink Plaza, Tower A, No. 18
Chaoyangmenwai Avenue
Beijing 100022 China
Tel: 86-10-6588-8155 Fax: 86-10-6588-3110
E-mail: cindy.zhan@publicitas.com.cn

Shanghai: Isabella Hou
Room 708, Wise Logic International Center, No. 66
Shanxi Road North
Shanghai 200041 China
Tel: 86-21-5116-8877 Fax: 86-21-5116-0678
E-mail: isabella.hou@publicitas.com.cn

South China: Sherry Yuan
Rm 1108, Derun Tower, No. 3 Yong'an Dongli
Jianwai Avenue, Chaoyang District
Beijing 100022 China
Tel: 86-10-5879-5885 Fax: 86-10-5879-3884
E-mail: sherry.yuan@publicitas.com.cn

Hong Kong–Publicitas Hong Kong Ltd.
Rana Rizvi
25/F & 26/F, Two Chinachem Exchange Square
338 King's Road
North Point, Hong Kong
Tel: 852-2516-1516 Fax: 852-2528-3260
E-mail: rana.rizvi@publicitas.com

OFFICE OF THE PUBLISHER
The US-China Business Council
1818 N St., NW, Suite 200
Washington, DC 20036
Tel: 202-429-0340 Fax: 202-833-9027

The Gap Year

Robert Poole

One way to look at US business and China in 2010 to date might be to see it as a year of many gaps, or spaces where common or agreed interests don't quite meet. Despite these differences, the underlying interest of both countries' consumers in each other's products remains strong, and even if parts of the business relationship are under challenge.

Where the gaps lie

The differences are numerous and occasionally lead to exaggerated media headlines and mutual pointing of fingers. Both governments recognize the vital need for cooperation, and yet

- Vows against protectionism have been belied by tariff and other actions in Washington and Beijing;
- Pledges on climate change have led to more promises and limited technical cooperation, without real progress on either side; and
- Industrial policy discussions have not markedly reduced worries and distrust of US and Chinese companies of each others' markets, despite earnest efforts.

Economic and financial views

US and Chinese perceptions of what constitute suitable economic and financial policies have also diverged widely, with the battered Western model of lightly regulated market competition dimming considerably in most Chinese eyes against the relatively strong results of China's own government-led economy. China's economic and financial reforms have certainly slowed, and the debate over the best model for its modernization has fractured further.

Business policies: Encouraging Chinese growth or protectionism?

In business, gaps have grown more prominent, too. PRC officials have been surprised at world reaction to industrial policies aimed at their highest priorities: addressing domestic imbalances, maintaining employment, and transforming China's economy by moving manufacturing up the value chain and spurring services growth. Steps to promote "indigenous innovation" have provoked legitimate international business fears that have reached the highest levels in foreign capitals. PRC officials have met foreign allegations of grand industrial conspiracy with defenses that seemed to range from "You just don't understand us" to "Our model works better than yours, for us."

Company views of China

In some instances, views of China between in-country executives and their counterparts at headquarters back home have widened. On a number of occasions, the US-China Business Council (USCBC) has been asked to gently disabuse visiting CEOs of the belief that 10 percent economic growth in China should enable the company's China operations to grow revenues by multiples of that amount easily! But executives are right to appreciate the relatively good results that have come from China—most companies' China operations outperformed other locations in 2009. Another bright point is retail spending, up 18.1 percent in the first quarter of 2010 over the same period of 2009, contributing to first-quarter growth of 11.9 percent.

Looking past the gaps

Several observations have stood out in the ups and downs of recent months. In stormy March, Amway Corp.'s President Doug DeVos wisely reminded a Beijing audience of Chinese and foreign officials and media that times of difficulty or strain in a relationship cause us to think more about the other side's needs and can thus push us to find compromises and resolutions. Equally insightful was a PRC State Council official who told USCBC in April that China's optimism about the long-term relationship with the United States is tempered by a realization that there will be "w-shaped" ups and downs along the way.

We all would probably do well to rein in our fears about the gaps—and our expectations about easy cooperation and profit. Instead, we should focus on the underlying commercial interests, always looking at the value proposition of good products and innovations for consumers, high quality in the services sector, and good employment practices and community citizenship.

My own optimism is grounded with the Chinese individual and corporate consumers who have demonstrated a growing desire and ability to afford world-class products. It is tempered by a keen awareness of risk for US companies in China, including weak intellectual property rights protection, worrisome business policies, and larger issues regarding the sustainability of economic growth.

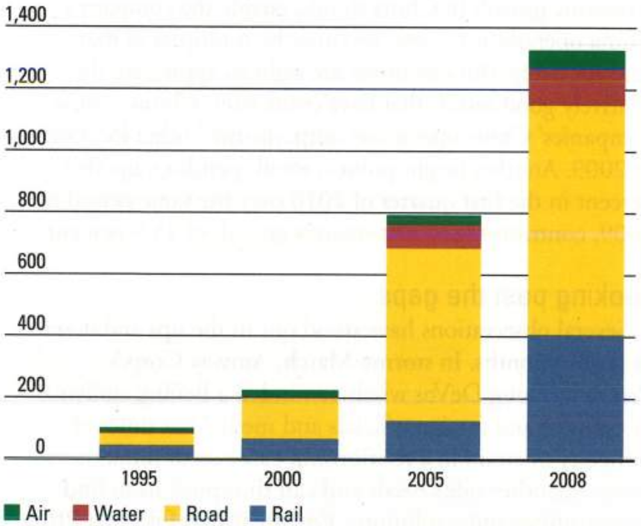
Seen from Beijing by someone with regular contact with US companies throughout China, 2010 is perhaps a year when gaps are more visible, but a year that may help us to focus on ways to reduce and resolve them. 完

Robert Poole *(rpoole@uschina.org.cn) is vice president, China Operations, at the US-China Business Council in Beijing.*

China's Distributio

Investment in transportation infrastructure has soared, fueled by China's economic growth.

Investment in National Transport in China, 1995–2008 (¥ billion)



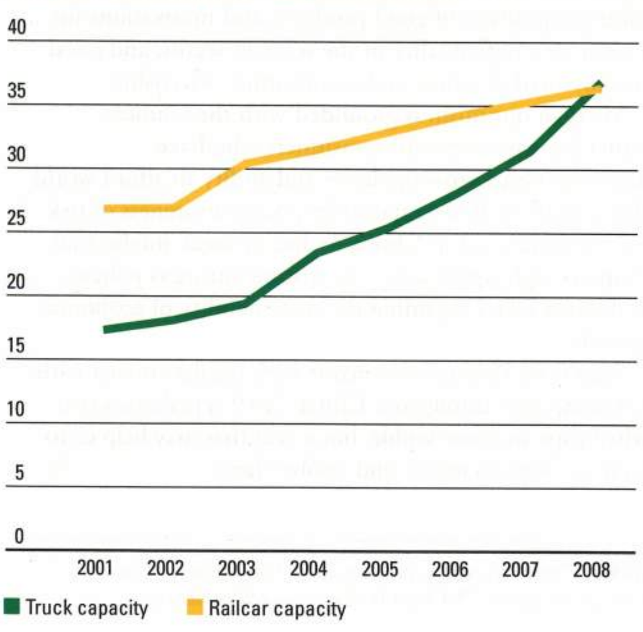
All forms of freight traffic have risen sharply, but road remains the main mode of transport.

National Freight Traffic 2004–08 (million tons)

Type	2004	2005	2006	2007	2008	% change 2007–08	% change 2004–08
Rail	2,490	2,693	2,882	3,142	3,304	5.1	32.7
Road	12,450	13,418	14,664	16,394	19,168	16.9	54.0
Water	1,874	2,197	2,487	2,812	2,945	4.7	57.2
Air	2.8	3.1	3.5	4.0	4.1	2.5	46.4

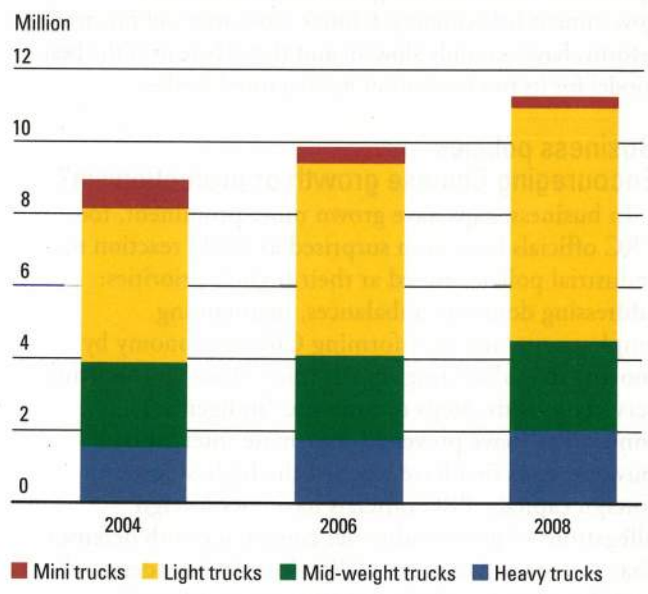
As China expanded its highway system, its truck capacity more than doubled...

Capacity of Trucks and Freight Railcars, 2001–08 (million tons)



...and heavier trucks became more common.

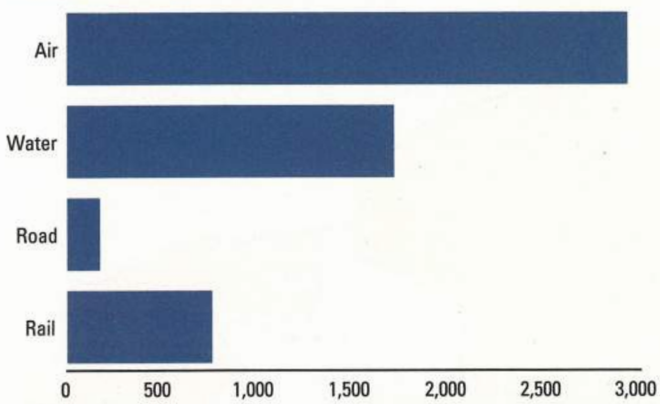
Freight Trucks in China, 2004–08



ector Expands

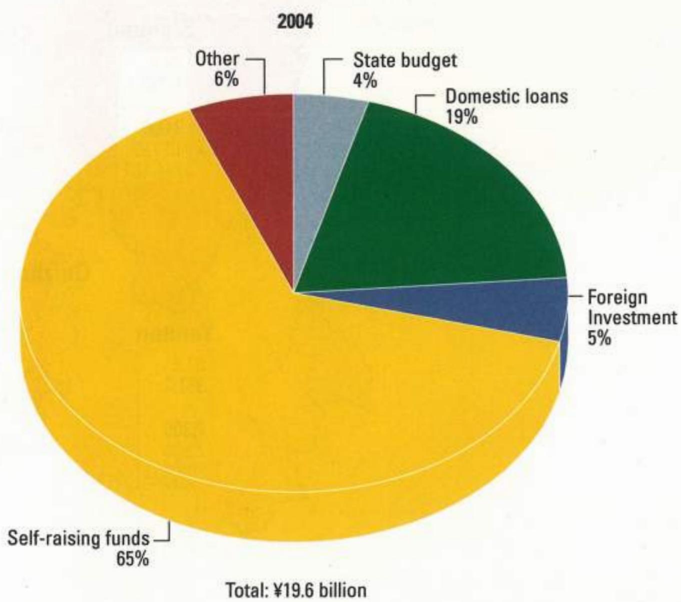
Air and water are used for long-distance transport.

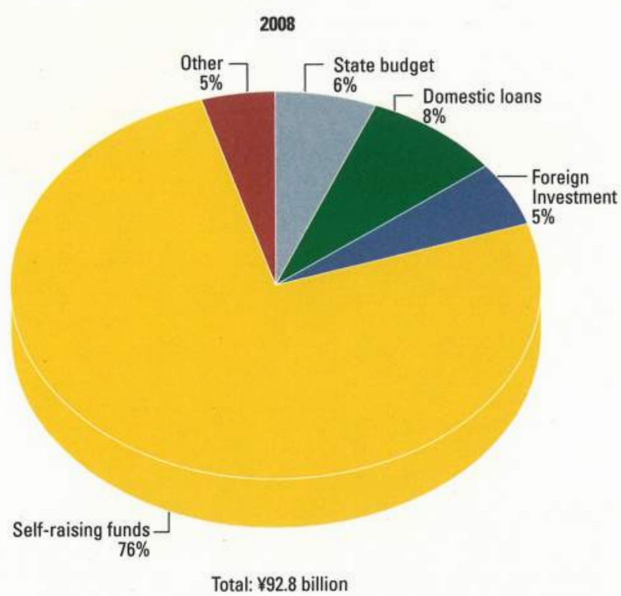
Average Transportation Distance of Freight, 2008 (km)



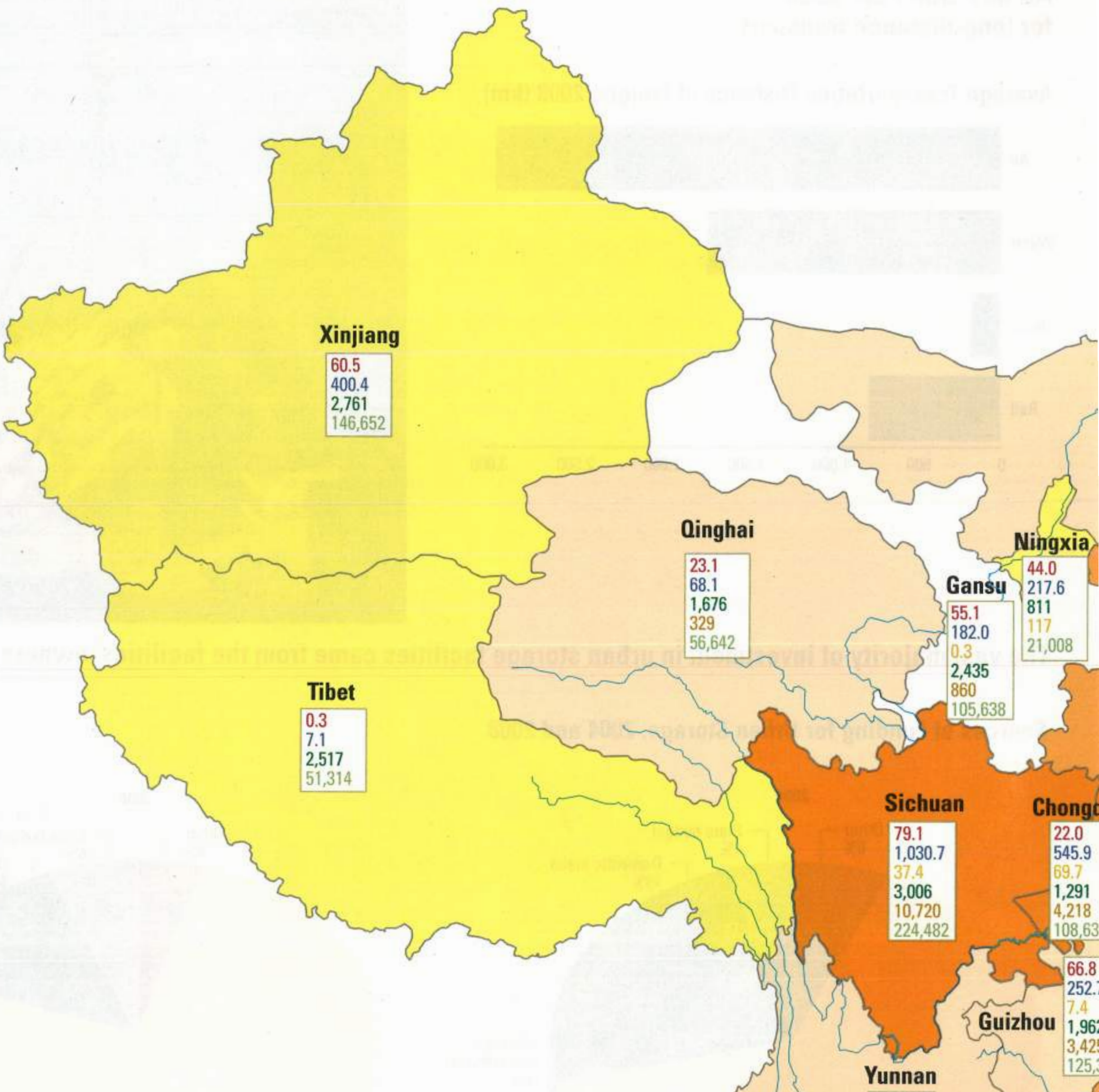
The vast majority of investment in urban storage facilities came from the facilities' owners.

Sources of Funding for Urban Storage, 2004 and 2008

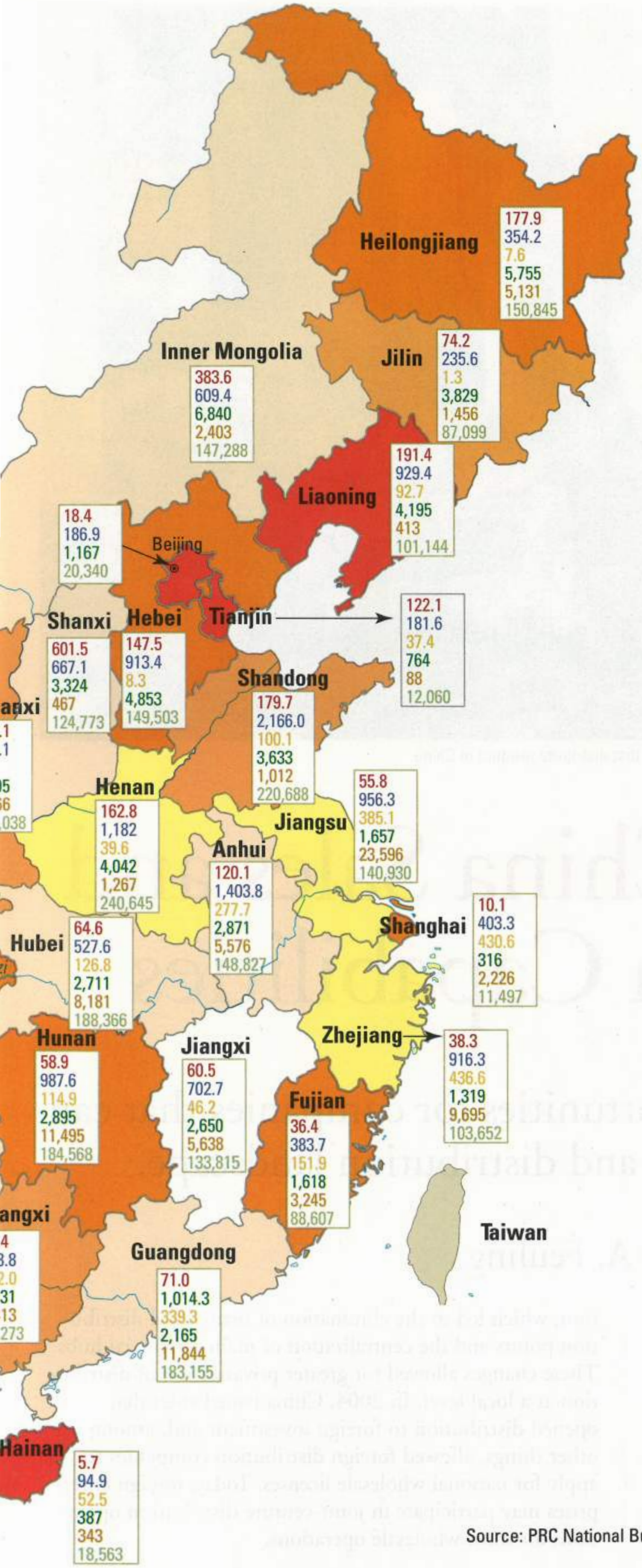




Note: Totals may not equal 100 percent because of rounding.
Source: PRC National Bureau of Statistics, *China Statistical Yearbook*, 2001–09



Xinjiang
60.5
400.4
2,761
146,652
Tibet
0.3
7.1
2,517
51,314
Qinghai
23.1
68.1
1,676
329
56,642
Gansu
55.1
182.0
0.3
2,435
860
105,638
Ningxia
44.0
217.6
811
117
21,008
Sichuan
79.1
1,030.7
37.4
3,006
10,720
224,482
22.0
545.9
69.7
1,291
4,218
Guizhou
Yunnan
52.2
391.2
3.4
2,309
2,539
203,753



Growth of Investment in Transport, Storage, and Postal Infrastructure by Province, 2004–08

(Shaded provinces)

- Greater than 200%
- 150%–200%
- 101%–149%
- 51%–100%
- 0%–49%
- Less than 0%

Freight Traffic and Transportation Lines

(Boxed numbers)

- Railway freight moved (million tons)
- Highway freight moved (million tons)
- Waterway freight moved (million tons)
- Length of railways (km)
- Length of navigable inland waterways (km)
- Length of highways (km)

Source: PRC National Bureau of Statistics, *China Statistical Yearbook*, 2001–09

China Foto Press

China's fragmented distribution networks create inefficiencies for companies that distribute product in China.

Developing China Sales and Distribution Capabilities

The China market offers opportunities for companies that can navigate its evolving sales and distribution landscape.

Bradley A. Feuling

Before the launch of economic reforms in 1978, the PRC government controlled China's nationwide distribution channels, including the system of managed distribution centers, wholesale operations, and retail outlets. The State Planning Commission issued production requirements and allocated inventory.

As reforms progressed, the government phased out central planning for many products. China's 2001 World Trade Organization (WTO) entry brought more foreign competition, which led to the elimination of many local distribution points and the centralization of main provincial hubs. These changes allowed for greater privatization of distribution at a local level. In 2004, China issued rules that opened distribution to foreign investment and, among other things, allowed foreign distribution companies to apply for national wholesale licenses. Today, foreign enterprises may participate in joint-venture distribution operations for most wholesale operations.

Sales and distribution networks evolve

Bigger markets demand better distribution systems

With the increased privatization of distribution channels, sales in China have risen exponentially. Retail sales alone rose from ¥4.3 trillion ($520 billion) in 2001 to ¥12.5 trillion ($1.8 trillion) in 2009, growing about 12.5 percent each year. Last year, retail sales grew 16.9 percent over 2008 despite the global economic downturn, according to the PRC National Bureau of Statistics, and a PRC Ministry of Commerce (MOFCOM) official in November 2009 said that China's retail sector is expected to grow 16 percent in 2010. An April 2010 Boston Consulting Group report noted that "the increase in middle- and affluent-class households will double consumer spending power in nearly a quarter of China's cities and counties over the next decade." The authors further estimated that consumer companies looking to reach 70 percent of this segment need to be in nearly 240 locations today—and in more than 400 by 2020.

Many companies are marketing their brands beyond the major cities to meet growing demand. More than 160 cities in China have populations of at least 1 milslion. Some companies, such as Adidas-Salomon AG and Nike, Inc., already have strategies to penetrate smaller cities. These developments and forecasts imply that companies in China will need to greatly expand and strengthen their distribution and logistics capabilities, whether on their own or through third-party providers. In addition, PRC government efforts to boost consumption will reinforce these trends.

Quick Glance

- China's highly fragmented, localized distribution landscape increases costs, especially for companies that want to distribute products nationwide.
- Lead times can be significantly longer in China than in markets with more developed distribution networks.
- Foreign suppliers should factor in additional time and costs and invest in streamlining product delivery.

Logistics and distribution take center stage

In recent years, the PRC government has invested a great deal in the country's logistics infrastructure. China allocated nearly 40 percent of its massive 2008 economic stimulus (¥1.5 trillion [$219 billion]) to public infrastructure development. In 2009, China built or upgraded 156,000 rural stores and 1,100 distribution centers across the country, according to MOFCOM. China now has 420,000 rural stores that cover 75 percent of all townships and 50 percent of all administrative villages.

Over the last decade, China has invested in improving infrastructure in interior cities, with a focus on building larger interior cities into major logistics and distribution hubs. For example, Wuhan, Hubei, is becoming the multimodal logistics hub of central China. The city has one of China's largest inland ports, handling up to 40 million tons of cargo annually, with shipping lanes that lead to 14 countries. National highways and railway lines link Wuhan to other major Chinese cities. In May 2010, the Wuhan government announced a ¥14.6 billion ($2.1 billion) investment in the Wuhan Tianhe International Airport, which will expand the airport's cargo capacity to 400,000 tons per year. Many large multinational companies (MNCs), such as the Coca-Cola Co. and Kimberly-Clark Corp., have made the city a key strategic distribution hub. Other inland cities developing similar hubs include Chengdu, Sichuan; Chongqing; Xi'an, Shaanxi; and Zhengzhou, Henan.

Bottlenecks in logistics expansion

Logistics in China is a highly fragmented industry. Bottlenecks hamper efficient and low-cost product delivery. With more than 730,000 registered logistics operators, according to the Global Supply Chain Council, coordinating supply chain capacity and material handling often affect material flows.

One challenge with logistics optimization involves city restrictions on truck sizes during certain times of day. Shanghai, like many other major Chinese cities, limits the use of trucks during daylight hours to alleviate traffic congestion. This complicates distribution and batch shipment optimization. Distribution companies must resort to a fleet of smaller cars and vans or pay exorbitant taxes and fees to use trucks. In this fragmented industry, faced with high transportation costs and low sales margins, distribution companies survive by keeping their prices low.

Companies must also decide whether to outsource logistics or develop in-house logistics capabilities. In 2001, outsourcing logistics operations revenue was only $4.7 billion, less than 5 percent of China's gross domestic product (GDP). In 2006, logistics outsourcing as a percentage of total logistics spending declined to 2 percent, compared with 10 percent in the United States and nearly 25 percent in Europe. In 2009, Deputy Dean Jiaqi Yang of Wuhan University of Technology's School of Transportation estimated that China's logistics outsourcing industry would grow 33 percent each year through 2010. According to the Global Supply Chain Council, third-party logistics is a more than ¥60 billion ($8.8 billion) market in China. As logistics outsourcing grows, competitive advantages for third-party logistics providers—namely in service and efficiency—will lead to greater integration for business operations.

Distribution networks with Chinese characteristics

The main distribution models used in China each have characteristics that affect reach and brand awareness.

■ **Recently privatized channels** Many of China's domestic agents and distribution channels are offshoots of the state-owned system and were privatized over the last decade. Such distribution channels—made up of many smaller distribution networks—tend to be large, combine well-established infrastructure networks, and require companies to use strong *guanxi* at the county- and municipal-government levels (see below). Companies that use privatized channels to distribute product in China may find it necessary to build strong relationships to make sure product moves as planned. Even when brand recognition and power is strong, bureaucratic processes may limit efficiency.

Companies that use privatized channels to distribute product in China may find it necessary to build strong relationships to make sure product moves as planned.

■ **Concentrated wholesale markets** In the late 1980s and 1990s, merchants began to congregate in various locations to sell branded and similar products. A decade or two later, some cities have become famous for certain products. Suzhou, Jiangsu, offers furniture wholesale markets; Yiwu, Zhejiang, is famous for small commodities. Such focused channels serve as distribution points for small and medium-sized manufacturers, allowing them greater access to China's urban consumers. According to a Li and Fung Group report, 4,567 wholesale markets boasted sales revenues that exceeded ¥100 million ($14.6 million) in 2008, up 10.8 percent year on year.

■ **Business-to-consumer services** Increasingly, manufacturers have been expanding their business-to-consumer capabilities. Customers that buy directly from manufacturers often get lower prices but receive service that tends to be below industry benchmarks, because customer service lies outside a manufacturer's core competencies. Few manufacturers have successfully transitioned from original equipment manufacturer to original designer and original brand owner. Among those that have made the transition are Jiangsu Anyang Fashion Co., Ltd. and Shenzhen Kingsun Optoelectronics Co., Ltd. Anyang Fashion began as a US-invested firm that produced garments solely for export. Today, it is a Chinese-owned company with design capabilities and plans for brand and retail expansion. Shenzhen Kingsun Enterprises, the largest high-power light-emitting-diode (LED) lighting product supplier in China, now has a research and development team of more than 400 people.

■ **Decentralized distribution systems** With the liberalization of the commercial sector in 2004, a growing number of foreign agents and distributors have established themselves in China. Through complex subcontracting networks, foreign distributors can work directly with traditional retailers. But these networks tend to lack advanced practices in demand planning, inventory management, and logistics networking—which leads to higher operational costs. This is primarily because such networking involves Chinese partners who lack a

Three Tips for Distribution in China

For companies targeting the China market, developing effective sales and distribution channels is critical. When developing sales and distribution channels, companies must consider

■ ***Guanxi*** Personal networks and relationships are an important component of a successful distribution strategy in China (see p.20). Chinese "networks" are often restricted and exclusive, especially at the local level, where these networks may consist of only a handful of decisionmakers. Thus, forging personal relationships with these individuals is particularly important for distribution channel development.

■ **Distribution partners** Companies must analyze potential distribution partners, paying attention to material movement within China, because poor inventory positioning and stock-outs can harm brand reputation.

■ **Efficiency** In many cases, responsibility for distribution operations is initially placed on the distributor without identifying clear procedures and targets. Companies that use material flow mapping, particularly in rural China, and that have fairly sophisticated logistics, in-transit inventory, and distribution capabilities are likely to be more efficient and better at delivering goods on time and with minimal loss or damage. Mapping helps identify each part of the supply chain and which stakeholder is accountable for what. By graphically mapping material flows, companies can more accurately assess the metrics that directly affect service levels and costs.

—Bradley A. Feuling

sophisticated knowledge of international-standard operations and technology.

Online distribution channels The rapid expansion of the Internet in China, which now has more than 400 million users, has created online distribution channels. Alibaba.com Ltd. and its subsidiary Taobao.com reach a broad range of customers. In April 2010, Taobao reported over 190 million users. The combination of Alibaba and Taobao creates business-to-business and business-to-consumer opportunities. Foreign companies are also expanding into this market through such online distributors as JiGoCity.com. JiGoCity works with a large network of consumer service companies to offer collective buying directly to customers through their expanding network of online users.

Areas ripe for improvement

Downstream supply chain management

Companies should not assume that Chinese distribution partners have advanced knowledge of downstream supply chain management, including the ability to forecast accurately or to assess service levels. Operationally, this means that foreign-invested manufacturers and foreign companies that sell to China must invest more capital and time to transfer knowledge of material movement requirements, especially improvement strategies to reach key performance-indicator goals. If rapid expansion in China is the goal, the company should focus on improving flexibility in distribution scheduling, placing inventory closer to the customer, and buffering lead times. Ready-to-use contingency plans, including scenario-based strategic decisionmaking, should also be in place to respond to delays. As a whole, Chinese distribution companies lack the capabilities of world-class logistics and supply chain companies in more developed economies. In particular, they tend to be weak in inventory management, lead-time planning, distribution network optimization, and demand forecasting.

Inventory management

Inventory management and lead-time planning are becoming critical focal points for improvement as a more sophisticated customer base demands better service. In China, suppliers hold a large amount of inventory and restock only about three times a year on average, compared with suppliers in Europe, Japan, South Korea, and the United States, who tend to restock about 10 times a year. This means the lead time to delivery in China can be significantly longer than in countries with more developed distribution networks. Chinese suppliers face less flexibility when compared to more developed and advanced counterparts, where capital invested in on-hand inventory is lower. Faster inventory turnover increases liquidity, which can be invested in expansion and resource development. Foreign companies should invest their resources in helping downstream partners increase annual inventory turnover so that downstream partners maintain a healthier cash flow that allows them to invest in expansion.

Inventory management and lead-time planning are becoming critical focal points for improvement as a more sophisticated customer base demands better service.

Distribution structure

The distribution structure is another area that can be streamlined. Many of China's distribution networks are highly decentralized, creating fractured and often redundant distribution systems. For example, as many as five tiers may exist at a given level of distribution in Shanghai's complex beverage distribution network, resulting in lower profit margins at every level—producer, wholesaler, distributor, and retailer. To streamline this process, downstream distribution analysis should include a supply chain assessment of factors such as capacity, throughput, and operational metrics, as determined by the company's key performance indicators. If bottlenecks disrupt distribution, suppliers can leverage their influence to identify more direct routes for end-product distribution.

The challenge of fractured and redundant distribution systems is compounded by highly localized and regional distribution networks. A wholesaler may have exclusive access to a district or city, but wholesale distribution remains fragmented nationally, and companies trying to distribute nationwide must use multiple channels and vendors. Network optimization suffers because distributors are reluctant to work with distributors in other geographic areas. To maintain low logistics costs on long-distance distribution, companies try to avoid hauling products one-way over long distances, which in turn often leads companies to establish storage facilities in multiple cities, increasing holding costs and the amount of capital tied to inventory. An alternative solution would be to invest directly by setting up in-house distribution capabilities rather than using local distributors, and companies such as Metro AG and Carrefour SA are investigating direct investment in cold chain logistics. Companies can also collaborate with other vendors in similar situations, such as through joint-procurement agreements.

Continued on page 25

China Foto Press

Working closely with supply chain partners and providing clear incentives for good performance helps improve supply chain efficiency.

Build a Winning Sales and Distribution System

Companies with successful sales and distribution systems in China have adopted certain common best practices.

Hubert Hsu, Waldemar Jap, Carol Liao, and Vincent Lui

Consumer wealth—and private consumption—is expected to grow markedly in the near future. Between 2010 and 2020, China's economic growth will raise nearly 90 million new households to middle- or affluent-class (earning ¥60,000 [$8,800] or more per year), according to Boston Consulting Group (BCG) research. BCG also expects that by 2020 China will have nearly 800 cities with a level of affluence similar to or greater than Shanghai in 2008.

The spread of economic development and wealth implies greater demand and that companies must expand their footprint rapidly to keep up. To unlock China's tremendous growth potential, companies must build an effective, sustainable sales and distribution (S&D) system. Foreign and local companies must therefore learn the keys to designing a successful distribution and organization model and avoid common traps during national rollout.

In their attempt to accelerate growth, however, many companies end up with an S&D system in disarray. Such systems typically show these symptoms:

- Sales-force productivity (as defined by sales generated per full-time equivalent and daily sales calls) that is well below industry peers' average in China, sometimes achieving only one-half or one-third of the average;
- Highly inconsistent sales-force performance with much time spent on administrative, non-revenue generating tasks;
- Account management and resources that are heavily biased toward large, existing markets and accounts with limited attention given to new sources of growth;
- Many distributors and wholesalers with poor retailer or account coverage, logistics, or information technology (IT) capabilities; and
- Limited control over product flow and pricing across regions.

Foreign companies that try to apply proven S&D techniques from their home countries to China usually find the results far from satisfactory. For example, foreign consumer companies typically have better retail capabilities in key account management and point-of-sale (POS) marketing than their Chinese competitors. But these foreign companies often lose out to local players when expanding into the highly fragmented traditional retail sector, which is comprised of small independent stores and small retail chains, and in fast-growing smaller cities that have less organized retail channels. Foreign business-to-business companies—such as those in technology, industrial goods, or healthcare sectors—often find their well-established brand and product advantages nullified by weak channel control and customer coverage relative to local players.

S&D hurdles in China

Companies that underestimate expansion challenges struggle to build effective S&D systems in China. Understanding the top obstacles can help companies prepare solutions to potential problems before launching S&D system transformation and rapid growth programs.

Scarce talent and unsophisticated trade partners

China's primary S&D challenge is its scarcity of S&D talent—a scarcity exacerbated in recent years by rapid economic growth. To cope with staff attrition and business expansion needs, many companies promote their still-green sales representatives to become city-level managers within less than a year. Furthermore, the capabilities of many distributors and wholesalers remain unsophisticated even after decades of experience. The phenomenon is unsurprising given their tremendous growth with relative ease: Distributors that have been growing 50–100 percent each year just by expanding into underpenetrated markets have not been compelled to build value-adding capabilities, such as logistics or IT systems.

Fragmented markets and channels

China's highly fragmented markets and channels mean companies must spend a lot of time and money getting their products to small retailers (see the *CBR*, May–June 2010, p.16). (The top 100 retailers in the United States represent about 60 percent of the retail value, whereas the top 100 retailers in China contribute only 20 percent to the retail value.) Though the distribution system is fragmented and disorganized in most Chinese cities, it is generally worse in small Chinese cities, where most future growth potential lies (see p. 12). Distribution across provinces and administrative regions is also difficult, because of local protectionism and bureaucratic inefficiencies.

Quick Glance

- To avoid hurdles and adopt winning sales and distribution (S&D) strategies, many companies are reviewing their S&D systems in China.
- Successful companies often build a detailed market fact base, develop consistent S&D models, provide appropriate incentives to partners, and boost staff training.

Intense competition

The China market has become crowded with increasingly sophisticated competitors. While foreign companies have been pouring investment into China, bringing their know-how, Chinese companies have matured by learning from their mistakes and observing global practices brought by their foreign counterparts.

Higher costs

Winning the S&D game is becoming more expensive. To reach new consumers, companies must set up infrastructure in remote cities, invest more money in human resources to attract and retain quality staff, and build IT systems to cope with high business volume and the increasing need to track activities at a granular level.

Opaque systems

The lack of visibility of actual business performance and control over business activities in more remote markets often leads to kickbacks or embezzlement by company staff and trade partners. Furthermore, companies find it difficult to obtain reliable, cost-effective information on the performance of potential trade partners. Many companies thus find it difficult to mitigate the potential business loss and legal risks associated with doing business in remote areas.

Despite these challenges, companies should not feel intimidated or avoid taking bold steps to transform their S&D system. By understanding China's S&D landscape, companies have found ways to expand and maintain an advantage.

Successful S&D systems

Because companies have different starting points, business objectives, and competitors, there is no one-size-fits-all solution to building a successful S&D system. Successful companies tend to follow a few common best practices, however.

Build a robust market fact base

Granular, up-to-date databases on market potential, channel structure, and customer landscape (for example, data broken down by category, price segment, and retailers in a particular city) are unavailable for most industries in China. As a critical first step, many companies—with products ranging from milk to mobile phones—have developed a robust, exhaustive fact base and planning process about where to expand and invest S&D resources down to the individual POS or customer level. Though difficult to set up and often requiring the help of an external agency or temporary staff to create, the fact-base building and subsequent planning processes become much easier to repeat once the system is operational for one or two years. In addition, the process becomes a powerful tool for avoiding inventory build-up, irregular product flow, and pricing problems because it gives companies an objective baseline for allocating targets and resources.

Develop and use two or three consistent S&D models across the country

S&D models generally define how responsibilities for different S&D tasks—such as account coverage, order taking, logistics, and inventory management—are split between a company's sales team and sales partners. For example, in top cities, companies tend to adopt a direct model in which their own sales force directly covers, and delivers to, key accounts. In smaller cities, many companies maintain their own sales teams to recruit new customers or retailers and take orders while distributors provide logistical support and working capital. Companies must adopt different models based on the complexity of the S&D tasks required and determine the split of tasks based on the capabilities and economics of the distributors and sales force.

Though companies may find it acceptable to allow sales teams in each region or city to define their own S&D models to fit local market needs, companies should prohibit deviations from two or three pre-selected models as much as possible. By avoiding proliferation of S&D models and local practices, companies will take full advantage of common sales tools and processes, including account planning and call procedures. More important, companies can improve control over sales teams and trade activities by measuring performances against a standardized set of metrics as defined in the selected S&D models.

Companies should also tightly control the organization of their field sales force. Though specific designs of functions and roles vary across industries and are highly dependent on the S&D models chosen, companies with an efficient, highly engaged S&D team often use common

Key Questions to Help Launch S&D Improvements

Companies often find it difficult to improve their sales and distribution (S&D) systems, in part because no single way to build an effective S&D system for all companies exists. In addition, the sheer number of staff and external parties involved, the uncertainties about how competitors and customers might respond, and the seemingly "unchangeable" practices and habits rooted in all parts of an organization have kept many companies from making more fundamental improvements.

The following questions should help companies determine where to start, take some initial steps, and plan the actions required to build a lasting S&D advantage in China.

- **Does your company have consistent S&D and sales organization models across China?** Having only one model might be too restrictive to enable growth across China's heterogeneous markets. Having more than three models (or worse—not knowing the types of models or practices sales teams are adopting) means the company should assess whether it is allowing too much flexibility in the field.
- **What are the key strengths and weaknesses of your company relative to your competitors along each step of the S&D process? Where is your company losing or winning market share?** These types of analyses will help create a strong fact base for gaining alignment across the organization, including by helping the company realize its top S&D challenges and where to focus its efforts.
- **What are the company's growth aspirations for China? Can your company's current S&D system help achieve these goals and meet future coverage requirements, channel evolutions, and customer needs?** This type of gap analysis will help the company prioritize weaknesses that should be addressed first. For example, it may help a company decide whether it will focus on recruiting more capable distributors first or building new capabilities in its own sales force.
- **Does your company have up-to-date, accurate data with a sufficient level of granularity to guide S&D resource allocation and help control irregular activities such as cross-market product flows?** Having a robust, exhaustive fact base on market potential and channel landscape would help enable more targeted resource allocation (such as headcounts and trade spending), better control over pricing and product flows across markets, and more objective benchmarks for measuring the performance of the sales force and trade partners.

—Hubert Hsu, Waldemar Jap, Carol Liao, and Vincent Lui

best practices. One best practice is to set up only four or five reporting layers between the national sales head and the last sales representative on the frontline and have each managerial position control 8–10 sales representatives per reporting layer. Given its short chain of command, such a design improves responsiveness to the market. The design also pushes salespeople to see customers instead of hiding behind managerial or administrative work.

Offer appropriate incentives to trade partners and sales staff

Companies should institute appropriate incentives—and disincentives—for trade partners and sales staff. Many companies often fail to reward their trade partners for good behavior with attractive incentives and seldom penalize wrong behavior severely enough. This usually occurs because of insufficient data or resistance from the sales force or distributors. They may argue against incentive and disincentive policies because it is difficult to capture up-to-date, accurate sales or inventory data to measure performance in a particular market. Though some of the concerns may be valid, many of them could be resolved by building a robust market fact database, investing in IT systems, and tracking processes.

The benefits of implementing a stronger incentive and disincentive system can far outweigh the costs. For example, instead of giving identical trade terms and incentives to all distributors, companies can significantly reduce spending on wholesale discounts or rebates by implementing a scheme in which a full-service, highly capable trade partner achieves a much higher incentive than a less-capable, logistics-service-only distributor. Businesses can often achieve a 3–5 percentage point improvement in margins by implementing this kind of segmented incentive system. Such a system also provides incentives for trade partners to improve their capabilities.

For the sales force, companies will need a highly variable compensation scheme to motivate sales staff in China. In many companies, as much as 40–50 percent of compensation is variable pay. Along with measuring against sales targets, businesses should implement incentives for longer-term channel or customer development tasks such as expanding customer or POS coverage, deepening penetration in new markets, and improving return of trade spending.

Recruit and train strong sales staff—and provide them with necessary tools

Reaching a maximum number of accounts and achieving sales targets are important goals, but the quality of the sales organization is also critical for ensuring long-term profitability and competitive advantage. Given the scarcity of talent and intense competition in China, recruiting and retaining the right sales team is a top priority. Many companies operate extensive programs to recruit from lower-tier cities and away from school campuses, where competition for talent is less intense. (For example, some companies recruit experienced workers who have been forced to retire early because of state-owned enterprise restructuring.) Moreover, providing ample career development opportunities is effective. Some companies have intentionally created more "grades" of sales representatives to increase promotion opportunities without creating extra reporting layers. Another effective way to retain talent is to provide overseas training or rotation opportunities—something that is easier for foreign companies to offer.

Equipping the sales force with tools and guidelines to manage daily activities is essential. Many companies have set up a dedicated sales development team that focuses on advancing tools, such as customer or retailer census and sales-call procedures. In the case of sales calls, guidelines may even include details on how sales representatives should greet customers, given the scarcity of experienced talent.

To enable effective performance and incentive management for trade partners and frontline staff, companies need ample granular, up-to-date sales data. For example, implementing a more complex trade incentive scheme well requires lots of detailed and reliable data. Many companies that have delayed investing in such fact bases and data systems have witnessed their competitors, which made the investment years earlier, reap full advantage from the data.

Manage change in S&D transformations carefully

Given the tremendous internal and external challenges of transforming S&D systems, many companies have adopted a cautious, methodological approach to change. Ideally, companies should conduct several pilots to test newly developed processes and tools across cities with different channel landscapes and stages of development. Companies should also spend significant time and effort communicating changes and the rationale behind the changes to affected employees and trade partners. Apart from building mutual trust and addressing concerns, the communication effort will educate staff and partners, encouraging them to change long-held views and habits.

Time for a review?

Though China's consumer market offers tremendous potential, its vast territory and significant regional differences make it difficult for companies to develop a sustainable S&D system. To do so, companies must put tremendous effort into creating a fact base, redesigning business models and organizations, and developing tools and IT systems. Rather than avoiding or delaying a potentially inevitable transformation, companies should regularly review the "state of health" of their S&D system and make sure the competition is not leaving them behind. 完

Hubert Hsu *(hsu.hubert@bcg.com) is a senior partner and managing director in the Boston Consulting Group's (BCG) Greater China Practice and the leader of the Consumer Practice in Asia.* ***Waldemar Jap*** *(jap.waldemar@bcg.com),* ***Carol Liao*** *(liao.carol@bcg.com), and* ***Vincent Lui*** *(lui.vincent@bcg.com) are partners and managing directors in BCG's Greater China Practice.*


China Foto Press

The process that leads to signing a supply agreement can take much longer in China than in the West, and the potential supplier often helps shape the buyer's need.

Marketing and Selling to Chinese Businesses

Western suppliers of Chinese businesses must understand and market to local needs to be successful.

Matthew Harrison and Mark Hedley

The opportunities presented by the China market are becoming increasingly difficult for Western businesses to ignore. With China expected to become an engine for global economic growth over the next decade, many Western companies are realigning their global strategies to put a stronger emphasis on China and other Asian markets. In addition, Chinese companies are becoming more sophisticated, and their expectations for quality are rising. At the same time, competition in China is increasing, making the question of how to sell and market effectively to Chinese companies more important than ever.

Quick Glance

- Foreign suppliers should tailor their products and services—and adapt their marketing approaches—to meet local needs.
- Foreign companies should highlight their commitment to the China market, product quality, and after-sales services.
- Chinese companies will select suppliers who they like and trust personally, not just professionally.

Chinese attitudes toward marketing and sales

Marketing tends to be less widely valued within Chinese businesses than it is in companies from more mature markets. Many Chinese companies view marketing as a task for the sales department—a function that sometimes involves little more than managing the company logo and brochures as part of sales promotion. Engineers are responsible for product, sales departments make pricing decisions, and senior management makes distribution decisions. At times, marketing departments are derided as spending departments that offer a poor substitute for the personal relationships that heavily influence Chinese business decisionmaking.

In contrast, salespeople and salesmanship are widely respected in China. A good salesperson must be able to adeptly forge business relationships and friendships with potential customers. This emphasis on relationship building tends to lead to a long sales process that requires patience, continual learning, and an on-the-ground presence.

How Chinese companies want to be approached

A 2008 B2B International survey comprised of 100 in-depth interviews with Chinese business owners and senior purchasers in Beijing and Shanghai revealed strong preferences for how they would like to be contacted by potential suppliers (see Figure 1). Respondents worked for companies with at least 250 employees in a variety of industries. All respondent companies worked with Western companies.

Conferences and exhibitions

The highest number of respondents (almost 40 percent) preferred to learn about supplier offers at an event. Conferences and exhibitions are excellent ways to make initial contact with customers and to move a relationship forward relatively quickly. They allow potential customers to ask questions and establish the face-to-face contact that Chinese buyers value so highly. More important, foreign-company willingness to spend time and money to participate in these events demonstrates that companies are committed to the local market.

E-mail

E-mail is now the primary means of communication among Chinese businesses—and more than 35 percent of respondents favored learning about supplier products and services in this way. E-mail is particularly important at the introduction stage of a sales relationship—buyers tend to react positively to a personalized e-mail as a prelude to face-to-face discussion. Western companies will be most successful if they make a telephone call before sending company details by e-mail—"cold," non-personalized messages are even less likely to be taken seriously in China than in Western markets.

Websites

Thirty percent of respondents said that websites were among their most favored ways of learning about new supplier products and services. The number of Internet users in China exceeds 400 million, making China the world's largest online community. A clear and attractive website that conveys a company's offering is vital to generating interest from Chinese businesses—and it can set a foreign company apart from the local competition. Many Chinese buyers are critical of Chinese companies' websites and believe that they are poorly designed, lacking in information, and generally unprofessional. A well-designed, Chinese-language website enables Western companies to communicate with a wider target audience and demonstrate their commitment to the China market.

Main Chinese Requirements for Western Businesses Other than Price

From most to least important

1. Quality of product or service
2. Company reputation
3. Reliability of delivery or service
4. Experience working with similar companies
5. Understands and wants to meet needs
6. Easy to work with
7. Local presence
8. After-sales service

Source: B2B International

Social networking sites

Companies should consider engaging potential customers through social networking sites. Ninety-two percent of Chinese netizens use some form of social media, and many consumers post messages regularly on online forums or blogs. A mistrust of traditional media channels and advertising, along with the heightened importance of social networking within Chinese society, makes China especially suited for online business networking. Many Chinese buyers and technical staff use online communities to evaluate products and services they plan to buy. Most of the social networking sites used widely in China are homegrown—such as QQ, 51, and Baidu—rather than those popular in the West.

Face-to-face meetings

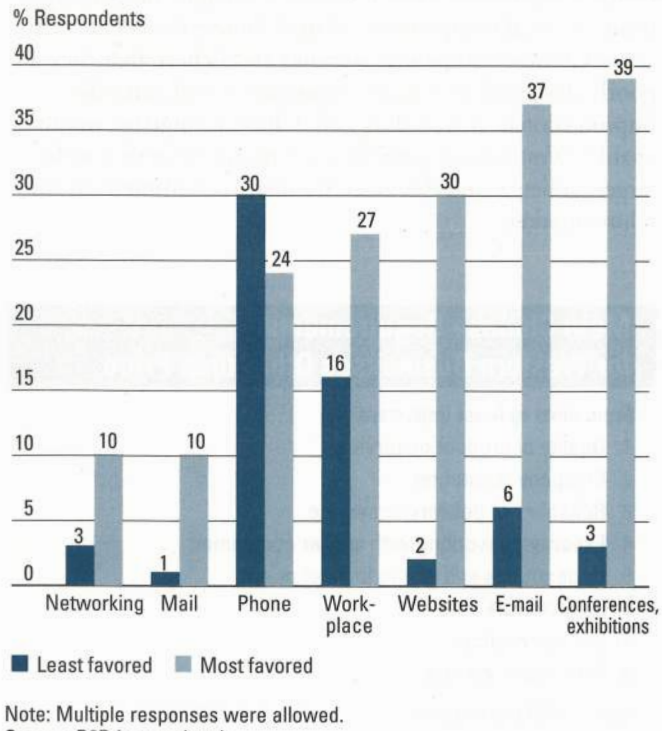
In-person meetings in the workplace are an essential step toward making a sale in most business markets, and more than one-quarter of respondents said that this was a favored way of hearing about a product or service. Being able to speak at least basic Chinese is a good way to impress, show respect, and build rapport with a potential customer. Though being able to speak Chinese fluently is helpful, many senior Chinese executives at larger companies can speak English, and interpreters can be used to avoid any linguistic misunderstandings.

Phone calls

More respondents disliked phone calls than liked them as a way of hearing about products and services, but using

Figure 1: Communicating with Chinese Clients

What are your most and least favored ways of hearing about a supplier's product or service?



Note: Multiple responses were allowed.
Source: B2B International

the telephone remains an effective way to make an initial introduction and identify key decisionmakers within an organization. The high turnover rate of Chinese employees, even in senior positions, means that buyers change frequently, and a quick phone call is often useful to confirm the name and contact details of the key personnel before sending an e-mail.

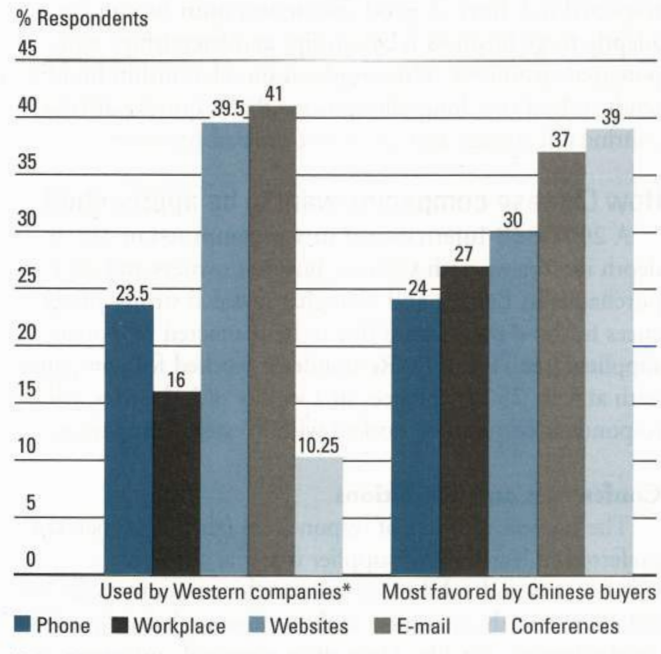
Mail

It is increasingly acceptable—perhaps even expected—for company literature to be sent electronically. Hard-copy brochures and presentations are used widely but generally only during in-person meetings. Receiving quality company literature by mail is such a rare occurrence that companies that do it well can make a good impression.

Relationships and networking

Drawing on personal networks (or *guanxi*) is critical to doing business in China, where business relationships can often transform into personal friendships and vice versa. Many Chinese businesspeople spend a great deal of time and energy nurturing such relationships—often through entertaining or gift-giving—activities that can seem onerous and unnecessary to many Westerners. Though a relatively low number of respondents said that *guanxi* was their favored means for learning about supplier offers, the importance of *guanxi* is likely understated, as it is often a basic requirement to be used in combination with other types of marketing and outreach.

Figure 2: How well do Western companies choose their marketing and sales approaches in China?



Notes: Multiple responses were allowed; *as perceived by Chinese companies.
Source: B2B International

What Western suppliers should communicate to Chinese customers

Western suppliers are targeting Chinese businesses on a large scale, but Western companies' marketing does not always align with Chinese buyers' preferences. In fact, based on the B2B International survey, Chinese companies perceive Western companies as having strong communication through online media but weak interpersonal communication (see Figure 2).

One Chinese respondent's remarks reflect broader respondent sentiment about Western companies' strengths: "Western companies are excellent at using their websites to tell you exactly what they offer and how it can benefit you. They get straight to the point. Chinese companies tell you about their people and what industry they are in but don't really tell you what they do." In written business communications, this directness and clarity is a trait that many Western companies can use to their advantage.

Other traits and attitudes Western companies should emphasize when communicating with potential Chinese customers include superior quality, experience, and service.

Superior quality

Good quality is a "hygiene" requirement—the minimum a Western supplier must provide to justify prices that tend to be higher than those of the local competition. Differentiating and extracting superior value in Chinese business-to-business markets is extremely challenging because competition has driven down prices, local companies are improving their quality and are better able to communicate their offerings, and foreign companies based in China have localized management and procurement positions, resulting in a greater willingness to buy local. On the other hand, most Chinese buyers assume a Western offering will be high quality, which usually is the case. General professionalism—from company literature, appearance and knowledge of staff, and paperwork—is also seen as a key strength of Western companies.

Experience and credentials

Western suppliers must prove that they are "established" in the market and demonstrate experience in dealing with similar companies, preferably in China, to gain the trust of their target audience. From the earliest stage in the relationship, a Western company must prepare and provide comprehensive case studies and client lists, presenting itself in the best possible light and showing that other customers are satisfied with its products and services.

Brand

The challenge of gaining trust can be turned into an advantage if the company leverages its Western brand to the maximum. A company's brand can communicate experience and credentials in the same way as a case study or reference. To Western companies' advantage, many Chinese buyers still appear to associate Western brands with quality.

Service

Chinese buyers have extremely demanding service requirements on issues as diverse as lead time, availability after hours, and technical service. When dealing with Western companies, Chinese businesses feel that they are paying for top quality and expect technical issues to be

Tips for Successful Selling in China

In such a vast and diverse country as China, there are, of course, differences by industry sector, region, and a host of other factors. Nevertheless, several general rules apply across the China market.

■ **Remember the marketing basics** of product, price, place, and promotion. All of these should be researched before and after market entry to ensure that the value proposition meets and will continue to meet the target market's needs.

■ **Patience** is required when applying the marketing basics. The sales process is longer and more complex in China, and it will take time to convince local buyers that a Western company has the "local" credentials to meet their needs.

■ **Listen and adapt** to understand and thus be able to meet local market needs. Chinese companies rarely want a product or service that has come straight off a shelf in the West.

■ **Relationships** are important, but do not over-focus on them. Any salesperson must be prepared to be friends with a potential supplier, but this should complement the marketing mix, not replace it.

■ **Be confident and market quality,** because Western companies are usually assumed to have excellent quality. Focus on the value added and be prepared to explain why the product or service can add value in China specifically.

■ **Be flexible** on issues such as product, service, payment terms, and price. Western companies should do their best to identify and meet Chinese customers' real needs rather than assuming these needs mirror those of customers in the West.

■ **Negotiate** when selling to Chinese businesses. First proposals are unlikely to be accepted. Keep in mind that buyers may be deliberately benchmarking suppliers, and always try to reserve sufficient margin for further price reductions.

■ **Avoid exaggeration** and focus on business credentials rather than exaggerating to make up for perceived deficiencies. Chinese companies want, above all, to trust their suppliers.

—Matthew Harrison and Mark Hedley

dealt with quickly and efficiently. Companies that can demonstrate a track record of customer satisfaction in this area will have an advantage.

Willingness to listen

Most Chinese buyers do not expect suppliers to understand their needs immediately. Suppliers who claim to have the solution as soon as they begin talking are seen as crass, naïve, and untrustworthy. Suppliers who listen, absorb, and suggest are considered to understand the problem, be qualified to offer a solution, and be willing to work for the benefit of the customer.

Respondents frequently said that Western companies do not listen well, indicating to the Chinese buyers that the supplier is not interested in their needs. This perception can be particularly damaging, and it often stems from the way Western companies conduct pre-sale negotiations.

In general, the process leading up to the sale of a product or service in Western markets is clearly structured: A need is identified and a specification prepared; after some discussion the proposal is prepared, fine tuned, negotiated; and ultimately a purchase decision signed. Briefing documents are rare, as are structured tender procedures.

Within Chinese companies, each stage of this process tends to run concurrently, while the whole process from beginning to end is longer. Typically, initial contact with potential suppliers happens at a relatively early stage, when the customer's need is still being defined. It may not even be certain that the product or service in question is needed. The potential supplier therefore becomes a participant not only in the definition of how the need can be met but also in the definition of the need itself. Though the Chinese buyer may speak to a number of other potential suppliers during the supplier process, the company that helps the Chinese buyer define its need typically has an advantage and will often be asked to meet that need.

Friendliness

Chinese buyers want suppliers that are easy to deal with and that engage them on a personal level. Westerners' abilities are seen as lacking, however, in terms of interpersonal contact. This manifests itself in a perceived unwillingness to attend events, visit the client's workplace, or even to make phone calls. One of the most commonly mentioned grievances is that Westerners tend to think that "work is work" and therefore limited to the workplace. Companies that are unwilling to take the discussion outside the workplace are often seen as unfriendly, and—more significantly—hard to get to know, perhaps willfully so. This perception can be fatal in an environment where gaining trust is crucial to success.

Willingness to negotiate

The Chinese approach to completing even relatively simple sales deals usually involves multiple rounds of negotiation, with many people involved in the negotiating process. Even when parties have agreed verbally, they can often redraw the contract several times before reaching a final agreement.

A Western company that allows the Chinese negotiator to gain "face" by taking home a last-minute price reduction will often gain a loyal customer.

From the Chinese perspective, Western companies tend to avoid compromise during negotiations, have overly rigid purchasing procedures, and regard certain issues as "out of bounds" at the negotiating table. Chinese companies also tend to perceive many Western companies as being unwilling to tailor their offerings sufficiently to the China market, whether in terms of product specification, lead time, payment terms, or other customer requirements.

Such inflexibility is absolutely the wrong approach in China, where negotiations are extensive and the opening price is almost never the price the customer ends up paying. Procurers are expected to walk away with the best deal, and a Western company that allows the Chinese negotiator to gain "face" by taking home a last-minute price reduction will often gain a loyal customer.

Take the time to create an effective approach

Chinese and Western companies have different approaches to marketing, selling, and conducting business. Western companies that have some knowledge and awareness of these differences—and that tailor their approach to highlight their strengths, introduce flexibility into their sales processes, and take the time to get to know and listen to potential Chinese customers—can succeed in the China market. 完

Matthew Harrison *(matthewh@b2binternational.com) is director in B2B International's White Plains, New York, office.* ***Mark Hedley*** *(markh@b2binternational.com) is Asia business development and research manager for B2B International's Beijing office.*

Developing China Sales and Distribution Capabilities

Continued from page 15

Localized demand forecasting

Localized demand forecasting is also underdeveloped in China. Many distributors are, in fact, investment companies that purchase and resell products. Few Chinese distributors have sophisticated knowledge of demand forecast planning. They often exclude important variables such as seasonality, product cannibalization, and forecasting cycles; use weak assumptions to forecast sales; and rarely compare forecasts to actual sales to ensure accuracy. Use of more advanced modeling such as regressions, product correlation, and smoothing is limited. ("Smoothing" is the use of variables in demand forecasting to reduce fluctuations that disrupt otherwise normal behavior.) When working with local distribution partners, foreign companies should determine how sophisticated the forecasting tools used by their downstream networks are. To reduce risk, foreign companies should also factor in additional time and costs when planning to supply the China market.

Efficiency: Good for the environment and the bottom line

The potential market for distribution operations in China is large. Total transportation and logistics expenditures account for roughly 20 percent of GDP, compared to about 10 percent in the United States, according to the Council of Supply Chain Management Professionals. Analysts estimate logistics sector growth in China of between 15–20 percent per year. Consolidation in the highly fragmented market has yet to take place, but it will occur as service performance indicators—namely, on-time and in-full product delivery—improve. The PRC National Committee of Logistics Standardization has proposed regulations that aim to improve cold chain logistics, standardization, and information flow integration through technology. These and other new government regulations that affect logistics industry practices will play a role in standardizing the market nationally but may not be thoroughly implemented at the local level for some time.

With China's target of reducing carbon intensity per unit of GDP by 40–45 percent of 2005 levels by 2020, the government will remain focused on improving efficiency in logistics and distribution. Efficient truck use and more sustainable supply chain operations are important to meeting this goal. For example, the PRC Ministry of Transport will consider global discussions about reducing unused transportation capacity, and such discussions are likely to affect domestic and foreign logistics use and packaging in China.

China's Eleventh Five-Year Plan (2006–10) included an unprecedented focus on domestic logistics development. In Shaanxi, for example, Xi'an was selected as one of 17 national logistics centers, according to a Shaanxi provincial government website. In the four years since the plan was released, Xi'an has invested heavily in logistics parks, creating a new bonded logistics zone and a railway container terminal with a capacity of 23 million metric tons annually. Zhengzhou, Henan, was another city selected to become a logistics center. The city established an export-processing center and plans to invest ¥18.2 billion ($2.7 billion) in highway infrastructure in 2010.

MOFCOM is also focusing on rural distribution centers. The government's focus on consolidating distribution and improving efficiency in inland China will strengthen the emphasis on improving China's distribution network.

Continued growth and expansion of sales channels in China will spur advances in distribution in the coming years. Logistics networks will become more efficient, and logistics providers will gain knowledge of advanced capacity planning, inventory management, and demand forecasting. The development of China's economy will lead to the evolution of its supply chain, which will become more similar to those in developed countries. 完

Consolidation will occur as service performance indicators —namely, on-time and in-full product delivery—improve.

***Bradley A. Feuling** (bradley@kongandallan.com) is the CEO of Kong and Allan (Shanghai) Consulting and is based in Shanghai. **Shaun Nath**, associate consultant at Kong and Allan (Shanghai) Consulting, provided research assistance. Kong and Allan Consulting specializes in supply chain operations.*

China Foto Press

A steady rise in Chinese consumption will help ensure global economic growth.

Consumption: New Key to Chinese Growth

China must boost domestic demand to absorb new productive capacity.

Erik Britton

China's economy has achieved stunning growth since it entered the World Trade Organization (WTO) in 2001. Annual growth has averaged 10 percent in real terms over the last decade, and gross domestic product (GDP) was 162 percent higher in 2009 than in 1999 in constant prices. This growth has largely stemmed from two developments: the lifting of the lid that had been placed on Chinese growth for decades, particularly the freeing up of international trade flows; and capital deepening, or an increase in the stock of fixed capital per person. Capital deepening increases the average productivity of each Chinese employee (and thus total output) and is exactly what emerging market economies need to "catch up" with developed economies.

Capital deepening—and the resulting increase in production—could continue for many more years. But because external markets cannot absorb rapidly rising amounts of Chinese goods forever and may already be nearing saturation, growth in Chinese production will have to be absorbed by increases in Chinese demand. The transition to relying on domestic demand carries risks—risks that will show up first in government finances.

Gambling on growth

The proportion of China's GDP devoted to investment has jumped over the last decade. In 2000, fixed-asset investment was 35 percent of GDP (in current prices)—high, but not unprecedentedly so. By 2009, it had risen to about 44 percent, but this number significantly understates the real increase in investment, since the prices of investment goods have fallen globally relative to other goods and services. Expressed in constant prices, the increase in the investment-to-GDP ratio over the period would probably be twice as large as it is in current prices.

Since no official data on the size of the capital stock in China are publicly available, it is difficult to know by how much it has increased over the last decade. GDP has risen 162 percent in that period, and it looks as though capital accumulation can explain most if not all of that increase. The question is how much of that growth can be attributed to capital deepening. Of the 162 percent increase in GDP, Fathom Consulting estimates that about 135 percent was likely due to capital deepening, 6 percent to the modest increase in labor supply, and the remaining 20 percent to growth in total factor productivity (TFP). That equates to 1.8 percent TFP growth per year, which is about average for a developing, rapidly industrializing economy. That apportioning suggests that the capital stock has increased three to four fold over the decade.

Such a high rate of capital accumulation implies an increasing capital-to-GDP ratio across the economy as a whole, and an increasing capital-to-labor ratio, as the Chinese population rose by barely 0.6 percent per year over the last decade.

Despite the dramatic growth in the Chinese capital stock, however, the overall capital-to-labor ratio across the whole economy remains low by international standards. (Much of the rural population is engaged in labor-intensive agriculture, which keeps the average capital per head and average GDP per head low.) Capital accumulation per head in China would need to quadruple again to bring China's capital-to-labor ratio into line with that of South Korea, for example. That could happen—but only if China were to find a market for the extra output such an increase would imply.

Quick Glance

- Capital deepening, which underlies rising average productivity and output, has helped fuel China's economic growth over the last decade.
- To sustain current growth rates, China will need to find new markets to absorb the extra output.
- With developed economy markets reaching saturation, China's domestic market is the best bet, but Chinese consumers will need significantly more buying power to consume at such a scale.

China's impact on the global economy

Major structural shifts within China, such as capital deepening, matter at the global level. China has already had a dramatic impact on global growth and has achieved a significant market share by maintaining low export prices, keeping its currency low, and holding down manufacturing wage costs through rural-to-urban migration. The country has been a net saver abroad, recycling its export earnings into purchases of foreign financial assets, particularly US government bonds. China's growth strategy has meant that global goods prices have been kept low, and government bond prices have been held up, depressing real interest rates globally.

Developed economy demand for manufactured products cannot increase without limit, no matter how cheap those products become. When developed economies—particularly the United States and the United Kingdom, which have essentially been borrowing from China to buy Chinese products—enter a deleveraging cycle, as is happening now, the process breaks down. Developed economies have borrowed too much already, and those high levels of debt are acting as a brake on further consumption. In the next decade, developed economies are far more likely to become net lenders to the rest of the world than to borrow more.

The search for new markets

China urgently needs to find other sources of demand for its products if its productive capacity is to increase at anything like recent rates. The alternatives are either much weaker growth or an excessive investment cycle, which would result in bad loans, low or negative rates of return on investment, falling prices, and recession.

The last decade has seen a cumulative $10 trillion (in constant, 2009 prices) spent on fixed capital in China. Over the same period, Chinese GDP has increased by $3.3 trillion (in constant, 2009 prices). If China were to follow the path of South Korea over the coming decade in terms of fixed investment per person, cumulative investment would top $40 trillion, according to Fathom Consulting estimates. The result would be an annual GDP increase of about 12 percent—in other words, at the top of the range that China has achieved over the last decade. A more modest scenario would see investment per person rise to half the peak reached in South Korea, with cumulative investment of around $25 trillion over the decade. In that scenario, GDP would grow about 8 percent per year, toward the bottom of the range that China has achieved over the last decade.

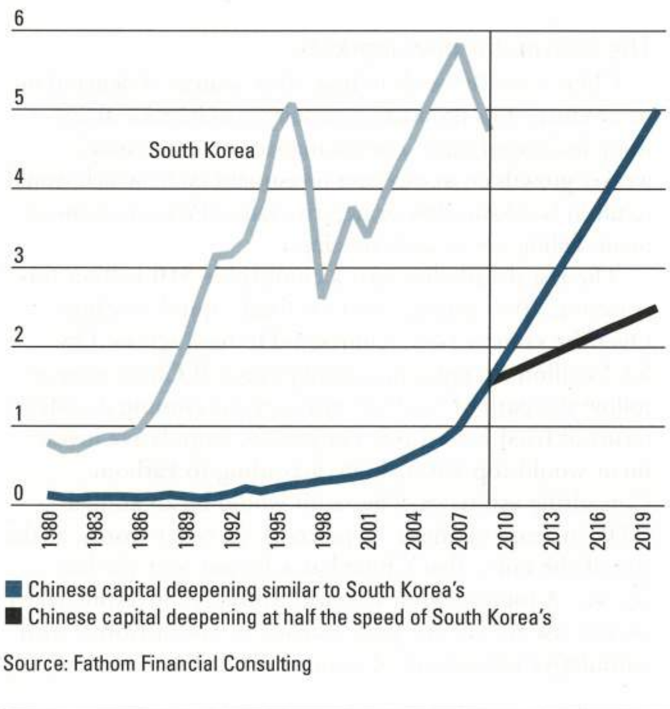
In either case, China must find a huge new market. In the high-investment scenario, Chinese supply capacity would increase massively, but Chinese demand for investment goods would absorb a large proportion of that supply. In the modest investment scenario, Chinese supply capacity would increase by much less, but investment would absorb a smaller proportion of that increase. The bottom line is that between $5 and $7 trillion worth of extra Chinese-produced goods and services will need to find a home—every year—by the end of the coming decade (in constant, 2009 prices).

The world economy as it stands cannot readily absorb so much new capacity. Global GDP, excluding China, is in the region of $55 trillion. But global growth in aggregate demand outside China over the coming decade will at best equal (and will probably be less than) global growth in productive capacity outside China. Therefore, China must be able to absorb not only growth in its own capacity but also some of the growth in global capacity.

Enter the Chinese consumer

China therefore cannot rely on external global demand to absorb its new output. With developed economies deleveraging, and developing economies already net exporters to China, most of this growth will have to come from private and government consumption in China. The most feasible new market to absorb the extra Chinese capacity is China's own domestic market. Tapping that market means unlocking the Chinese consumer.

Annual Per Capita Spending on Fixed Capital Investment ($, constant prices)



Source: Fathom Financial Consulting

Chinese consumers spend an average of about $1,200 to $1,400 per year. If they were to absorb two-thirds of the lower estimate of additional Chinese output by the end of the coming decade, they would have to spend around $4,000 to $6,000 per year (in constant, 2009 prices). For Chinese consumers to have that kind of spending power, the average standard of living will need to increase by a factor of between three and five in a decade—a rather ambitious goal.

The alternative is a huge overhang of spare capacity in China, which would depress prices, interest rates, and growth for decades to come in China and in the rest of the world. PRC authorities are keenly aware of these issues and have instituted policies to reduce capacity in certain industries. But the size of the challenge is daunting. If China can boost domestic incomes and demand to the point where the domestic market can absorb China's extra production, the coming decade will see strong growth in China and the rest of the world. If not, the world risks entering a deflationary spiral driven by debt and excess capacity.

Government finances will provide an early warning

One of the first problems PRC authorities will likely encounter relates to the fiscal position. The PRC government ran a budget deficit during 2009 for the first time in over a decade. The collapse in export markets during the global recession meant that China had to fall back on domestic demand to support growth and, in the short term, the only option was government spending. The government chose to focus that spending on capacity-building infrastructure projects, largely in inland regions—aggravating the problem of finding a market large enough to absorb that new extra capacity in the longer term.

China's budget deficit was worth about 2.8 percent of GDP during 2009 and is expected to be about the same in 2010. Although this level is not considered dangerous, it could rise quickly if the world economy turns down again and Chinese domestic demand does not pick up the slack. If the Chinese consumer steps up, and demand for Chinese goods recovers and starts to grow again at the sort of rates seen before the recession, the deficit will shrink and return to surplus. This scenario would require Chinese private consumption to increase by around 12 percent to 15 percent in real terms every year for the next decade—significantly more than the average real growth rate of 8 percent over the past decade.

That kind of consumption growth would presumably be fueled by wealthier consumers who could afford to pay more tax, giving the PRC authorities a tax base that, in a decade's time, should allow them to balance the books comfortably. But the transition to that situation could be delicate, in part because China would have to change its tax structure.

Until now, Chinese taxes have largely fallen (directly or indirectly) on export-oriented industry. With export markets now much weaker, that source of tax revenue has shrunk, resulting in last year's budget deficit. China now faces a conundrum: It must replace that lost revenue, but not by raising taxes quickly, which would dampen the consumption growth needed to absorb new productive capacity. If it holds back on raising taxes, and global growth remains as weak as expected, the deficit could widen further, potentially reaching double digits as a proportion of GDP. That could create a funding problem.

How would the PRC government finance its deficit in such a case? It has three options: issue new debt, print money, or draw down its reserves of foreign currency.

The first two options would lead to higher inflation, which worries the PRC government for political reasons. The third implies either increasing government imports of foreign goods and services, which would cause the trade balance to deteriorate, or selling foreign currency to buy renminbi, which would drive up the value of the currency.

Whichever option China chooses, the current account of the balance of payments will deteriorate sharply, and China would no longer be able to add to—and may even have to reduce—its foreign-exchange reserves. Of course, that is exactly what the global economy needs.

A fundamental shift to ensure global growth

The best-case scenario for global growth will see China shift from being a net lender to the rest of the world to being a net borrower from the rest of the world over the coming decade. The Chinese consumer will flourish, the renminbi will appreciate in real terms, and the PRC government will draw down its foreign currency reserves. Such a mix would deliver an extremely positive outcome for the world economy, correcting many of the imbalances that led to the recent crisis in financial markets and the global recession. Moreover, this also presents the best option for the Chinese economy to maintain the kind of growth rates it has achieved over the past decade.

But there are many pitfalls along the way. If PRC authorities raise taxes too early—before consumers become wealthy enough to spend significantly—or try to prevent the deterioration in net trade that this scenario demands, the consequences could be dire, and not just for China. The world could face a prolonged, investment-led recession on a scale not seen for decades.

Foreign companies exporting to or investing in China face important consequences. Under the best-case scenario, the Chinese domestic market for consumer goods and services would quadruple in the next decade—effectively creating a new consumer market worth \$5 to \$7 trillion by the end of the decade. This new market will provide foreign companies with a much-needed source of demand. Another layer of this transformation is even more beneficial for firms in developed economies: Growth in Chinese demand for foreign financial and business services will likely outstrip growth in demand for manufactured goods. Financial and business services are industries in which developed economies have a comparative advantage. The blossoming of the Chinese consumer market for goods and services over the coming decade could provide developed economies with their best route for future growth. 完

Erik Britton (erik.britton@fathom-consulting.com) is director, Fathom Financial Consulting.


China Foto Press

China's economy will likely grow about 10 percent this year.

China's Economy: After the Stimulus

Three economists discuss their outlooks for China's economy.

Despite the global economic downturn and uncertainty about the health of the global economy, China's economy remained a relative bright spot in 2009. Though global trade contracted 12 percent—and Chinese exports slowed—China's economy as a whole remained fairly resilient. Now, as many major economies begin to emerge from the downturn, China's economy is speeding ahead, registering 11.9 percent growth in the first quarter.

To discuss China's sustained economic growth—and challenges that remain—CBR Assistant Editor Daniel Strouhal interviewed three China economists in May.

China's economy continued to grow rapidly in 2009 and the first quarter of 2010. With demand in the United States and many of China's other trading partners still relatively low, will China be able to maintain rapid growth? Is domestic demand beginning to drive the economy?

Lu: We expect China to grow 10.1 percent in 2010. We believe that China's gross domestic product [GDP] growth has already peaked at 11.9 percent year on year in the first quarter of 2010, in part boosted by a low comparison base, and it will drop to about 9.0 percent in the fourth quarter of 2010 and in 2011. From a long-term perspective, the post-crisis potential growth of the Chinese economy will likely be 9.0 percent, down from the 11.0 percent pre-crisis level.

From 2009 to 2010, the major source of China's growth acceleration will likely be exports, which dragged down

Ting Lu is China economist at Bank of America-Merril Lynch.

Stephen Roach is chair of Morgan Stanley Asia.

Victor Shih is a political economist and professor at Northwestern University.

GDP growth by 2.5 percentage points in 2009 but could contribute 1.6 percentage points in 2010, according to our calculation. The difference here would be 4.1 percent. If consumption and investment growth maintain the same pace, China's GDP growth in 2010 would be 12.8 percent (8.7 percent year on year from consumption and 4.1 percent year on year from exports). We think consumption growth could be stable, but capital formation will slow on higher comparison bases and macro tightening.

Already factoring in a slowdown in fixed-asset investment [FAI] growth this year, we don't expect the property tightening measures to lead to a collapse of FAI growth in China. The PRC government is determined to curb property speculation, but it has no intention of slowing real estate FAI growth. Instead, the PRC government aims to expand housing supply by discouraging land hoarding, and it will also aggressively advance the construction of welfare housing.

Roach: I think there's good momentum in the Chinese economy heading into mid-year 2010. At that point, China's stimulus, which has played an important role in producing rapid growth, together with a turnaround in the inventory cycle in the West, will begin to fade. Growth prospects in the second half of this year and in early 2011 are still somewhat in doubt, and the risks of that forecast are now underscored by what seems likely to be a reduction of Chinese property investment stemming from the fairly aggressive actions that the PRC government took in mid-April to take a lot of the air out of the property bubble. The domestic demand support to the economy has largely been in the investment area, which is probably in danger of having run too fast, too hard. It's also been in some of the consumer durables areas, especially in the auto sector, where there have been special incentives provided to car buyers. These types of factors are more temporary than sustainable.

China is likely to return to a more flexible currency policy in the second half of the year. Such a move, together with likely persistent sluggishness in underlying end-market demand growth in the West, would also underscore a little bit of downside pressure to exports. So when I add it all up, I think that China's momentum in the first half of this year is going to be hard to sustain in the second half.

Shih: For 2010, I think growth will be robust, but investment continues to play a large part in China's growth story. I am not entirely convinced that domestic demand can completely replace the role previously played by exports to produce marginal growth. However, given that investment is still growing robustly over last year, growth will almost certainly surpass 10 percent this year and will remain robust through the first half of next year.

How successful was China's massive government stimulus? Has the stimulus given rise to any unexpected—or particularly difficult—challenges?

Lu: The stimulus measures were successful overall from a cost-and-benefit perspective. In 2009, China gained an additional 4 percentage points of growth, thanks to the ¥4 trillion [$586 billion] stimulus, but the cost of this Keynesian management may be 1–2 percent of China's GDP. Because of an overly loose credit policy in 2009, the property bubble was inflated when the economy was not overheated, and there was a rapid rise of Chinese local-government debt.

This seemingly high 11.9 percent year-on-year GDP growth in the first quarter is not sufficient to conclude that the Chinese economy was overheated. If adjusted for the low base, GDP growth in the first quarter was just 6.2 percent year on year. Going forward, we think that year-on-year growth of GDP, industrial production, and FAI will post noticeable slowdowns in the second half of 2010. The top risk for the Chinese economy is still the property market, in our view.

Roach: The stimulus provided a huge boost to fixed-asset investment spending. The surge in investment spending alone accounted for about 70 percent of the 8.7 percent [GDP] growth in 2009. Obviously, the economy would have grown much more slowly had it not been for the impacts of the stimulus. I think it created a situation where the investment sector, which had already been excessive as a share of GDP, became more excessive, ending the year at close to 47 percent of China's GDP. This is a record for China—and a record for any major economy in the modern history of the world.

The investment stimulus was funded by an unprecedented surge of bank lending in China. A disproportionate share of bank lending was directed to local investment companies, in part funded by local government units that drew support from this bank-lending binge. These local investment companies are unlikely to provide further support for Chinese growth in the months and quarters ahead.

The economy is not overheated except in the property sector itself. That's less of a construction problem and more of a pricing problem, with speculators rushing to buy multiple homes to take advantage of a property bubble. The government recently introduced some very tough measures aimed at reducing multiple purchases of real estate by individual speculators. So unlike the West, where we tend to let asset markets get out of hand and impart a devastating blow to our asset-dependent real economies, the Chinese moved pretty quickly to preempt that. I think they've done what will turn out to be a good job.

Shih: [The stimulus] succeeded in generating some of the highest growth in 2009, but implicit government debt grew tremendously as a result. To be sure, China did not do anything that the rest of the world did not do. But local authorities are showing no signs of slowing down. At a time when the PRC government should begin thinking about retrenching, local authorities continue to announce very ambitious investment drives. If this momentum is not stopped soon, debt may rise to a challenging level. The central government needs to find ways to transfer some of this liability back onto the center's ledger by issuing bonds. The money raised by bond issuance would be used to repay local debt.

Massive lending related to China's stimulus raises questions about the growth of nonperforming loans (NPLs). How will the potential rise of NPLs affect China's development?

Lu: NPLs will inevitably rise in China because of the stimulus, especially from loans to local-government projects. This could bring down some rural credit unions or small urban commercial banks, but the majority of local-government financing vehicle (LGFV) NPLs will be absorbed with the help of fiscal transfers from upper-level governments.

The central government may ask some provincial governments to set aside a special amount to help local governments repay some LGFV debts. The rest will be taken over by the People's Bank of China [China's central bank] as the lender of last resort. We estimate that NPLs from the loose credit policy in 2009 are no more than ¥550 billion [$80.6 billion], and we do not expect Beijing to set up a national asset-management company like it did a decade ago to absorb NPLs.

Roach: I think this NPL issue is overblown. There are certainly issues in terms of the debt quality of locally funded and state-directed investment companies. The China Banking Regulatory Commission [CBRC] is scrutinizing these loans very carefully. There may be some charge-offs associated with some of this lending in the second half of this year, but they are unlikely to be devastating and nowhere close to what the charge-offs in China were in the early 1990s.

The most important thing to recognize is that the bulk of the stimulus went to infrastructure—roads, bridges, rail—where the risks of loan quality are much less problematic than is the case in other forms of investment, such as in apartments, office buildings, or even factories. Though many aspects of the stimulus were unsustainable, this was a necessary step for China to take in the depths of the crisis. The consequences of these actions are unlikely to deal a devastating blow to Chinese financial institutions, provided they are disciplined at addressing these issues quickly, as they appear to be.

Shih: Even without NPLs, China's banks are already finding it difficult to recapitalize. The CIC [China Investment Corp.] will likely have to inject additional billions of US dollars to restore banks' capital base. If there were a couple trillion yuan in NPLs, the banks would need to be massively recapitalized, further shifting China's foreign-exchange reserve toward ownership in Chinese bank shares. Credit expansion will likely slow, which will slow the economy. Some of this dynamic may begin to play out in 2012.

China's local-level government debt appears to be on the rise. How much will local-government debt affect the country's development? Does this debt have any implications for foreign companies that operate in China?

Lu: Our general view is that LGFV debt is a problem we cannot ignore, but we believe it is manageable. Beijing may have to bail out some LGFVs and provide support to some small banks, but the chance that China will suffer a full-blown financial crisis is extremely low. The path to the final solution could be painful, however. Project cancellations—a "killing the chicken to scare the monkey" step we have long expected as part of the tightening package in 2010—may play a key role in bringing LGFVs to heel.

Local-level debt should not have a direct effect on foreign companies operating in China. Though infrastructure construction, which was jump started in 2009 and heavily geared to less-developed central and western

China, may at first have a low return on capital, it will have longer-term positive implications for foreign capital: Foreign investors will be able to explore domestic market opportunities in those regions or relocate to take advantage of lower production costs.

Roach: As I noted earlier, the surge of local debt has been funneled through municipal investment companies. This played an important role in implementing much of the infrastructure stimulus package. There clearly has been a big increase in debt, and that's particularly worrisome given that the debt service associated with those obligations is largely funded out of local-government revenues, which themselves are heavily dependent on property-market transactions. To the extent that the property market cools off, that will inhibit the debt servicing capacity of local government units.

CBRC is looking at this local-debt issue very closely right now. In large part that's because so much of the local investment-company debt was funded by Chinese banks, and the last thing that China wants is a new surge of NPLs. So I think this problem is going to be addressed. I don't think that it will have a lasting impact on China's economic development because, unlike in most economies where the investment in property dynamics can suffer from a shortfall in demand, there is ongoing outsize migration from rural communities to urban cities in China that runs somewhere between 15–20 million people a year. That creates a huge natural demand for shelter. This will ultimately provide a good deal of support for local-government revenues—and the debt-servicing capacity of that revenue stream.

Finally, I don't think there are any real serious implications of the local-debt issue on foreign direct investments of Western and other multinationals that choose to set up in China. I think they do it largely because of the phenomenal labor-cost arbitrage between their workforce and the Chinese workforce, as well as very efficient logistics of a modern, China-centric Asia supply chain.

Shih: I think local governments have massively overbuilt infrastructure in many places. If the world faces a double-dip recession, the marginal gains from additional infrastructure investment in China going forward will be constrained. It is hard for me to imagine how China can effectively stimulate the economy in the future besides the Keynesian "digging a ditch and filling it up again." Much of the infrastructure built before 2008 will likely be useful for China's economic future, but I think the rush to accelerate investment in 2009 introduced a lot of dubious projects.

Some local authorities have massively subsidized local businesses, which may give them unfair advantages vis-à-vis their foreign competitors. Wind-turbine production is one example.

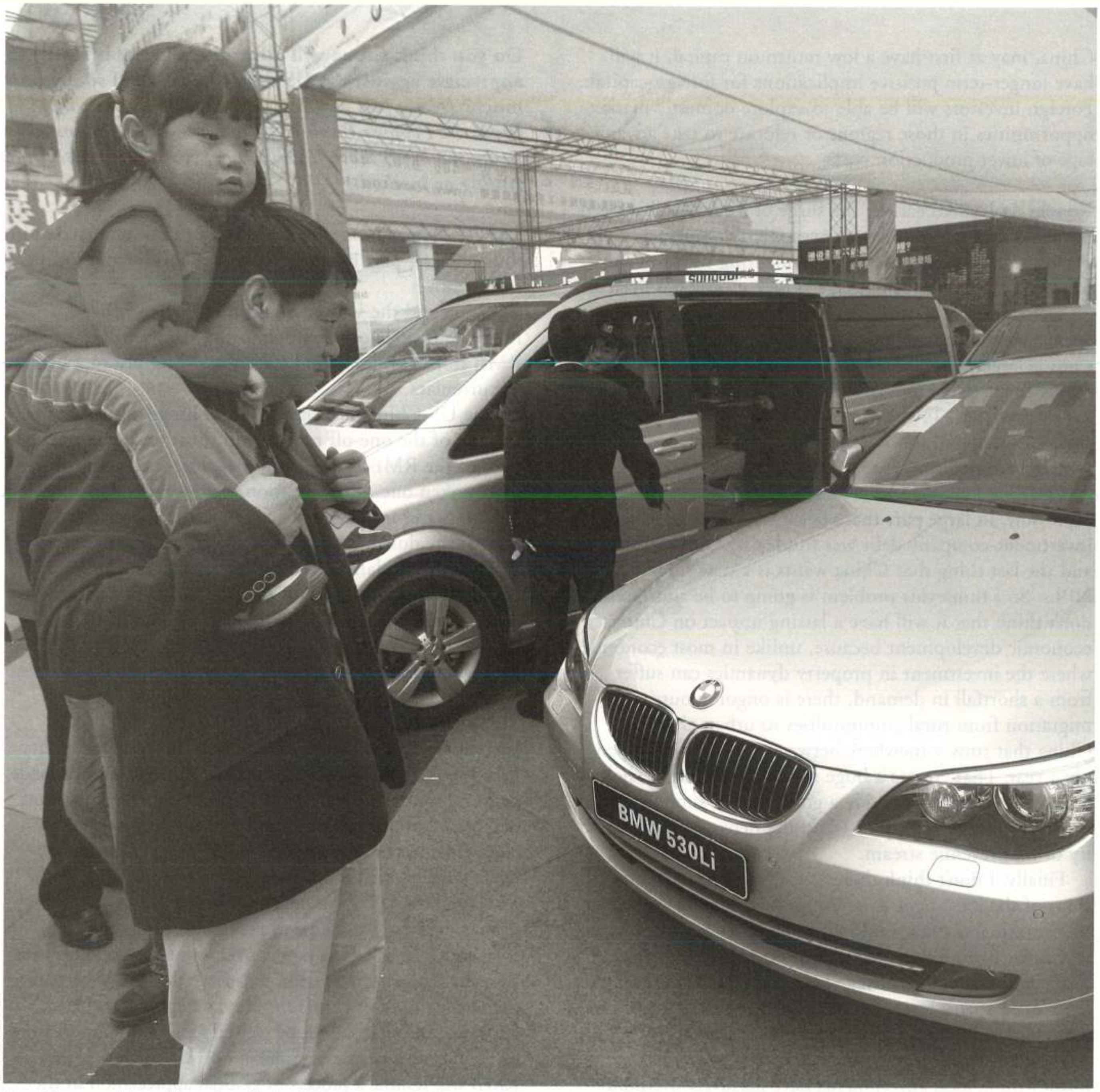
Do you think China will allow the renminbi (RMB) to appreciate against the US dollar in 2010? If so, by how much? ***(Note: Just as* CBR *was going to press in late June, the People's Bank of China announced plans to make the RMB more flexible but provided no details on timing or method.)***

Lu: Our expectations for the RMB can be summarized in four points—peg, band, one-off revaluation, and timing of the move:

- China and the United States might already have reached an agreement on one thing: China will unpeg the RMB from the dollar and start a crawling peg to a basket of currencies.
- The US-China negotiation could hinge on two issues: the size of the one-off revaluation (possibly zero) and the pace of the RMB's appreciation against the basket. A small token one-off revaluation cannot be excluded, or the United States might ask for faster RMB appreciation against the dollar.
- The current daily RMB-US dollar movement band could be widened from 0.5 percent to 1.0 percent or more, though that would be largely a token move.
- Regarding the timing, it might be impacted by the European debt crisis. We believe there will be no move to appreciate the RMB before the end of September.

Roach: This is obviously a serious issue in the global policy debate right now. Though the premier himself has not made specific pronouncements on RMB policy, the People's Bank of China Governor Zhou Xiaochuan has been reasonably clear: [He] has underscored the point that the current currency policy, which is pretty much a fixed peg between the RMB and the US dollar, must be viewed as a temporary set of measures that was taken in the depths of the crisis. Consequently, as China now moves away from dealing with the crisis, there's good reason to believe that it will be returning to the pre-crisis currency policy, which is a gradual RMB appreciation. That should be viewed as an important feature of China's post-crisis exit strategy. So I do think that the RMB will resume a process of gradual appreciation in the second half of this year—somewhere in the 2–4 percent range. That will be helpful, but it will not necessarily take all the heat off the currency issue as a serious bone of contention between China and the US Congress.

Shih: I think China will appreciate [the RMB] on its own terms, depending on the alignment of domestic interests. It would be a mistake to think that China will appreciate [the RMB] because senior PRC officials, especially those in the central bank, have signaled in that direction. Given the crisis in Europe, China has more reason now to delay the revaluation as it assesses how exports perform in the coming months. 完



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A car's image and brand factor heavily into Chinese consumers' purchase decisions.

China's Auto Retail Market

Spurred by growth and evolving consumer expectations, car dealerships and finance companies have revamped their offerings.

Kyle Sullivan

China has emerged from the global recession as the world's largest auto market, with a total sales volume that eclipses the United States by a substantial sum. In 2009, China's new vehicle sales reached 13.6 million units and total output hit 13.8 million units, up 46.2 percent and 48 percent from 2008, respectively (see Tables 1 and 2). Though sales in 2010 may not grow as fast as they did in 2009, China's auto market is poised for more impressive growth. According to recent China Association of Automobile Manufacturers statistics, China sold 7.6 million cars and produced 7.5 million cars in the first five months of 2010. The association forecasts that total sales and total output are each on track to exceed 15 million units this year.

Original equipment manufacturers (OEMs) and auto distributors have grown significantly, along with the rest of China's auto market. As a result, foreign and domestic OEMs are looking to expand their distribution networks throughout China, with a focus on second- and third-tier markets (see p.36). Auto sales in these markets have outpaced sales in first-tier cities in the last five years. According to recent data, between January and September 2009, auto sales in second- and third-tier cities grew 41 percent and 51.4 percent, respectively, while sales in first-tier cities rose 33.6 percent.

Changing market landscape for auto dealerships

China's auto market has changed significantly in the past two years. At the onset of the global financial crisis, many dealerships and suppliers faced low liquidity levels and high debt ratios. As a result, OEMs began to cut vehicle prices to encourage consumer demand. Meanwhile, tighter access to credit and weaker OEM support led many analysts to believe that dealerships would fold in large numbers.

Auto sales in China rebounded after the PRC government in mid-2009 unveiled stimulus measures that offered tax breaks, subsidies for new-vehicle purchases, and looser credit for companies and individuals. According to the China Association of Automobile Manufacturers, year-on-year vehicle sales grew 83.6 percent (reaching 1 million cars) in September 2009 and 50 percent in January 2010. By late 2009 and early 2010, demand had grown so dramatically that many dealerships were struggling to keep cars in stock.

Quick Glance

- China's auto sales—including used-car sales—are on the rise, boosted by government stimulus and support policies.
- Car retailers are reformatting their business models to meet growing demand and changing consumer preferences.
- As the auto market matures, a vibrant used-car market is emerging.

Evolving retail formats

China's auto retail market is responding to a host of pressures. Since the onset of the global financial crisis, OEMs and independent distributors have been integrating their distribution networks to achieve economies of scale and greater financial viability. New retail formats that have emerged within the past several years show that retailers are becoming larger to adapt to market pressures and increasingly sophisticated consumer tastes.

4S model

First established in China in 1998 and considered the most advanced marketing model, the 4S model offers sales, showrooms, services, and spare parts all under one roof. These types of stores are expensive to operate and require significant investment and start-up capital. This is largely because they offer high-end facilities located in expensive districts in downtown areas where rental fees are high. Top brands typically maintain multiple 4S stores in a major market, compounding costs and forcing some stores into the red. A report published by the Cheung Kong School of Business early this year stated that nearly 80 percent of 4S dealerships along China's coast operate at a loss.

Table 1: Top-Selling Auto Companies in China, 2009

Company	Units sold
1. Shanghai Automotive Industry Corp.	2,425,546
2. FAW Group Corp.	1,758,801
3. Chang'an Automobile (Group) Co., Ltd.	1,703,081
4. Dongfeng Motor Group Co., Ltd.	1,688,685
5. Beijing Automobile Works Co., Ltd.	1,132,330
6. Guangzhou Automobile Industry Corp.	542,839
7. Chery Automobile Co., Ltd.	436,336
8. BYD Co., Ltd.	388,247
9. Brilliance China Automotive Holdings Ltd.	316,924
10. Jianghuai Automobile Co., Ltd.	296,711

Source: *China Car Times*

Table 2: China's Auto Production and Sales, 2000–09

Year	Production (10,000 autos)	Sales (10,000 autos)
2000	206.9	208.9
2001	233.4	236.4
2002	325.0	324.8
2003	444.4	439.1
2004	507.1	507.1
2005	570.8	575.8
2006	728.0	721.6
2007	888.2	879.2
2008	934.5	938.1
2009	1,379.1	1,364.5

Source: China Automotive Dealership Association

Despite its popularity among consumers, OEMs are not entirely satisfied with the 4S model. Manufacturers note that high-quality, reliable dealers are hard to find and relationships with dealers are generally difficult to manage. This is because 4S dealers tend to be local businesses that cater to a localized market and do not necessarily share the same strategies and objectives as OEMs, which have broader or national interests. Nonetheless, the 4S format's high popularity among Chinese customers, who prefer the five-star treatment that these outlets offer, will likely keep this model in operation.

Auto supermarkets

In simple terms, auto supermarkets are large dealerships. They come in many formats—1S, 2S, 3S, and 4S—and can be single- or multiple-brand dealerships. (1S outlets offer only sales; 2S outlets offer sales and services; and 3S outlets offer sales, services, and spare parts.) The advantage of this structure is that it attracts more customers, who can find a variety of brands and models at a single auto supermarket without having to travel to different dealerships. The disadvantage is that many foreign OEMs refuse to sell directly to auto supermarkets because they do not want their models displayed alongside rival brands. Consequently, auto supermarkets must often purchase their stock from OEM-authorized dealerships at a higher rate.

Several domestic OEMs are building their own auto supermarkets. For example, Jianghuai Automobile Co., Ltd. is building auto supermarkets at the county level to sell the full range of its vehicles, from sedans to light trucks. Chang'an Automobile (Group) Co., Ltd. is also building auto supermarkets in second- and third-tier markets, where it will offer autos produced by its wholly owned entity, Chana International Corp., and by its joint ventures (JVs). Chang'an currently has 7 supermarkets and plans to expand this number to 100 by the end of 2010.

Media reports indicate, however, that auto supermarkets that offer low- and mid-range vehicles face serious cost pressures and are at risk of failure. Facing rising operating costs and long-term price decreases (despite short-term price increases), low- and mid-range automakers might struggle to afford distribution through supermarkets and may need to identify more cost-effective distribution channels.

Mega-dealerships

Owned by a single distribution company, mega-dealerships are a network of OEM-authorized auto dealerships that sell multiple brands. Mega-dealerships are performing well. According to *Beijing Business Today*, about 25 percent, or 2,472 authorized dealers, belonged to mega-dealerships and accounted for 44 percent of China's total auto sales in 2008. Prominent mega-dealerships in China include Guanghui, Pangda, Yongda, and Zhongsheng.

Auto trade markets

Auto trade markets are essentially clusters of separately owned 3S and 4S car dealerships that offer multi-brand auto sales and services. They are comprised of multiple dealers, vendors, and traders of thousands of vehicles. The advantages of auto trade markets are their economies of scale, one-stop shopping for maintenance, and spare parts supply—which allow dealers to reduce operating costs and lower prices for consumers. Used-car buyers also favor auto trade markets, which allow car owners to trade in their old cars and receive a discount on new vehicle purchases. China's largest auto trade market, North Asia Car Market in Beijing, has over 160 dealers.

Auto parks

Some large auto companies are beginning to form massive regional auto parks that include clusters of 4S outlets, repair and service outlets, refinishing services for used cars,

Foreign Auto Companies Expand Sales Networks in 2010

China's promising auto market has foreign original equipment manufacturers (OEMs) looking to expand their sales network in 2010 and beyond. According to media reports, several major foreign brands have announced plans to open new dealerships across China, particularly in second- and third-tier markets.

- **Ford Motor Co.** announced that it will significantly expand its network of dealerships in 2010 but did not indicate by how much. At the end of 2009, Ford's authorized dealer network included 241 full-service dealerships and more than 350 sales and service outlets across China.
- **General Motors Corp. Chevrolet** plans to open 120 more Chevrolet dealerships by the end of 2010.
- **Honda Motor Corp.** has announced that it will increase dealerships in China to 700 and boost annual output capacity by about 20 percent to 650,000 units by the end of this year.
- **Mercedes-Benz GmbH** will reportedly establish another 130 dealerships in China in 2010.
- **Nissan Motor Co., Ltd.** has said that it will extend its network of dealerships from the current 367 to 408 by the end of the year.
- **Saab Automobile AB** plans to double its number of dealerships to 32 by the end of 2010.
- **Toyota Motor Corp.** plans to add another 100 dealerships in China this year to bring its nationwide total to 650.
- **Volkswagen AG** plans to expand its distribution network in China from 1,000 to 2,000 dealerships by 2018.

—*Kyle Sullivan*

and outsourcing centers that provide insurance and auto financing services. Chongqing currently has one, and such regional parks are expected to grow in number.

Auto finance takes off

Auto finance in China has grown significantly in recent years. According to the People's Bank of China, auto loans totaled ¥158.3 billion ($27.1 billion) by the end of 2008—of which ¥31.8 billion ($4.7 billion) came from auto finance companies. To regulate this market, the China Banking Regulatory Commission (CBRC) issued the Administrative Measures on Auto Finance Companies and related implementing rules in 2003 and revised and combined the two regulations in 2008. The measures define auto finance companies as non-bank financial entities approved by CBRC to offer financial services for auto purchasers and dealers in China. Major investors of these companies must be non-bank financial entities or enterprises that produce or sell motor vehicles (see below).

To support the auto finance industry, CBRC in August 2009 began allowing auto finance enterprises to issue public bonds to raise capital, with the hope that the companies will expand their portfolios of financial products to attract consumers. According to PRC media reports, the number of Chinese consumers that take out loans will increase 40–50 percent in the next decade, and total auto finance loans will reach more than ¥550 billion ($80.5 billion) by 2025.

China's used-car market grows—supported by government policies

As new auto sales have grown, so have sales of used cars. China Automobile Dealer Association statistics show that the trade volume of used vehicles has soared from 250,000

China's Ten Automotive Finance Companies

China has 10 auto finance companies, 9 of which are foreign-invested. All 10 companies are affiliated with auto manufacturers and provide credit to individual consumers for purchases and inventory financing to dealers for their branded autos.

■ **Chery Huishang Bank Auto Finance Co., Ltd.**, established in 2009 as a joint venture (JV) between Chery Automobile Co., Ltd. (80 percent) and Huishang Bank Co., Ltd. (20 percent), is China's only domestic auto finance company. The company provides loans to dealers and auto buyers and, according to a 2009 interview, planned to provide loans for car buyers in 10 Chinese cities by the end of 2009.

■ **DaimlerChrysler Auto Finance (China) Ltd.** entered China in 2005 as a wholly owned subsidiary of DaimlerChrysler AG with ¥500 million ($73.2 million) registered capital. In 2009, DaimlerChrysler merged with Fiat SpA, which now controls DaimlerChrysler Auto Finance.

■ **Dongfeng Nissan Auto Finance Co., Ltd.**, established in 2007, is jointly owned by Nissan Motor Co., Ltd. (65 percent) and Dongfeng Motor Group Co., Ltd. (35 percent). The company provides financing for customers of—and inventory financing for dealers of—new Nissan and Infiniti cars. It has ¥500 million in registered capital.

■ **Dongfeng Peugeot Citroën Auto Finance (China) Ltd.** was established in 2006 with a total investment of ¥500 million. It is the sixth auto financing company in China and the first to be jointly established with the Bank of China Group Insurance Co. Ltd. The company distributes loans through local Bank of China branches to individual consumers and auto dealers.

■ **Fiat Automotive Finance Co., Ltd.** provides retail and dealer financing services for all vehicle brands produced and sold by the Fiat Group in China, including Case Machinery, Chongqing Hongyan Heavy Truck, Chrysler, Fiat, and Nanjing Naveco. Its services for dealers include loans for inventory and for construction of 4S stores. By 2009, the company had offered loans to 1,500 individual customers and 118 dealers and expects demand for its services to increase 60–65 percent in 2010.

■ **Ford Automotive Finance (China) Ltd.** is a wholly owned subsidiary of Ford Motor Credit Co., which established its representative office in Beijing in 1996 and was licensed to provide financial services in China in 2005, with an initial investment of $60 million. The company provides auto loans and installment payment plans to individual consumers.

■ **GMAC-SAIC Automotive Finance Co., Ltd.** is a JV established in August 2004 between GMAC Inc. and Shanghai Automotive Group Finance Co. Ltd., a subsidiary of Shanghai Automotive Industry Corp. Group (SAIC). The company offers financial services for individuals, business groups, and dealers.

■ **Toyota Motor Finance (China) Co., Ltd.** was established in 2005 in Beijing as a wholly foreign-owned subsidiary of Toyota Motor (China) Investment Co., Ltd. The company offers services such as auto loans for new cars and insurance products for Toyota and Lexus vehicles.

■ **Volkswagen Finance (China) Co. Ltd.** is a wholly foreign-owned subsidiary of Volkswagen Financial Services AG that was founded in September 2004 with registered capital of ¥500 million. The company offers loans for auto purchases, leasing, and insurance products.

■ **Volvo Auto Finance (China) Ltd.** was founded in 2006 with about ¥500 million total registered capital. The company is the first auto finance enterprise to provide exclusive financial services for its branded commercial vehicles, including trucks and construction equipment.

—Kyle Sullivan

in 2000 to more than 3.3 million in 2009. To take advantage of this growing market, major auto manufacturers have begun to offer used-car services for their branded autos at their certified dealerships in China. Most of the service packages cover used-car quality accreditation and assessment, certification, replacement, quality guarantee, and trading and transactions. Mega-dealerships also play an active role in the used-car market. For example, Shanghai Yongda Auto Management Service Co., Ltd. started its used-car business in 2002 and now owns a trading market, evaluation enterprise, agent, and two operating companies to provide a full range of services.

Apart from consumer demand, several government policies and regulations have boosted the used-car market.

- The **Administrative Measures on Used Cars**, released in 2005, are the primary regulation governing the used-car market. The measures introduced a competition mechanism that allows OEM-authorized auto dealerships to run used-car businesses. The measures also regulate different parties—including trading markets, agents, and operators—and strengthen the administration of organizations that appraise the value of used cars.
- The **Notice on Upgrading the Used-Car Trade Market** was announced by the ministries of Commerce and Finance in July 2009. The circular aimed to improve the used-car industry. Initially, the PRC government selected 10 provinces and municipalities—Beijing, Hubei, Jiangsu, Jiangxi, Liaoning, Shandong, Shanghai, Shenzhen, Tianjin, and Zhejiang—to receive fiscal funding to conduct pilot programs that focused on the management and information on used-car transactions to improve transparency.
- The **Auto Industry Revitalization Plan**, released in 2009 by the State Council, calls for the establishment of a national appraisal and evaluation standards system and a temporary ownership registration system. The plan also calls for adjusting the value-added tax rate on used-car transactions and encourages dealerships to participate in vehicle replacement programs.

Challenges and opportunities ahead

China's auto market is unlike any other in the world. In 2007, it overtook Japan to become the world's second-largest car market and, in 2009, surpassed the United States as the world's largest. China is selling cars faster than any other country in the world, but it is doing so with relatively immature retail formats, OEM-to-dealer relationships, consumer tastes, and financing options.

China's auto market is maturing, however. Retailers are consolidating and improving services with an eye toward retaining customers. Numerous retail formats have emerged in recent years, such as the mega-dealership and auto supermarket, offering consumers in different market segments a range of options for vehicle purchases. In addition, more dealerships are offering auto financing plans, allowing consumers to rely less on bank loans and personal savings to purchase vehicles. Used cars are also gaining traction among Chinese consumers. As these market trends develop, so will opportunities for retailers, OEMs, and consumers in China's auto market.

> Foreign retailers must understand and cater to local preferences to ensure long-term success in China's auto market.

The major challenge ahead for auto retailers is the ability to retain customers. Consumers are paying more attention to brand, image, and style, and some buyers turn to a certain car solely based on its image and branding. This is particularly true for second- and third-time buyers. Foreign retailers must therefore understand and cater to local consumer preferences to ensure long-term success in China's auto market.

In addition to branding, retailers must also focus on the overall experience of purchasing a car. Chinese consumers tend to enjoy 4S or similar types of dealerships that offer the whole package: fancy showrooms, attentive sales personnel, after-sales service, and spare parts. Dealerships that make the process of buying a car an enjoyable one will attract more customers in China. 完

__Kyle Sullivan__ (ksullivan@uschina.org.cn) is manager of Business Advisory Services at the US-China Business Council's Shanghai office.

China's Priorities for the Next Five Years

As the drafting process for China's Twelfth Five-Year Plan (12th FYP) for Economic and Social Development (2011–15) continues, a clearer picture of China's economic, industry, and social objectives—and the policy guidelines that will be used to achieve these goals—has emerged. The plan, which lays out national social and economic policies for the next five years, will focus on restructuring the country's economy to rely less on exports and fixed investment. Other policy objectives of the plan will include developing new energy sources, increasing energy efficiency in industry, and correcting imbalances in education, healthcare, housing, income distribution, and social security.

Top priorities for the 12th FYP

The 12th FYP is expected to make several major changes to China's economy. According to statements from senior PRC government officials, key areas for reform will include:

■ **Economic restructuring** China will focus on shifting economic growth away from reliance on exports and investment toward domestic consumption (see p.26). The drop in demand for China's exports since the economic crisis highlighted for PRC regulators that relying on Western consumer demand to sustain domestic growth is untenable.

■ **Industry structure** Industry-related policies will aim to accelerate the growth of China's services industries. Though no targets have been announced, PRC regulators will look to increase the proportion of services industries in the overall economy from the current 43 percent. Policies will favor the development of the outsourcing, banking, insurance, e-commerce, logistics, and supply chain management sectors. Industries that suffer from inefficiency or overcapacity—such as cement and coal—will remain targeted.

■ **New energy** The plan will set capacity quotas for four types of new energy: hydro, nuclear, solar, and wind. The PRC government reportedly aims to have a wind energy capacity of 90 gigawatts (GW) and nuclear energy capacity of 40 GW by the end of 2015.

Policy goals

FYPs typically continue long-term economic and social policy goals from previous plans. Many social and economic goals listed in the 11th FYP, such as minimizing urban-rural income disparities, address long-term challenges. The 12th FYP will revise targets for these goals.

■ **Economic growth** Maintaining a stable economy and improving living standards remain priorities. According to PRC media reports, policymakers have set an average economic growth target of 7 percent for the 12th FYP, down from 7.5 percent in the 11th FYP.

■ **Urban and rural development** Increasing urbanization, narrowing the income gap between urban and rural citizens, and connecting China's cities with rural areas remain top concerns. A government economist recently said that China would invest up to ¥7 trillion ($1 trillion) to develop urban infrastructure, including ¥700 billion ($102.5 billion) on urban rail transit during the 12th FYP period.

■ **Energy efficiency** China will set policies to achieve two major energy targets by 2020: reducing carbon intensity by 40–45 percent of 2005 levels and increasing the use of non-fossil energy to 15 percent of primary energy consumption. Because China is behind on its goal to reduce energy intensity, experts speculate that the country might have to strengthen its energy targets in the 12th FYP to reach these long-term targets.

■ **Basic public services** Improving social insurance, healthcare services, and education remains a policy goal for the 12th FYP. In May, the State Council approved the Medium- and Long-Term National Educational Reform and Development Plan (2010–20), which aims to boost investment in China's education system to 4 percent of gross domestic product by 2012, up from the current 3.48 percent. Similarly, the 12th FYP may include new targets for healthcare spending.

■ **Regional development** Since the 9th FYP, regional development policies have focused solely on generating rapid economic growth in underdeveloped regions in central and western China. The 12th FYP will seek to encourage more balanced growth between China's developed and underdeveloped areas.

Emerging policy goals

The 12th FYP will support new industries by adopting measures to encourage the development of emerging industries, particularly biotechnology, energy conservation, new energies, and new materials. The plan is also expected to support China's indigenous innovation policy by encouraging ministries to continue to develop favorable financial, human resource, tax, and other policies to spur innovation (see the *CBR*, March–April 2010, p.14).

Significance of the FYP for business

FYPs are one of the most useful government documents that companies can study to understand China's broad economic and industrial goals. The 12th FYP makes it clear that energy efficiency, economic restructuring, and industry revitalization will remain priorities for the next five years and over the long term. As companies form their corporate objectives, identifying areas in which their business can align with PRC government priorities can result in long-term government support (see the *CBR*, May–June 2010, p.14). 完

This article is adapted from a report that first appeared in China Market Intelligence*, the US-China Business Council's (USCBC) members-only newsletter. To find out more about USCBC member company benefits, see www.uschina.org/benefits.html.*

Sales and Investment

May 2010

The following listings contain information from 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.* 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 (publications@uschina.org). *CBR* subscribers with online access and members of the US-China Business Council can access complete China Deal Database listings from 2000 to present at www.chinabusinessreview.com.

Compiled by Joseph Luk

Agriculture

INVESTMENTS IN CHINA

Singbridge International Singapore Pte Ltd., Fullerton Financial Holdings Pte Ltd., units of Temasek Holdings Pte Ltd., Singapore Food Industries Ltd., Agri-food and Veterinary Authority (Singapore)/Jilin Provincial Government
Signed agreements to co-develop the China Jilin-Singapore Modern Agricultural Cooperation Food Zone.

OTHER

International Cotton Association (UK)/China Cotton Association (Beijing)
Signed MOU to strengthen cooperation between the two associations.

Architecture, Construction & Engineering

CHINA'S INVESTMENTS ABROAD

Meydan Group (UAE)/Guangsha Middle East Construction, LLC (Zhejiang)
Signed MOU to construct and develop the first phase of the Meydan Metropolis Business Park in Dubai.

Automotive

INVESTMENTS IN CHINA

Daimler AG (Germany)/BYD Co. Ltd. (Guangdong)
Will form JV, Shenzhen BYD Daimler New Technology Ltd., to develop electric cars in China. (Germany:50%-PRC:50%). $88 million.

PSA Peugeot Citroen SA (France)/Chang'an Automobile (Group) Co., Ltd. (Sichuan)
Signed letter of intent to form JV to manufacture cars in China. (France:50%-PRC:50%).

NV Umicore SA (Belgium)/Suzhou Industrial Park (Jiangsu)
Signed MOU to construct technology development center for auto catalysts in Suzhou.

OTHER

EnerDel, Inc., a subsidiary of Ener1, Inc. (US)/Wanxiang Group Corp. (Zhejiang)
Formed JV to produce battery packs for electric cars.

Aviation/Aerospace

OTHER

The Boeing Co. (US)/Chinese Academy of Sciences Qingdao Institute of BioEnergy and Bioprocess Technology (Shandong)
Will expand cooperation on algae-based aviation biofuel development.

The Boeing Co. (US)/PetroChina (Beijing)
Signed agreement to evaluate establishing a sustainable aviation biofuel industry in China.

Government of Kuwait/Government of the PRC
Signed MOU to develop air-cargo and aviation services with China.

Merukh Enterprises (Indonesia)/AVIC International (Beijing)
Merukh will buy Chinese aircraft, ships, and trucks in exchange for coal, nickel, and copper for 30 years.

The Boeing Co. (US)/Chinese Academy of Sciences Qingdao Institute of BioEnergy and Bioprocess Technology (Shandong)
Will expand cooperation on algae-based aviation biofuel development.

Banking & Finance

OTHER

Credit Lyonnais Securities Asia, a subsidiary of Credit Agricole SA (France), CITIC Securities International Co. Ltd. (Hong Kong)
Signed agreement to form JV to combine their brokerage and investment banking businesses in China.

Government of Qatar/Government of the PRC
Signed MOU to strengthen financial-sector cooperation.

Singapore Exchange (SGX)/Chongqing Municipal Government's State Assets Supervision and Administration Commission (SASAC)
Signed MOU to promote the listing of companies supervised by Chongqing SASAC on SGX.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Green Tech America, Inc. (US), Novozymes A/S (Denmark)/COFCO (Beijing)
Signed agreement to use yeast developed by Purdue University to produce cellulosic ethanol in plants in China.

Abbreviations used throughout text: 3G: third generation; ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CATV: cable television; CBRC: China Banking Regulatory Commision; 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 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; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LCD: liquid crystal display; LNG: liquefied natural gas; LOI: Letter of intent; MIIT: Ministry of Industry and Information Technology; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PV: photovoltaic; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise.

Education

OTHER

Punjab University (Pakistan)/ Sichuan University
Signed MOU to promote cooperation on research and faculty and student exchange.

Electronics, Hardware & Software

INVESTMENTS IN CHINA

Acer Inc. (Taiwan)/Founder Group (Beijing)
Signed MOU to develop and sell each other's personal computer products in China.

IBM Corp. (US)/UFIDA Software Co., Ltd. (Beijing)
Signed MOU to jointly establish cloud computing lab in China.

Taiwan Semiconductor Manufacturing Co. Ltd.
Will invest in new venture capital firm in Shanghai that will have a total capitalization of $73.2 million and focus on China's integrated circuit business. $5 million.

Energy & Electric Power

CHINA'S EXPORTS

China Guodian Corp. (Beijing)
Signed initial agreement to build coal- and hydro-power plants in Myanmar.

China National Electric Equipment Corp. (Beijing)
Will build coal-fired power station in Australia. $750 million.

CHINA'S IMPORTS

American Superconductor Corp. (US)
Will provide electrical components for 1.5 MW wind turbines to Beijing-based Sinovel Wind Group Co. Ltd. through 2013. $445 million.

SPX Corp. (US)
Won contract to design and supply cooling tower system for the Huaneng Shanxi Zuoquan Power Plant, owned by Beijing-based Huaneng Power International, Inc. $33 million.

INVESTMENTS IN CHINA

Beijing Hebaiyi Energy Technology Development Co., Ltd./Preseco Oy, Gaia Network Association Ry (Finland)
Signed MOU to jointly produce and sell biocarbon in China.

Cougar Energy Ltd. (Australia), Direct Invest Pte Ltd. (Singapore)/Inner Mongolia Qi De Investment Co. Ltd.
Signed letter of intent to develop underground coal gasification project in Inner Mongolia.

Verdant Power, Inc. (US)/ China Energy Conservation Environment Protection Group (Beijing)
Signed MOU to develop tidal energy power projects in China.

OTHER

Alternate Energy Holdings, Inc. (US)/China Zhongyuan Engineering Corp., a subsidiary of China National Nuclear Corp. (Beijing)
Announced partnership to produce and market nuclear desalinization reactors globally.

Government of Qatar/ Government of the PRC
Signed MOU to strengthen energy cooperation.

Environmental Equipment & Technology

OTHER

Applied Materials, Inc. (US)/ China Energy Conservation and Environmental Protection Group (CECEP, Beijing)
Signed MOU to collaboratively develop CECEP's solar technology.

Food & Food Processing

INVESTMENTS IN CHINA

Molson Coors Brewing Co. (US)/Hebei Si'hai Beer Co.
Will form JV, Molson Coors Si'hai Brewing Co., in Chengde, Hebei. (US:51%- PRC:49%).

Healthcare Services & Investment

CHINA'S INVESTMENTS ABROAD

Government of Australia/State Administration of Traditional Chinese Medicine (Beijing)
Signed MOU to open new medical center in Sydney to provide traditional Chinese medical treatment.

Light Industry/Manufacturing

CHINA'S EXPORTS

Haier Group Co. (Shandong)
Will construct an industrial complex and sell household appliances in Venezuela.

CHINA'S INVESTMENTS ABROAD

Continental Cement Co. LLC (US), Women Investment Portfolio Holdings Ltd. (South Africa)/ China-Africa Development Fund (Beijing), Jidong Development Group Co., Ltd. (Hebei)
Signed MOU to build JV cement manufacturing plant in South Africa. (PRC:51%-South Africa: 23.9%-US:25.1%). $221.2 million.

GD Midea Holding Co., Ltd. (Guangdong)
Will acquire 32.5% stake in Egypt-based Misr Refrigeration and Air Conditioning Manufacturing. $57.48 million.

Media, Publishing & Entertainment

INVESTMENTS IN CHINA

Prime View International Co., Ltd. (Taiwan)/Phoenix Publishing & Media Network (Jiangsu)
Signed letter of intent to form JV that will provide digital content for Chinese students.

OTHER

Commercial Radio Australia Ltd./ Beijing Jolon Digital Media Broadcasting Co., Ltd.
Signed MOU to develop DAB+ digital radio application.

Medical Equipment & Devices

OTHER

Government of Hong Kong SAR/ Government of the PRC
Signed agreement to enhance cooperation and communication to control drugs and medical devices.

Metals, Minerals & Mining

CHINA'S INVESTMENTS ABROAD

Australian Zircon NL, a subsidiary of DCM DECOmetal GmbH (Austria)/Guangdong Orient Zirconic Ind Sci & Tech Co., Ltd.
Signed letter of intent to set up JV, which will acquire all of Australian Zircon's assets. (PRC:51%-Australia:49%).

Jinchuan Group Ltd. (Gansu), China-Africa Development Fund (Beijing)
Will provide South Africa-based Wesizwe Platinum Ltd. with $877 million in funding and acquire 51% stake in the company.

Padbury Mining Ltd. (Australia)
Signed MOU for a Chinese investor to acquire 143 million shares in Padbury. $4.1 million.

PT TransCoal Minergy (TCM, Indonesia)/Zhongding International Engineering Co. Ltd. (ZIEC, Jiangxi)
Signed MOU for ZIEC to acquire underground mining operations and majority stake in TCM's coal project in South Kalimantan, Indonesia.

Steel Development Co. (US)/ Anshan Iron & Steel Group Corp. (Liaoning)
Signed MOU to jointly invest in deformed steel bar manufacturing project in Armory, Mississippi.

INVESTMENTS IN CHINA

JPMorgan Chase & Co. (US)
Increased its stake in Shandong-based Yanzhou Coal Mining Co. Ltd. from 10.95 percent to 11.13 percent. $7.43 million.

Petroleum, Natural Gas & Related Equipment

CHINA'S INVESTMENTS ABROAD

CNPC (Beijing)
Acquired 35% interest in Syria Shell Petroleum Development BV, which is owned by Royal Dutch Shell.

Government of Iraq, Turkiye Petrolleri Anonim Ortakligi (Turkey)/CNOOC (Beijing)
Signed agreement to form JV oilfield complex in Iraq. (PRC:85%-Turkey:15%).

Nigerian National Petroleum Corp./Chinese State Construction Engineering Corp. (Beijing)
Signed MOU to establish three greenfield refineries and one petrochemical complex in Nigeria.

Zhejiang Rongsheng Holding Group Co., Ltd., China National Chemical Engineering Co., Ltd. (Beijing)
Signed MOU to build oil refinery in Egypt and retain ownership of the plant for 25 years. $2 billion.

Royal Dutch Shell Plc (the Netherlands), Qatar Petroleum/ CNPC (Beijing)
Signed 30-year deal for gas exploration and production in Qatar. (The Netherlands:75%-PRC:25%).

Saskatchewan Provincial Government (Canada)/CNPC (Beijing)
Signed MOU to develop natural gas and heavy-oil resources in Saskatchewan.

Sinochem Corp. (Beijing)
Acquired 40% stake in Brazil's Peregrino oil field from Norway-based Statoil ASA. $3.07 billion.

OTHER

Petroleo Brasileiro SA (Petrobas, Brazil)/CDB, Sinopec (Beijing)
Signed agreement for Petrobas to export oil to China for 10 years in exchange for $10 billion loan from CDB.

Pharmaceuticals

CHINA'S INVESTMENTS ABROAD

Beijing Yu Sheng Tang Pharmaceutical Group Ltd.
Acquired 70% stake in Japan-based Nihon Seiyaku Kogyo Co. Ltd. $7.6 million.

Rail

OTHER

Government of the United Arab Emirates/Ministry of Railways (Beijing)
Signed MOU to cooperate on railway construction.

Real Estate & Land

CHINA'S INVESTMENTS ABROAD

Korea Trade-Investment Promotion Agency/Jiangsu Tianyu Group (Shanghai)
Signed agreement to build residential area for foreigners near Incheon International Airport. $1 billion.

INVESTMENTS IN CHINA

WEE Hur Holdings Ltd. (Singapore)/Hui Feng Real Estate Co., Ltd. (Jiangsu)
Signed non-binding MOU to set up JV in China that will acquire Jiangsu-based Hui Feng Real Estate Enterprise Co., Ltd. and four plots of land in Jiangsu. (PRC:70%-Singapore:30%).

Standards, Licensing & Inspections

OTHER

US Customs and Border Protection/Government of the PRC
Signed MOU to collaborate on supply chain security standards.

Telecommunications

INVESTMENTS IN CHINA

BlackBerry Partners Fund, co-managed by JLA Ventures and Royal Bank of Canada Venture Partners (Canada)/China Broadband Capital Partners (Beijing)
Formed JV, BlackBerry Partners Fund China, to invest in China's mobile market. $100 million.

Textiles & Apparel

CHINA'S INVESTMENTS ABROAD

Shandong Ruyi Group Ltd.
Will acquire 41% stake in Japan-based Renown Inc. $44 million.

OTHER

Itochu Corp. (Japan)/Ningbo Shanshan Garment Co., Ltd. (Zhejiang)
Signed agreement to allow Shanshan to use Itochu's ELLE trademark in Greater China until 2015 for an annual fee.

Tourism & Hotels

OTHER

Government of India/Government of the PRC
Signed MOU to allow visa-free entry and exit for airline staff between the two countries.

Transportation

OTHER

Government of Myanmar/ Government of the PRC
Signed MOU to cooperate on the development of Ruili-Kyaukphyu China-Myanmar platform road project.

Government of the United Arab Emirates/Ministry of Railways (Beijing)
Signed MOU to cooperate on railway construction.

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China-related events near you

July–November 2010

Please confirm dates and venues with the organizer prior to attending events. To post listings for future issues and view additional entries, visit the *China Business Review's* website at www.chinabusinessreview.com/conference-calendar.php.

International Processing, Packaging, and End-Line Printing Exhibition, July 14–16

Wenzhou International Optics Fair

JULY 10–12

Location: Zhejiang: Wenzhou International Convention & Exhibition Center
Organizers: Donnor Exhibition Co., Ltd.; Wenzhou Spectacles Association
Contact: Cecilia
Tel: 86-577-8890-0601
visitor@donnor.com
www.donnor.com/glasses

International Processing, Packaging & End-Line Printing Exhibition

JULY 14–16

Location: Shanghai New International Expo Center
Organizers: Allworld Exhibitions; China International Exhibitions Ltd.
Contact: Susan Zhang
Tel: 86-21-6209-5209
propak@chinaallworld.com
www.propakchina.com

Shanghai International Machine Tool Fair

JULY 15–18

Location: Shanghai New International Expo Center
Organizer: EASTPO International Expo Co., Ltd.
Contact: Robert Bu
Tel: 86-21-5239-6999
eastpo.net@gmail.com
www.eastpo.net/exhibition.asp

China Product Certification

JULY 20

Location: Washington, DC: The Westin City Center
Organizer: American Conference Institute
Tel: 1-888-224-2480
www.americanconference.com/cccmark.htm

China In Vitro Diagnostic Workshop

JULY 26

Location: California: Anaheim Convention Center
Organizer: US Commercial Service
Contact: Jennifer Loffredo
Tel: 1-586-469-6447
jennifer.loffredo@trade.gov
www.export.gov

Asia Outdoor Trade Show

JULY 28–31

Location: Jiangsu: Nanjing International Exhibition Center
Organizers: China Council for the Promotion of International Trade (CCPIT) Nanjing; Messe Friedrichshafen Co., Ltd.; Nanjing Nantex International Exhibition Center Co., Ltd.
Contact: Belinda Qin
Tel: 86-25-8689-1013
qqq@njiec.com
www.asian-outdoor.com

International Gift & Home Decor Trade Fair

AUGUST 5–8

Location: Shanghaimart
Organizers: Business Guide Shan Inc.; China Gift Chamber of Commerce; Shanghaimart
Contact: Daniel Chong
Tel: 86-21-2325-5281
daniel.chong@shanghaimart.com.cn
www.giftsexpo.org

China International Auto Supplies Sourcing Fair

AUGUST 18–20

Location: Shanghai: Everbright Convention & Exhibition Center
Organizers: Guangzhou Wanghe Exhibition Co., Ltd.; Guangzhou Yiyuan Culture Development Co., Ltd.; Shanghai Gehua Exhibition Planning Co., Ltd.
Contact: Brian
Tel: 86-21-5152-7671
brian@csaeexpo.com
www.csaeexpo.com/en

China International Metallurgical Industry (Tianjin) Exhibition

AUGUST 18–21

Location: Tianjin: Binhai International Convention & Exhibition Center
Organizers: Tianjin Zhenwei Exhibition Co., Ltd.; Zhenwei Exhibition Group
Contact: Guo Yun
Tel: 86-22-6622-4371
gyun@zhenweiexpo.com
www.chinacime.com.cn

MEDTEC China

AUGUST 25–26

Location: Intex Shanghai
Organizers: Canon Communications LLC; CCPIT Shanghai; *China Medical Device Manufacturer; European Medical Device Technology; Medical Device and Diagnostic Industry Magazine*
Contact: Keith Kwok-Ho Tsui
Tel: 86-21-6135-7160
keith.tsui@cancom.com
www.canontradeshows.com/expo/shanghai10

China Conference Calendar

Hotelex Beijing

AUGUST 25–27

Location: Beijing: China National Convention Center
Organizers: China Tourism and Hotel Association; China Tourism News Press; Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Tel: 86-21-6437-1178
hotelex@ubmsinoexpo.com
www.hotelex.cn/hotelexbeijing/tabid/211/language/en-us/default.aspx

China Offshore Wind Summit

AUGUST 26–27

Location: Weihai, Shandong: Hai Yue Jianguo Hotel
Organizers: Noppen; Weihai People's Municipal Government
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/offshore_wind/offshore_wind.asp

Assembly Technology Expo China

AUGUST 26–28

Location: Guangdong: Shenzhen Convention & Exhibition Center
Organizer: Reed Exhibitions
Contact: Lisa Wang
Tel: 86-21-5153-5129
lisa.wang@reedexpo.com.cn
www.atexpochina.com

China International Environmental Protection Fair

AUGUST 27–29

Location: Liaoning: Dalian Star-Sea Convention & Exhibition Center
Organizers: Dalian Environmental Protection Bureau; Dalian Northern International Exhibition Co., Ltd.
Contact: Cindy Pei
Tel: 86-411-8253-8628
cindypei@dbfexhibition.com
www.sinoexhibition.com/ep/en/showcontent.asp?tg=home

China International Synthetic Leather Fair

AUGUST 27–29

Location: Zhejiang: Wenzhou International Convention & Exhibition Center
Organizers: Donnor Exhibition Co., Ltd.; Wenzhou Shoes and Leather Industry Association
Contact: Cecilia
Tel: 86-577-8890-0601
vip@donnor.cn
www.donnor.com/china/leather

Shipping Finance China Summit

AUGUST 30–31

Location: Beijing: Swissotel Beijing, Hong Kong Macao Center
Organizer: International Quality and Productivity Center
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.shipping-finance.com

Electronics Assembly & Packaging Technology Expo

AUGUST 31–SEPTEMBER 2

Location: Guangdong: Shenzhen Convention & Exhibition Center
Organizer: Reed Exhibitions
Contact: Lisa Wang
Tel: 86-21-5153-5129
lisa.wang@reedexpo.com.cn
www.atexpochina.com/ate2007/eng/index.htm

China Advanced Railway Technology Congress

SEPTEMBER 2–3

Location: Nanning, Guangxi: Marriot Hotel
Organizers: Nanning Municipal Government; Noppen
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/railway/railway.asp

New Energy Vehicle Technology & Investment Congress

SEPTEMBER 2–3

Location: Crowne Plaza Tianjin
Organizers: Noppen; Tianjin Municipal Government
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/ne_vehicle/ne_vehicle.asp

China Jilin-Northeast Asia Investment & Trade Expo

SEPTEMBER 2–6

Location: Changchun International Convention & Exhibition Center
Organizers: Jilin Provincial Government; Ministry of Commerce; National Development and Reform Commission
Contact: Louise Du
Tel: 86-431-8276-5550
louise-dujuan@hotmail.com
www.neasiaexpo.org.cn

World Investment Forum

SEPTEMBER 6–9

Location: Fujian: Xiamen International Conference and Exhibition Center
Organizer: UN Conference on Trade and Development
wif@unctad.org
www.unctad-worldinvestmentforum.org

China International Furniture Expo

SEPTEMBER 7–10

Location: Shanghai New International Expo Center
Organizers: China National Furniture Association; Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Contacts: Alan Rosenthal, Stella Zhong
Tel: 1-301-424-7060, 86-21-6437-1178
www.furniture-china.cn

China International Fair for Investment in Property

SEPTEMBER 8–11

Location: Fujian: Xiamen International Conference & Exhibition Center
Organizer: China (Xiamen) International Investment Promotion Center
Contact: Kelvin Huang
Tel: 86-592-531-9358 x289
jetblue@chinafair.org.cn
www.chinafair.org.cn/english/realtye/index.aspx

China International Fair for Investment & Trade

SEPTEMBER 8–11

Location: Fujian: Xiamen International Convention & Exhibition Center
Organizer: PRC Ministry of Commerce
Tel: 86-592-266-9827
cifit@chinafair.org.cn
www.chinafair.org.cn

China Animal Husbandry Congress

SEPTEMBER 9–10

Location: Chongqing: Sofitel Forebase
Organizer: Noppen
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/husbandry/husbandry.asp

China Conference Calendar

Search Engine Strategies Hong Kong

SEPTEMBER 13–14

Location: Hong Kong: Renaissance Harbor View Hotel
Organizer: Incisive Media Investments Ltd.
Contact: Pablo Cot Gonzalez
Tel: 852-3411-4829
pablocg@incisivemedia.com
www.seshongkong.com

Chemical Industry Fair

SEPTEMBER 15–17

Location: Shanghai New International Expo Center
Organizers: CCPIT, Chemical Industry Sub-Council; China National Chemical Information Center
Contact: Jia Yunan
Tel: 86-10-6422-2898
jiayunan@ccpitchem.org.cn
www.icif.org.cn

China Paper

SEPTEMBER 15–17

Location: INTEX Shanghai
Organizers: Adforum AB; China National Pulp and Paper Research Institute; E.J. Krause & Associates, Inc.
Contact: Phoebe
Tel: 86-10-8451-1832
phoebe@ejkbeijing.com
www.huiyee.com/event/2009paper_en/index.html

China FPSO Summit

SEPTEMBER 16–17

Location: Shanghai: Crowne Plaza Century Park
Organizer: Noppen
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/fpso/fpso.asp

China Solar Energy Technology & Investment Congress

SEPTEMBER 16–17

Location: Kunming, Yunnan: Kai Wah Plaza International Hotel
Organizers: Kunming Municipal Government; Noppen
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/2nd_solar/2nd_solar.asp

China Solid Waste Summit

SEPTEMBER 16–17

Location: Shanghai: Ramada Plaza Pudong
Organizers: IGVision; Shanghai Technical Transfer & Exchange
Contact: Tina Tian
Tel: 86-21-5181-5373
tina@igvision.com
www.solidwastesummit.com

China Import & Export Fair

OCTOBER–NOVEMBER

Location: Guangzhou, Guangdong: China Import and Export Fair Complex
Organizer: China Foreign Trade Center
Tel: 86-20-2608-9999
info@cantonfair.org.cn
www.cantonfair.org.cn

P&T Expo Comm

OCTOBER 11–15

Location: Beijing: China International Exhibition Center
Organizer: E.J. Krause & Associates, Inc.
Contact: Helen Zhao, Sabrina Yuan
Tel: 86-10-8451-1832
helen@expocommcn.com
sabrina@expocommcn.com
http://expocomm.com/china/

World Youth & Student Travel Conference

OCTOBER 17–20

Location: Beijing: China World Hotel
Organizer: World Youth Student & Educational Travel Confederation
Contact: Melle Arifin
Tel: 45-3393-9620
ma@wystc.org
www.wystc.org

China International Food Safety & Quality Conference & Expo

OCTOBER 19–21

Location: Shanghai: Longemont Hotel
Organizer: PRC Administration for Quality Supervision, Inspection, and Quarantine
Contact: Angela Cheng
Tel: 852-2865-1118
angela.cheng@infoexws.com
www.chinafoodsafety.com

Luxury Brands

NOVEMBER 8–10

Location: Sheraton Shanghai
Organizer: Marcus Evans
Contact: Esther Wong
Tel: 603-2723-6736
estherw@marcusevanskl.com
www.marcusevans.com/marcusevans-conferences-event-details.asp?eventid=16778

World Scrap Metal Congress

NOVEMBER 9–12

Location: Shanghai: TBA
Organizer: Terrapinn
Contact: Christine Foo
Tel: 65-6322-2793
christine.foo@terrapinn.com
www.terrapinn.com/2010/scrap

Money Fair International Exposition

NOVEMBER 19–21

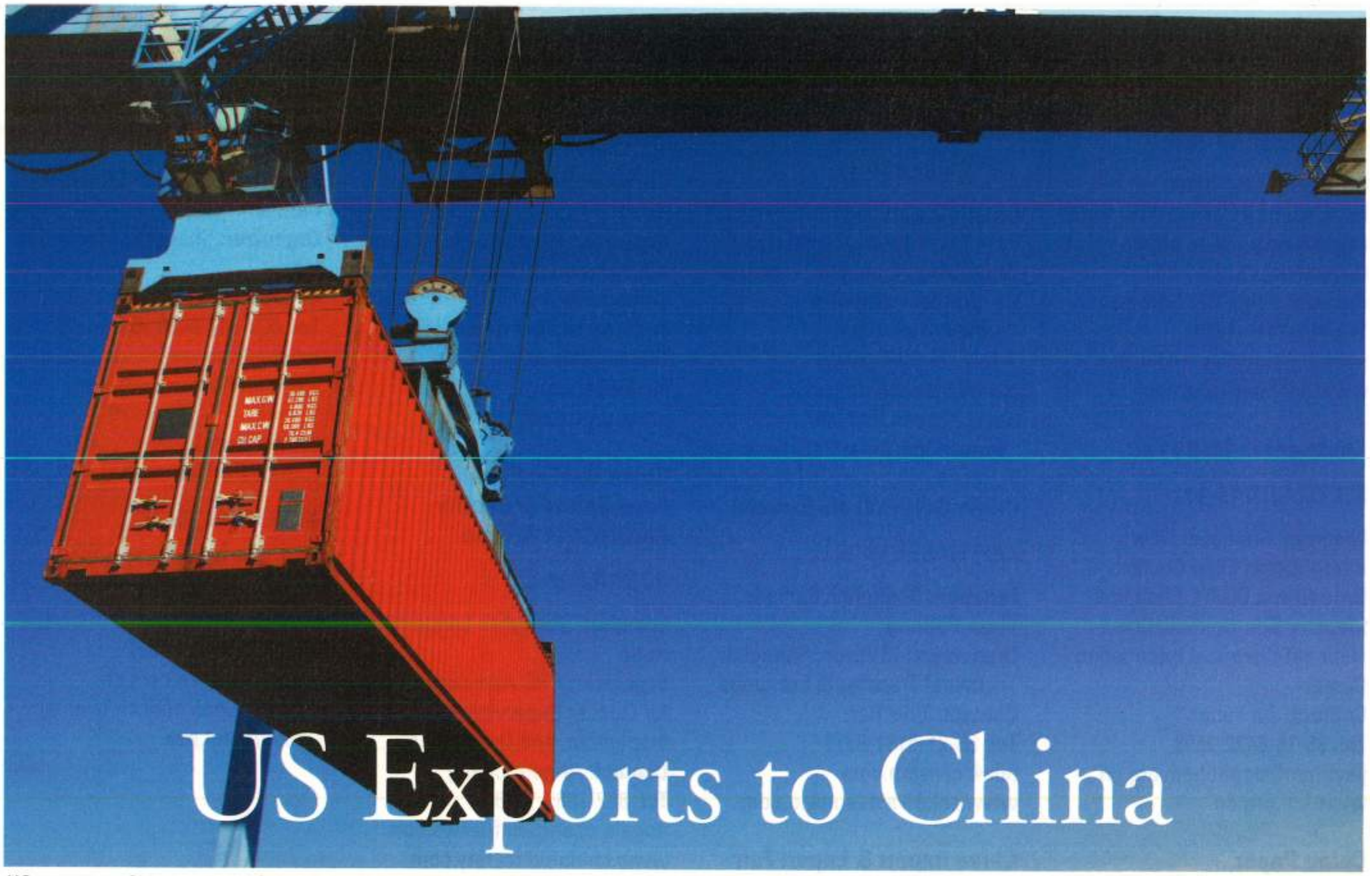
Location: Shanghai Exhibition Center
Organizer: Shanghai Media Co., Ltd.
Contact: Jim Prince
Tel: 800-341-9488 x531
jprince@moneyfairchina.com
www.moneyfairchina.com

China Hotel Expansion Summit

NOVEMBER 25–26

Location: Hainan: TBA
Organizer: Noppen
Contact: Alan Shen
Tel: 86-21-6085-1001
alans@noppen.com.cn
www.noppen.com.cn/events/hotel/hotel.asp

30 Find more China-business events on the *China Business Review*'s website at www.chinabusinessreview.com/conference-calendar.php.



US Exports to China

US exports to China reached $67.6 billion during 2009.

US state exports to China were resilient in 2009 despite the global recession, and strong export growth is emerging in 2010.

US-China Business Council staff

China was a strong export market for US goods in 2009, though US exports as a whole declined. The US-China Business Council's (USCBC) fourth annual survey of state exports shows that for the third year in a row, China was the third-largest US export market, after Canada and Mexico. US exports to China reached $69.6 billion during 2009, down just 0.2 percent from 2008—by far the best record for a major US export market in 2009. When US exports to Hong Kong are included, the total rises to $90.7 billion. US exports to the rest of the world combined fell nearly 20 percent in 2009.

Despite the recession, almost half of US states increased exports to China in 2009. Nineteen states exported more than $1 billion in goods to China in 2009, up from 18 in 2008. California remains the country's export leader to China with $9.7 billion in exports last year, with Washington ($9.1 billion) and Texas ($8.9 billion) close behind. Key manufacturing states such as Ohio, Pennsylvania, Illinois, and Michigan also remained among the top 15 exporting states to China in 2009, as they have been for the past two years. Only 10 states had slower export growth to China than to the rest of the world in 2009.

Top exports nationally were computers and electronics (including components), agricultural products, chemicals, and transportation equipment.

US exports to China have jumped 330 percent since 2000, the last full year before China entered the World Trade Organization and was required to reduce many trade barriers. In comparison, US exports to the rest of the world during this period grew just 29 percent. USCBC expects exports to China will continue to grow and outpace exports to other markets in 2010, as global economic growth resumes. US exports to China in the first quarter of 2010, the most recent quarterly data available as *CBR* went to press, rose 47 percent over the same period in 2009.

All 2009 data used in the USCBC study come from the US Department of Commerce's Census Bureau. For each of the 50 US states, the report tracks the annual volume of exports to China over the past 10 years, 2000–09 growth in exports to China, 2000–09 exports to the rest of the world, top-five export markets, and top-five exports to China. The complete report is available on the USCBC website (www.uschina.org).

The China Business Information Center Helps US Exporters

US government agencies offer US exporters to China several services. Though many US firms are familiar with services offered by the US Department of Commerce's Commercial Service, some firms may not be aware of the resources available through its China Business Information Center (BIC).

Commerce's China BIC provides China-specific export information to US businesses to help them succeed in the China market. The China BIC consists of three components: a comprehensive website (www.export.gov/china), a toll-free number (1-800-USA-TRADE) that US exporters and trade professionals may call to speak with a China specialist, and a series of domestic outreach events.

A virtual resource, the China BIC is supported by Commercial Service specialists in Washington, DC, and various US cities. China BIC staff in the United States work with US Commercial Service staff in China to boost US exporters' success in the market.

Website

The China BIC website is a clearing house of information on doing business in China from many of the federal agencies in the interagency Trade Promotion Coordination Committee. Commerce aims to offer US exporters easier access to information by housing this info in a single place. A wide range of information and resources—such as the Office of the US Trade Representative's "Special 301" report on the state of China's intellectual property rights environment and Commerce policy initiatives under the Joint Commission on Commerce and Trade—are bundled into the website. Many visitors use the website for information and links on PRC laws, standards, and customs regulations. The website also contains market profiles of China's second-tier cities where the Commercial Service maintains American Trading Center partnerships; industry research reports and recorded interviews; and a US calendar of China-related webinars, seminars, and opportunities to meet with Chinese buyer delegations (see "Business Resources" in the November–December 2006 online *CBR*).

Hotline

Because each company's situation and export transactions differ, China BIC's toll-free line aims to put companies in touch with an international trade specialist who can provide counsel specific to the product and export scenario. China BIC Program Manager Kellie Holloway recently explained:

> *Sometimes an exporter will call to confirm a duty rate, but in the course of the conversation will discover other important considerations, such as whether a product is subject to China Compulsory Certification mark requirements. Or a caller from a green-building material firm may learn of a trade show opportunity, in addition to identifying market research on China's sustainable building design practices. Likewise, a caller hoping to verify the credentials of an unsolicited purchase order can learn of practices for self-initiated due diligence and background investigation services, or a caller with concerns related to protecting products from counterfeit can learn of the free China intellectual property advisory program and the wealth of information on www.stopfakes.gov.*

Events

China BIC's seminars, webinars, and other outreach events are designed to educate exporters on market opportunities, best practices, and pitfalls to avoid when entering or increasing sales in China. The center hosts live, virtual, and recorded events across the United States throughout the year. The China BIC recently facilitated a "Selling Cosmetics to China" webinar, which focused on product registration and pricing, and a more macro-level webinar, "China's Stimulus Package and Its Implications for US Exporters." Holloway added:

> *Though many seminars are general, we also work to support product-specific briefings that can drill down to address an exporter's information needs. For example, on July 26, the China BIC is supporting a workshop "Challenges and Opportunities of Chinese In Vitro Diagnostics (IVD) Market Entry," a sector that has impressive growth potential for US manufacturers of IVD medical equipment. We collaborate with colleagues in China to identify markets of greatest opportunity for US products and deliver programs that bring insight directly to exporters.*

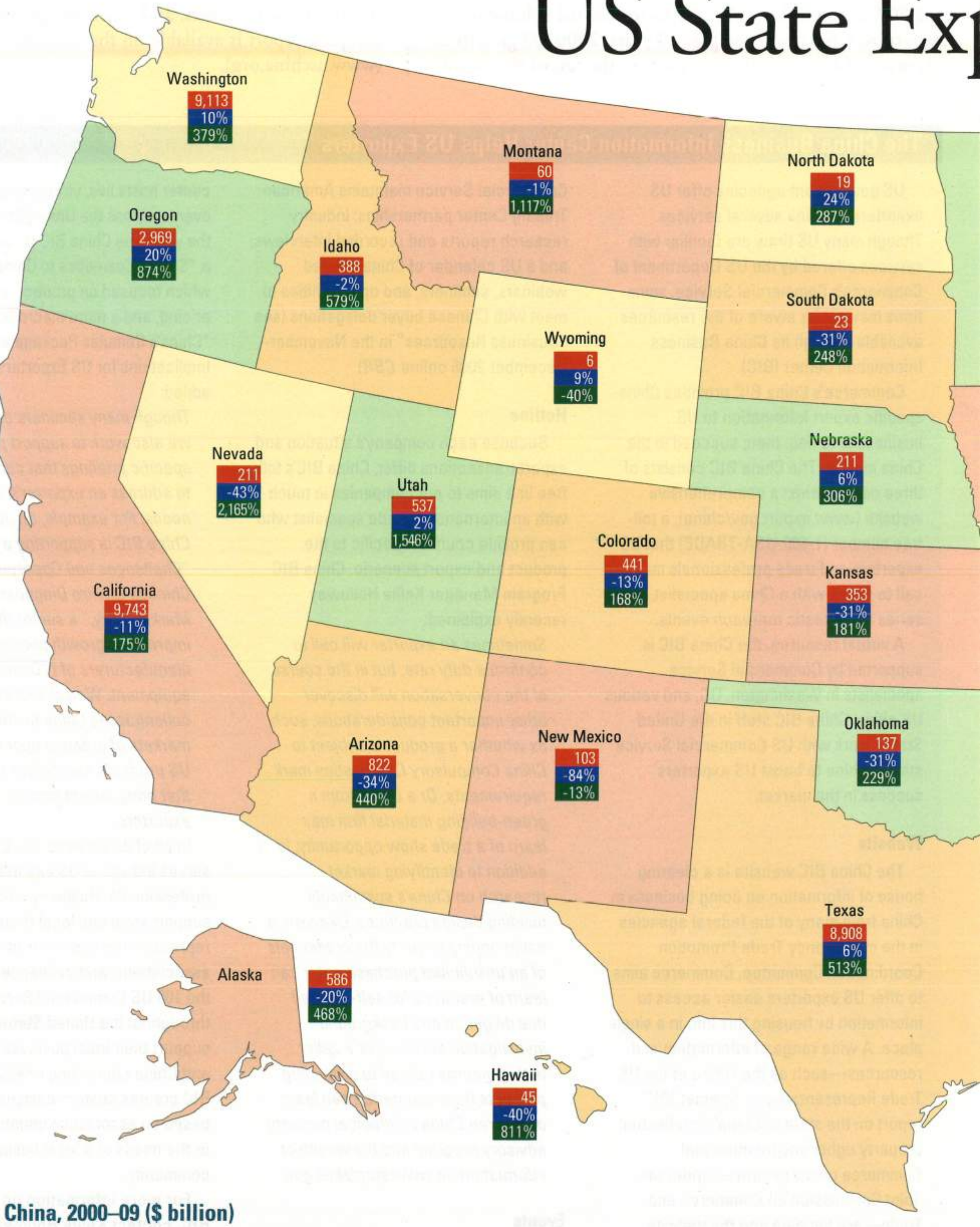
In all of its services, the China BIC serves individual US exporters and trade professionals. Holloway added, "We support state and local trade representatives, world trade centers, associations, and colleagues located in the 108 US Commercial Service offices throughout the United States, working to support their local business community and China counseling needs." The China BIC creates custom-designed briefings based on association membership profiles or the needs of a local business community.

For more information on the China BIC, contact Kellie Holloway (chinabic@trade.gov).

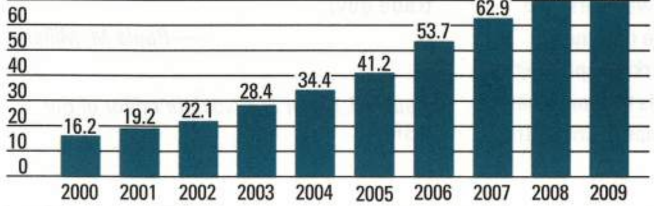
—*Paula M. Miller*

Paula M. Miller is associate editor of the CBR.

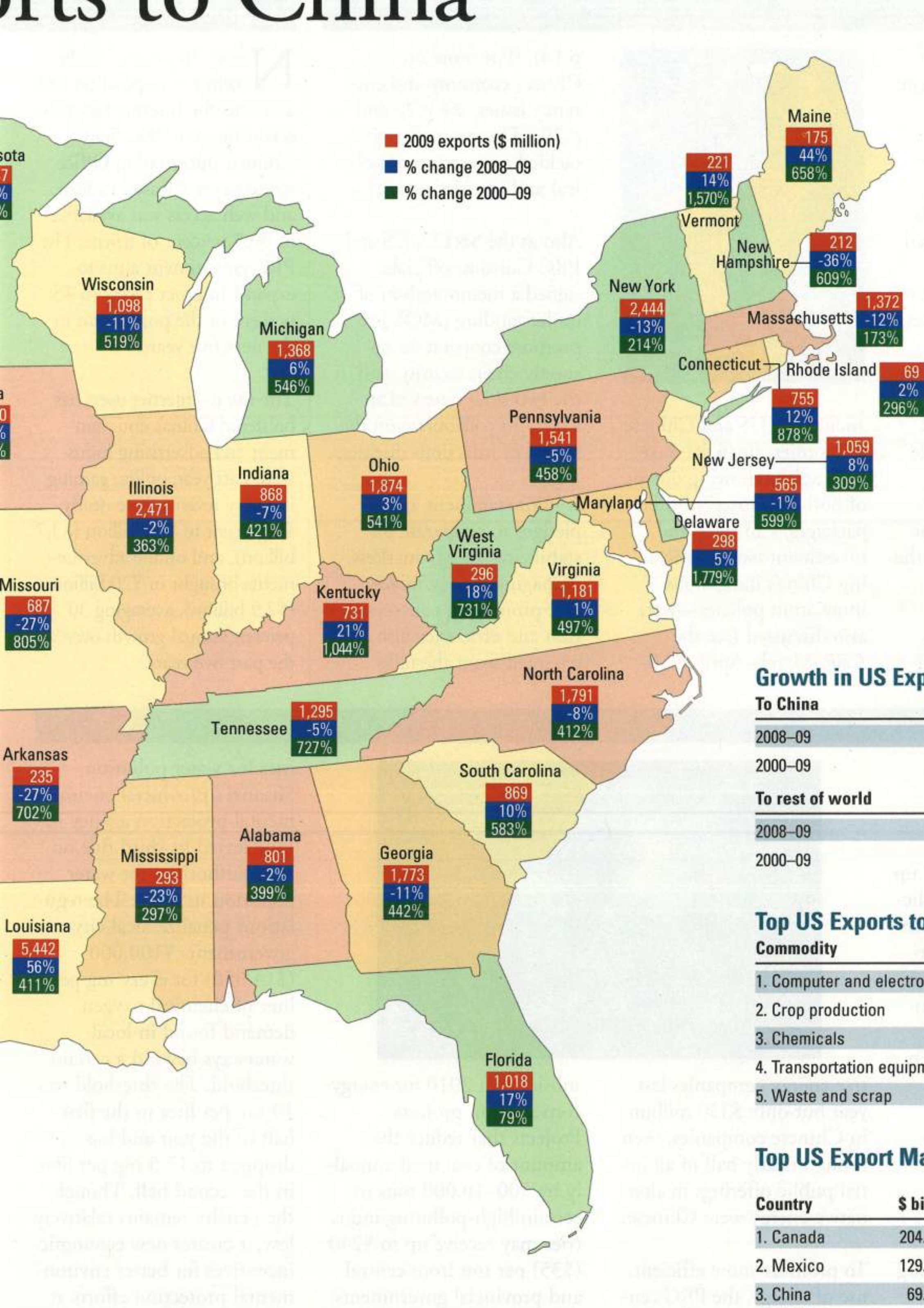
US State Ex



US Exports to China, 2000–09 ($ billion)



orts to China



Growth in US Exports

To China	% change
2008–09	-0.2
2000–09	330.0
To rest of world	
2008–09	-19.0
2000–09	29.0

Top US Exports to China, 2009

Commodity	$ billion
1. Computer and electronics	12.5
2. Crop production	10.6
3. Chemicals	9.7
4. Transportation equipment	7.5
5. Waste and scrap	7.2

Top US Export Markets, 2009

Country	$ billion	% change over 2008
1. Canada	204.7	-21.6
2. Mexico	129.0	-14.7
3. China	69.6	-0.2
4. Japan	51.2	-21.4
5. United Kingdom	45.7	-14.7

Sources: US Department of Commerce; US-China Business Council, *US Exports to China by State, 2000–09*

Bilateral Dialogue

The second session of the US-China Strategic and Economic Dialogue (S&ED) took place in Beijing May 24–25. The largest US delegation of such high-profile officials to travel to China engaged PRC counterparts on a variety of economic, security, and cross-cutting issues. US Secretary of the Treasury Timothy Geithner and PRC Vice Premier Wang Qishan co-chaired the economic track, while US Secretary of State Hillary Rodham Clinton and PRC State Councilor Dai Bingguo co-chaired the strategic track.

The economic track discussed strategies for rebalancing the US and Chinese economies, financial recovery and the drawing down of both countries' stimulus packages. Currency and investment issues—including China's indigenous innovation policies—were also discussed (see the *CBR*, March–April 2010, p.14). (For more on China's economy and currency issues, see p.26 and p.30.) The strategic track tackled a spectrum of political and security issues.

Also at the S&ED, US and PRC Customs officials signed a memorandum of understanding (MOU) to promote cooperation on supply chain security, and the two sides renewed an MOU to collaborate on the spread of infectious diseases.

A joint statement and pledges to cooperate on stabilizing energy markets, managing energy mixes, and promoting conservation and efficiency also emerged from the talks.

Internet

Nearly 30 percent of the country's population had access to the Internet last year, according to a PRC State Council Information Office white paper released in June, and web access was available in 99.3 percent of towns. The PRC government aims to expand Internet access to 45 percent of the population in the next five years.

The rise in Internet users has bolstered China's entertainment and advertising industries. Last year, online gaming industry revenue rose nearly 40 percent to ¥25 billion ($3.7 billion), and online advertisements brought in ¥20 billion ($2.9 billion), averaging 30 percent annual growth over the past five years.

Thinking Green

US-based investment fund VantagePoint Partners and the China Beijing Environmental Exchange recently teamed up to create an index for publicly traded Chinese companies that operate in the low-carbon sector. The China Low Carbon Index, the first renminbi-denominated index for low-carbon firms, covers 35 companies in nine fields—such as solar and wind power—and aims to raise the profile of China's green technologies.

Chinese start-ups tend to have more difficulty securing financing than their US counterparts. For example, venture capital firms invested $3.5 billion in US alternative energy companies last year but only $330 million in Chinese companies, even though nearly half of all initial public offerings in alternative energy were Chinese.

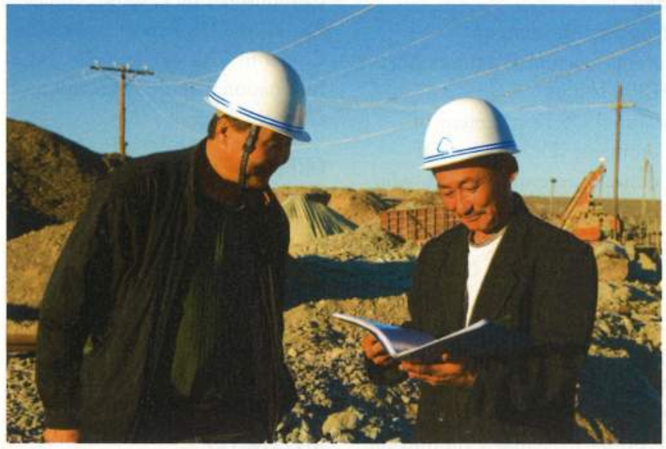
To promote more efficient use of energy, the PRC central government in June announced plans to allocate ¥2 billion ($293 million) in subsidies in 2010 for energy-conservation projects. Projects that reduce the amount of coal used annually by 500–10,000 tons in certain high-polluting industries may receive up to ¥240 ($35) per ton from central and provincial governments.

Armed with a new law that allows it to fine local authorities for water pollution, Shaanxi's provincial environmental protection agency in June levied its third fine on local authorities for water pollution in 2010. The regulations penalize local city governments ¥100,000 ($14,650) for every mg per liter of chemical oxygen demand found in local waterways beyond a certain threshold. The threshold was 19 mg per liter in the first half of the year and has dropped to 17.5 mg per liter in the second half. Though the penalty remains relatively low, it creates new economic incentives for better environmental protection efforts at the local level.

Online criminal activity has also risen, according to the white paper. The number of computer crimes in China jumped from 142 reported cases in 1998 to 48,000 cases in 2009. The China Internet Network Information Center reported that 52 percent of Chinese netizens encountered Internet security problems and 21.2 percent suffered financial losses as a result of Internet fraud in 2009.

Labor

China's private sector accounts for 90 percent of new jobs created, according to the PRC State Administration for Industry and Commerce. At the end of the first quarter, private firms employed more than 152 million people in China, and more than 700,000 workers that had been laid off during the global downturn found new jobs in the private sector last year.



As the labor market tightens, many companies are under pressure to increase their wages and improve working conditions. The recent high-profile strikes at Chinese factories that supply parts for Honda Motor Co., Ltd.—and a series of suicides at Foxconn Technology Group's Shenzhen facilities—have attracted authorities' attention, resulting in salary adjustments and wage increases at Honda and Foxconn facilities. The number of labor disputes in China declined amid economic uncertainty in 2009 but has risen in recent months.

Minimum wages are also on the rise. According to *People's Daily*, more than 10 provinces, autonomous regions, and municipalities have raised their minimum wages in 2010, beginning with Jiangsu in February. The minimums for Guangdong, Shanghai, and Zhejiang now exceed ¥1,000 ($146) per month, while that of Shenzhen, Guangdong, rose to ¥1,100 ($161).

To spur economic development and move Chinese industry up the value chain, the PRC government plans to attract more highly skilled foreign workers. In June, China unveiled its National Medium- and Long-Term Talent Development Plan (2010–20), which aims to establish favorable tax, insurance, housing, living, and other policies as incentives for foreign workers to come to China. According to Xinhua News Agency, the government will also make it easier for foreigners to receive permanent residency.

Hong Kong

A new supplement to the Closer Economic Partnership Agreement (CEPA) further liberalizes trade and investment between the Hong Kong Special Administrative Region government and the mainland. The agreement supplements the original 2003 CEPA and six previous supplements signed between 2004 and 2009.

The latest supplement loosens investment restrictions in 10 services sectors, including banking, distribution, medical, and tourism services. For example, Hong Kong air-transport or audiovisual services companies may now set up wholly owned enterprises on the mainland, and

Hong Kong medical services providers can open wholly owned hospitals in Chongqing, Fujian, Guangdong, Hainan, and Shanghai.

CEPA has led to the creation of 54,700 jobs in Hong Kong and 40,600 jobs on the mainland since 2003, according to a Hong Kong government statement.

Lured by the incentives China offers to Hong Kong firms, foreign services firms looking to enter the mainland are investing more in Hong Kong. According to InvestHK, 26 percent of the 265 foreign companies assisted by InvestHK cited CEPA as a key consideration for investing or expanding in the special administrative region in 2009.

Event Wrap Up

BEIJING

May

Breakfast Briefing on Foreign Corrupt Practices Act (FCPA) Issues

Featured US Department of Commerce (DOC) General Counsel Cameron F. Kerry, who discussed DOC's China-related initiatives and activities and FCPA-related issues. Nathaniel Edmonds, assistant chief, Fraud Section, Criminal Division of the Department of Justice; Troy Beatty, senior counsel, Office of International Affairs, the Securities Exchange Commission; and Patrick Norton and Susan Munro, partners at Steptoe & Johnson LLP, also discussed FCPA issues. Cosponsored by the US-China Business Council (USCBC) and American Chamber of Commerce (AmCham) in China.

Cybersecurity Briefing

Featured Stewart Baker, former assistant secretary for Policy at the Department of Homeland Security. Cosponsored by USCBC and the US Information Technology Office.

Lunch Briefing with US Secretary of Commerce Gary Locke

Locke discussed trade opportunities in China for US businesses. Cosponsored by USCBC and AmCham-China.

CHICAGO

May

Nearly Four Decades in China: A CEO's Perspective

Featured Boeing Co. Chairman, President, and CEO W. James McNerney, Jr. Cosponsored by USCBC and the Chicago Council on Global Affairs.

June

Luncheon on Current Issues in US-China Trade

Featured USCBC Chief Representative of Shanghai Julie Walton, USCBC Vice President Erin Ennis, and Sidley Austin LLP Partner Scott Lassar. Cosponsored by USCBC, Sidley Austin, the US Export Assistance Center in Chicago, and the International Trade Association of Greater Chicago.

MINNEAPOLIS

June

Breakfast on Current Issues in US-China Trade

Featured Julie Walton and Erin Ennis of USCBC and Nelson Dong, partner at Dorsey & Whitney LLP. Cosponsored by USCBC and Dorsey & Whitney.

SHANGHAI

May

Issues Briefing on Best Practices in Workplace Health and Safety: Responding to Hepatitis B

Featured Dr. Samuel So, director of Stanford University's Asian Liver Center; GE China Medical Director Dr. Jean Wu; and GE Asia Pacific General Counsel Stephen Maloy. Cosponsored by USCBC and AmCham-Shanghai. Special thanks to GE (China) for underwriting this event.

Issues Luncheon on Indigenous Innovation and Industrial Policies

Featured USCBC's Vice President of China Operations Robert Poole.

Breakfast Program for US Department of Transportation (DOT) Secretary Ray LaHood

After LaHood offered remarks, he and a senior DOT delegation engaged US industry representatives on issues related to transportation sustainability and interconnectivity. Cosponsored by USCBC and AmCham-Shanghai.

June

Luncheon with the Shanghai Economic and Information Technology Commission (SEITC) on Investment Opportunities

Featured Ma Jing, SEITC's chief engineer, who spoke on reform efforts in Shanghai's advanced equipment manufacturing, information technology, new-energy, and new-materials industries. Zhao Yan, deputy chief of SEITC's foreign economic division, and Zhang Ying, deputy chief of SEITC's advanced technology division, spoke on how companies can obtain government financial support.

WASHINGTON, DC

May

Roundtable with PRC Assistant Minister of Finance Zhu Guangyao

Featured Zhu, who discussed financial-sector issues in advance of the May Strategic and Economic Dialogue (S&ED), and a Ministry of Finance delegation. Cosponsored by USCBC and the Financial Services Forum's Engage China program. Special thanks to Baker & McKenzie LLP for co-hosting the event.

Briefing with David Dollar

Featured Dollar, the US Department of the Treasury's economic and financial emissary to China, who discussed preparations for the economic track of the May S&ED. Cosponsored by USCBC and the Financial Services Forum's Engage China program. Special thanks to Winston & Strawn LLP for co-hosting the briefing.

Issues Briefing: EU Engagement with China and US-EU Cooperation on China Issues

Featured Hiddo Houben, head of the Trade Section at the European Union Delegation to the United States.

June

37th Annual Membership Meeting

See p.53

USCBC Board of Directors Meeting

See p.54

Welcome Reception for Incoming USCBC Board Chair and New Directors

See p.54

Outcomes of the 2010 JCCT Mid-Year Review

Featured Deputy Assistant Secretary of Commerce for Asia Pacific Ira Kasoff and Assistant US Trade Representative for China Claire Reade, who participated in the S&ED and the Joint Commission on Commerce and Trade's mid-year review in May. Cosponsored by USCBC and the US Chamber of Commerce.

Reception and Luncheon Welcoming PRC Ambassador to the United States Zhang Yesui and Mme. Ambassador Chen Naiqing

Featured China's new ambassador to the United States, his wife, and other PRC embassy officials. Zhang offered remarks on ways to continue building strong bilateral commercial relations and on recent developments following the May S&ED. Special thanks to the Coca-Cola Co. for sponsoring the event.

Upcoming Events

WASHINGTON

US-China Energy Briefing: Strategic and Economic Dialogue Outcomes

July 8, 2010

US-China Working Group 5th Anniversary

July 27, 2010

BEIJING

China Operations Conference

August 5, 2010

For more information, see p.29

For more information on USCBC or its events, visit www.uschina.org.

USCBC Holds 37th Annual Membership Meeting in Washington

US-China Business Council (USCBC) members gathered for the organization's 37th Annual Membership Meeting in Washington, DC, on June 1. Leading China political analyst Harry Harding kicked off the event with a look at the current state of US-China relations, noting that some recent frictions between the United States and China have passed and the bilateral relationship has stabilized—but that some tensions are inevitable. He predicted that over the next few years, the most likely flashpoints in the relationship would be tensions on the Korean Peninsula, Taiwan's election in 2012, and China's own leadership succession that year.

Pieter Bottelier, a professor at Johns Hopkins University and a former World Bank director in Beijing, presented on China's economy, stressing that China's stimulus package has been effective and that the government has begun to pull back from credit-driven stimulus. He also stated that challenges for policymakers include housing bubbles in some local markets in China, inflation, low export demand, and protectionism abroad and in China.

Julie Walton, USCBC's chief representative in Shanghai, gave a preview of PRC economic development policies in the next five years and commercial implications for US companies (see p.39). Walton encouraged companies to examine PRC pronouncements, catalogues, and plans to find opportunities to show that foreign companies can help China achieve its goals.

Monica Debiak, associate at Paul, Hastings, Janofsky & Walker LLP, updated the audience on recent developments surrounding collective bargaining, unionization, and other human resources developments in China. Of particular note, China's unionization drive appears to be picking up again as China's economy pulls out of the recession, and employee claims against companies, especially for overtime, are rising. Debiak predicted that in the near future, labor disputes and pressure to unionize will rise, and multinational corporations will face increased media scrutiny.

Wrapping up the afternoon was a briefing on the results of the previous week's Strategic and Economic Dialogue (S&ED) in Beijing from a panel of US government officials who participated: David Loevinger, executive secretary and senior coordinator for China affairs and the S&ED at the Department of the Treasury; Derek Chollet, principal deputy director of the secretary of State's policy planning staff; and David Shear, deputy assistant secretary for East Asian Affairs at the Department of State. The panelists stressed the S&ED's value in setting the agenda for other bilateral discussions and in engaging with senior PRC officials who do not interact frequently in international settings. Panelists also provided insights into discussions of key topics such as China's innovation and procurement policies, the US and PRC economic recoveries, the European debt crisis, and current tensions with North Korea.

USCBC President John Frisbie opened the June 1 Annual Membership Meeting.

Harry Harding, dean at the University of Virginia, and Pieter Bottelier, senior adjunct professor at Johns Hopkins University, discussed US-China relations and China's economy, respectively.


Julie Walton, USCBC's chief Shanghai representative, spoke on trends in the commercial environment.

Monica Lynn Debiak, associate at Paul, Hastings, Janofsky & Walker LLP, discussed human resources developments in China.

The State Department's David Shear, Secretary of State's Derek Chollet, and Department of the Treasury's David Loevinger spoke on the Strategic and Economic Dialogue and its aftermath.

USCBC Board Meets Geithner and Zhang, Elects New Chair

US Treasury Secretary Timothy Geithner met with the US-China Business Council's (USCBC) board of directors during its June 2 meeting at the Library of Congress. Geithner spoke on the results of the previous week's Strategic and Economic Dialogue (S&ED) in Beijing and prospects for key economic and commercial issues. Geithner highlighted that China's indigenous innovation and government procurement policies were an important part of the S&ED discussions and that US industry had captured the PRC government's attention on these issues. He also stressed the S&ED's importance in supporting global economic recovery by coordinating macroeconomic policies. In addition, the board of directors met with China's new ambassador to the United States Zhang Yesui, who also spoke on S&ED results and bilateral trade relations.

USCBC's board elected Muhtar Kent, chairman and CEO of the Coca-Cola Co., as chair and elected three officers. USCBC member companies re-elected 10 current directors for three-year terms and welcomed four new board members. For USCBC's complete board list, see www.uschina.org.

USCBC Board Chair Muhtar Kent and US Treasury Secretary Timothy Geithner at the board of directors meeting.

Geithner discussed US-China trade issues with USCBC board officers and directors.

USCBC President John Frisbie, Kent, and PRC Ambassador Zhang Yesui.

Zhang and Janet Howard, vice president of International Affairs at the Coca-Cola Co.

USCBC Board Meets Geithner and Zhang, Elects New Chair

USCBC and the Librarian of Congress James H. Billington hosted an evening reception for USCBC's new chair, Muhtar Kent, chairman and CEO, the Coca-Cola Co., and new USCBC officers and directors. Held at the Library of Congress on June 2, numerous US and PRC government officials, former Cabinet officials, USCBC member company executives, and members of the think-tank and China-watching community attended the reception. USCBC President John Frisbie, Kent, and PRC Ambassador to the United States Zhang Yesui offered remarks on US-China trade relations. Special thanks to the Coca-Cola Co. for underwriting this event.

Nearly 250 guests attended the welcome reception for USCBC's new chair, Muhtar Kent, and board of directors at the Library of Congress.

PRC Ambassador Zhang Yesui, Kent, and the Honorable Donald McHenry.

The Honorable Madeline K. Albright, Kent, and Mme. Ambassador Chen Naiqing.

Ambassador Zhang discussed his new role as Beijing's top envoy to Washington, US-China relations, and bilateral commercial issues.