THE CHINA BUSINESS REVIEW

MAY-JUNE 1995

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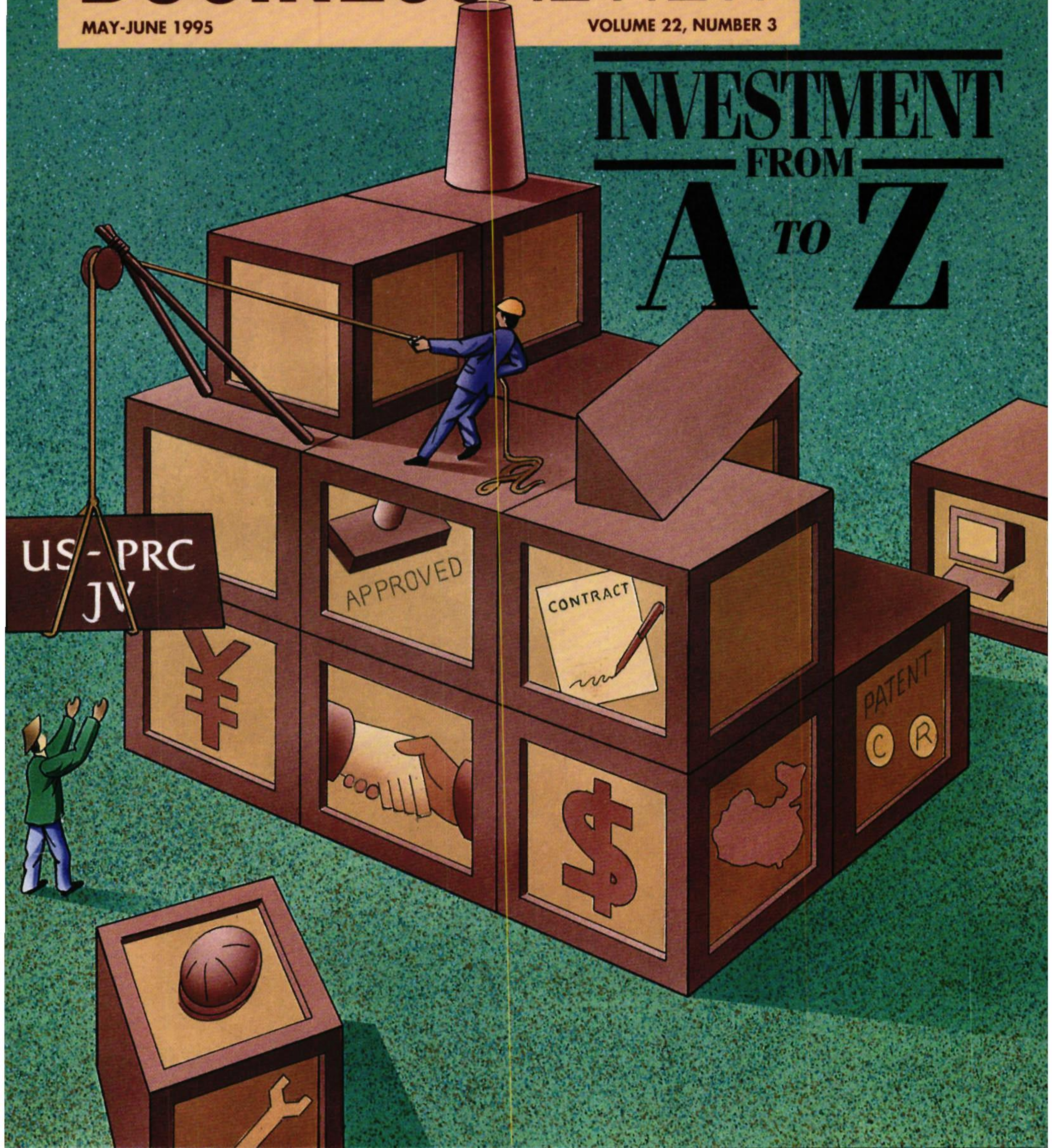
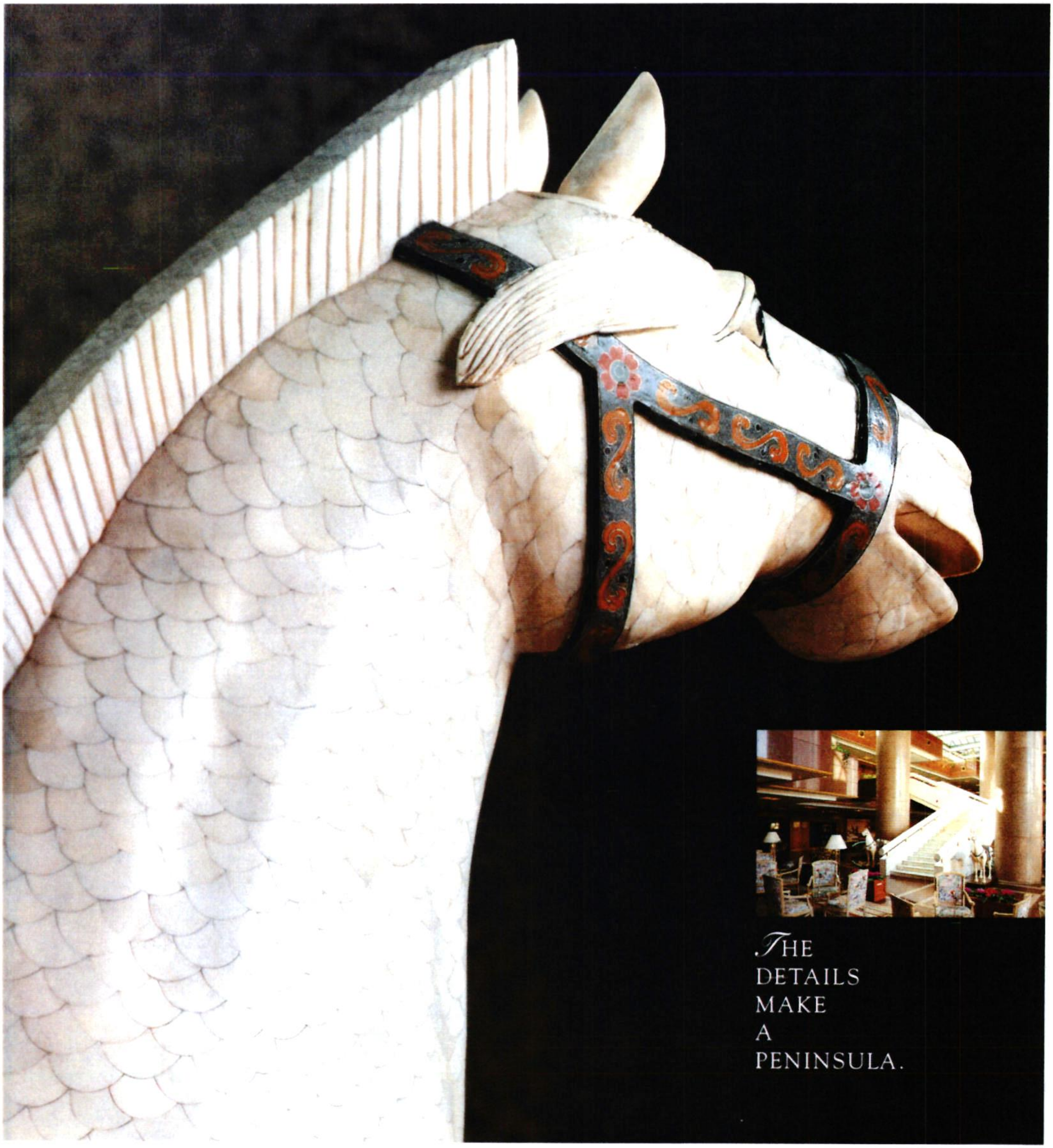
INVESTMENT FROM A TO Z

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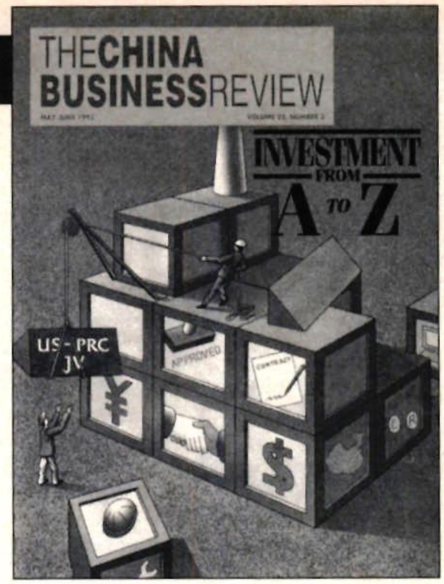

FOCUS:

INVESTMENT FROM A TO Z

DEPARTMENTS

Cover illustration by John Yanson

NPC Session Highlights Economic Growth

The third session of the Eighth National People's Congress (NPC), held in Beijing from March 5-18, focused heavily on the complicated set of problems Beijing must resolve to transform the Chinese economy into a market-based system. In a 35-page government work report that opened the session, Premier Li Peng promised renewed efforts to restrain excessive growth and inflation, setting official targets of 8-9 percent GDP growth and 15 percent inflation for 1995. These goals may be overly optimistic, however, as Beijing must also address complex problems related to banking, prices, social security, and State enterprises.

The NPC session also passed two significant new laws. China's first Education Law (to become effective September 1) will allocate more funds to education in both rural and urban areas. The long-awaited Law on the People's Bank of China (PBOC), which had been in the drafting stage since 1979, officially recognizes the PBOC as China's central bank. By penalizing urban credit cooperatives and other non-bank institutions for unauthorized lending, the law should help strengthen central control over credit policies and the money supply.

Whether the PBOC does actually gain independence and control over monetary matters remains to be seen. Standing in the PBOC's way might be a "monetary policy committee" reported to be in the works by the State Council.

This NPC, like others in the past, announced a number of personnel changes. Reputed Jiang Zemin allies Wu Bangguo, 53, and Jiang Chunyun, 64, were named as vice premiers, bringing the ranks of vice premiers to six. Most recently Party secretary in Shandong Province, Jiang will oversee agriculture. Wu, who has spent much of his career in Shanghai's electronics and vacuum industries, will handle industrial policy. Both Jiang and Wu joined the Politburo in 1992.

Changes were made in other government organs as well. Minister of Internal Trade Zhang Haoruo was replaced by Chen Bangzhu, formerly governor of Hunan Province. State Administration of Taxation Director Jin Xin retired and was replaced by Vice Minister of Finance Xiang Huaicheng. Liu Hongru, director of the China Securities & Regulatory Commission (CSRC), was replaced by Zhou Daojiang, former vice director of the State Development Bank.

Some big questions still remain unanswered. Predictably, this NPC spawned numerous rumors about factions likely to emerge in the post-Deng era, though the announcements of personnel changes shed little light on the true nature of China's succession politics. Some reports reiterated, for example, that the growing ranks of Shanghai officials in top positions solidifies Jiang Zemin's status as Deng's heir apparent. Other observers report a rivalry developing between Li Peng and Qiao Shi, fueling new speculation that Li Peng's popularity is waning even further.

— *Anne Stevenson-Yang*

Anne Stevenson-Yang is director of the Council's Beijing office.

IN MEMORIAM

Chen Yun, former vice chairman of the Chinese Communist Party (CCP) and vice premier of China's State Council, died at the age of 90 on April 10. Chen, considered the architect of China's planned economy and Deng Xiaoping's principal opponent on economic reform measures, had been one of China's most influential leaders for the past 15 years.

Contrary to the popular perception that he was a stalwart critic of free enterprise, Chen was the first PRC official to champion the use of markets. Indeed, his proposal in 1956 to introduce market forces in certain sectors of the economy made him one of the most reformist leaders in China, and possibly in the entire Soviet bloc, during the 1950s and 1960s. His calls for the use of the market to complement the State plan later formed the impetus behind some of China's economic reforms of the late 1970s and early 1980s.

Despite his early endorsement of market forces, Chen, who joined the newly formed CCP in 1925 and participated in the Long March in 1934-35, was clearly the most outspoken proponent of macroeconomic balance in China's leadership circles. But the ideological conservatism reflected in his fear of uneven economic growth and his advocacy of slow, careful advance often challenged other leaders who sought to develop certain economic sectors at the expense of others.

Over the last 10 years, many viewed Chen Yun and Deng Xiaoping as archrivals. Chen did indeed play major roles in the rise of Li Peng and the demise of Deng proteges Hu Yaobang and Zhao Ziyang. However, when Chen and Deng worked together, they often agreed on such key issues as agricultural policy and inflation control. But Chen was less willing to experiment than Deng and was initially skeptical of the open policy .

Though current leaders such as Li Peng and Zhu Rongji share with Chen concern about maintaining economic stability, Chen's death means the loss of the most powerful and important proponent of macroeconomic balance in China and portends the possibility of greater economic instability. At the same time, though, the passing of one of the most powerful conservatives in Beijing should open the door to further economic experimentation and, perhaps, deeper economic reforms.

—*David Bachman*

David Bachman is chair of the China Studies Program at the University of Washington and author of Chen Yun and the Chinese Political System.

Letter from the Editor

This is perhaps the easiest—and hardest—letter I've had to write during my tenure as editor. The easiest because there's no question about what to write, the hardest because saying farewell is never easy. After six and one-half years with *The CBR*, five of them as editor, I am leaving after this issue goes to press.

Editing *The CBR* has been a challenging, rewarding—and exhausting—experience. Like every other business in the China field, the magazine has been through many ups and downs over the past six years, and I consider it a great personal achievement to be leaving it in an "up" position. Clearly I didn't accomplish this feat alone; much of the credit must go to Associate Editor Vanessa Lide Whitcomb, who will be succeeding me. Vanessa knows *The CBR* inside out, and under her direction the magazine will no doubt continue to flourish.

Vanessa has already hired a talented crew of assistant editors—Tali Levine Kamis, Kirsten Sylvester, and Tina Valdecañas—to help her produce the magazine. Together, these three bring a wealth of experience in policy, publishing, and China matters to *The CBR*, which can only prosper as a result. The editors are well complemented by Caitlin Stewart Harris, who has been promoted to business manager, and the amazing Jon Howard, whose designs always make us look good.

As for me, though come May I'll no longer be part of *The CBR* crew, that doesn't mean I won't show up from time to time on its pages; my new position will keep me very much involved in China business. As Director-Hong Kong for the US-China Business Council, I'll be opening a new office in the territory to cater to our members there. This office marks a significant expansion of the Council's presence in Asia, and I am honored to be tasked with getting it up and running.

Before I leave, I want to thank you, our readers, for supporting *The CBR*, and I especially want to thank the many authors who have so generously contributed their time and expertise to the magazine. It has been a pleasure to work with you, and I hope you will continue to share your ideas and enthusiasm with Vanessa and her staff.

Best regards,

Pamela Baldinger

Pamela Baldinger
Editor

SHORT TAKES

China Lowers Tariff Rates

China reduced its tariff rates by an average of 50 percent on more than 200 products January 1. The affected goods include chemicals, electronics equipment, industrial machinery, and primary products.

Beijing Sets a Minimum Wage...

On December 2, 1994, the Beijing municipal government announced a minimum wage of ¥1.10 per hour, or ¥210 per month. At current exchange rates (¥8.5/$1), the figures amount to roughly $0.13 per hour, or $24.70 per month. The regulations cover all Beijing employees in State, collective, and private enterprises. Businesses that violate the regulations will be subject to fines. Other municipalities are expected to set similar minimum wage rates for their jurisdictions.

...And Adds a New Digit

Since March 26, 1995, international and domestic callers have had to add an extra zero when calling Beijing—the new city code is 10. International callers must now dial 86-10 before the 7-digit local number to reach the capital city, while long-distance callers within China must dial 010 before the 7-digit number. Calls made within Beijing are not affected.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

美中商贸评论

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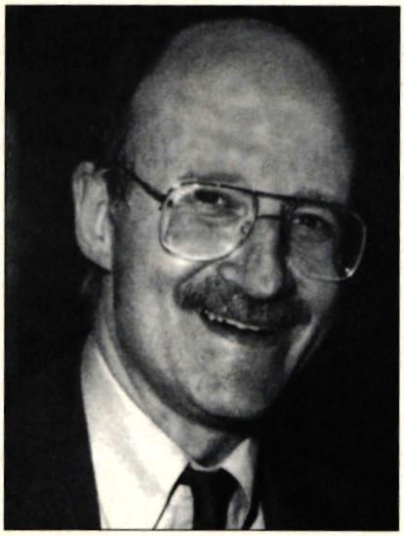


Robert A. Kapp

Does Business Need a Code of Ethics?

US companies operating overseas give the Administration's business principles a mixed review

The long saga of the Statement of Business Principles for US firms operating abroad (which is circulating unofficially as *The CBR* goes to press) presents a cloudy mixture of ethics and politics, altruism and calculated self-interest, and clear-headedness and muddle-headedness. The emergence of this document, nearly a year after President Clinton first spoke of it, does not mean the debate over its contents—or future—is over yet.

The first premise of the Statement is that US business is a positive worldwide force in support of human rights. The Administration's principles are explicitly voluntary, proposed as guidelines that US firms can apply to their operations abroad. The Statement recommends that US firms operating overseas do the following:

- provide a safe and healthy workplace,
- avoid the use of child and forced labor,
- respect the right of association and the right to organize and bargain collectively,
- uphold responsible environmental practices,
- comply with US and local laws promoting good business practices, and
- maintain a corporate culture that respects freedom of expression.

The Statement is not specific to China or any single nation. It is not intended for legislation. The Administration has not asked American corporations to "sign on."

An alternative to conditions

The birth of the Administration's principles dates back to May 26, 1994, when President Clinton renewed normal US trading relations with China—Most-Favored Nation (MFN) treatment—without again making MFN conditional upon changes in the Chinese government's treatment of its citizens. In his May 26 speech, the President also pledged to meet with US business leaders to discuss the development of a set of voluntary principles that would guide American business practices in China. This pledge, said by Washington insiders to have been added to the President's speech at the last moment, was intended to offer something to those in the anti-MFN camp whose other demands the President was not prepared to meet.

What happened over the next 11 months was neither exciting nor inspiring. The Administration held one major meeting with business representatives in June 1994 and met separately with human rights and labor organizations. Business representatives made clear their aversion to anything mandatory or country-specific—and expressed their worries that a "voluntary" measure today would likely become a mandatory one tomorrow. Most of all, they objected to the notion of a White House-generated code of conduct because, they argued, that gave credence to the anti-MFN forces' old claim that US business was itself the cause of the imperfections of China's human rights environment.

In September 1994, China watchers learned that the Administration had been discussing a draft code of conduct with several leading CEOs, who reportedly discontinued the dialogue because they found the draft to be unacceptably inflammatory. During the six months that followed, business provided the White House with copies of many extant corporate codes of conduct, but the two sides remained at a distance. The business community was not about to provide counsel or suggest text to the drafters of a document that was at best unnecessary and at worst repellent. The White House, meanwhile, was not about to have this sensitive issue hashed out in large group meetings.

As they circulated the completed Statement of Business Principles to interested parties, including the US-China Business Council, on March 27 of this year, Administration representatives expressed hope that the business community would respond favorably, but indicated their expectation that more consultations with business would be needed before the document could be officially rolled out.

The verdict

What was the end result of this process? On its face and read in a vacuum, the text of the Statement of Business Principles probably would raise few eyebrows at many US firms; indeed, many of its points are drawn from existing corporate formulations and are compatible with the principles of the Organization for Economic Cooperation and Development (OECD) and the International Labor Organization (ILO). Even on the two most potentially controversial items—recognition of labor's right to organize and responsibility for reporting corporate performance—the Statement treads far more lightly than many expected it would. The Statement embodies so many of the points made or demanded by American firms that the corporate community could conceivably have declared victory after its release and gone about its business.

Many business leaders and spokespersons, however, find the Statement unacceptable, for two principal reasons. First, the notion that the US government needs to feed American corporations *any* principles is fallacious, even insulting; and second, both the Statement and the Administration's hints of long-term, government-initiated follow-up activities portend the growth of a cottage industry of compliance-examiners, publicists, and single-issue advocacy groups dedicated to filtering US business through a sieve. Such actions could effectively revive the battle formations of the China MFN struggle—but on a worldwide basis.

> US companies strive to respect deeply held American values and laws.

In other words, businesspeople recoil at the prospect of the needless politicization of their work. They scratch their heads when asked to respond favorably to a document whose very issuance was politically designed to assuage the feelings of their opponents in the MFN debate—especially when those opponents have already rejected the document as a feeble half-measure.

The range of corporate responses to the Statement has meant that business organizations, the Council included, have generally refrained from issuing definitive statements on the document. Several corporate representatives with whom I have met have indicated that *of course* a document devised by the White House would be considered seriously when they begin to draft or amend their own corporate standards. A number of firms have felt it important to engage with the White House, not so much on the now-final Statement itself, but on the potentially mischief-making verbiage that will accompany its formal release to the public. Some firms have given careful thought to the Administration's argument that supporting the Statement will help to prevent far more damaging Congressional mandates in this area, but others don't accept that premise.

Several points are beyond debate, I think, to all of us in the China business community. The very issuance of the Administration's Statement of Business Principles ensures that it will be considered seriously by those US firms that decide to write or revise their own codes of global conduct—whether individual companies attest to this or not. In that sense, the Administration can be confident that it will achieve its stated goal even if it fails to secure the measure of overt business support it sought. Second, legislative action—already initiated in the 104th Congress—to mandate and monitor US corporate behavior in China is unacceptable. The inference that US business is the cause of perceived injustices in China and therefore bears responsibility for their alleviation was, and is, fallacious, and must be rejected whenever and wherever it is voiced. Third, within the stern realities of the Chinese business environment, US companies and their employees have strived, do strive, and will continue to strive to respect deeply held American ethical values and laws, as well as the laws and traditions of their host country. It is not an easy job, but we should do nothing less. 完

Council Best Bets

As China's attraction as a foreign investment locale has increased, so has the number of books and periodicals devoted to explaining its business environment. If the number of titles we receive here at *The CBR* is any indication, China is "hot" in the publishing world right now—and that's good news for businesspeople.

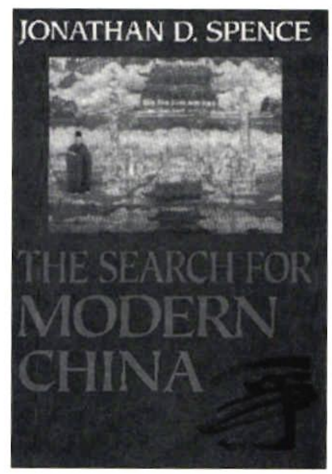
Perhaps the only down side to this trend is that it has become virtually impossible for any one person to read and compare all of the China publications that have come out over the past few years. But, given this special *CBR* investment issue, I wanted to highlight some volumes that foreign investors might find particularly useful. So, I surveyed the staff of the US-China Business Council to discover what books they recommend to readers contemplating China investments. I asked them to list their selections in four general categories: Chinese history, Chinese culture and business protocol, specialized business/investment issues, and the ever-popular "other," for books that don't fit into one of the first three categories but might prove helpful.

The staff's recommendations follow. Keep in mind that just because something isn't listed doesn't mean it's not good; not everyone has read all the same books. Nevertheless, there were certain books that were mentioned consistently as "must-reads." Check them out for yourself.

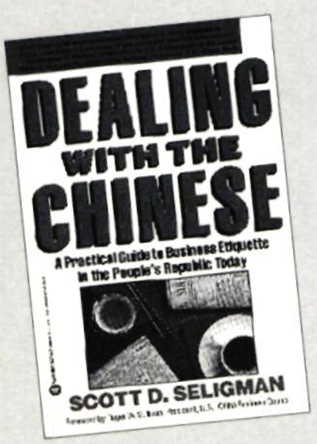
Chinese History

The Search For Modern China (New York, NY: W.W. Norton & Co., 1990), Yale historian Jonathan Spence's 800-odd page volume, was the only book cited by every member of the staff. Tracing China's historical development from the sixteenth century through the events on and around Tiananmen Square in 1989, Spence provides a masterful account of the various social and political forces that have shaped modern-day China. Spence's excellent index is particularly handy for businesspeople who want a quick explanation of a historical person or event.

Other recommended books on Chinese history include *Red Star Over China* (New York, NY: Random House, 1938), Edgar Snow's classic on the rise of Mao and the Communist Party; *The Soong Dynasty* (New York, NY: Harper & Row, 1985), Sterling Seagrave's account of the Sung family and its influence on Chinese politics in the first half of this century; and *Enemies of the People* (New York, NY: Alfred A. Knopf, 1987), a collection of personal anecdotes on life during the Cultural Revolution, compiled by Anne Thurston.



Chinese Culture and Business Protocol

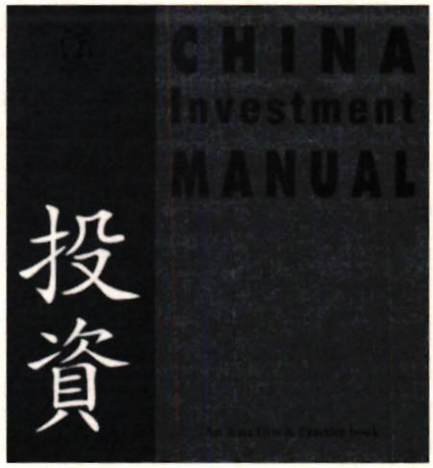


Topping the list in this category was *Dealing with the Chinese* (New York, NY: Warner Books, 1989), by Scott Seligman. Chock full of practical advice on everything from how to arrange seating assignments at banquets to how to greet Chinese counterparts, we'd recommend this book even if it wasn't written by a former Council staffer. Unfortunately, it is now out of print. *Chinese Commercial Negotiating Style* (Cambridge, MA: Oelgeschlager, Gunn & Hain, 1982) by Lucian Pye also contains lots of useful advice, including pointers on how to recognize and counteract Chinese negotiating tactics. An updated version, *Chinese Negotiating Style: Commercial Approaches and Cultural Principles*, was released by the Greenwood Publishing Group in 1992. For those interested in learning what to expect after the contract is signed, *Beijing Jeep* (New York, NY: Simon & Schuster, 1980), Jim Mann's case study of Chrysler's auto joint venture, provides a compelling account of the problems and successes of what is perhaps China's best-known foreign investment.

Specialized Business/Investment Information

The staff was fairly unanimous in its selections for this section. Two of the volumes are published by Asia Law & Practice in Hong Kong: *The Life and Death of a Joint Venture in China* (1993) and *The China Investment Manual* (1994). Both of these volumes, which rarely sit for long on our library shelves, provide reference and practical information on a gamut of investment issues. Any businessperson, whether new to China or an old hand, will find something of interest in these studies. Arne DeKeijzer's *China Business Strategies for the 90s* (Berkeley, CA: Pacific View Press, 1992) also stands out for its wealth of case studies on foreign joint ventures in China. De Keijzer's book gives practical insights into strategic planning, joint venture negotiation, and human resource management in China.

For researchers or statistics hounds, Council staff can attest to the indispensability of at least three books. All are published annually. *China Directory*, published by the Japanese company Radiopress, provides—in both English and Chinese—names, titles, and organizational charts for government agencies, associations, and corporations. The *pinyin* index of all the names appearing in the book is especially handy. *The Almanac of China's Foreign Economic Relations and Trade*, published in English by the Ministry of Foreign Trade and Economic Cooperation, offers full texts of selected Chinese laws and regulations, statistical summaries of investment in 55 localities, and national foreign trade figures. Another Chinese government publication, the State Statistical Bureau's *China Statistical Yearbook*, is a gold mine of figures ranging from total horsepower of agricultural machinery used annually to basic demographic and industrial resource consumption figures.



Other Useful Works

As you might imagine, this category showed the most range. Given the lack of consensus, you receive the editor's choice. Starting with the most contemporary selection, *The Lonely Planet Guide to China* (Berkeley, CA: Lonely Planet Publications, 1994) is often referred to as the "backpacker's Bible," but can also be valuable reading for business travelers, especially those straying off the beaten path. Updated every few years, *The Lonely Planet Guide* was one of the first guidebooks on China and is probably still the most comprehensive. The book is great for independent travelers who don't understand Chinese, though some of the authors' comments can be annoyingly gratuitous.

Those who don't need a guidebook but are looking for something to read on those interminable trans-Pacific flights might like Perry Link's *Evening Chats in Beijing* (New York, NY: W. W. Norton & Co., 1992), a thoughtful account of the concerns of China's intellectuals post-Tiananmen. And, last but not least, no list of recommended China reading would be complete without Sun Tzu's *The Art of War* (Boulder, CO: Westview Press, 1994). This ancient Chinese text on military strategy is now probably more commonly studied in corporate boardrooms than in military institutions.

—PB

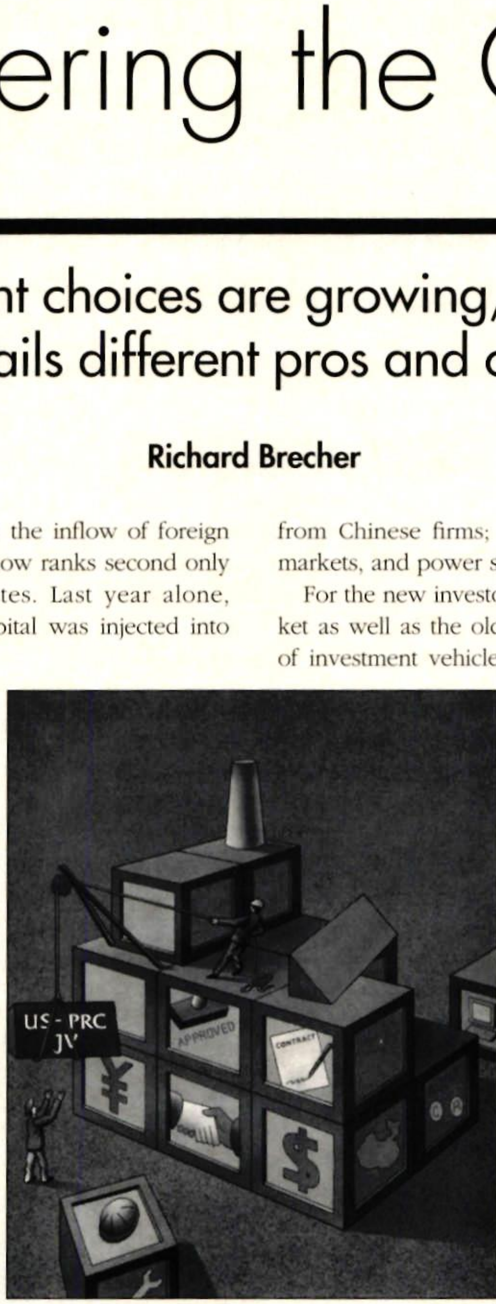
Considering the Options

Investment choices are growing, but each entails different pros and cons

Richard Brecher

From barely a trickle 10 years ago, the inflow of foreign direct investment (FDI) to China now ranks second only to that going to the United States. Last year alone, roughly $34 billion in foreign capital was injected into investment projects in China.

Despite this impressive figure, investing in China is not the same as investing in Peoria. Companies unfamiliar with China may be confused by the array of central, provincial, and local-level bureaucracies and the country's opaque regulatory regime. Adding to the uncertainty is a new, yet-to-be introduced investment policy that could have significant implications for the scope of future FDI in China. Nevertheless, any foreign company intent on reaching the vast PRC infrastructure market or wanting to take advantage of low production costs to manufacture goods for export is still likely to consider setting up one or more ventures in China, if it has not already done so. For those thinking of taking the plunge, choosing the right investment vehicle will be one of the first—and most important—decisions they make.



Once a foreign company decides to pursue a project in China, its choice of investment vehicle will depend on a broad range of issues, such as the project's compatibility with the PRC's national industrial plans, the size of the venture, the amount of capital and technology needed, and the project's overall purpose. In addition, businesses must consider factors such as protection of intellectual property rights; competition from Chinese firms; and access to adequate supplies, target markets, and power sources.

For the new investor just beginning to explore the China market as well as the old pro with multiple investments, the types of investment vehicles to choose from are expanding quickly. Currently, almost half of all contracted FDI in China is in the form of equity joint ventures (EJVs), although wholly foreign-owned enterprises (WFOEs), contractual joint ventures (CJVs), and other options are also permitted.

A first step

Although technically not considered a foreign-invested enterprise (FIE), a representative office (*dai biao chu*) is a quick and relatively simple way to become acquainted with the China market. Representative offices allow firms to establish contacts with key industrial ministries and begin to build their company's reputation in China. Chinese regulations restrict representative offices from engaging in direct "profit-making" activity, though, and PRC law precludes parent companies or their representative offices from receiving fees for services, signing contracts, or engaging in other activities that directly generate income in China.

A representative office can, however, conduct market research and and act as liaison to various Chinese commercial and State offices. Of the total 24,402 representative offices operating in China as of 1994, 3,802 were located in Beijing, 3,294 in Shanghai, and 6,918 in Guangzhou. Far fewer have been established in interior locations.

Though establishing a representative office is comparatively easy, a host of regulatory and start-up fees make them quite expensive to maintain. Until recently, representative offices were not permitted to hire local staff directly, but were forced

■ **Richard Brecher is head of the US-China Business Council's business advisory services.**

to recruit and hire employees on a contractual basis through the Foreign Enterprise Service Co. (FESCO), which pays the employees' salaries and provides English language courses. This indirect way of retaining labor has bred many problems for representative offices, not least of which are difficulties fostering loyalty to the firm and protecting confidential information. Although FESCO is supposed to contribute a portion of the representative offices' payments into health and unemployment insurance funds for the offices' employees, in many cases it has failed to do so, obliging conscientious representative offices to cover these benefits themselves. FESCO now allows representative offices to pay local hires directly, though technically it remains the employer.

In addition to high labor costs, representative offices must usually pay high rents, as they tend to be located in major cities where office space is in chronic short supply (*see The CBR*, March-April 1994, p.13). Representative office costs rose again January 1 this year when the Chinese Customs Administration, without prior warning, rescinded the offices' rights to import various types of office and personal equipment duty free. The newly imposed tariffs can be as high as 100 percent and extend to 20 types of "luxury" goods, including computers, photocopiers, fax machines, furniture, video and audio equipment, telephone equipment, calculators, typewriters, air conditioners, refrigerators, washing machines, and other items.

The popular choice

The most common form of investment in China is the equity joint venture (*hezi qiye*). A limited liability corporation with Chinese and other foreign partners, the EJV has legal-person status and can enter into contracts. By June 1994, foreigners had signed more than 127,000 EJV contracts, accounting for roughly 64 percent of all FIEs.

To set up an EJV, each partner contributes cash (in foreign currency or *renminbi*) and/or a combination of buildings, equipment, materials, intellectual property rights, labor, and land-use rights toward the venture's registered capital. The contributions are assigned a value during the initial negotiations and are used to determine the venture's equity split. If an EJV is dissolved, its profits, losses, and assets are distributed according to each partner's stake in the venture's registered capital. Registered capital cannot be withdrawn during the term of the contract.

Currently, a foreign company's share in the EJV must be at least 25 percent of total equity; there is no upward limit in most industries. Beijing's new investment

> Foreign investors seem to prefer EJVs because they provide long-term connections to the Chinese market.

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policy may change this practice, however, and may restrict foreign investors to varying minority stakes in industries deemed critical by the central government. Because foreign companies generally believe a partner's managerial control is proportional to the size of that partner's equity stake, foreign investors often prefer to hold a majority share in the venture. This correlation, however, is not necessarily valid. Regardless of the equity split, consensus management is the norm and, generally speaking, little can be accomplished without the support of the joint-venture partner.

The main law governing EJVs is the 1979 Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment (*see* p.12). The key implementing regulations of the law were published in 1983 and have since been augmented by hundreds of additional national laws and regulations addressing foreign exchange, labor management, taxation, import duties, trading rights, and land-use rights. Provincial and major municipal authorities have also issued parallel regulations for many of these matters. A 1990 update to the law specifies no maximum term of operation for EJVs, although most are granted 50-year terms. An EJV's term may be extended, however, pending agreement by all parties and the relevant Chinese approval authority.

Foreign investors seem to prefer EJVs because they provide long-term connections to the Chinese market. The EJV's ability to sell through the local partner's established marketing channels seems to be especially attractive to manufacturing businesses looking to penetrate the domestic market. In addition, the Chinese partner's vested interest in the long-term success of the venture may make him more willing to use his pull with local government officials to help the FIE. For its part, Beijing also favors this investment vehicle because EJVs usually involve significant technology transfer to the Chinese partner. Such ventures often receive special access to utilities and critical inputs, at least relative to other, less-favored investment vehicles, such as wholly foreign-owned enterprises.

Ventures with greater flexibility

Somewhat akin to EJVs are cooperative, or contractual, joint ventures (*hezuo qiye*)—business partnerships in which each party cooperates as a separate legal entity and bears its own liabilities. The two firms entering into a CJV also have the option of forming a limited-liability entity with legal-person status, similar to that of an EJV. Although the approval process for establishing CJVs and EJVs is the same, the primary difference between the two vehicles is that the CJV's profits and assets are shared as specified in the contract—not necessarily according to the percentage of each partner's share of total investment.

The 1988 Sino-Foreign Cooperative Contractual Joint Venture Law governs CJV activities and offers foreign investors wide discretion to organize and manage such ventures. No minimum (or maximum) foreign contribution is specified in the law, and there are no limits on the term or scope of the contract or prohibitions for withdrawal of registered capital during the term of the contract. Since de-

China's Key Foreign Investment Laws and Regulations

	Law	Date Promulgated	Drafting Agency
General	Law of the PRC on Joint Ventures Using Chinese and Foreign Investment; amended in April 1990	July 1979; implementing regulations issued in September 1983	State Council
	Provisions of the State Council for the Encouragement of Foreign Investment ("The 22 Articles")	October 1986; implementing regulations issued in 1986–87	State Council
	Provisional Regulations of the State Administration for Industry and Commerce on the Ratio of Registered Capital to Total Investment of Sino-Foreign Joint Ventures	March 1987	State Administration of Industry and Commerce (SAIC)
	Certain Provisions on Capital Contributions by Parties to Sino-Foreign Joint Ventures	January 1988	Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and SAIC
	Sino-Foreign Cooperative Contractual Joint Venture Law	April 1988	MOFTEC
	Law of the PRC Concerning Enterprises with Sole Foreign Investment (WFOEs)	April 1986; implementing regulations issued in December 1990	MOFTEC
Foreign Exchange	Provisional Regulations for Exchange Control of the PRC	December 1980	State Council
	Rules for the Implementation of Exchange Control Regulations Relating to Enterprises with Overseas Chinese Capital, Enterprises with Foreign Capital, and Sino-Foreign Joint Ventures	August 1983	State Administration of Exchange Control (SAEC)
	Provisions of the State Council on the Question of the Balancing of Foreign Exchange Receipts and Expenditures of Sino-Foreign Joint Ventures	January 1986	State Council
Labor	Regulations of the PRC on Labor Management in Joint Ventures Using Chinese and Foreign Investment	July 1980; implementing regulations issued in January 1984	State Council
	Labor Law	July 1994	Ministry of Labor
Taxation	Foreign Investment Enterprise and Foreign Enterprise Unified Income Tax Law	April 1991; implementing regulations issued in June 1991	Ministry of Finance (MOF)
	Value-Added Tax, Consumption Tax, and Business Tax Regulations	November 1993	MOF
Other	Opinion of Standards for Companies Limited by Shares	May 1992	State Economic Commission; implementing agency is the State Commission for Restructuring the Economy
	Company Law	December 1993	SAIC

Compiled by Kirsten Sylvester from US-China Business Council files tailed implementing regulations regarding CJVs have not been issued, these ventures have great freedom to structure their assets, organize their production processes, and manage their operations.

The flexibility of a CJV can be highly attractive for a foreign company interested in property development, resource exploration, and other production projects in which the foreign party incurs substantial up-front development costs. A CJV, for example, can build an accelerated return on its share of investment into the contract to allow it to recoup its equity share by the end of the venture's term. Moreover, CJVs can be developed quickly to take advantage of short-term business opportunities and dissolved when they complete their assigned task.

The lack of a firm regulatory framework can, however, hinder a CJV's operations. Until detailed implementing regulations are issued—which could be very soon, according to Council sources—CJVs will find themselves at the mercy of the local authority's interpretation of an acceptable scope of business. This means some CJVs may not be granted limited-liability status if the State Administration of Industry and Commerce (SAIC) judges them to be undercapitalized. And, if they are viewed as short-term or temporary investments, they may not receive adequate consideration by the Chinese authorities regulating access to materials, financing, and tax benefits.

Going it alone

A good number of investors forego investing with a Chinese partner in favor of establishing a wholly foreign-owned enterprise (WFOE, *waizi duzi qiye*). Governed by the 1986 Law on the PRC Concerning Enterprises with Sole Foreign Investment and the detailed implementing regulations issued in 1990, WFOEs are—as the name suggests—solely owned and operated by a foreign investor. They may or may not have legal-person status, and may or may not be organized as limited liability companies.

In a WFOE, the foreign investor receives all the profits and bears all the risks. The investor unilaterally decides on the make-up and operational features of the venture and need not worry about such problems as relations with a Chinese partner, redundant labor, or excessive demands for technology transfer. The 40,650 WFOEs approved by mid-1994 account for only about one-fifth of the total number of approved FDI contracts in China, although their number has grown steadily over time.

WFOEs have traditionally been viewed by Beijing as offering little in the way of technology transfer or other benefits to the PRC economy. In recent years, the relative attractiveness of this investment vehicle to the government has gradually increased. Beijing's support of WFOEs still trails far behind that given EJVs, but when domestic credit is tight, WFOEs provide China with a means of attracting foreign investment when Chinese firms cannot commit start-up capital.

> WFOEs are generally held to stricter foreign-exchange balancing requirements than equity joint ventures.

Because WFOEs operate beyond the control of a Chinese partner, however, investment approval authorities often hold them to a higher standard. Likewise, WFOEs are generally held to stricter foreign exchange balancing requirements. In some instances, notably the Motorola venture in Tianjin, the WFOE has been able to leverage Chinese demand for its high-technology products to reduce this export commitment and gain a higher degree of access to the domestic market.

Another problem encountered by many WFOEs is competition from Chinese authorities and ambitious local producers. If a WFOE is profitable, the Chinese government may encourage it to find a Chinese partner, in the hope of getting the foreign party to share its profits and pass along technological and management know-how. Or, a Chinese business may try to form a joint venture with another foreign party producing a similar good to compete with the existing WFOE.

Selling shares

A relatively new type of investment resulting from regulations passed in 1992 is the limited company (*gu fen you xian gongsi*), or enterprise limited by shares (*see The CBR*, January-February 1993, p.50). Limited companies have legal-person status and raise capital by issuing shares. Though similar in many ways to a traditional joint venture, the limited company has a supervisory board that elects the board of directors and managers who are in charge of the company's daily operations. Shareholders in the company determine the dividend paid on each share and decide when to issue more shares or bonds.

There are two basic types of limited companies—those that issue privately held shares and those that issue publicly traded shares. Which form the company will take depends upon the percentage of its shares held by the initial promoters, who must be legal persons. To set up a private limited company, the firm issues shares which it—or its sponsors—buys back; together the promoter and sponsors own all of the shares. Alternatively, in publicly traded limited companies, the promoters may purchase only 30-35 percent of the venture's shares and the balance is sold to the public at large.

If 25 percent of the company is foreign-owned, the venture is considered an FIE and is accorded preferential treatment. Foreign-invested limited companies require at least ¥30 million in registered capital and dividends are distributed in proportion to equity shares. Existing joint ventures may be converted into limited companies, pending approval by MOFTEC and the original approval authority.

Looking to the future

Companies anticipating making many investments in China should consider a relatively new option, the "holding" or "investment" company (*konggu gongsi*), a vertically integrated company established by firms that already have some presence in China. This type of FIE acts as a central holding company, overseeing such activities as the manufacture of products in China, the importation of goods for domestic sale, marketing, and sourcing of subsidiary company products, and training for management and staff subsidiaries. Investment companies are also

able to invest in subsidiary projects and provide after-sales support (*see* p.49).

Because investment companies are such a recent development, the legal framework governing their activities has been rather sparse. New regulations released at the end of April, however, should shed more light on the investment company option. To date, MOFTEC has exercised substantial discretionary approval authority over investment companies, and appears to have been experimenting with several different models to govern their operations. Problems or questions regarding the companies approved thus far have been handled on a case-by-case basis. MOFTEC reports that approximately 50 investment companies had been established in China by the end of 1994.

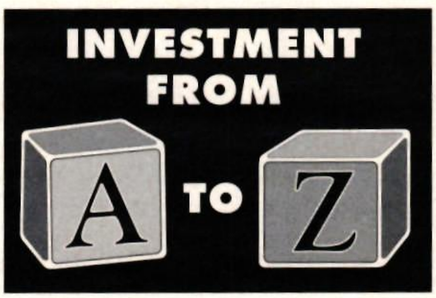
The increasing attention foreign firms are giving investment companies is a natural product of the expansion of investment activity in China. No longer are major multinationals concentrating on small $1-2 million joint ventures, or supervising their entire China sales operations through a tiny representative office headed by a 25-year-old Chinese history major. Rather, companies such as AT&T, IBM Corp., E.I. du Pont de Nemours & Co., and others are appointing high-level executives to aggressively expand their China business and invest in a coordinated series of multiple ventures. Investment companies are a means—albeit limited—for meeting these objectives within the context of China's limited legal structure.

Branching out

The final option a foreign business has for establishing a presence in China is to open a branch office (*fenzhi jigou*) of the foreign parent. A few sketchy paragraphs of China's 1993 Company Law lay out the framework for branch offices. An FIE can also open a branch office in another part the country to expand its operations in China (*see The CBR*, May-June 1994, p.52).

To date, only a handful of foreign banks and law firms have been approved to open and operate branch offices. These offices are limited to specified cities and their scope of business is highly regulated. Branch offices may ultimately offer a relatively simple means for establishing or expanding a presence in China, but the fact that they do not have legal-person status in the PRC means the foreign parent company is liable if civil charges are brought against the branch. To shield the parent company from unlimited damages,

MOFTEC reports that approximately 50 holding companies had been established in China by the end of 1994.



companies interested in establishing branch offices in China should designate an offshore subsidiary as the parent.

New policies ahead

As the above examples suggest, over the past 15 years China's investment officials have proven themselves flexible, pragmatic overseers with some sensitivity to the needs of foreign investors. Initially, these officials preferred EJVs over other types of investment and granted them preferential tax treatment and other incentives. Beijing has since expanded this special treatment to other investment vehicles and responded to changes in the country's development priorities by creating new forms of FDI. Beijing is now encouraging foreign investors to consider build-own-operate (BOO) and build-own-transfer (BOT) models, for instance, for large-scale infrastructure projects. Very few such projects are up and running, however, due in large part to difficulties working out financing and equity arrangements (*see The CBR*, November-December 1993, p.28).

To clarify government investment policy and eliminate confusion generated by the many changes in China's investment rules over the last few years, the State Planning Commission is preparing to release new documents on China's official foreign investment policies. These policies are expected to direct major projects in infrastructure (telecommunications, transportation, and water conservancy), "basic industries" (coal, power generation, chemicals, raw materials, iron and steel), "pillar industries" (electronics, machinery, automobiles, and construction), and high-tech and financial services into Chinese hands by imposing equity caps on foreign investment in these sectors. Most of the caps have yet to be devised, but will probably range from 30-49 percent. The new documents will also spell out requirements for research and development, local content, and export targets in certain sectors.

Central government officials insist that the measures are just a codification of long-standing practices, although the equity caps are indeed a new development. In many of the targeted sectors, large-scale foreign investment is a relatively recent phenomenon, and Chinese officials and foreign investors alike appear to be feeling their way through the problems that arise. As China develops its own experience in these sectors, however, it is reasonable to presume foreign participation may be restricted to minority positions.

The Chinese economy, after all, is—and will remain—a continental economy devoted to promoting industrial development and high growth. Although foreign investment is an integral part of this economy, it will remain subservient to China's overall economic goals.

How foreign investors respond to the new policies remains to be seen. Excess demands on the part of investment and industry officials may scare off some prospective investors, especially if the potential returns don't seem to justify the rising costs and risks. But if the past 15 years have been any indication, foreign investors will no doubt continue to seek out new opportunities in China. They can anticipate continued evolution of China's investment regime as Beijing shifts from investment promotion to investment management. Foreign investors should proceed with caution and should brace themselves for an interesting ride.

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Finding a Home

Foreign investors in China have access to a broad range of special incentives, depending on the location of their venture, the nature of the project, and how the enterprise is classified. A foreign-invested enterprise (FIE) located in an open coastal city or certified as technologically advanced, for instance, can be eligible for certain tax holidays and other benefits. In the early years of joint venturing in China, equity joint ventures generally received the most favorable tax treatment, but the tax regimes were unified for all forms of foreign direct investment in 1991.

Investment incentives in China still vary depending on locale and type of investment (*see* p.18). Foreign investors can negotiate for reductions in, or exemptions from, corporate income tax and withholding taxes on dividends. Depending on the type of venture or particular area in which the investment project is located, priority access to domestic financing may be available, along with reduced land-use fees.

Any foreign investor looking at opportunities in China needs to understand exactly which preferential policies may apply to a particular project. However, getting a firm handle on this is not always easy and local government officials—eager to entice foreign investment—may exaggerate the incentives in a particular locale. In recent years, the explosion of "special areas" has left many investors wondering how to choose one locale over another. Few of these "special" zones have been authorized to offer any preferential investment policies, however, and many have been shut down by Beijing.

China's bona fide zones include the Special Economic Zones (SEZs), Open Coastal Cities, Economic and Technological Development Zones (ETDZs), High-Technology Zones, Free Trade Zones (FTZs), and Open Coastal Economic Areas. Officials in each type of area are given varying latitude in the development of local investment policies with regard to approval ceilings, tax incentives, and other investment-related policies. Central government agencies are now considering measures that would extend investment incentives to foreign investors who choose to locate in China's interior. It remains to be seen if preferential policies would boost foreign investment in inland areas, where lack of infrastructure poses a disincentive to foreign activity. For now, China's official special investment areas include:

■ **Special Economic Zones** Four SEZs were announced in 1979 and formally established in 1980: Shenzhen, Zhuhai, Shantou, and Xiamen. Hainan Island was elevated to provincial status and designated the fifth SEZ in 1988. Initially established as experimental areas for economic reforms, the SEZs were also expected to attract export production facilities and generate foreign exchange. SEZs, which operate under the direct supervision of the central government, provide preferential tax policies and have considerable leeway to approve foreign investment projects at the local level.

■ **Open Coastal Cities** The following 14 port cities were designated open coastal cities in 1984: Beihai, Dalian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinghuangdao, Shanghai, Tianjin, Wenzhou, Yantai, and Zhanjiang. These cities were granted greater autonomy to approve contracts and offer special incentives, such as capped land-use fees, tax exemptions, and tax holidays. Each city was also permitted to establish an Economic and Technological Development Zone (ETDZ) to offer further tax reductions and holidays outside the city core.

■ **Open Coastal Economic Areas** Three special areas were so designated in 1985; the Pearl River delta and the area surrounding Guangzhou; the Yangtze River delta around Shanghai, including Suzhou, Wuxi, and Changzhou in Jiangsu Province and Jiaxing and Huzhou in Zhejiang Province; and the Southern Fujian-Min River delta, including Xiamen, Quanzhou, and Zhangzhou. In 1988, the Shandong and Liaoning peninsulas were added, extending the Open Economic Area concept to more than 260 cities and counties in China. These areas, which offer investment incentives similar to those available in the open coastal cities, are designed to integrate the high-growth export production industries of the coastal cities with raw material and component production in interior locations.

■ **Pudong New Development Area** Established in 1989, this 350 sq km zone across from the Bund in Shanghai offers many of the same investment incentives as an SEZ, and has been the site of intensive development and foreign investment over the past several years. Pudong itself is subdivided into four zones: the Lujiazi Financial and Trade Zone, Jinqiao Export Processing Zone, Waigaoqiao Free Trade Zone, and the Zhangjiang High-Tech Park. Over 4,000 industrial sites are currently under construction in Pudong.

■ **Free trade (or bonded) zones** These zones allow duty- and tax-free import and processing of goods for export. Established in coastal cities after 1990, these zones allow foreign trading, banking, and insurance providers to set up operations in their boundaries. As of June 1994, 13 free trade zones had been established in Dalian, Futian, Fuzhou, Guangzhou, Haikou, Ningbo, Qingdao, Shantou, Shantoujiao, Tianjin, Xiamen, Waigaoqiao, and Zhangjiagang. Foreign investors in these zones are eligible for many of the tax benefits available to SEZs or ETDZs.

■ **Other areas** Other special areas okayed by Beijing in recent years include 52 national development zones; 18 open provincial or regional capital cities; 11 State tourism and holiday zones; and 13 open border towns. These zones are authorized to extend preferential policies on par with the open coastal cities.

In practice, investors often find little distinction between incentives offered in different types of zones. Legal distinctions do exist, however, and special offers extended by local officials may be without legal support and subject to reversal in the future. If officials in one of the designated areas appear to offer incentives over and above what is listed in the accompanying table, the foreign investor should investigate the claims carefully before committing to a project.

—Richard Brecher

Major Tax Incentives for Foreign-Invested Enterprises in China's Special Investment Zones

	Nationwide	Special Economic Zones (SEZs) [5 areas]	Economic and Technological Development Zones (ETDZs) [30 areas]	Pudong New Development Area of Shanghai
"Manufacturing" Enterprise[1] Income Tax Rates:	30%	15%	15%	15%
Except for those in the petroleum, natural gas & rare metals sectors, manufacturing enterprises with terms of at least *10 years* qualify for tax exemptions for the first 2 profit-making years, followed by a 50% reduction for the next 3 years	Same	Same as nationwide. Infrastructure and agricultural FIEs with *15-year* terms in Hainan receive additional benefits	Same as nationwide	Same, but enterprises with *15-year* terms engaged in energy or transportation construction are exempt each profit-making year for 5 years and receive a 50% reduction for the next 5 years
Non-manufacturing "Service Industry" Enterprise Tax Rates:	30%	15%	15%	15%
Service industry enterprises investing over $5 million with terms of at least *10 years* qualify for tax exemption for the first profit-making year, followed by a 50% reduction for the next 2 years	No nationwide exemptions	Tax exemption the first profit-making year, followed by a 50% reduction for the next 2 years (7.5% tax rate). Additional incentives also may be provided	Tax exemption the first profit-making year, followed by a 50% reduction for the next 2 years (7.5% tax rate)	Same as ETDZs
Foreign Joint-Venture Banks or Branches (investing at least $10 million for at least *10 years*)	30%	15%, but tax exemption for the first profit-making year, followed by 50% reduction for the next 2 years	30% for bank representative offices; 15% for bank branches approved by the State Council	15%
Income Tax Rates for Enterprises Certified as Export-Oriented or Technologically Advanced	15% in any year they export more than 70% of their output	10% upon the expiry of income tax exemptions if an export-oriented enterprise; technologically advanced FIEs qualify for 50% reduction for 3 years after expiry of exemption (7.5% rate)	Same as ETDZs	Same as ETDZs
Income Tax Refunds For FIEs with Reinvested Profits	40% tax refund paid on profits reinvested or used to establish other enterprises for at least 5 years	Same	Same	Same
Local Income Tax Rates	generally 3% (10% of national tax rate), but often waived by the locality	0%, but subject to locality	0%, but subject to locality	0%, but subject to locality
Withholding Tax Rates				
On dividends, interest, and other non-earned income; on repatriation of profits	10% for US companies; 10%	10%; exempt	Same as SEZs	Same as SEZs

SOURCE: Compiled by Piper Lounsbury from US-China Business Council files

[1] A manufacturing FIE is engaged in: machinery manufacturing and electronics; energy (excluding production of petroleum and natural gas); chemical industry; light industries; medical industry; agriculture, animal forestry and husbandry; construction industry; scientific development; communications and transportation; and other industries determined by the State Council.

Open Coastal Cities [14 cities]	High-Tech Zones [52 areas]	"Bonded Zones" or Free Trade Areas (FTZs) [13 areas]	Open Coastal Economic Areas [260 cities and counties]
24%, but 15% if FIE is technologically advanced, investing at least $30 million, or investing in transportation or harbor industries	15%, but must be approved as high-tech enterprise	15%, but rate subject to to locality	24%, but 15% if FIE is technologically intensive, investing at least $30 million, or investing in energy, transportation or harbor industries
Same as nationwide	Enterprises with at least *10-year* terms are tax exempt for first profitable year and receive a 50% reduction for the next 2 years	Same	Same
24%	30%	15%, but rate subject to locality	24%
Same as ETDZs	Same as ETDZs	Same as ETDZs	Same as ETDZs
15%, but rate subject to State Tax Administration	15% approval by	15%	15%, but rate subject to approval by State Tax Administration
12% in any year FIE exports more than 70% of their output; technologically advanced FIEs qualify for 50% reduction for 3 years after the expiry of exemption (12% rate)	Same as ETDZs	Same as ETDZs	Same as Open Coastal Cities
Same	Same	Same	Same
0%, but subject to locality	0%, but subject to locality	0%, but subject to locality	0%, but subject to locality
Same as SEZs	NA	NA	NA

NA = Information not available

Getting Started

■ Sheila Melvin

A carefully chosen partner and a wisely negotiated contract can save time and money later on

■ Sheila Melvin, formerly a business advisory associate at the US-China Business Council, is now associate director of China operations in the Council's Beijing Office.

One of the most important decisions facing a foreign company that wishes to establish a joint venture in China is the selection of a local partner. In the first days of foreign investment in the early 1980s, foreign firms had little choice in this decision; the relevant ministry simply assigned the foreign investor a Chinese partner. Nowadays, however, foreign investors are free to find their own partners and negotiate contracts that meet their needs.

Although this new system is more flexible, it tends to be more complex. Joint-venture negotiations involve both technicians and senior management, are time-consuming, and, as a result, expensive for foreign companies. Market data is scarce and suspect even when available. Business statistics from the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the State Statistics Bureau, and other agencies are now usually available only for a fee, while efforts to conduct due diligence may engender bad feelings on the part of potential Chinese partners.

Thus, selecting the right partner can be difficult. But beginning the search is relatively easy, since virtually all Chinese companies are eager to attract the capital, technology, and tax breaks a foreign joint venture can provide. Foreign companies must take care when conducting their research and negotiations with potential Chinese partners, however, so as not to offend anyone along the way.

Furthermore, foreign investors should understand that they will not only be negotiating with their potential partners, but also with various local and central government agencies—players who might take issue with the foreign company's plans or choice of partner. While these and other factors may make the selection process arduous, companies that do their homework well can be confident that they will find a good match.

Narrowing the field

Before any foreign investor goes shopping for a local partner, it should have a clear sense of its long-term goals in China. For example, companies that want to set up export platforms will probably want a partner located close to a seaport or in a Special Economic Zone, since these areas offer exporters special import-export privileges (*see* p.17). If, however, the investor's goal is to sell the venture's output domestically, good distribution networks will be crucial to the success of the joint venture and the extent of a potential partner's market reach will therefore be very important. More significant, the Chinese partner must share the common business objective of penetrating the domestic market. The foreign-invested enterprise (FIE) could run into trouble if the Chinese side is intent on developing export markets for the products instead of marketing them domestically.

A company that wants to sell the FIE's products in China must also confirm that its Chinese partner possesses the physical means of distributing the product as well as the *guanxi*, or connections, required to sell it in other provinces. This said, however, a company should not place too much significance on a potential partner's *guanxi*. While good connections can certainly ease the process of establishing and maintaining a joint venture, *guanxi* alone will not assure the success of the project. More important than *guanxi* are fundamental indicators of the soundness of the Chinese company's core business operations, such as its sales records, assets and liabilities, and supplier networks. The foreign investor should therefore carefully examine its potential partner's financial statistics and major business associates.

Other factors to consider when selecting a partner include whether the firm has access to raw materials, skilled and unskilled labor, adequate electricity, and convenient transportation links. Less tangible factors may also affect a foreign company's choice of a Chinese partner. For example, if a company wishes to make a pharmaceutical product that requires a highly sanitized production area, it should select a partner located in an area with comparatively low levels of air pollution. If the joint venture will need expatriates on site, it should consider establishing its operations in a location with adequate housing and plenty of amenities, as it is generally difficult to attract expatriates to less-developed areas.

Finally, the selection process should not be rushed. Although a negotiator may feel pressure from his home office as well as the Chinese partner to conclude the negotiations, he should not act hastily. It is better to have no partner than to be stuck with a bad one.

Finding the right match

With these general caveats in mind, foreign companies wishing to find a good local partner should contemplate adopting the following tactics:

■ **Play the field** Smart companies look at a variety of potential Chinese partners before making a final choice. Avenues of introduction to Chinese companies include the relevant supervisory ministry, the China International Trust and Investment Corp. (CITIC), the Chinese Council for the Promotion of International Trade (CCPIT), trading companies, consultants, and US business associations. If the foreign company has its eye on a certain geographical area, it should ask the relevant ministry and local government authorities to provide introductions to potential partners in that region.

> In the Chinese partner's eyes, the contract is rarely the end-all agreement that Western firms expect.

The prospective foreign investor should also consider establishing a joint venture with a Chinese company outside its own industry. A Chinese enterprise in an unrelated field that is willing to assimilate the foreign company's technology and management expertise may be a better partner choice than a firm in the same product line that appears inflexible or is interested in the joint venture only as a source of capital.

A foreign company may also wish to establish a joint venture with more than one Chinese partner. Depending on the circumstances, a third, minor partner can compensate for any weaknesses the major local partner may have. Bringing in an influential government ministry, for example, can provide the venture with clout at the central level. Or, if the chosen partner lacks access to credit or foreign exchange, a financial institution might make a good partner.

■ **Seek truth from facts** A company should learn as much as possible about a potential partner by obtaining and then verifying detailed business statistics about the firm. The foreign investor should not hesitate to retain lawyers or accountants to investigate its Chinese counterpart and may want to hire a market research firm. A company can also contact the US Foreign Commercial Service and request a "Gold Key" search on the Chinese partner. The more accurate information the investor has, the more likely it will choose the right partner.

■ **Make sure the potential partner has the authority to joint venture** The foreign investor must be certain that its potential partner is allowed to engage in joint-venture activities. Many foreign companies have negotiated for months before discovering that their Chinese counterparts were never authorized to enter into a foreign-funded venture in the first place. To avoid this problem, the foreign investor should discuss its plans with local foreign trade and investment officials, including the commission on foreign trade and economic cooperation (COFTEC) and the local bureau of the appropriate industrial ministry (*see* p. 26).

■ **Proceed with caution** When looking for a suitable partner, a company must take care not to offend those Chinese companies it rejects. The foreign investor should not make promises it does not plan to keep. While it may want to conduct preliminary discussions with many Chinese enterprises, the foreign investor should not take negotiations to the brink of conclusion with several potential partners at the same time if the ultimate plan is to establish only one project. If a foreign company rejects a well-connected Chinese partner at a late stage, the company may find that it has alienated not only a potential partner, but also powerful players within the industry.

On to the negotiating table

Once a prospective foreign investor has found a suitable partner, it is time to begin negotiating the joint-venture contract. Westerners should realize, however, that in Chinese eyes, the contract really represents an agreement to begin a project, the details of which will be negotiated throughout the course of the project's life—the contract is rarely the end-all agreement that Western firms expect. Nevertheless, companies should take negotiations, even preliminary negotiations, seriously; though details may be revisited, it is difficult to deviate from a term of reference once it has been established.

When negotiations begin, the foreign investor's team (which might consist of only one or two people) might find itself facing 15-20 representatives from a number of interested parties on the Chinese side. In addition to the potential partner, these could include officials from the local government, the relevant ministry, MOFTEC or its local branch, and a bank or financial association. The foreign company should seek to understand what each party participating in the negotiations hopes to gain from the transaction, as well as each organization's relative level of influence over the project.

In addition to understanding the parties involved, the foreign investor must pay special attention to its own negotiating team. First, the foreign investor should maintain a consistent team throughout the negotiating process to save time and prevent the Chinese from reinterpreting for a new team matters that had already been settled during previous negotiations. Second, the negotiators should be familiar with the full range of commercial and technical issues to be discussed, and should have authority to make decisions on behalf of the US company. Third, the foreign investor should not send a CEO or similarly high-level employee to conduct the initial negotiations. As the status of the representative who makes the initial contact is very important to the Chinese, sending a high-ranking employee early on would convey the foreign investor's desire to produce results quickly, and could be seen by the Chinese partner as a sign of weakness that can be taken advantage of. Participation of senior employees—such as paying a courtesy call to a high-level Chinese official—may be useful if the negotiations run into trouble, but should be saved as a trump card.

Aside from maintaining a consistent negotiating team, a foreign company must accommodate for differences between US and Chinese negotiating styles. Some of these differences are cultural, though others are tied to specific objectives (*see The CBR*, March-April 1993, p.13). The desire to sign a memorandum of understanding (MOU) even before the agreement has been reached, for example, usually reflects the Chinese partner's desire to show something concrete to higher levels of authority. The document can also be used as a negotiating tool, however, and the Chinese side may later attempt to hold the foreign party to the general spirit of cooperation embodied in the MOU.

To make sure the two sides are in tune with each other, the foreign investor needs to keep on his toes—and take good notes throughout all discussions. The foreign investor should always bring his own interpreter, who must be well versed in the legal and business terminology necessary to carry out discussions and draft the contract. As the joint-venture contract will likely be written in both English and Chinese, a bilingual lawyer should verify that both versions of the contract are accurate and binding.

> Export amounts should be written as targets, not guarantees, and each target should be qualified as much as possible.

While the Chinese may not see the contract as the formal end to the negotiations, they do view a contract as a legal document with the weight of law behind it. Companies should therefore be careful to spell out all details—no matter how trivial—in the joint-venture contract. Failing to pay attention to the specifics can come back to haunt the venture after it is up and running. Specifically, the foreign company's negotiators should:

■ **Make certain the Chinese partner is a "legal person"** To enter into a contract, an enterprise must be considered a legal person under Chinese law. As Chinese business licenses indicate whether the holder is a legal person, a foreign investor can request a copy of its Chinese counterpart's business license at the beginning of the negotiating process to ascertain the enterprise's standing.

■ **Avoid being tied to a rigid export commitment** The Chinese are likely to insist that the venture export at least some of its product in order to generate foreign exchange. Under no circumstances, however, should a foreign company commit to exporting a specific amount of the venture's output. Export amounts should be written as targets, not guarantees, and each target should be qualified as much as possible. A foreign investor can insist, for example, that the contract stipulate that the venture will "strive to export" a set percentage of the product "if market conditions permit."

■ **Use a third party for asset valuation** Asset valuation can be one of the trickiest aspects of joint-venture negotiations. Foreign companies often believe that the Chinese counterparts overvalue their contributions to the joint venture. The Chinese side, on the other hand, frequently thinks that foreign partners nickel-and-dime them in an effort to reduce the value of the Chinese contribution.

To avoid disagreements over valuation matters, all partners must agree on the criteria to be used to value the parties' contributions and who will perform the valuation. Article 25 of China's Joint-Venture Law Implementing Regulations states that the assets contributed to a joint venture may be valued through consultation between the joint-venture partners, or by a mutually agreed-upon third party. Rather than squabble with their Chinese partners, most American companies prefer to avail themselves of a third-party assets valuer. Typically a large international accounting firm, this third-party valuer may not be the Chinese partner's preference, but will usually be accepted.

As for valuation criteria, the foreign party should insist that the Chinese partner's assets be valued in Chinese currency rather than in dollars, and that the valuation reflect local conditions. The foreign side should not allow its Chinese counterpart to value its assets, raw materials, and labor on the basis of what they would cost in Hong Kong or Taiwan, as all of these costs are likely to be far higher outside of China.

■ Stipulate as many details as possible During a long negotiation, the temptation to skip over details relating to logistics, sourcing, distribution, and other aspects of FIE operations is great, but should be avoided. One American company, for example, established a joint venture in China's interior and accepted its partner's assurance that transporting raw materials in bulk containers would present no difficulty. The company soon discovered, however, that its containers were too big for China's freight trains and thus had to find an alternative means of packaging the materials at considerable expense. To be on the safe side, prospective investors should try to double check and verify any claim made by the local partner, and then be sure to spell out each party's obligations in the contract.

■ Protect intellectual property Intellectual property issues must be monitored closely during the negotiation process and throughout the life of the joint venture. When a foreign company submits a technical proposal, it is immediately translated into Chinese. In some cases, the information might be disseminated improperly. One American executive saw his company's confidential proposal in the hands of Japanese competitors just five days after he had given it to the Chinese ministry involved in the negotiations.

The foreign partner might need to transfer technology to local vendors to ensure input quality.

To avoid such problems, the foreign investor should specify the terms of the technology transfer in the joint-venture contract. He may also want to try transferring basic technology first, and bring over more advanced technology only when he is confident his partner will honor its commitments. The foreign investor should also ensure that its technology is registered and patented in China (*see The CBR*, March-April 1995, p.12).

■ Hedge bets on sourcing A Chinese partner is likely to insist that a high percentage of inputs and components be sourced in China. While sourcing locally usually lowers production costs over the long term, it may not always be possible to obtain the necessary quality and quantity of inputs. Therefore, it is wise to commit to source locally only "when feasible." And, if the enterprise decides to develop a local sourcing network, the foreign partner should be aware it might need to transfer technology to local vendors to ensure the quality of locally available inputs.

Disputes can be resolved

Perhaps the most important thing to remember about business in China is that almost everything is negotiable. If contract negotiations seem to be at an impasse, bear in mind that the Chinese propensity to build consensus will likely work to the foreign investor's advantage. To protect against future disputes between partners, however, the foreign investor must be careful to cover as many details as possible in the contract. The contract should also spell out how disputes are to be handled by specifying which arbitration body, if any, will be used to resolve their differences (*see* p.45).

Many foreign investors are now finding that their Chinese counterparts are far more adept at negotiating investment contracts than before. In the 1980s, even small modifications to joint-venture contracts inevitably caused extensive delays. Today, Chinese companies themselves may ask for changes, and modifications requested by either side need not bring the negotiations to a halt. Nevertheless, foreign investors should remember that creating and operating any joint venture is very much a team effort, and that negotiating a contract, like aging a fine wine, takes time. Most of all, investors should try to cover all bases during the negotiation phase; though there is no guarantee that a particular venture will succeed, a good contract will at least lay the foundation for a cooperative relationship. 完

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Signing on the Dotted Line

■ Daniel Martin

Bureaucratic hurdles demand the patience and attention of prospective foreign investors

After coping with the rigors of finding the ideal partner and negotiating a sound contract, a foreign investor might think the worst is behind him. The fact that more than 20 different chops, or official seals, might be required for his project to receive final approval thus might come as a shock. For the most part, though, the basic procedures for obtaining these approvals are easy to follow. While the approach in Chengdu might differ slightly from that in Shenyang, investments in almost all localities must undergo the same five-step approval process: project proposal, letter of intent, feasibility study, contract and articles of association, and business license. Foreign investors nevertheless need to budget the time and resources to navigate this process and get their China ventures off to a good start.

Approval bigshots

From the outset, a foreign investor needs to determine all of the players likely to be involved in the approval of his project. Generally, the size and location of the venture will dictate which agencies the foreign investor must contact for approval. While all investment projects will inevitably include local authorities to some extent, State Council rules mandate central-level involvement in many cases. Though the roles of certain agencies will depend on the nature of the project (*see* box), the following players are most commonly involved in the approval process:

◆ **Ministry of Foreign Trade and Economic Cooperation (MOFTEC)** If a project will exceed $30 million in total investment or if the investors intend to establish a holding company, approval from MOFTEC in Beijing will be necessary. In most towns, local MOFTEC bureaus, referred to as commissions on foreign trade and economic cooperation (COFTECs), are able to approve projects with a total investment value of less than $10 million, while COFTECs in most major cities can approve projects up to $30 million. Tianjin and Shanghai authorities have claimed that they are permitted to approve projects up to $50 million, though investors should be sure to verify this with MOFTEC.

If a project's total investment exceeds $100 million, the State Council must approve it, and the project usually must be incorporated into a national five-year plan. Approval from several central-level agencies, such as the State Planning Commission and/or the State Economic and Trade Commission, will likely also be required.

◆ **COFTECs** At the local level, foreign companies deal primarily with the local COFTECs, which are directly subordinate to MOFTEC in Beijing. If a deal is under the local approval threshold, the local COFTEC or its equivalent will review all of the relevant documents and issue the

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final approval. COFTECs are also sometimes known as local trade bureaus or foreign investment offices. Because of slight name variations, prospective American investors should verify with other foreign investors in the locality, the US embassy in Beijing, or regional US consulates that they are dealing with the right agency and not with a Chinese consultant.

Increasingly, foreign investors find that local authorities—including COFTEC officials in some cases—seek to bend the rules to keep approvals at the local level regardless of project size. Eager to get foreign ventures operating quickly, approval officials in a given locality may be reluctant to notify Beijing about large investments because they fear central authorities will determine that a particular project would be more suitable in a different location. Local officials may suggest that projects over $30 million be split into several phases or might encourage the foreign investor to set up several smaller operations that can be merged later into one large entity. Such evasion tactics may cause considerable trouble, however, and foreign investors should be careful to include MOFTEC and other central-level authorities in the preliminary discussions for any large project (*see The CBR*, January-February 1995, p.8).

◆ **"One-stop chop shops"** In some larger cities, the local government has established a single agency to move a foreign investment through the proper government channels and procure all necessary chops. Perhaps the best known one-stop shop, the Shanghai Foreign Investment Commission, will facilitate the entire approval process for a slight—sometimes negotiable—fee based on the size of the project. In most cases, one-stop shops work closely with the local COFTEC; the head of these commissions is usually also a senior COFTEC employee. In both Chengdu and Wuhan, for example, COFTEC officials have established Foreign Investment Service Centers that function much like the Shanghai Foreign Investment Commission. Investors are not required to use these one-stop shops, but should realize that the local COFTEC often has a financial stake in them and thus may push companies to use their services.

While paying a fee to a government agency to perform its routine duties may appear unethical, foreign companies report that the use of such offices can minimize the hassle of dealing with each local authority involved in the approval process. A notable upside to using a one-stop shop is that these offices are usually well connected with the local bureaucracy. The Shanghai Foreign Investment Commission in particular is noted for its ability to cut through layers of red tape. The downside to these offices is that foreign users of their services will not gain exposure to agencies with which they likely will be dealing at a later date.

The local planning commission typically regulates access to scarce resources such as coal, electricity, and water.

◆ **Local planning commission and local economic commission** Depending on the nature of the proposed venture, the local planning commission or the local economic commission reviews the initial project proposal submitted by the Chinese partner and, in consultation with the local industrial bureau, grants preliminary approval to a venture. Upon approval, the commission issues a supporting document (*lixiang*) to the Chinese partner. In addition to granting approvals for project proposals, these commissions advise the Chinese and foreign partners on the availability of resources in a given locality. The local planning commission typically regulates access to scarce resources such as coal, electricity, and water; the local economic commission focuses more on service-sector requirements.

◆ **Various industrial bureaus** Almost all industrial sectors in China are regulated by one or more central-level ministries. Each ministry maintains bureaus at the provincial and municipal levels. The legal documents for an investment project refer to the various industrial bureaus as "the appropriate department(s) in charge." The department in charge of a pharmaceutical plant, for example, might be the local bureau of the Ministry of Public Health. A department in charge of a computer company would probably be the local bureau of the Ministry of Electronics Industry.

These bureaus serve as liaison to other agencies under whose authority the proposed venture falls. Typically, officials from these bureaus review the initial project proposal, though in some cases this authority passes to the central ministry. The local bureaus also administer the applications for export-oriented and advanced technology certification.

◆ **Local administration of industry and commerce (AIC)** These local bureaus, offshoots of the State Administration of Industry and Commerce (SAIC) in Beijing, are responsible for issuing business licenses to all enterprises in China. The local AIC can also confirm that a prospective local partner is a bona fide, registered Chinese company. While the issuance of a business license is usually a routine matter once the proper paperwork has been filed, some investors have been known to encounter difficulties. Investors should be aware that the local bureau can revoke a project's business license if any party involved in the deal fails to invest its capital according to the capitalization schedule specified in the contract.

◆ **Local administration of exchange control** This agency, under the aegis of the State Administration of Exchange Control (SAEC) in Beijing, has recently become more involved in the investment approval process. Under a new system established in 1994, each foreign-invested enterprise (FIE) is given a "Foreign Investment Enterprise Foreign Exchange Registration Certificate" (*waishang touzi qiye waihui dengji zheng*), which entitles the venture to foreign exchange drawing rights on an annual basis. This certificate governs each project's access to hard currency and is required for any bank transaction involving foreign exchange. As FIEs are responsible for balancing their own foreign exchange, prospective investors should meet with this bureau during the approval process to determine local policy on foreign exchange balancing. The SAEC branches will likely continue to be key players in the approval process even if the government eventually eliminates swap centers and expands the interbank trading system.

Making the grade

Once the foreign company has identified all the players in the approval process, it can begin the application process. The steps in the approval process occur roughly in the following order and include:

■ **Project proposal** The first step in the approval process is preparation of a proposal outlining the Chinese entity's plan to seek foreign investment. The proposal should specify the need for foreign investment and detail the type of foreign technology sought. The prospective Chinese partner submits this document to its "department in charge." An FIE proposal to manufacture telecommunications equipment, for example, may require approval from the Ministry of Posts and Telecommunications and/or the Ministry of Electronics Industry.

Though foreign investors rarely play an active role in drafting and gaining approval for the project proposal—a general document without many specifics—they should be sure to verify that the project proposal has been approved by the local planning commission before engaging in final joint-venture negotiations. To verify approval at this stage, foreign investors may request a copy of the Chinese company's *lixiang*. Even if the proposal is not yet approved, it is still possible to begin negotiations, but foreigners should wait until pre-approval is granted before tackling detailed discussions. Once a project appears on an official project list circulated by local or provincial officials, foreign investors can feel fairly confident that pre-approval has been granted—but the *lixiang* itself is the only sure way to verify this.

In most cases, approval of the project proposal is routine, and serves mainly to inform local authorities about factories that are seeking foreign investment so that these investments can be incorporated into commission plans. Local government agencies may also use this information to direct foreign investors to what they consider "appropriate" partners.

For large projects—and, in some cases, for smaller projects—a "pre-feasibility" study or outline of the project must be

Approval Makers and Breakers

While approvals from the local commission on foreign trade and economic cooperation (COFTEC) and the local administration of industry and commerce (AIC) are required for all projects, investors may need to seek approval from or consult with other agencies, depending on the exact nature of the proposed foreign-invested enterprise (FIE). These agencies include:

Local tax bureau Early on in the investment approval process, foreign companies should visit the local tax bureau—a local branch of the State Tax Administration (STA) in Beijing—to determine their project's applicable tax rate. Tax rates, which vary widely and can be negotiated, are likely to be an important factor in determining the optimal location to establish a greenfield project. Foreign investors should request a letter from the tax bureau or a binding ruling, if possible, to fix the project's tax rate at the negotiated level. This rate can then be cited in the feasibility study and contract.

Local land administration bureau If the project involves the transfer of land-use rights, the foreign investor is certain to encounter this office, which is the local branch of the State Land Administration. The land administration bureau is responsible for administering land-use certificates, which are similar to the property deeds issued in the United States. Because an annual land-use fee is charged for the right to use land, communication with this bureau is necessary to determine the overall cost of the project.

Local labor bureau Subordinate to the Ministry of Labor, this bureau is not directly involved in approving most foreign investments, but can provide useful advice on appropriate wage levels for a given industry and location. This bureau also grants permission to joint ventures or wholly foreign-owned enterprises to terminate or transfer Chinese employees.

The local labor bureau can usually inform the investor about the required contributions to employee pension, disability, and medical insurance funds. Labor bureaus throughout China are also starting to play a larger role in the formation of the country's social security system, which eventually will require the full participation of FIEs and all other companies in China (*see The CBR*, November-December 1994, p.46).

Local Customs bureau Almost all FIEs will need to import raw materials or, at the very least, office equipment. While some items can be imported duty free if they are part of the foreign party's capital contribution to the project, foreign investors should still confirm this with the local Customs bureau.

Local auditing bureau In general, the local auditing bureau seeks to ensure through consultations with the COFTEC that the Chinese party to a joint venture is not being cheated. Recently, MOFTEC and officials in the State Auditing Administration have expressed concern that too many foreign investors in joint ventures have been inflating their capital contributions and under-rating the contribution of their Chinese partners. The problem is particularly acute with respect to land valuation, as few guidelines exist for land pricing. Aside from re-assigning land valuations, this bureau can also take action when it believes that machinery and technology contributed by the foreign party is overvalued or lacks proper documentation.

One US joint venture in Sichuan, for example, encountered a frustrating lag in negotiations when the auditing bureau decided that the assessment value of the US company's equipment was too high. After months of negotiations, the bureau finally accepted a signed statement from the US company's president, who guaranteed that the equipment would perform as indicated in the contract or else his company would replace the malfunctioning equipment. In light of this example, including the auditing bureau in the negotiating process seems crucial to avoiding surprises just prior to finalizing the contract.

—Daniel Martin

prepared by the Chinese party and submitted with the project proposal to approval authorities. Depending on the locality, the pre-feasibility study is approved by the local planning commission or by the local COFTEC. If the project size exceeds the approval authority of local officials, the pre-feasibility study will be passed to MOFTEC and the State Planning Commission.

■ Letter of intent Immediately prior to submission of the project proposal or just after it is approved, both parties to a prospective joint venture often co-author a one- to two-page letter of intent or memorandum of understanding. This document, though not required or legally binding, lays out the basics of the planned investment and provides a foundation for the subsequent feasibility study. The letter should specify the venture's intended investment, business scope, equity shares, special inputs, foreign exchange requirements, and intended markets.

As foreign companies explore their options thoroughly and meet with prospective partners, they may find that a potential Chinese partner insists on a letter of intent since local authorities will not approve the project proposal unless a foreign party has demonstrated sufficient interest in the project. Insistence on such a letter might also signal, however, that the project lacks high-level support within the locality. Or, the Chinese side may insist on a letter of intent to determine whether the foreign party is truly interested in working cooperatively or is merely investigating possible opportunities. In general, Chinese tend to place more importance on the letter of intent than their foreign counterparts, and may try to construe the document as legally binding. Foreign investors must therefore take appropriate precautions when drafting the letter.

■ Feasibility study After the letter of intent has been drafted, both partners prepare and bear the costs of a feasibility study that informs the local planning commission of the proposed project's needs. The Chinese party may say that the joint feasibility study, which is not legally binding, is only a formality that need not involve the foreign partner. The foreign investor should insist on playing an active role in developing the study, however, since it will form the basis for other critical documents, including the joint-venture contract and the articles of association.

Both partners prepare and bear the costs of a feasibility study that informs the local planning commission of the proposed project's needs.

Preparation of the feasibility study is no small feat, and can serve as a test of compatibility between potential partners—if the parties cannot work together at this stage, then there is little chance they will be able to work out the lengthy details of the joint-venture contract. In some cases, a third-party consultant will assist the partners in conducting the study. After several agencies review the study—a process that can take up to two months—the local planning commission will either approve the study or return the documents for modifications.

The feasibility study should contain at a minimum the following elements: names and equity shares of the partners involved; specification of the product(s) to be produced; the venture's location and scope; the volume of production; the target market and basic market research information; need for loans; the technology to be used; land-use requirements; environmental impact assessment; raw material costs; labor requirements; expected return on investment; and expected taxes, tariffs, and fees. If the joint-venture partners seek to claim technologically advanced or export-oriented status for income tax purposes, this should also be stated in the study. It is essential that the foreign investor verify in the early stages of negotiation that its Chinese partner shares its views on these basic points.

Foreigners should be wary, however, of including in the feasibility study pricing and monetary figures, because Chinese companies may later try to hold the foreign partner to these figures. Inflation in most of China's major cities is currently running at more than 20 percent, and since there is always a time lag between completion of the feasibility study and project start-up, it is extremely difficult to predict actual project costs.

The feasibility study will be reviewed first by the Chinese partner's "department in charge" and the local planning commission, and then shared with relevant local agencies. Since each local agency will budget resources for the joint venture based on the specifics of the feasibility study, it is important to articulate the joint venture's resource needs as accurately as possible in the study.

Wholly foreign-owned enterprises (WFOEs) must file a less detailed feasibility study with MOFTEC or the local COFTEC that includes: the location and scope of the enterprise, goods to be produced, raw materials required, technology to be used, and overseas and domestic sales projections.

■ **Contract and articles of association** Once the feasibility study is approved, parties begin to undertake the most arduous step in the approval process: preparation of the contract. The contract, which lays out the entire structure of the joint venture and the rights and obligations of each partner, requires approval from the local COFTEC or, for projects over $30 million, from MOFTEC.

Generally ranging in length from 80-130 pages, the contract must include the names, countries of registration, and legal addresses of the parties and their legal representatives; the name, address, purpose, and scope of the proposed venture; the language(s) of official correspondence; the total amount of the investment and registered capital; the amount and breakdown of each partner's capital contribution; each party's time limit in paying registered capital; and the ratio of profit distribution. With respect to personnel, the contract must include the composition and powers of the board of directors; the powers and method of hiring the manager, deputy manager, and other senior employees; and labor management, welfare, and insurance information.

The contract should also stipulate the type and source of equipment and technology to be used; the method of purchasing raw materials and selling finished products; the ratio of products to be exported to those sold on the domestic market; land or building sites to be used; foreign exchange balancing methods; insurance provisions; assignment of taxes, tariffs, and fee provisions; finance, accounting, and auditing measures; confidentiality clauses; dispute resolution procedures; force majeure provisions; merger, acquisition, and dissolution provisions; and liquidation procedures.

Projects approved in a hasty manner are apt to run into costly delays later.

To ease the burden of drafting an entire contract from scratch, MOFTEC provides a standard model contract to potential investors. While using the model contract's format facilitates the local COFTEC's review of the proposal, it is wise to bolster several of the provisions in the model, which dates back to the mid-1980s. Of particular concern are the model contract's weak foreign exchange balancing provisions.

WFOEs involving a single foreign company are not required to draft a contract, but must submit to the local COFTEC an application containing much of the information covered by joint-venture contracts. If the WFOE involves two or more foreign companies, the contract between the companies also must be submitted to the local COFTEC. The exact information required on the application is listed in Article 15 of the WFOE Law Implementing Regulations.

A corollary to the contract, the articles of association, is usually drafted simultaneously with the contract and must include such basics as the venture's name, address, business scope, and board of directors. These requirements are spelled out in detail in Article 16 of the Joint Venture Law Implementing Regulations and Article 16 of the WFOE Law Implementing Regulations. All equity joint ventures and WFOEs are required to submit articles of association. Contractual joint ventures may forego this step if there is no separate business entity created by the parties.

Once the drafts of the contract and articles of association have been finalized, they are submitted to the relevant approval authority along with an application for approval, the approved feasibility study report, and a list of the board of directors. The local COFTEC must decide within three months whether to reject the documents or issue final approval. In many cases, before issuing final approval, the COFTEC will require minor changes in the contract on issues such as land-use provisions, debt and equity stipulations, and asset valuation.

■ **Business registration** When the contract and articles of association have been approved, the foreign investor has 30 days in which to submit several documents to the local AIC to register the venture and receive a business license that outlines its scope of operations. An FIE must possess a business license before it can engage in any business transaction.

The documents that must be submitted to the local AIC include an application for approval (obtained from the COFTEC or AIC); the project approval document issued by MOFTEC/COFTEC; the project proposal, feasibility study, contract, articles of association, and all accompanying approval documents; applicant credit information; and a final list of board members. A processing fee—usually 0.1 percent of the venture's registered capital—must be posted when the documents are submitted. Within 30 days, the local AIC will issue a business license valid for the duration of the venture.

The business license may be revoked if an investor fails to inject registered capital as outlined in the contract. The local AIC may also revoke the license if the venture fails to begin operations within six months of receiving the license or if the venture ceases operations for more than one year at any time during the project term. Because FIEs that operate outside their approved scope risk fines and revocation of their licenses, investors should try to specify a broad a range of activities under the "business scope" section of the contract and articles of association.

Don't hold your breath

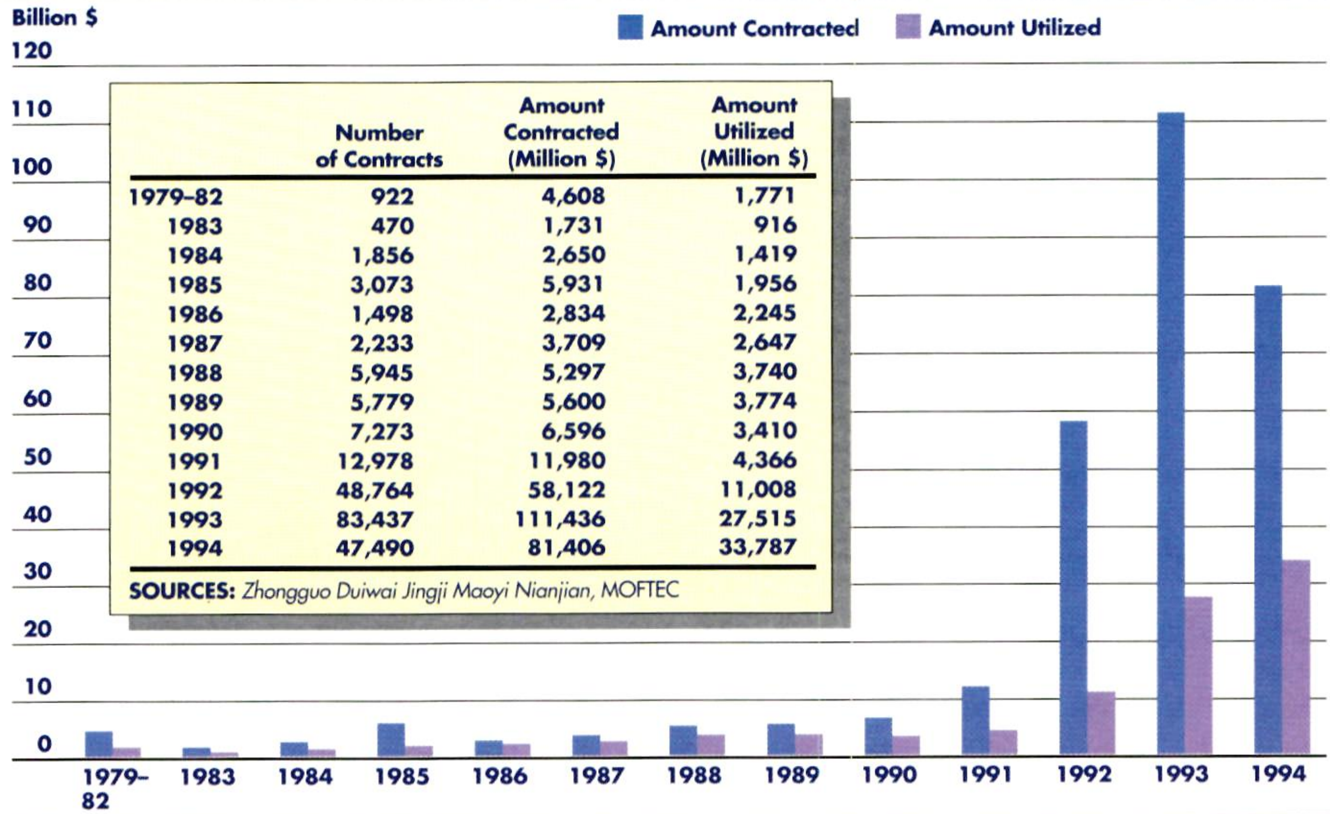
The entire investment approval process, from investigating partners to receiving a business license, usually takes at least 18-24 months. While it is possible to gain approval for a project in a matter of weeks, projects approved in a hasty manner are often poorly structured and are apt to run into costly delays once the venture gets under way.

Shrewd foreign investors often try to speed the approval process along by negotiating several steps simultaneously. For example, investors may draft a proposed contract while the feasibility study is underway. By working on several steps at any given time, the foreign investor ensures that each government agency is aware of the project early in the process, minimizing the chances that a particular player will voice objections later.

Some companies simultaneously negotiate multiple joint-venture deals in different locations in China.

Another way that foreign investors maximize the use of their resources is to adopt an investment strategy similar to that of a Japanese *keiretsu*. These conglomerates negotiate multiple joint-venture deals in different locations. When negotiations stall in one locality, they divert resources to more promising projects. Because risk is spread across numerous projects, the foreign investor need not rely on any single project and thereby gains leverage in all contract negotiations. E.I. du Pont de Nemours & Co., for instance, had only two China investments approved in 1990. Just four years later, according to press reports, Du Pont Chairman Edgar Woolard indicated that his company had 28 joint ventures under simultaneous negotiation in China. 完

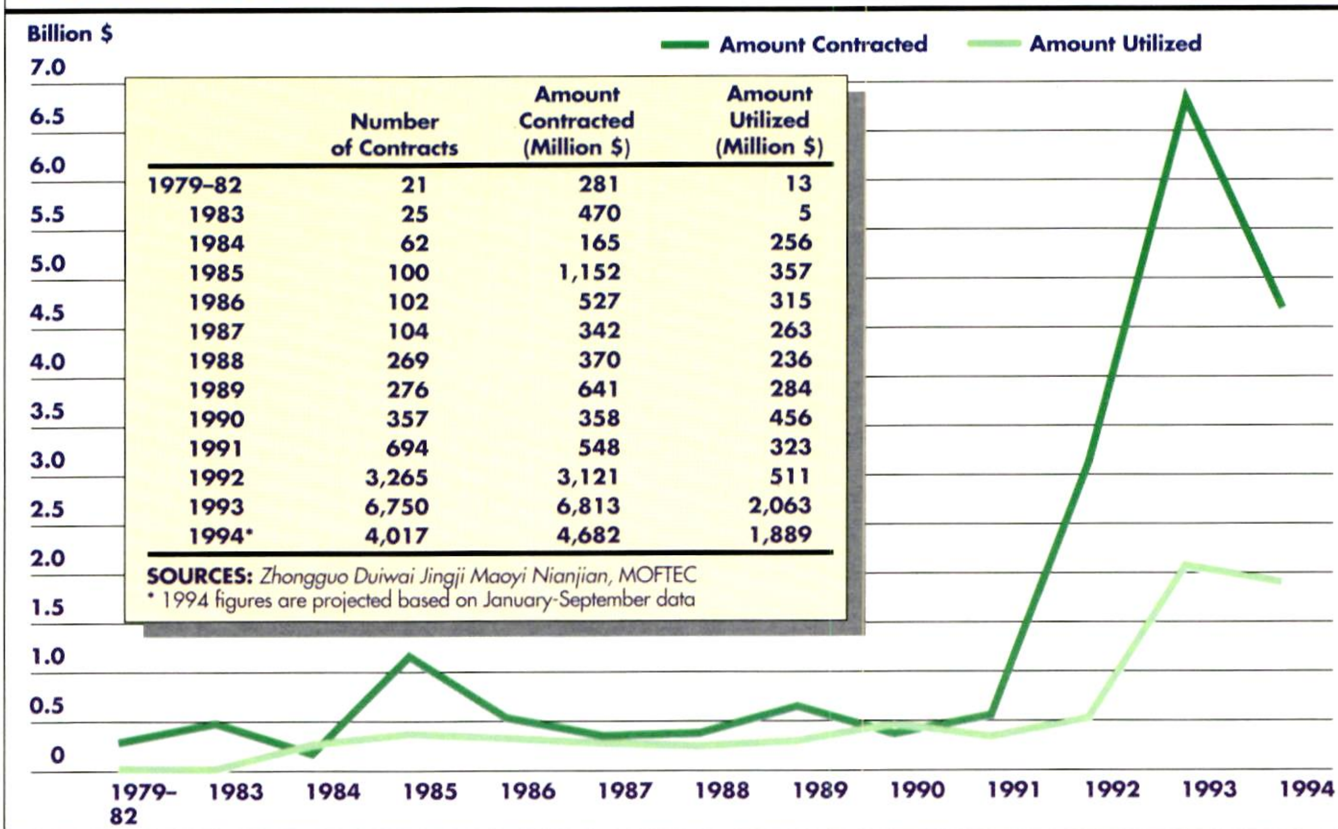
Total Foreign Direct Investment in China



	Number of Contracts	Amount Contracted (Million $)	Amount Utilized (Million $)
1979–82	922	4,608	1,771
1983	470	1,731	916
1984	1,856	2,650	1,419
1985	3,073	5,931	1,956
1986	1,498	2,834	2,245
1987	2,233	3,709	2,647
1988	5,945	5,297	3,740
1989	5,779	5,600	3,774
1990	7,273	6,596	3,410
1991	12,978	11,980	4,366
1992	48,764	58,122	11,008
1993	83,437	111,436	27,515
1994	47,490	81,406	33,787

SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC

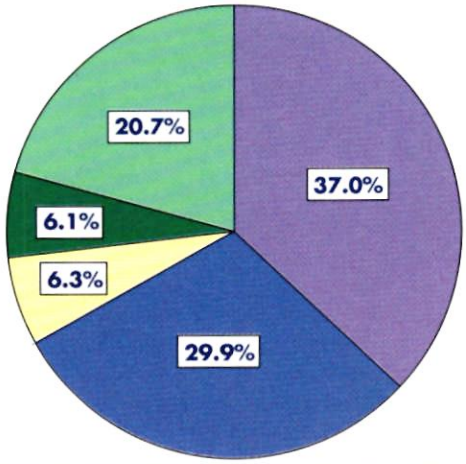
US Direct Investment in China



	Number of Contracts	Amount Contracted (Million $)	Amount Utilized (Million $)
1979–82	21	281	13
1983	25	470	5
1984	62	165	256
1985	100	1,152	357
1986	102	527	315
1987	104	342	263
1988	269	370	236
1989	276	641	284
1990	357	358	456
1991	694	548	323
1992	3,265	3,121	511
1993	6,750	6,813	2,063
1994*	4,017	4,682	1,889

SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC
* 1994 figures are projected based on January-September data

Foreign Direct Investment in China by Region, 1994



Region	Share of Contracted Investment
Coastal provinces	37.0%
Guangdong	29.9%
Shanghai	6.3%
Beijing	6.1%
Interior provinces	20.7%

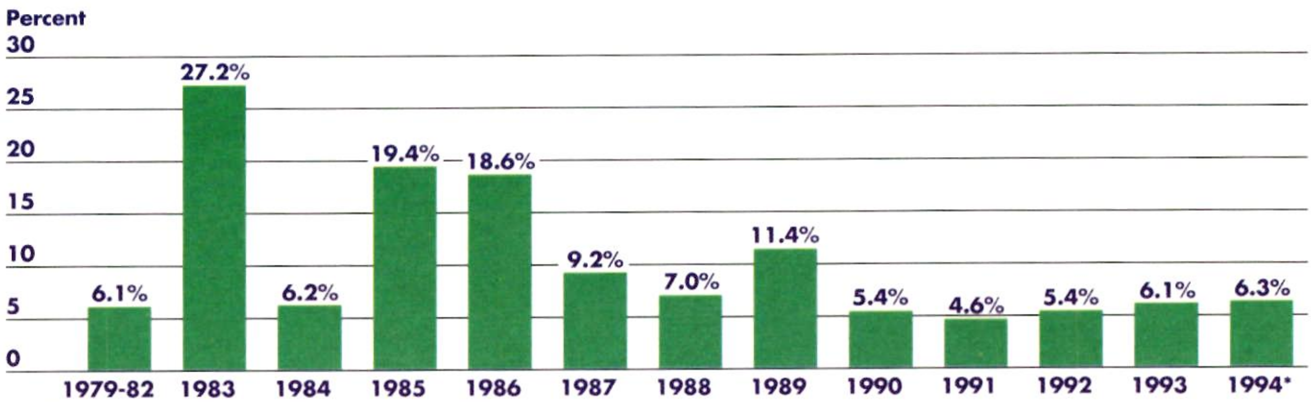
SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC

Foreign Direct Investment in China by Country

	Amount Contracted (Million $)									
Country/Region	**1985**	**1986**	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994***
Hong Kong & Macao	4,134	1,450	1,974	3,583	3,244	3,943	7,507	41,531	76,753	47,969
Taiwan**	NA	NA	100	400	600	1,000	3,430	5,543	9,965	4,878
US	1,152	527	342	370	641	358	548	3,121	6,813	4,675
Japan	471	210	301	276	439	457	812	2,173	2,960	3,529
Germany	20	43	132	471	149	456	558	1,229	2,493	745
Others	154	604	960	597	1,127	1,382	2,555	4,455	12,452	13,815

SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC
* The 1994 figure is projected based on January-September data
**1987–91 figures are US-China Business Council estimates
NOTE: NA = not available

US Share of Total Contracted Foreign Direct Investment in China



SOURCES: *Zhongguo Duiwai Jingji Maoyi Nianjian*, MOFTEC
* The 1994 figure is projected based on January–October data

Making Your China Investment Work

■ Anne Stevenson-Yang

Operational squabbles can plague even the strongest Sino-foreign partnerships

In a well-worn cliche, joint-venture partners in China are often depicted as a bride and groom. No contract signing seems complete without speeches comparing the Chinese partner to a blushing bride and the American side to the traditional Chinese bridegroom offering gifts in order to persuade the bride's many bureaucratic aunts and uncles of his worthiness. The analogy affords many excuses for banqueting, red decorations, and off-color humor while new business partners who likely cannot speak to each other without an interpreter bond warily over XO at the head table.

If the talk about the challenges of tying the knot is half in jest before the venture gets under way, however, too many business partners never feel themselves so disagreeably united as during the first few months of operations. The US partner often becomes frustrated with his failure to anticipate operational obstacles and indignant that the Chinese partner finds such obstacles normal, predictable, and impossible to remove. If the foreign investor has a clearer picture of the type of troubles a foreign-invested enterprise (FIE) is likely to encounter, both sides may be better able to weather the rough spots.

Living up to vows

As soon as the contract is signed and work begins on establishing the joint venture, financing headaches often emerge. Despite Chinese partner promises during the negotiations and reassuring visits to the local bank manager, many FIEs find themselves high and dry when it comes time to seek loans for starting capital.

At the outset, the foreign partner typically contributes equity in the form of cash, equipment, patents and trademarks, and industrial technology, while the Chinese partner contributes land and buildings. Since China regulates the proportion of equity to debt in FIEs, there are limits to what the FIE can borrow. The smaller the total investment, the greater the equity requirement; for companies with registered capital under $3 million, equity must represent seven-tenths of the investment, while for capital over $30 million, equity must be one-third of the total. The rest may be borrowed, though all *renminbi* (RMB) loans must be approved and registered with the State Administration of Exchange Control (SAEC). Beijing's tight credit policy has made it extremely difficult for FIEs to obtain domestic loans and guarantees in recent years.

If a foreign investor is able to obtain a loan, he may have trouble getting a guarantee. Even if a domestic guarantor can be found, the institution might not actually have the authority to issue the guarantee. Therefore, when an organization promises to guarantee loans during the negotiations, the foreign company should confirm with the SAEC that the organization is an authorized guarantor and that its head office has approved the guarantee.

■ Anne Stevenson-Yang, director of China operations at the Council's Beijing office, is a former associate editor of *The CBR*.

In the absence of a guarantee, some banks will accept security for loans. Chinese law permits banks to accept land-use rights as mortgage collateral, but this option is limited to those cities that have published mortgage laws—so far, this includes Beijing, Fujian, Guangdong, Ningbo, Shanghai, Tianjin, and Wuhan. In most of these areas capital equipment can also be used as collateral. Fujian, Guangdong, and Shanghai also recognize marketable securities, patents and trademarks, and certain other kinds of intangible property as collateral.

Keeping the boat afloat

Even after the FIE overcomes the initial financial hurdles, cash-flow problems can plague operations. Companies involved in industrial production—particularly those supplying State-owned companies or manufacturing large, expensive pieces of equipment—frequently lack adequate working capital.

At the heart of the problem is the vicious "triangular" debt cycle within China's State-owned sector. State-owned companies usually receive regular bank credit to finance their operations, but if this credit dries up, the State-owned companies do not have the funds to pay their suppliers. In turn, without payments from the State-owned companies, the suppliers must seek loans from banks to cover their cash-flow needs.

If an FIE is a supplier, however, it rarely has the option of turning to local banks. While some can avoid joining the triangle by selling directly to individual consumers or by supplying a product for which demand is extremely high—therefore making it easier to dictate forms of payment—many FIEs cannot help but be drawn into the maelstrom of IOUs. A recent US-China Business Council survey show that accounts receivable of 180 days are common in China's FIEs, and that foreign managers' time is often consumed with efforts to collect on outstanding obligations (*see* p.39).

To make matters worse, Chinese authorities currently do not allow FIEs to account for their costs on a percent-of-completion basis, which would ease the constraints somewhat in industries with long production lead times. In addition, legal regulations prohibit foreign operations in China from making loans to their China-based subsidiaries, since only financial institutions can make loans. Some may offer "working capital advances," but these must be short term, relatively informal, and non-interest bearing. There is currently no regulation barring foreign parent companies overseas from making loans to Chinese ventures, but the loans must be registered and must meet legal requirements, such as staying within an FIE's permissible debt-to-equity ratio.

Joint-venture contracts should permit currency swaps.

The debt problem has been exacerbated by a woefully under-automated banking system and rigid rules governing financial transactions. A company wishing to receive payment from a customer in a different city, for example, often must send a collector by train to the customer's offices to collect a cash payment, since checks are not honored outside the issuing bank's city or province. Moreover, some checks are good for as few as five days. Wire transfers can take as long as 30 days to clear. Many companies, therefore, require hand-delivered payment by cash or cashier's check.

Customers not wanting to pay can find many creative delaying tactics in China's exacting clerical environment, where writing a check with a ballpoint instead of a felt-tip pen or in blue instead of black ink is grounds for rejection. Large contracts have been known to be invalidated because of one spelling error in the city name. And, even when a creditor successfully brings suit against a customer for nonpayment, companies report that enforcement of judgments is patchy at best. Together, these factors unite to empty the coffers of even large, successful FIEs and force them to turn to the banks. The best way for an FIE to ease accounts receivable problems is to require cash-on-delivery whenever possible and ask for down payments on large orders.

The scarcity of RMB over the last year and a half has, however, helped FIEs cope with another financial worry—obtaining hard currency. In the past, many FIEs found dollars to be in short supply on China's official foreign exchange balancing or "swap" markets. Lately, the supply problem has eased. While Chinese authorities attribute this change to banking reforms implemented last year, many foreign businesspeople suspect the tight rein on RMB may be driving the current ample supply of hard currency. If this is the case, foreign investors could see foreign exchange shortages reappear once the credit valves are opened a notch.

Foreign companies thus should not expect their foreign-currency needs to be met each year without problem. Conditions on the swap markets have fluctuated dramatically since the markets' inception and could do so again in the future. Import liberalization and other market-access reforms Beijing will likely undertake to enter the World Trade Organization (WTO), for example, could threaten China's balance of trade and foreign-exchange reserves, spurring Beijing to tighten controls on the use of foreign exchange.

To protect themselves, foreign investors should draw up joint-venture contracts that permit swapping, but should avoid relying on the swap markets exclusively. Localizing production and exporting output can help a venture reduce dependence on the swap market, but foreign investors should not agree to specific localization or export schedules, lest these unmet targets be used to keep them from swapping RMB earnings for hard currency in the future (*see The CBR*, September-October 1994, p.52). In many cases, companies have won permission to purchase goods in China with RMB earnings and export these goods in exchange for dollars to balance their foreign exchange earnings. Foreign companies with extensive PRC operations might also want to consider establishing their own finance companies in China to assist in the financing of their various FIEs (*see* p.49).

More money worries

While many FIEs are well versed in the obstacles presented by China's tight credit policy and immature banking system, few manage to avoid unexpected costs at some point during their venture's operation. An FIE may be operating with swimming success, only to be told midstream of new fees, newly mandated approvals and inspections, or other regulatory changes that add to the cost and difficulty of doing business.

The 1994 tax reform, for example, raised tax rates in some industries and has contributed to FIEs' general cash-flow problems in the past year. The new system unified various Consolidated Industrial and Commercial Tax (CICT) rates into a 17 percent Value-Added Tax (VAT) on most goods (*see The CBR*, March-April 1994, p.40). In addition, all companies must now pay a consumption tax at the point of import and final sale on luxury items and a business tax on certain services and intangibles, such as patent transfers and land-use rights. A ruling last summer from the State Administration of Taxation made pre-1994 FIEs liable for VAT on materials needed to make certain export products, though wholly Chinese companies pay no VAT on their exports. Although some of the VAT paid on inputs used for exported products should eventually be refunded along with other "excess" VAT, this ruling has contributed to the cash crunch facing many FIEs.

China's other taxes are even less understood than the VAT and can also come as a rude surprise to unprepared companies. These include a Land Appreciation Tax, a stamp tax on contracts (including expatriate housing), a Vehicle Acquisition Surcharge, and a Horizontal Integration Tax designed to ensure that highly diversified conglomerates purchasing materials from their own operating units are still liable for VAT. Companies should discuss tax issues thoroughly with their partners, legal counsel, and Chinese tax authorities before commencing operations.

One of the most common problems foreign investors face is finding the appropriate mix of local and expatriate workers to manage the operations of a new investment.

Another costly shock for which FIEs are now bracing is the Chinese government's increased zeal for enforcing land-transfer regulations. Beijing amended the Chinese constitution in 1988 to allow for the "alienation of land-use rights," or the right to use land for limited periods of time. Since then, many business transactions have been mired in confusion over who actually owns land, how it should be valued, and who should control the prices. As a result, a series of regulations has sought to clarify the land transfer system by establishing procedures for determining land values and user fees.

Current regulations distinguish between two types of land held by Chinese entities: land that has been "allocated" and land that has been "granted." Holders of granted land pay a fee to obtain the rights to use that land and effectively own it for a renewable term of 40-70 years. Rights to granted land may be transferred or sold. Allocated land, however, is effectively lent by the government to the user at little or no cost and can be reclaimed at any time. The entity occupying the allocated land cannot sell it. The land may be rented, but the rent must go to the government.

A business entering into a joint venture should ensure early in the negotiation process that its partner has followed the appropriate steps in contributing land to the FIE. Chinese partners are supposed to convert allocated land to granted land via a fairly complex and costly procedure before using it as equity in a joint venture, but some localities in the past routinely ignored the land-grant requirements. As a result, some ventures have been revisited by central authorities insisting that the FIE land be put through a grant process. A venture could thus find itself required to reapply and pay fees for land that was contributed as part of the Chinese partner's original equity. This unexpected expense could prove significant, since land-grant fees are based on a rough estimate of income that the government could otherwise obtain from the land over the period of the grant.

Finding the right employees

Labor—another contribution the Chinese partner is likely to make to the venture—can also be a headache for the FIE. One of the most common problems foreign investors face is finding the appropriate mix of local and expatriate workers to manage the operations of a new investment. Despite the abundant pool of labor in China, skilled workers and managers are often in scarce supply and many FIEs have difficulty finding the right personnel. Among these, the most common obstacles are:

■ Letting go redundant workers In many cases, the Chinese partner brings with it far more workers than the new venture needs. Ideally, companies address the problem of redundant workers during contract negotiations by stipulating that the venture will accept only qualified employees. Furthermore, the foreign partner should specify that the FIE is a new company, and that all employees begin their tenure with no seniority from their previous work. In reality, however, the foreign partner is often unable to avoid hiring unwanted workers and other solutions are needed.

Even though Chinese law technically allows enterprises to lay off workers with local labor bureau approval, most foreign companies find it extremely difficult to discharge Chinese workers. Instead, some companies simply provide a per-capita sum to the Chinese partner to retrain and re-employ the extra staff. Chinese partners often request ¥50,000 per discharged worker, although some foreign companies have reported paying as little as ¥15,000 per employee.

Rather than pay the Chinese partner up front, some foreign investors establish a training center under the aegis of the Chinese partner to educate and relocate redundant workers. But some investors fear that the FIE will remain saddled with these workers if no new employment is found. Other FIEs may establish a separate enterprise to employ redundant workers, perhaps a venture providing services to the original operation. The venture might run a cafeteria or maintain the first venture's housing stock, for example.

■ Hiring staff and keeping them happy Once the venture has settled upon the number of the local partner's employees it will hire, it may need to recruit additional workers with specialized skills. Because China's ability to train young people has not kept pace with the influx of foreign investment, FIEs face tremendous—sometimes insurmountable—difficulties locating accountants, financial managers, salespeople, and supervisors trained in specific industrial sectors. Outside of Beijing, Guangzhou, and Shanghai, the problem is even more acute. Most companies must train their own managers in house and provide them with a large amount of responsibility, rapid advancement, and relatively high compensation to tie them to the company.

> Chinese regulations require equal pay for equal work, not for equal job titles.

After recruiting staff, companies agonize over what to pay them and what benefits to offer. Compensation levels in joint ventures will often be dictated by previous salary levels in the Chinese partner's company. In general, Council surveys suggest that average cash compensation (that is, base salary and bonus) for FIE employees in large, coastal cities is about ¥2,000 per month (*see* p.39). That average might range from ¥600 per month for starting-level production workers to ¥3,000 per month for general and deputy managers.

Benefits for local FIE employees are devilishly complex and in rapid flux. Laws require FIEs to contribute to funds that provide health insurance, pensions, maternity benefits, unemployment insurance, and accident and disability insurance. Ventures also must provide for workers' housing in some form. In addition, a patchwork of other payments might be required, perhaps to a welfare fund, a recreation fund, and a union fund.

■ Setting expatriate salary levels The expatriate workers assigned to a start-up operation inevitably cause friction between Chinese and foreign partners, because the Chinese partner seldom agrees that it is necessary to spend such large sums of money on expatriate compensation. Often, the Chinese partner will ask for a rapid "localization schedule" to transfer management positions to Chinese nationals, and for parity between expat and Chinese managerial pay. The US side should be cautious about agreeing to either provision, since it may be difficult to find Chinese managers with the same skills or dedication to the US parent company that the expat has.

If the Chinese partner asks that a Chinese manager of a comparable level receive equal compensation, the US partner should remember that Chinese regulations require equal pay for equal work, not for equal job titles. The foreign partner should stipulate early in contract negotiations that the Chinese manager's pay will be based on domestic market rates and the expatriate manager will be paid according to international market rates. If the Chinese partner insists on some sort of parity, one solution has been to deposit the Chinese managerial compensation payments—the difference between Chinese and international market rates—into a special housing fund for those employees.

Getting down to business

Once the dust has settled on start-up and personnel issues, FIEs must devote close attention to quality control and distribution. Because of domestic regulations governing these areas, foreign companies often find it difficult to replicate within China the success they have enjoyed in other foreign markets.

As China's industrial policy promotes the use of local components and penalizes companies for relying on imports, quality control quickly becomes an issue of great importance. Every FIE puzzles over how to build its product from Chinese sources without threatening quality; some companies even cultivate local supplier networks long before opening their doors in the PRC. McDonald's, for instance, developed potato farms before making french fries in China.

Few, however, have time to lay such groundwork. Most must find adequate inputs after operations are under way. Some companies have wooed overseas suppliers to China by offering them loans and business assistance. A few firms have combined the forces of ordinarily independent business units to send unified sourcing teams to China. Still other companies have tried using supplier fairs to invite factories to meet their business units and learn what inputs the FIE needs. Success rates tend to be mixed, depending partly on whether the fair is organized by a ministry, municipality, or the foreign company itself. Those sponsored by the FIE or its foreign partner tend to yield the best results.

At the other end of the production cycle, marketing and distribution barriers may make it difficult for the venture to obtain needed modes of transportation, especially for perishable products. Once the goods are delivered, moreover, government-designated wholesalers and distributors may be less than accommodating in moving the product down to the retail level. In addition, various government restrictions on business establishments can hamper a company's efforts to create its own sales network (*see The CBR*, January-February 1994, p.30).

None of these obstacles is insurmountable, though, and most companies find they are able to build distribution networks slowly, one region at a time, while still maintaining links with national distributors where applicable. A sales force can be set up through a branch of the FIE or even work out of a representative office, as long as the representative office does not sell directly. Many companies prefer to hire salespeople in Beijing or Shanghai and send them on a temporary basis to other cities. If taxes on these employees are paid in the original place of hire and if legal residences do not change, the authorities usually have no objections.

A few firms have combined the forces of ordinarily independent business units to send unified sourcing teams to China.

To help build up regional markets for their products, many FIEs look to advertise their goods via local media. Companies selling consumer products tend to get better results using television rather than print advertising, though results can be difficult to gauge, as little consumer research is currently conducted in China. Advertising, whether in print or broadcast format, should be planned early on, since space often gets booked months in advance. Companies planning to advertise should also become familiar with the provisions of China's new Advertising Law, which took effect February 1, 1995. The law places new constraints on cigarette advertisements and makes claims of superiority or medicinal effects illegal (*see The CBR*, January-February 1995, p.4).

Together for the duration

Ultimately, the most important element of doing any sort of business in China is maintaining a good working relationship with one's business partner. The relationship begins with the contract negotiations, during which the American side should determine whether the Chinese partner shares its business goals. Ideally, the two sides should share a common vision of what the venture should achieve (*see* p.20).

When the relationship does run into problems, as it inevitably will, the cause may not be a concrete business issue, but a cultural or interpersonal issue of which the American partner is only dimly aware. One expatriate manager, for instance, discovered his FIE's board of directors was organizing a vote to have him expelled because they felt he had unfairly usurped financial and accounting responsibilities from the Chinese bookkeeper. In other instances, expatriate managers have alienated Chinese staff with their eagerness to jump into operations immediately after arriving at the FIE. Americans tend to prefer setting definite targets and goals at the beginning of assignments, while the Chinese side often expects the new manager to settle quietly into his new environment before making dramatic moves.

If such disagreements arise, companies can often peel back the rhetoric and recognize the underlying, practical reasons for the Chinese partner's actions. For example, when one company representative was invited to two meetings by a central government ministry and arrived to find none of her hosts had shown up, she eventually learned that the ministry was offended because the company had refused to host a Chinese delegation to the United States. Another company was embarrassed when its host organization presented a bill for tea during a government meeting. It learned that it had offended the host by having engaged outside consulting services.

In the end, Americans working in China need not try to become more Chinese than the Chinese—that would be impossible and even counterproductive. Rather, the foreign investor and his Chinese partner should try to understand the motivations and objectives behind the other's actions when operational difficulties arise—and handle the small problems amicably before they mushroom into bigger headaches. No foreign investor should expect smooth sailing from day one, but if the couple learns to work as a team, it should be able to weather whatever unexpected operational difficulties arise. 完

Feeling Upbeat

A Council survey reveals members are generally satisfied with their China investments

Ever-changing rules and regulations, an intrusive bureaucracy, and an immature legal system make China a difficult place to conduct business. Despite these obstacles, foreign direct investment (FDI) continues to flow into China at an unprecedented level—only the United States attracts more. In 1994, China captured 17 percent of worldwide FDI and one third of total FDI in developing countries.

To learn more about US companies' perceptions of China as an investment locale, the US-China Business Council in mid-1994 surveyed its members with foreign-invested enterprises (FIEs) in the PRC. Responses reveal both the attractions and the pitfalls of doing business in the world's most populous country. The results indicate that temporary operational problems triggered by high inflation and tight credit have supplanted, at least for now, the structural shortcomings of China's byzantine bureaucracy and inconvertible currency.

Despite numerous operational difficulties, however, virtually all of the enterprises that responded were either profitable or at least meeting their long-term profit expectations. Somewhat unexpectedly, questions on market penetration also drew generally positive responses, with more than half the survey participants reporting their ventures had met market access goals.

Who answered?

The survey included responses from 31 FIEs, the majority of which were manufacturing enterprises. General managers completed more than half of the surveys, though FIE finance managers, operations managers, and presidents also responded. Nineteen percent of the respondents' FIEs are located in Beijing, 26 percent are based in Shanghai, and 10 percent are based in Guangzhou. Twelve percent of the FIEs are located in interior provinces, while the remaining 33 percent are in the coastal areas (excluding Shanghai and Guangzhou).

Equity joint ventures comprise 57 percent of the respondents, contractual joint ventures 23 percent, and wholly foreign-owned enterprises (WFOEs) 20 percent. The average life span of all the FIEs is 3.9 years. Because of the relatively small size of the sample, the survey cannot be considered a scientific study of FIE operations. Rather, the results provide an overall picture of China's current foreign investment landscape and some insight on issues little examined elsewhere, like company policies on maternity leave.

New worries

The survey reveals that changes in China's operating conditions have caused investors to reorder their principal concerns. In the Council's 1993 investment survey, member companies reported that their main operational concerns were for-

Table 1
Most Serious Operating Difficulties in China

	Average Rank 0 = severe 1 = not severe 2 = no problem
Inflation/rising costs	0.41
Rising accounts receivable	0.74
Bureaucratic interference	0.93
Transportation	1.04
Quality of locally produced inputs	1.04
Supply of RMB working-capital loans	1.11
Supply of raw materials	1.13
Access to domestic markets	1.30
Production and quality control	1.30
Relations with partner(s)	1.30
Electricity supply	1.33
Obtaining import licenses	1.40
Achieving export quality	1.42
Supply of dollars at swap centers	1.42
Access to local swap centers	1.54
Provision of after-sales service	1.62
Demonstrations/worker slowdowns	1.85

SOURCE: US-China Business Council 1994 Investment Survey

eign exchange balancing, employee housing, and labor practices. By mid-1994, the top three concerns had become:

- **inflation,**
- **rising accounts receivable,** and
- **bureaucratic interference**

(*see* Table 1).

Inflation and bureaucratic interference have been recurrent investor concerns since the late 1980s, and the fact that respondents in 1994 highlighted these issues is not surprising. The phenomenon of mounting accounts receivable, a result of China's tight credit policy, was a pressing problem for FIEs in 1989-90 and has only recently resurfaced as a widespread complaint.

The FIEs responding to the 1994 survey generally had unusually high accounts receivable for the first eight months of the year. Unable to collect payments from their customers, some of the FIEs refuse to extend credit to Chinese customers and insist on cash-on-delivery. According to the survey, the "triangular," or inter-company, debt problem is especially prevalent among FIEs selling capital equipment to China's State enterprises.

In the black

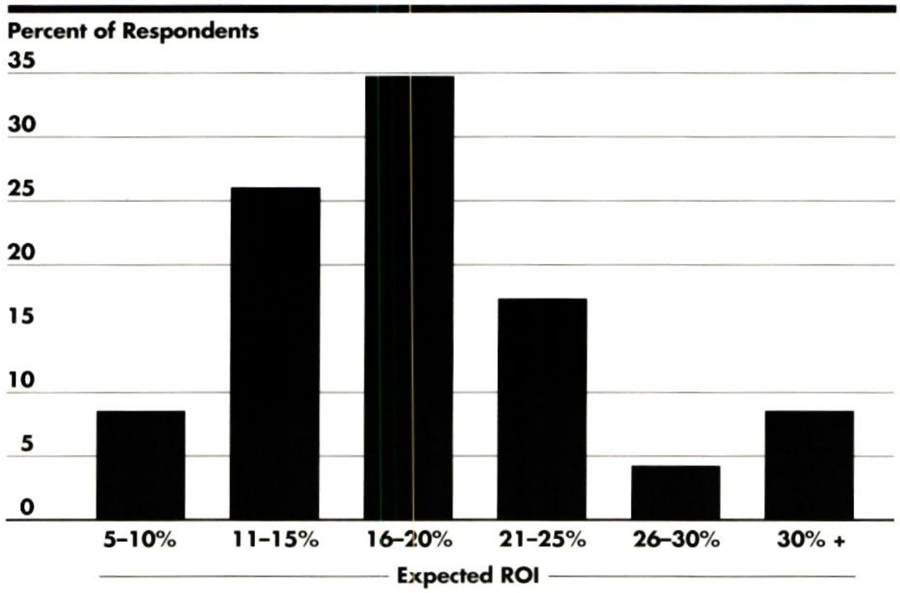
In spite of the difficulties FIEs face in China, the vast majority (76 percent) of those surveyed are profitable, with 14 percent reporting current profit margins that exceed original expectations. Of the unprofitable firms, 67 percent express no alarm at this situation, stating that the progress of their ventures is on schedule. About 17 percent of this latter group, however, report disappointment at not having met their profit timetables. Many of the respondents report that their US parent companies expect handsome long-term returns on their China investments, with the bulk of FIEs aiming for a 16-20 percent rate of return (*see* Figure 1).

For over half of the respondents, market penetration goals and the creation of export-production bases have proceeded at an acceptable pace, though access to raw materials and integration of the FIE into the parent company's global operations appear to be falling short of expectations.

In another measure of business success—how current operations compare with those projected in the feasibility study—the respondents' experience has been mixed. While more than one third of the FIEs report that they are operating according to their feasibility studies, nearly as many say they are operating on a smaller scale. Only one quarter claim to have exceeded the scope of their feasibility studies.

The survey also indicates that the FIEs appear to enjoy good relationships with their Chinese partners. Fifty-six percent of the respondents characterize their relationship with their Chinese partner as "positive," 12 percent believe it is "invaluable," and 24 percent say it is "neutral." Only 8 percent dub the relationship "counterproductive." Cutting through red tape appears to be the Chi-

Figure 1
Expected Long-term Rate of Return on Investment (ROI) for FIEs in China



SOURCE: US-China Business Council 1994 Investment Survey nese partner's most valued contribution, followed by access to local markets, the provision of personnel, and access to *renminbi* (RMB) financing.

The tax overhaul of January 1994 seems to have affected some FIEs more than others. Taxes decreased for 12 percent of the enterprises, remained unchanged for 27 percent, and increased by an average of 10 percent for the remainder of those responding. Of the latter group, most (65 percent) sought refunds from the local tax bureau to offset the increase, but many also adopted other measures. Some FIEs coped with the higher taxes by switching to suppliers that qualify for VAT receipts (30 percent), seeking concessions from business partners, localities, or government officials (20 percent), and/or raising prices (10 percent). One quarter of the respondents took no action to combat the increase. While the vast majority of the FIEs surveyed report they are paying all appropriate VAT rates, 21 percent claim they have avoided paying the appropriate VAT rate on some products.

Rapidly escalating wages

A large section of the survey was devoted to labor issues. The results confirm that despite the expense of hiring expatriate managers, most FIEs are willing to assume these costs—some 77 percent have expatriate managers on site, and most of these employ more than one. Even more FIEs—93 percent of respondents—have Chinese managers running some or all of their operations.

Most FIEs offer local employees individual contracts, though some FIEs sign group contracts with their Chinese partner (17 percent of respondents) or with the local labor bureau (3 percent). Seven percent of the FIEs report they have not signed any labor contracts.

To no one's surprise, the survey responses indicate that nominal and real wages are rising rapidly; the average annual wage for a Chinese worker increased 27 percent in 1994. This increase typically encompassed two raises within the year, but some FIEs gave employees as many as four raises. The average monthly take-home pay (wage plus bonus) for Chinese employees totaled ¥2,041 ($240) last year.

Pay scales at FIEs in China show a relatively tight distribution, with the highest-paid workers—treasurers—earning four times as much as the lowest-paid menial workers (*see* Table 2). The survey confirms that despite their rank, Chinese general managers on average earn less than Chinese deputy general managers, treasurers, and senior engineers—perhaps because FIEs often hire general managers less for their technical skills than for political purposes.

The average monthly take-home pay (wage plus bonus) for Chinese employees totaled ¥2,041 ($240) last year.

More than salaries

Because FIEs in China assume many costs of social programs typically found in rival State enterprises, non-wage compensation accounts for a sizable portion of overall company costs. The fact that FIEs may now decide whether they want to provide certain benefits such as food and transportation (rather than be compelled to provide them) may be a sign of economic liberalization, but the government still insists that FIEs contribute to employee welfare, housing, medical, and training funds. Most FIEs surveyed offer at least some discretionary benefits, though none offer the entire range of benefits (*see* Table 3).

While discretionary compensation practices allow FIEs to fashion cost-effective plans for their employees, FIEs still must bear the high costs of providing government-mandated employee benefits. More than a third of the respondents report that non-discretionary non-wage compensation accounts for 45-51 percent of their total remuneration bills. Among survey respondents, the average contribution to government-controlled programs is 44 percent of the FIE's remuneration costs (*see* Figure 2). Only 13 percent report that these contributions are taxed locally.

Based on our survey, FIEs in Beijing allocate 20 percent of their total monthly employee compensation bill to contributions to an FIE pension fund; 20 percent toward labor insurance and welfare funds; 7.5 percent to medical expense funds; and 1.5 percent to employee education funds. Beijing, like almost all localities in China, also requires a 2 percent contribution to the FIE's labor union.

The FIEs in the survey report that employee pension funds generate a large part of the non-discretionary wage bill. Local governments usually control these funds, though one-fifth of FIEs control their own pension funds and a few are managed by insurance companies or banks. Seventy-five percent of the survey respondents report that pension funds are transferable upon an employee's departure from an FIE.

Medical benefits cost the FIE an average of ¥1,057 per local employee per year. Half the FIEs pay these benefits through an insurance policy and half through an FIE-held medical fund. FIEs have devised a wide range of medical plans: some offer employees full reimbursement for all medical expenses, while others pay up to 20 percent of each employee's annual salary to cover yearly medical expenses. One FIE pays a ¥10 bonus to each employee who has not filed a medical claim in a given month. Other FIEs stress preventive care and offer free physicals once every three years for employees under age 45.

Survey respondents report that over one third of their local staffs are female. Under the Labor Law that became effective January 1, 1995, female employees of all enterprises in China, including FIEs, are entitled to at least 90 days of paid maternity leave. Most FIEs at the time of the survey were either in compliance or were soon to be in compliance with this new provision. Many firms provide more than the minimum leave required by law and some offer extra food subsidies or pay 100 percent of medical expenses for pregnant employees. Others offer shorter work days once the employee returns.

Though most FIEs must make payments into a housing fund, they are not required to provide housing to local employees. Though doing so might be an effective means of retaining employees, the survey shows that few FIEs believe they can afford to house all local staff. Only one respondent offers housing to all its employees, but 76 percent of the FIEs surveyed provide housing to at least some local staff. The average cost to FIEs is ¥179,444 per housing unit (approximately $21,100 at ¥8.5/$1), with FIEs in Shenyang reporting an average of ¥20,000 and those in Beijing, ¥650,000. Many FIEs (43 percent) either purchase housing or rely on the venture's Chinese partner to provide housing. One third of the FIEs rely on multiple methods to obtain homes for their employees.

Table 2
Average Monthly Compensation and Bonus for Chinese Employees of FIEs (RMB)

Position	Average Total Salary*	Range of Average Total Salary*	Average Basic Wage	Average Bonus
General manager	2,750	700–7,800	1,933	900
Deputy general manager	3,007	800–6,707	1,979	703
Treasurer	3,205	800–9,750	1,895	495
Accountant	1,989	500–4,250	1,344	423
Senior engineer	3,008	782–10,000	1,806	792
Senior salesperson	2,091	705–4,200	1,355	469
Junior salesperson	1,466	453–4,000	921	410
Production supervisor	2,244	500–9,208	1,510	425
Production workers	994	420–2,167	717	210
Clerical	1,374	497–3,450	941	293
Menial worker	800	309–1,517	577	145
Driver	1,567	500–4,500	986	421
Average of all occupations	2,041	—	1,330	474

SOURCE: US-China Business Council 1994 Investment Survey
* The average total salary reflects the sum of the basic wage and bonus data reported by each FIE, not the sum of the survey-wide average basic wage and average bonus.

Table 3
Non-Wage Compensation Provided at FIE's Discretion

	Average Monthly Compensation per Employee (RMB)	Range of Average Monthly Compensation per Employee (RMB)
Housing (voluntary FIE contribution separate from mandatory housing fund contributions)	320	0–1,750
Food subsidy	148	25–300
Transportation subsidy	79	0–400
Tax gross-up subsidy	0	0–0
Medical subsidies (beyond government guidelines)	31	0–86
Pension payments (beyond government guidelines)	57	0–138
Other (clothing subsidy, cash allowance, etc.)	90	55–125
Average total monthly discretionary non-wage compensation per employee*	274	0–1,900

SOURCE: US-China Business Council 1994 Investment Survey
* This figure is the average of the total reported monthly discretionary non-wage compensation per employee, rather than a sum of the preceding rows.

Housing funds controlled by the FIE constitute one of the most common sources of monies for employee housing (cited by 47 percent of respondents), followed by general welfare funds (27 percent), FIE profit funds (27 percent), FIE capitalization funds (20 percent), and bank loans (13 percent). In some cases (20 percent), the FIEs agree to compensate for part or all of the difference between expatriate and Chinese managers' salaries in the form of housing to the Chinese employee. (Because many respondents rely on more than one source of funds for housing, the responses do not total 100 percent.)

Although each FIE typically manages its own employee housing, the survey suggests that Chinese partners, management companies, and FIE labor unions can also serve as property managers. Only two FIEs—both located in Guangzhou—report they rent housing for their employees. Four ventures offer tax-free housing loans to their employees; repayment is being made through salary deductions over the term of the business license or through 15-20 year mortgages.

Once they obtain or arrange for housing stock, FIEs face the sensitive issue of allocation. On average, FIEs house about one-third of their local staff. The major factors considered in the allocation process, in order of priority, are job responsibility, job performance, seniority in the company, and individual employee needs.

Combatting job hopping

Given the difficulty and expense of obtaining housing for local staff, it is easy to understand why housing tops the list of labor-related concerns expressed in the survey. The other main worries are the skill levels of workers and actual job performance (*see* Table 4). Worker turnover emerged as an area of growing concern in 1994, with more than one third of the ventures—all located in major coastal cities—reporting it as a serious problem. Competition from other FIEs ("poaching") was the top reason cited for the high turnover rate, followed by competition from domestic enterprises, workers being hired away by foreign representative offices, and workers resigning to go overseas (*see The CBR*, November-December 1994, p.40). According to one FIE general manager, "Workers are simply job-hopping, looking for better opportunities."

Raising salaries appears to be the most common FIE response to poaching, though one third of those claiming employee retention problems have taken no action, perhaps due to a shortage of funds. Longer-term measures being implemented include an emphasis on training and improvements in the work environment. Despite numerous press reports of stock incentives being offered to employees as a means of retaining them, only three of the FIEs surveyed have such a program in place.

On average, FIEs house about one-third of their local staff.

FIEs and organized labor

Perhaps because they typically provide benefits and working conditions superior to those in China's State enterprises, US FIEs voice little concern about organized labor—problems with trade unions ranked last in the long list of FIE labor concerns. Several FIEs, however, expressed concern about the announcement in mid-1994 that the All-China Federation of Trade Unions (ACFTU) planned to establish unions in all FIEs within two years. Of the 13 respondents without unions, only two—one in Guangzhou and the other in Dalian—report that they have been approached by the ACFTU, suggesting that the union's main targets are small, export-oriented "sweatshops" usually financed by Taiwan and Hong Kong investors.

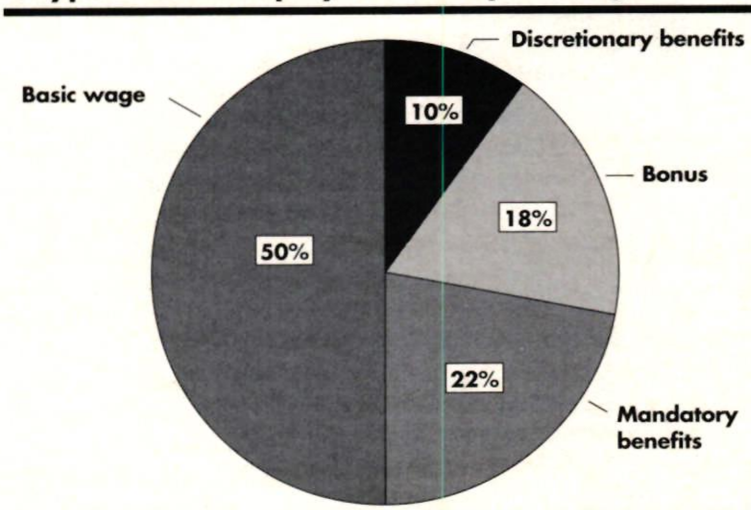
Roughly half of the FIEs surveyed report that their employees belong to unions, most of which are enterprise-specific affiliates of the ACFTU. A few of the unions encompass multiple enterprises in a city, or several enterprises within a specific industry sector.

Unions serve a wide range of functions in FIEs. Almost all organize recreational, cultural, and social activities, while roughly half also participate in meetings of the board of directors. Slightly fewer than half of the unions organize political study sessions on site. Other union functions include intervening in labor-discipline cases (reported by 35 percent of the FIEs), negotiating labor contracts (24 percent), participating in worker training (6 percent), and providing a forum for employee grievances (6 percent).

Looming problems

Aside from assessing the present climate for foreign investment in China, our survey sought to ascertain the

Figure 2
A Typical Local Employee's Salary Package



SOURCE: US-China Business Council 1994 Investment Survey

> FIEs want to be given more advance notice before the government issues new regulations.

Table 4
Most Critical Labor Issues for FIEs in China

Labor Issue	Average Rank 1 = serious 2 = fairly serious 3 = not serious 4 = no problem
Provision and cost of housing	2.20
Skill level of workforce	2.35
Job performance	2.71
Turnover of sales staff	2.78
Recruitment	2.85
Turnover of accountants	2.86
Turnover of engineers	2.96
Turnover of production workers	3.05
Excessive unit cost of labor	3.09
Turnover of local managers	3.12
Turnover of administrative staff	3.13
Employee transfers to other regions in China	3.33
Relations with trade union	3.86

SOURCE: US-China Business Council 1994 Investment Survey

longer-term concerns of foreign investors. To determine an overall FIE "wish list" on investment matters, the last part of the Council survey asked respondents to recommend measures that would improve China's investment environment. Many of the responses reflect the desire for greater transparency in China's legal system. Specifically, companies requested that all regulations be published and made readily available to the general public; existing regulations be enforced more consistently; Chinese companies be required to disclose more information about their assets; and that FIEs be given more advance notice before the government issues new regulations.

Other suggestions focus on the relationship between the Chinese bureaucracy and investors. FIE ideas on this issue include streamlining investment approval and reporting requirements; eliminating the "scope of business" contract stipulation; reducing the time needed for goods to clear Chinese Customs; and establishing more "one-stop" foreign investment centers.

A third area of concern to FIEs is the treatment of foreign nationals in China. Respondents believe that fees of Chinese service providers should be uniform and not based on the customer's nationality, and, moreover, payable in RMB; that FIEs should have equal access to RMB loans; and that FIEs should be able to hire workers directly from State enterprises and not have to worry about the release of the worker's dossier, or *dang an.*

Many respondents also offered suggestions on other, more general investment matters. They recommended that Beijing make the RMB fully convertible and abolish export requirements. Others want the government to remove restrictions on the amount of intangible assets that can be contributed to an FIE and abolish limits on the ratio of registered capital to loans. On tax matters, respondents would like to see the elimination of the stamp tax, and income tax rulings for FIEs made binding and easily obtainable in writing. Finally, many firms cite the need to strengthen the banking system to facilitate inter-provincial payments.

Almost all of the FIEs surveyed stress the need to improve China's infrastructure, calling for better provision of electricity, telecommunications, and roads. Respondents also hope to operate in an atmosphere of greater national environmental awareness and improved public safety.

In large part these recommendations reflect concerns that foreign investors in China have had for the past 15 years. But some of the specific suggestions, like a stronger interbank system, mark an awareness on the part of FIEs that Beijing has already made some progress on addressing investor concerns. FIEs should not expect the other problems to be solved overnight; in the near term, Beijing is likely to concentrate on modifying investment incentives to direct foreign capital and technology into certain preferred industries and geographical sectors. As long as the Chinese economy continues to grow, demand for foreign goods and services remains strong, and access to the domestic market improves, however, Beijing's efforts to exert control over investment matters are unlikely to deter foreign interest in China. 完

Moving From "No" to "Yes"

■ Stanley Lubman

When all else fails, foreign investors can turn to arbitration

■ Stanley Lubman, a San Francisco attorney specializing in Chinese law, is head of the China group of the international law firm of Allen & Overy. This article is drawn from a 1993 article he co-authored with Gregory Wajnowski in the *American Review of International Arbitration*.

No foreign investor goes into a China venture expecting the worst. For some foreign companies, however, sweet dreams of a good collaborative relationship with their Chinese partners may fade into tense and acrimonious nightmares. Though abandoning a sizeable project could entail significant losses, some foreign investors, frustrated by what they consider utter inflexibility or excessive demands on the part of their local partners, have even walked away from their ventures altogether.

Failed joint ventures, though far from the norm in China investment circles, serve as stark reminders that every foreign investor should take special care to ensure that his working relationship with his Chinese partner never deteriorates to an irreparable level. To a large degree, understanding the cultural and other factors that lead to disputes may help the foreign investor steer clear of situations likely to result in serious disagreements with his joint-venture partner. But, to be on the safe side, foreign companies should also be sure that their investment contracts detail exactly how the parties to the ventures will resolve any disputes that may arise.

Watching the details

Disputes among joint-venture partners can emerge for any number of reasons. These could include management disagreements over labor matters, misunderstandings over use of joint-venture technology or funds, or ill feelings if one partner commits the joint venture to actions or policies without properly consulting the other partner. Some disputes might be avoided if the foreign investor takes care to negotiate a very detailed contract. This precludes relying solely on the Ministry of Foreign Trade and Economic Cooperation (MOFTEC)'s model contract, which omits many details on management structure and does not cover important issues such as valuation of assets if the parties decide to dissolve the venture. A foreign investor should insist that the contract include very specific details on such matters as management structure, decisionmaking processes, and what happens if an investor wants to exit the venture. When they fail to address such basic matters, investors create areas of ambiguity that may help provoke or sharpen disputes. Though crafting a detailed contract may mean spending a few extra hours at the negotiating table, the time is usually well spent.

The last resort

The foreign investor should also insist that the final contract contain a well-drafted clause spelling out the types of dispute settlement the two parties agree to pursue should the need arise. The Chinese side will usually seek to specify that "friendly negotiations" and, sometimes, conciliation (inviting a third party to propose a compromise) should precede arbitration (*see* box).

The contract should also specify what steps must be taken if efforts to mediate a compromise fail. Many foreign investors prefer to keep dispute resolution out of China's still-nascent judicial system because the professional level of judges is often low and, worse yet, the courts tend to show favoritism to local organizations and individuals. The Chinese investor will generally want to avoid litigation anywhere. The alternative in almost all cases, therefore, is arbitration through a formal arbitration body.

While Chinese law permits the parties to a joint venture to choose third-country arbitration, Chinese parties to a foreign-invested enterprise (FIE) generally prefer to see their claims come before the China International Economic and Trade Commission (CIETAC) in Beijing. Foreigners, in contrast, generally desire arbitration outside China under the auspices of an independent body—many joint ventures specify the Arbitration Institute of the Stockholm Chamber of Commerce as the arbitration body of choice. Whatever arbitration institution the parties choose to

What Dispute?

As direct foreign investment in China expands, disputes between Chinese and foreign partners inevitably multiply. As they do, Westerners and Chinese may discover that their views of disputes and dispute resolution are as divergent as the differing attitudes toward business that undoubtedly contributed to their disagreements in the first place. To a large degree, cultural and bureaucratic attitudes in China will have a heavy influence on how disputes are settled.

When a dispute does arise, the Chinese parties are likely to display very traditional cultural attitudes toward the problem. For centuries, Chinese have always sought to resolve their differences through compromise, negotiation, and mediation. Official policy since 1949 has consistently emphasized mediation as the preferred method for resolving disputes. Most cases brought to China's civil court system, in fact, are settled through active mediation by the courts themselves.

These preferences mean that Chinese officials and businessmen are likely to express their distaste both for disputes and resolving problems by any process requiring third-party adjudication. Today, when foreign parties or their lawyers tell their Chinese counterparts that they are contemplating invoking an arbitration clause, common reactions include disbelief, shock, and surprise. On one occasion, when I suggested to a Chinese official that a foreign client would consider bringing suit in a Chinese court, the official's unease manifested itself in stammering, trembling hands, and the agitated observation that "a Chinese wouldn't do that!"

Avoiding the problem

Even if the parties have specified a formal mode of dispute resolution in their contract, Chinese counterparts often strive to avoid acknowledging that a serious dispute exists at all. In troubled joint ventures, the Chinese party sometimes finds it impossible to admit that cooperation has broken down (*see The CBR*, November-December 1990, p.42). The Chinese party may appeal to the foreign partner to consider long-term interests and the importance of maintaining an overall relationship, or to understand special Chinese circumstances that have caused the problems.

A foreign company involved in a dispute cannot, however, assume that its long-standing ties to his local partner or local officials will work in his favor. Reliance on "old friend" status can be dangerous, as Chinese parties to contracts can be just as legalistic as their Western counterparts. While most Chinese trading partners continue to prize established relationships, some Chinese investors may be more concerned with short-term profits than with long-term opportunities. Also, the economic reform process has placed the traditional Chinese emphasis on the primacy of relationships under great strain.

If discussions with the local partner break down or appear to be at an impasse, foreigners may try to appeal to local authorities or to the administrative superior of a Chinese trade or investment partner. In many cases, however, the local authorities are likely to ignore the collapse of relations and press for an "amicable" solution. I know of one investment dispute involving an industrial joint venture in which a foreign investor discovered multiple breaches of his joint venture contract by his two Chinese partners. The local investment authorities, when informed, agreed with the foreign investor's complaints, but refused to intervene or accept the notion that relations between the investors were beyond reconciliation. To some degree, this type of response may reflect Chinese officials' ingrained fear of being held responsible, legally or otherwise, for problems that arise in ventures they approved. It also reflects distaste for admitting that an investment project has failed.

Few options

The foreigner who has tried unsuccessfully to negotiate with his counterparts or local officials may find he has little choice but to proceed to arbitration. It is unlikely that an appeal to the Beijing ministry that ultimately directs the industry in which his Chinese counterpart is involved will lead to meaningful action. Focusing Beijing's attention on a local dispute has always been difficult, and is harder still nowadays because of the growing autonomy of China's localities.

Seeking publicity can also be risky. A foreign company's effort to discredit his Chinese partner publicly may yield a snappy story in a Western or Hong Kong newspaper, but the Chinese parties to the dispute are not likely to be pleased and the potential damage to the relationship could be fatal. The foreigner's only practical recourse—other than walking away from the dispute—may be arbitration.

—Stanley Lubman

hear any eventual dispute, most Chinese entities resist using anything but Chinese law to resolve disputes arising out of joint-venture contracts. Even so, the foreign investor may still prefer to hold the arbitration in a third country because it provides a neutral forum.

As foreign investment in China increases, investment disputes, too, are on the rise. CIETAC is emerging as the most common formal means for resolving these disputes. In recent years, CIETAC's workload has risen greatly. Over 700 new cases were filed in 1994, making it one of the busiest arbitral institutions in the world. While trade cases made up the bulk of CIETAC's docket in the past, investment-related matters now account for roughly half of the arbitration body's work.

CIETAC's rules are quite basic: arbitration is carried out by three-person tribunals, with each party choosing an arbitrator from a list that includes 89 foreigners and 202 Chinese. CIETAC itself chooses the third member, who acts as chairman of the tribunal. The parties must submit their arguments and evidence in writing to the tribunal, and must send their counsel and representatives to attend one or more hearings. No appeal to CIETAC or the courts is possible once the tribunal has issued its decision (*see The CBR*, September-October 1990, p.44).

The arbitral tribunal, which is specifically authorized to conduct conciliation during the arbitral process, always asks the parties if they wish to consider this option. If the parties agree to settle their dispute, the arbitrators issue an award in accordance with the content of the settlement agreement. In practice, a considerable number of CIETAC cases have been settled without full arbitration, but CIETAC's policy of keeping its data confidential makes it impossible to know what percentage of cases proceed to full arbitration. CIETAC did not begin publishing its determinations until 1993, when it issued a Chinese volume containing 72 sparse rulings.

If CIETAC were tinged with the politicization that affects many legal institutions in China, few foreigners would ever bother submitting to arbitration in China. But CIETAC's independence and impartiality have been above reproach, and it has further enhanced its reputation by adding a considerable number of Western lawyers to its list of available arbitrators. Until recently, almost all of CIETAC's arbitrators were Chinese and very few were trained in Western legal matters.

Because the Chinese party and CIETAC chairman each choose one of the three arbitrators on a tribunal, the tribunals are almost always dominated by Chinese arbitrators. Under these circumstances, the "cultural neutrality" that might be attained in other international arbitration institutions, which feature panels of three arbitrators from different countries, is unlikely to exist. This is not necessarily a defect, however, as Chinese arbitrators are likely to understand details of the Chinese bureaucracy that would confuse arbitrators in Paris or Stockholm.

> CIETAC recently added a considerable number of Western lawyers to its list of available arbitrators.

Common problems

To date, CIETAC has earned widespread respect for its integrity and independence, though it, like other arbitral bodies, suffers from some shortcomings, including delays, high costs, and enforcement problems. Some characteristics of CIETAC arbitration that foreign investors should be aware of include:

■ **Reliance on fact-finding rather than legal interpretation** CIETAC rules require the parties to a dispute to "produce evidence in support of the facts on which their complaint, defense, or counterclaim is based." This evidence must be "examined" by the arbitration tribunal. Consequently, CIETAC's arbitration consists largely of fact-finding. Arbitrators sometimes appear to use arbitral hearings to assemble statements about any of the facts in the case without distinguishing evidence from conclusions, trying to limit or focus arguments, or discussing competing allegations of fact. As a result, the foreign party may leave the hearings without knowing how the arbitrators will weigh the evidence presented.

CIETAC so emphasizes discovering "truth from facts" that its settlements rarely discuss any legal principles. Fact-finding, moreover, can be particularly difficult if the Chinese parties are legally unsophisticated or determined to impede the tribunal. To be fair, few international arbitration institutions provide detailed evidentiary rules or articulate a specific standard of proof for arbitration proceedings. Nonetheless, Western parties who expect CIETAC to invoke and apply Chinese rules may be surprised by the Chinese focus on facts. And, although CIETAC tribunals are required to issue a written award stating "the reasons on which the arbitral awards are based," the awards are likely to be brief, conclusory, and without reference to applicable legal rules. Moreover, they may not always address all of the issues raised by the parties.

■ **Slow proceedings** Until recently, parties often had to wait months or even years for CIETAC tribunals to issue their findings. In 1994, CIETAC amended its rules to require that tribunals collect all the related evidence and complete all necessary hearings within nine months. The enlarged panel of available arbitrators should also enable the organization to take on more cases. It is too early to tell whether these attempts to deal with a clogged calendar and overworked arbitrators will be successful.

■ **High fees** In the past, CIETAC arbitration probably cost less than similar proceedings conducted in the International Chamber of Commerce or the Stockholm Chamber of Commerce. Since CIETAC raised its administrative fees in April 1995, however, this may no longer be the case (*see* table). The total costs to a foreign disputant can be considerable after adding travel expenses for the arbitrators, fees connected with the hiring of experts, and the costs of translating documents into Chinese.

Attorneys' fees, of course, will also increase costs. The parties to a dispute before CIETAC may be represented by anyone they choose, including Chinese or foreign lawyers—though foreign lawyers may not appear in Chinese courts on behalf of their clients. Even if a foreign party prefers to rely on foreign counsel (whose travel and living expenses in China will have to be taken into account), he may still need the assistance of a Chinese lawyer because the proceedings and documentation will all be in Chinese unless the parties have agreed otherwise. Chinese lawyers' fees, moreover, are on the rise, fast threatening to approach the fee levels of their foreign counterparts.

CIETAC limits the amount of costs that can be recovered to 10 percent of the amount received by the winning party.

Even if CIETAC rules favorably for a foreign party, the potential for recovering costs and attorneys' fees is uncertain. CIETAC limits the amount of costs that can be recovered to 10 percent of the amount received by the winning party. The amount may be further reduced by CIETAC's tendency to apportion fees and costs according to the award itself. For example, if a claimant is awarded only half of the damages claimed, it may not be awarded the full amount of its arbitration fee and may not get very much toward its other expenses. If the claim is for a small amount, some costs could be unrecoverable.

■ **Enforcement of awards** The most troubling issue that surrounds CIETAC is its inability to enforce awards. CIETAC has no power or means to order Chinese agencies or companies to comply with its awards. Under Chinese law, moreover, the successful claimant—whether on a foreign or a CIETAC award—must sue a losing party that refuses to pay in that party's Chinese place of business. In effect, this means a foreign party could be forced to go to a local court to sue for non-payment of an arbitration award, and will likely face strong local protectionism. The foreign claimant in such a case would need to engage a local lawyer, adding further to its costs.

Even when suit is brought in a Chinese court, whether on an award issued by CIETAC or a foreign tribunal, Chinese law (consistent with that of many other countries) permits review only on certain procedural grounds. Although the court may not reopen the matter to examine the merits of the parties' claims, some foreign lawyers claim that Chinese courts sometimes bend this rule.

Hoping for the best

It is often difficult to predict the ultimate outcome of arbitration in China. Yet a foreign party can be pleasantly surprised, despite sometimes rocky proceedings. In one group of three recent cases involving the quality of goods shipped by a Chinese exporter who tenaciously fought the importers' claims, the losing Chinese party not only paid within 30 days but sent a fax inviting one of the victors to resume the business which had been interrupted by arbitration.

Even though CIETAC's defects are not necessarily unique, its lack of grounding in a developed legal system nourished by a legal tradition that is recognizable to Westerners necessarily inspires Western unease about CIETAC arbitration. Many foreign investors in China, however, may simply have no choice but to agree to CIETAC arbitration, as standard contracts and Chinese negotiators invariably insist on arbitration in China. Nonetheless, because it has established and maintained its integrity, CIETAC offers hope of a reasonable method of resolving Sino-foreign commercial disputes. As arbitration in Beijing or any other locale is likely to be costly, investors should try to avoid the problem in the first place by taking more time during the negotiations to try to understand the assumptions and expectations—not to mention the wishes and dreams—of both sides of the table. 完

CIETAC Arbitration Fee Schedule, effective April 1, 1995

Amount of Claim	Arbitration Fee
¥1,000,000 or less	4% of the claimed amount (minimum of ¥20,000)
¥1,000,000-4,999,999	¥40,000 + 3% of the excess over ¥1,000,000
¥5,000,000-9,999,999	¥160,000 + 2% of the excess over ¥5,000,000
¥10,000,000-49,999,999	¥260,000 + 1% of the excess over ¥10,000,000
¥50,000,000 or more	¥660,000 + 0.5% of the excess over ¥50,000,000

SOURCE: CIETAC
NOTE: Each case is also charged a flat ¥10,000 CIETAC registration fee.

Going Back for More

■ Jerome A. Cohen

When and how to expand your China investment

■ Jerome A. Cohen is a partner in the international law firm of Paul, Weiss, Rifkind, Wharton & Garrison and a professor at the NYU School of Law. He serves as an advisor to the Sichuan provincial government and is a member of arbitration panels set up by both the China International Economic and Trade Arbitration Commission and the China Securities Regulatory Commission.

In the greatest tribute to China's investment climate a company can make, many multinational firms are now expanding their existing operations or setting up new ventures in the PRC. There is no precise way to gauge how many foreign investors have expanded their original China investments to date. According to one Ministry of Foreign Trade and Economic Cooperation (MOFTEC) source, however, about one-third of the many thousands of foreign-invested enterprises (FIEs) approved at the central level have already added to their initial investments. Experience suggests that a significant number of FIEs approved at the local level have also expanded.

The search for figures on FIE expansion is not particularly meaningful, anyway, since many foreign companies in China have resorted to expansion methods that escape official statistics. For example, foreign and Chinese co-investors can simply earmark joint-venture profits toward the venture's expansion or contingency funds or categorize them as retained earnings rather than formally distribute and reinvest them. Such a move would not come under the scrutiny of MOFTEC or its equivalent at the local level, and thus would not be counted in official statistics. At the other end of the spectrum, if a foreign investor uses an entirely different investment vehicle, the new venture will be classified as a separate FIE, rather than an expansion of the existing investment. Although statistically elusive, the range of options the PRC now offers foreign companies has done much to make the investment climate more attractive.

Making a choice

The particular expansion vehicle that a foreign firm chooses should obviously reflect its goals in China, which may have changed since the initial investment was made. A manufacturing company that gingerly put its toe in China's joint-venture waters in the 1980s, for instance, may now want to achieve economies of scale in its effort to maximize sales in China's consumer market. If satisfied with the existing FIE's management, work force, and distribution network, the foreign investor may decide to build onto the existing venture and even set up a branch in another location. Or, wishing to optimize tax advantages or diversify into additional businesses, the company may decide it is time to set up one or more new FIEs.

In some cases, how the first venture was structured may have a strong impact on how the foreign party approaches the idea of subsequent investments (*see* box). For example, the original joint-venture contract may preclude the foreign company from taking on other PRC partners. In other cases, the company may want to broaden its activities in China, perhaps through the establishment of an investment company to oversee multiple operations.

Traditional methods...

Once a company decides whether to add on to its existing venture or undertake a separate effort, it will have other decisions to make. A company seeking to expand an existing enterprise by infusing some of the venture's profits back into the enterprise will need to scrutinize the joint-venture contract and articles of association carefully. If the foreign party has majority control of the board of directors and if the documents authorize the board to determine by a simple majority how profits are to be distributed each year, the foreign partner can decide to retain the profits and use them to expand the operation.

Documents requiring annual payout of all distributable profits, however, will need to be amended by the joint-venture parties and approved by the board and the original approval authority. If the documents confer majority control upon the PRC investor, or require unanimous board consent, the foreign party may have a difficult time persuading the Chinese partner to forego cash payouts now in anticipation of longer-term profits from the expansion. On the positive side of this retained earnings option is the fact that the venture's registered capital does not actually rise, and thus no document amendment or approvals are required.

Rather than retain profits, some foreign companies prefer to reinvest in the existing venture once the profits have been distributed. Chinese tax laws offer at least a partial income tax refund for reinvestments that meet certain standards, but offer no incentives for the retained profits option.

Reinvestment can also raise problems. Any PRC tax benefits that may accrue from reinvestment may be offset by foreign (e.g., US) income tax consequences triggered by the profit distribution. Moreover, because reinvestment increases the venture's registered capital, the unanimous consent of the venture's board of directors and the approval of the PRC authority that approved the original joint venture are required. If the PRC party disagrees with the foreign party's desire to reinvest, the PRC party may deny approval, since reinvestment would result in a dilution of the Chinese party's interest in the venture.

A third option, if retained or reinvested profits are inadequate to finance expansion, is to inject a significant amount of fresh capital into the original venture, regardless of the Chinese partner's willingness to contribute a proportionate share. This expansion method carries many of the same dilution/approval problems as previously discussed.

Some foreign companies prefer to reinvest in the existing venture once the profits have been distributed.

Even if the PRC investor is willing and able to contribute its share of the capital or does not object to dilution, obtaining the necessary government approval for enlarging the venture's registered capital could entail bureaucratic hurdles if the original investment only received local approval and the increased investment would push the total investment over the local approval threshold. In these circumstances, the application for approval of the increased investment usually must be submitted to MOFTEC in Beijing, slowing down the approval process (*see The CBR*, January-February 1995, p.8).

...and the cutting edge

Foreign investors increasingly are looking for creative new ways to finance expansion of their existing China ventures. Some Sino-foreign ventures have increased their equity investment and expanded manufacturing capacity through a private placement or public offering undertaken by the foreign investor outside of China. The proceeds of the offering are then contributed to the joint venture as additional registered capital. Like other injections of fresh capital, this contribution requires the approval of both the local partner and Chinese authorities, who sometimes reject such proposals because they leave the local partner with little choice but to match the capital contribution or find its share diluted.

An FIE may also raise capital by converting itself into a joint stock company either by the promoter method or by issuing a public offering domestically or abroad. Though the conversion is easier said than done, some joint ventures have been able to resort to this option. Many uncertainties surround the conversion method, however, and MOFTEC's recent Interim Provisions on Some Issues Regarding Foreign-Invested Joint Stock Companies, while presenting criteria and procedures for approval of such companies, have introduced new wrinkles of complexity. Moreover, the great difficulty of obtaining approval to make a public offering makes it likely that an offering by the foreign investor outside of China will remain a more realistic way of raising money on capital markets for additional investment in Sino-foreign joint ventures.

But even if the foreign company's financing activities are taking place outside of China, it will need to consider how to deal with the China Securities Regulatory Commission (CSRC). Depending on the facts, the CSRC could interpret a public offering abroad as a listing of the PRC assets of the joint venture. If the issuer is a true foreign entity—not one created with a PRC entity's connivance or investment—the CSRC would not appear to have jurisdiction, though the venture should inform the CSRC informally of the transaction in advance.

In some cases, the foreign investor can deal with government concern that the Chinese investor's interest will be diluted through an expansion by giving the Chinese party the right to fund a pro-rata increase of its share of registered capital during a prescribed period. Alternatively, the offshore company spearheading the expansion might lend rather than contribute the money to the joint venture. Such an action involves only registration—not prior approval—of the debt with the State Administration of Exchange Control (SAEC) if no PRC guarantor is required. Lending the funds would not increase the proportionate interest of the foreign party in the venture since there would be no increase in registered capital. Although the loan will generally boost the venture's total investment, MOFTEC will usually give its approval, as long as the size of the loan does not put the venture in violation of MOFTEC's debt-equity rules.

Opening a branch of the original venture

Assuming that financing is available and the Chinese partner concurs, a foreign investor may seek to expand by establishing a branch of the existing venture in another part of China. A branch of a joint venture can engage in manufacturing, sales, after-sales services, and related activities if it stays within the scope of the venture's business license. This route can prove far simpler than negotiating, obtaining approval for, and implementing a separate venture, though approvals from the local officials in both the place of the main office and that of the branch may be required. If the total investment becomes large enough, MOFTEC will have to approve the branch. In some cases, authorities at the proposed new location may

Looking at the JV Law

Any foreign company seeking to set up an equity joint venture in China, the most common form of FIE in the PRC, naturally comes under the jurisdiction of China's Joint-Venture Law, which was enacted in 1979 and revised in 1990 (*see* p.12). Companies now negotiating their first China venture should be aware that the relative inflexibility of this law could affect expansion plans down the road.

The Joint-Venture Law mandates that profits of equity joint ventures be shared strictly in proportion to each partner's contribution to the venture's registered capital. An expansion financed by the foreign party alone will thus increase the foreign party's proportionate interest—and dilute the Chinese counterpart's—on a dollar-for-dollar basis.

But the law does not take account of the fact that the equity in the venture may be considerably more valuable at the time of expansion than it was at the start-up stage. This leaves the venture's Chinese partners with a dilemma—they may not have the money to match the foreign party in a new round of financing, but they do not want to see their equity stake diluted, especially at a price that seems unfairly low. They can, of course, simply refuse the foreign party's proposed capital infusion, but this would deny the venture funds for a promising expansion (unless the partners agree on a loan for the venture that will not exceed its permissible debt-equity ratio). Or, the foreign investor can try to convince his Chinese partner that anticipated long-term growth in profits will make the expansion worthwhile for both sides, even if the PRC side's equity stake is diluted.

Should the Chinese partner still be unwilling to expand the venture, one solution might be to convert the venture into a cooperative joint venture, which gives investors the freedom to stipulate in the contract how they intend to share profits. Thus, the investors could agree to accord the PRC partner a greater percentage of profits than it would receive based on a simple dollar-for-dollar comparison of the parties' respective contributions. In such a scenario, the profit split would in effect reflect the foreign partner's payment of a higher "price per share." This often occurs outside China as ventures begin to get off the ground.

Conversion from an equity joint venture into a cooperative joint venture, like expansion of the registered capital, would require amendment of the joint-venture documents and approval from MOFTEC or its local sub-unit, but should be possible if the dilution problem is handled in a mutually acceptable fashion. Of course, the foreign partner may find it simpler to make a substantial payment to the Chinese partner as a "premium" in recognition of its acceptance of dilution.

If the PRC party cannot—or will not—come up with its share of increased investment, and if it is unwilling to suffer dilution, the foreign party runs a serious risk of being unable to attain a level of profitability sufficient to justify its involvement with China. This is why foreign investors often seek, when negotiating the initial joint-venture contract, to include a clause that commits the Chinese party to consent to dilution when it does not contribute capital pro rata to match the foreign party's added contribution. Because such an expansion would in effect assign a portion of the PRC party's interest to the foreign party and would also result in an increase in the venture's registered capital, approval by MOFTEC or its sub-unit would ordinarily be required even if the Chinese partner agrees to the dilution. Therefore, foreign partners should seek to insert in their joint-venture contracts a clause to the effect that approval of the contract by the relevant approval authority constitutes pre-approval of any subsequent dilution of a party's interest as a result of added investment. Unfortunately, the likelihood of obtaining such pre-approval is slim.

On some occasions, the reluctance of the PRC party to allow the foreign investor to increase its percentage of the registered capital represents an opportunity for another foreign party to participate in the PRC party's share of the proposed capital increase. Transfer to a third party of a portion of the PRC partner's interest in the joint venture at a premium can provide a source of funds to enable the Chinese party to minimize the dilution.

Indeed, the desire of Chinese parties to avoid dilution at what they consider to be inappropriately low prices may be a major source of opportunity for financial investors in China today. Amending the joint-venture contract and articles to reflect the capital increase and the transfer of a portion of the PRC party's interest in the venture to the new foreign investor can be straightforward. Though the original foreign investor might not want another new partner, under most joint-venture contracts it typically would have no means of preventing admission of the third party apart from exercising its right of first refusal to purchase the Chinese party's interest at the same premium offered by the third party.

—Jerome A. Cohen

welcome the foreign investor but not its original PRC partner, and may suggest that the foreigner establish a separate venture with a local concern, an option that may prove attractive to the foreign company.

Thinking new

Foreign companies seeking to penetrate different regions, engage in additional areas of business activity, or reap new tax benefits may choose to set up a new entity rather than expand the existing one. In this case, foreign investors have a number of options:

■ **Establish a new joint venture** Setting up a new base with a new partner in a different locale can help a company deepen its penetration of the China market. But even if nothing in its original joint-venture contract precludes the foreign investor from establishing a second venture with another PRC party, this new venture might offend the Chinese partner to the original venture—unless it is included in some way. This problem can be avoided by making the original partner a third and minor investor in the new project, usually by allowing the original joint venture to join the foreign investor and the new PRC party in the second venture. This permits the first PRC partner to save "face" and assures it a minimal, if indirect, interest in the new project.

A chief advantage of establishing a new venture is the tax savings enjoyed during the early stages of an FIE's operations (*see* p.18). But investors must be aware that a joint venture among an existing FIE, the foreign investor, and a new Chinese partner may not, for tax purposes, be considered an FIE. Such a venture would gain tax benefits only if the foreign investor, directly and indirectly via its proportionate interest in the original FIE's contribution to the new venture, contributes in foreign exchange at least 25 percent of the new venture's registered capital.

■ **Establish a wholly foreign-owned enterprise (WFOE)** If a foreign investor believes, on the basis of experience with its initial China venture, that the costs of having a Chinese co-investor and joint manager outweigh the benefits, it may try to set up a wholly foreign-owned enterprise. Investors in WFOEs, however, should recognize that these ventures will usually confront stricter export requirements than joint ventures and will be held to a higher standard than joint ventures when seeking to qualify as technologically advanced enterprises. Moreover, WFOEs are not permitted in certain industries.

■ **Open a branch of the foreign parent company** One of the newest options for expanding investment independently of the original venture still exists more in theory than in fact. For years, foreign companies, chafing under the restrictions placed on their PRC representative offices, have sought to establish branches that can actually undertake business transactions rather than mere liaison activities. The Company Law that went into effect last year allows foreign companies to open branches that "engage in production and operating activities," though the types of production and operating activities likely to gain approval remain to be seen (*see The CBR*, May-June 1994, p.52).

> Some Chinese government agencies have become increasingly concerned about the sale of State assets below their real value.

The utility of the branch option will soon be clarified when implementing regulations for the Company Law are released. PRC officials thus far have generally been reluctant to entertain concrete proposals for the establishment of foreign corporate branches prior to promulgation of these regulations. But since a branch will not confer limited liability on the foreign investor and will not be eligible for FIE benefits, it may ultimately prove unattractive.

■ **Buy into an existing enterprise** The quickest way to expand one's investment in China is to buy into an existing enterprise or acquire another foreign company with PRC ventures. Buying into FIEs has always been possible, but the new investor must strike a deal with an investor willing to transfer its interest and must obtain the agreement of any co-investors and the original Chinese approval authority.

While individual foreign investors can always purchase China stocks on the Chinese, Hong Kong, or New York exchanges, foreign and Chinese companies can also purchase minority or controlling interests in smaller Chinese enterprises listed for sale in "property rights" markets that have sprung up throughout China. To date, such transactions have generally escaped MOFTEC scrutiny, though some government agencies have become increasingly concerned about the sale of State assets below their real value. Government regulations on this subject may be issued. Reportedly, these rules may reflect current internal rules that preclude foreign investors from holding a majority share in an enterprise in a "pillar" industry.

Foreign companies should be careful to obtain accurate information when buying into a PRC entity. In particular, the foreign investor must identify and deal with the Chinese entity's existing liabilities. A joint venture, in contrast, will generally be a new entity starting fresh, and the foreign investor can shield itself in the joint-venture contract against the previously incurred obligations of its PRC co-investor.

Foreign investors can also in effect buy into a PRC entity by participating in its conversion into a foreign-invested joint stock company under MOFTEC's recent Interim Provisions.

■ **Establish an investment company** A number of foreign companies have established PRC investment companies—sometimes referred to as "umbrella," "holding," or "group" companies—in order to expand earlier China investments. As *The CBR* goes to press, the investment company regulations have just been released. A detailed analysis of the new regulations will appear in the July-August issue. Until now, each investment company has been approved on the basis of evolving internal guidelines and ad hoc negotiations with MOFTEC. Each has taken the form of either a WFOE or an equity joint venture that has been adapted to suit the investment company function.

Motives for establishing investment companies vary. Foreign companies with ambitious plans in China generally hope to obtain greater flexibility and efficiency for their PRC investments by erecting a vertically integrated corporate structure. Such a structure not only provides for parent investments and reinvestments in PRC subsidiaries, but also allows manufacturing by the parent itself. In addition, the parent could coordinate input purchases, sales and marketing in China and abroad, after-sales services and technical support, centralized management, foreign exchange transactions by subsidiaries; and training for employees and customers of the entire PRC group of projects (*see The CBR*, September-October 1993, p.9).

> MOFTEC has stiffened its criteria for approval of investment companies.

Although most investors would also like to use their investment companies to import finished goods, with few exceptions they have not even been allowed to import goods manufactured abroad by the investment company's parent. Investment company exports from China have also been restricted to products manufactured by its PRC ventures. Indeed, the scope of the investment company's business license must be painstakingly negotiated with MOFTEC.

In recent months, MOFTEC has stiffened its criteria for approval of investment companies. While debating whether to increase the requirement that an applicant have two or more FIEs established or at least under negotiation, MOFTEC has increased other thresholds. For example, the applicant must now have total assets of at least $400 million; the minimum registered capital for the applicant's investment company has been raised from $10 million to $30 million (this amount must be contributed in cash within two years of establishment); and at least $30 million must be used for new projects or expanded investments rather than for the purchase of the foreign company's interests in existing FIEs.

Other recent changes, however, may make the investment company option more attractive. MOFTEC and the People's Bank of China have agreed that a investment company may establish as one of its subsidiaries a finance company for the exclusive purpose of providing financial services—such as fixed asset loans, working capital, and trade financing—to members of the investment group. The investment company itself, however, may not engage in such services. Thus far, authorities have approved at least five finance subsidiaries, despite the fact that the requirements are rather rigorous.

The investment company option is not likely to interest every foreign company with multiple investments in China. This vehicle offers no significant advantage either in terms of foreign exchange balancing for members of the group, or in terms of trading finished products. Some companies have concluded that the burdens of the approval process and the added layers of corporate administration outweigh the benefits. For other multinationals, tax considerations may prove to be a critical factor in their decision to open an investment company.

So many choices

Foreign companies eager to expand their investments in China now confront a broad array of choices. Some of those options, particularly expanding or buying into an existing FIE or setting up a new one, are attractive because existing legislation and extensive practice make them transparent, feasible, and relatively predictable. Other methods, such as buying into a Chinese enterprise other than an FIE or seeking to establish a branch of the foreign company, lead investors into less-charted waters. Investors must select among these various options in an environment marked by bureaucratic struggles both within the central government and between the national and local governments.

In these circumstances, it behooves investors to consider each of the various options in order to select the one or ones most likely to meet their expansion needs and long-term goals. Even companies that are only now beginning to invest in China should think ahead and build a sound legal framework for future expansion. 完

Council Inaugurates Annual China Gathering

The Council's first annual meeting for its China-based members, China Operations '95, attracted 120 people to day-long discussions on operational issues for US businesses in China. Secretary of Energy Hazel O'Leary was the luncheon speaker at the February 24 meeting in Beijing.

Energy Secretary O'Leary (left) discusses her trip with Council President Robert Kapp and Marjorie Chorlins of Motorola.

Morning keynote speaker Pieter Bottelier, chief of the World Bank mission to China, gave a positive view of China's economic development to date. Bottelier claimed "confidence" is the greatest strength of the Chinese people, but pointed out that factors such as continued population growth and a serious water shortage could constrain future economic growth. The discussion then shifted to a micro-economic perspective, with Jack Perkowski, president of Asian Strategic Investments Co. (ASIMCO), describing his company's efforts to create economies of scale in China's fragmented industrial base. Specifically created to make direct investments in China, ASIMCO thus far has completed seven joint ventures in auto components and two beer-making ventures.

Council President Robert Kapp closed the morning session, giving his impression of the US Congress' attitude toward China and Taiwan. Kapp warned that the newly elected Republican Congress may seek to improve US relations with Taiwan, and that the first signal of its resolve to do so would likely involve putting pressure on the White House to allow Taiwan President Lee Teng-hui to visit Cornell University this spring. According to Kapp, US acquiesence to Taiwan's request, which would invite vociferous protests from the PRC, could damage relations between the United States and China.

After lunch, Secretary O'Leary briefed Council members on her meetings with Chinese officials and the deals signed by the members of her business delegation during their week in China. In total, US companies accompanying the secretary signed 34 contracts and letters of intent for deals valued in excess of $4.6 billion. Ranging in size from $648,000 to $500 million, these transactions will promote US technology in China and generate jobs for US and Chinese workers if they are finalized. The majority of projects involve wind power and thermal power plants.

The afternoon session of China Operations '95 was devoted to break-out workshops on specific operational issues. Panels of company representatives discussed a wide range of topics, including ways to localize sourcing of components, how to manage visits from top-ranking home-office executives, marketing and distribution channels in China, and how to manage Chinese labor.

The pros and cons of holding companies as an investment vehicle was the focus of discussion at one workshop. Industry representatives cited the right to hire Chinese staff directly rather than through a labor-service organization, US tax benefits, increased flexibility in trade, and the ability to offer sales and marketing support to joint ventures as advantages to operating via a holding company. They noted, however, that high costs, difficulties in liquidating the company, and high

Defense Conversion Moves Forward

Lieutenant General Huai Guomo, vice minister of China's Commission of Science, Technology and Industry for National Defense (COSTIND), briefed Council members on the first batch of proposed defense conversion projects for Sino-American cooperation at a Council luncheon on March 28. The COSTIND delegation, which was visiting the United States under the auspices of the US-China Defense Conversion Commission, was one of the first high-ranking military groups to visit Washington, DC, since 1989 (*see The CBR*, September-October 1994, p.56). Sponsored by several US companies, the delegation visited defense-related facilities in California, Florida, and Massachusetts. Commerce Deputy Under Secretary for Export Administration Barry Carter also attended the luncheon meeting and praised the defense conversion efforts of his Chinese counterparts.

During his briefing, Huai circulated a list of 49 projects which COSTIND compiled after carrying out "extensive market research and feasibility studies." The majority of the proposed projects involve foreign investment or technology exchange in Chinese defense industries to enhance China's environmental protection capabilities, improve medical facilities, and support the PRC's transportation and engineering industries. Huai invited Council members to submit other project ideas and noted that Beijing's support for defense conversion projects is reflected in the increasing number of such projects approved annually. Although foreign investors in defense conversion projects still must submit approval applications to the appropriate Chinese authorities, Huai stressed that the projects would have COSTIND support and would receive preferential treatment from the Chinese government.

Panelists compared methods for finding local suppliers of key components.

John Frisbie from GE China (center) and other China Operations participants discuss their views of holding companies.

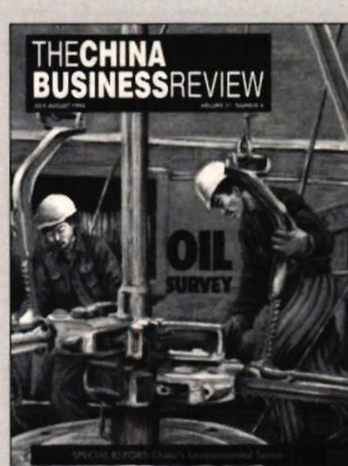
registered-capital requirements may preclude investors from choosing this option.

At the workshop on CEO visits, panelists stressed the need for China-based staff tasked with arranging such visits to set well-articulated goals and define the messages the CEO plans to deliver in China. The company's China staff must also work to avoid unrealistic expectations in the home office by letting the visitor know well in advance which Chinese government leaders he or she can expect to meet.

In the marketing and distribution workshop, panelists identified distribution channels typically used for different types of commodities and warned participants that developing markets in outlying provinces can be difficult and costly. They also stressed the importance of conducting thorough market research and establishing specific pricing strategies. The sourcing workshop, meanwhile, examined various methods of finding local suppliers of key components. One option involves holding a suppliers fair at which the foreign company's business units display the components they need and invite Chinese factory representatives to discuss whether their products are a good match. Other methods include sending inspection teams to Chinese suppliers recommended by the supervising ministries.

Finally, participants at the labor issues workshop discussed the need to conduct intensive training in China, especially of salespeople and managers, and the difficulty of keeping abreast of regulatory changes governing labor. Though panelists noted that utilizing company resources to provide local employees with social benefits can be costly, they agreed such benefits can motivate employees to be more productive.

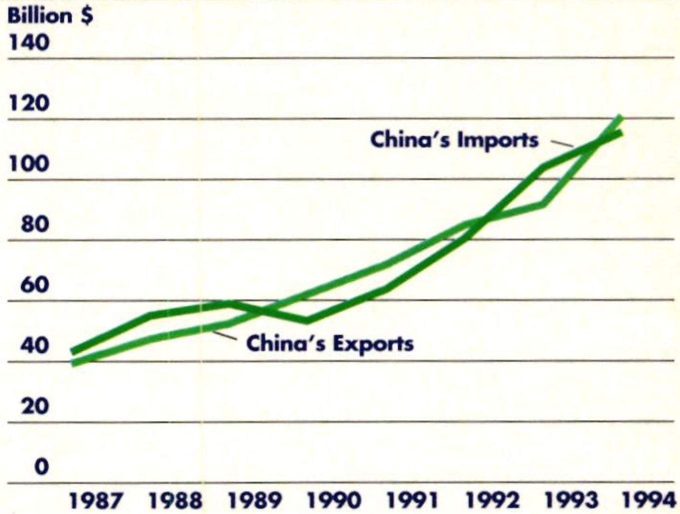
Members responded enthusiastically to China Operations '95, and the Council will plan a similar meeting in 1996 in either Beijing or Shanghai.



China's Trade with the World

Billion $	Exports (fob)	Imports (cif)	Total	Balance
1987	39.4	43.2	82.6	-3.8
1988	47.5	55.2	102.7	-7.7
1989	52.5	59.1	111.6	-6.6
1990	62.1	53.4	115.5	8.7
1991	71.9	63.8	135.7	8.1
1992	85.0	80.6	165.6	4.4
1993	91.8	104.0	195.8	-12.2
1994	121.0	115.7	236.7	5.3

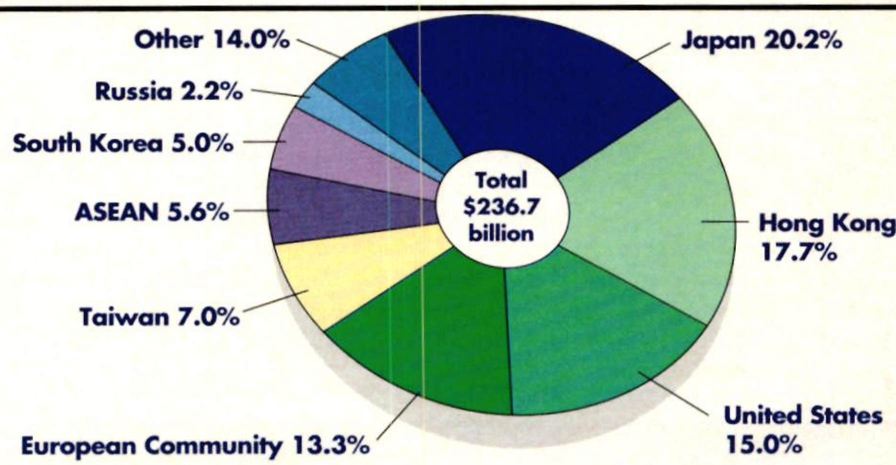
SOURCE: State Statistical Bureau



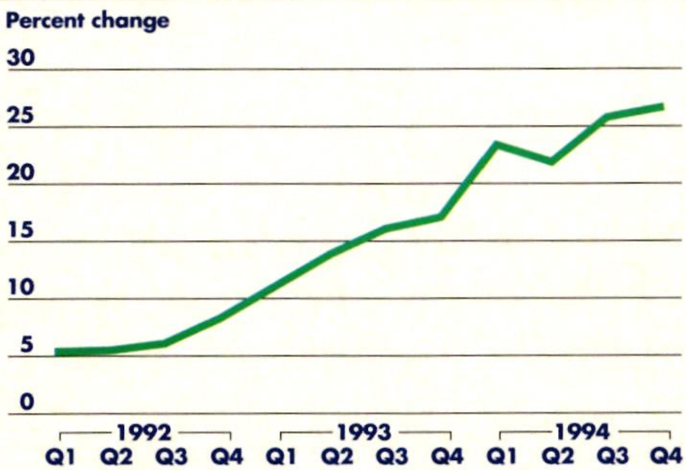
China's Top Trading Partners, 1994

Nation	Total Trade Billion $
Japan	47.9
Hong Kong	41.8
United States	35.4
European Community	31.5
Germany	11.9
Taiwan	16.3
ASEAN	13.2
South Korea	11.7
Russia	5.1

SOURCE: *China's Customs Statistics*



China's Inflation Rate

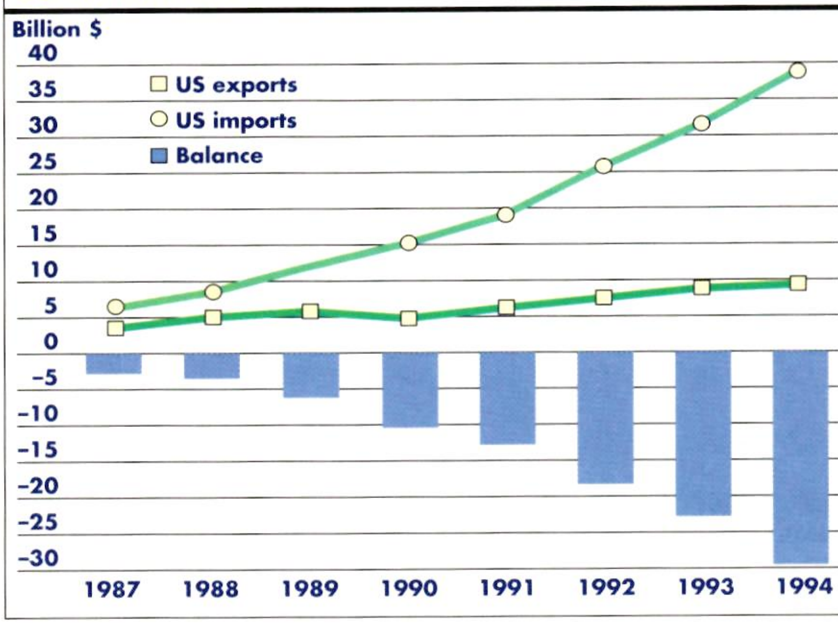


Change in Cost of Living Index (%)

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1992	5.4%	5.5%	6.1%	8.3%
1993	11.1%	13.9%	16.1%	17.1%
1994	23.4%	21.9%	25.8%	26.6%

SOURCE: World Bank

US-China Trade



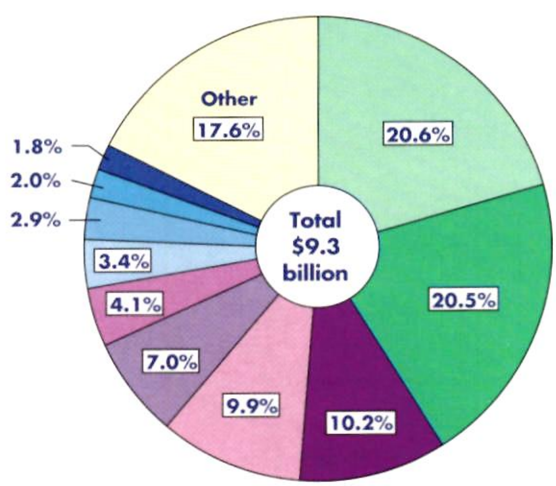
	US Exports (fas)	US Imports (cv)	US balance
1987	3.5	6.3	-2.8
1988	5.0	8.5	-3.5
1989	5.8	12.0	-6.2
1990	4.8	15.2	-10.4
1991	6.2	19.0	-12.8
1992	7.5	25.7	-18.3
1993	8.8	31.5	-22.8
1994	9.3	38.8	-29.5

NOTE: *Cv, or customs values, are approximately the same as fob or fas values, i.e., no shipping or insurance costs are included.*

SOURCE: US Department of Commerce

Top US Exports to the PRC, 1994

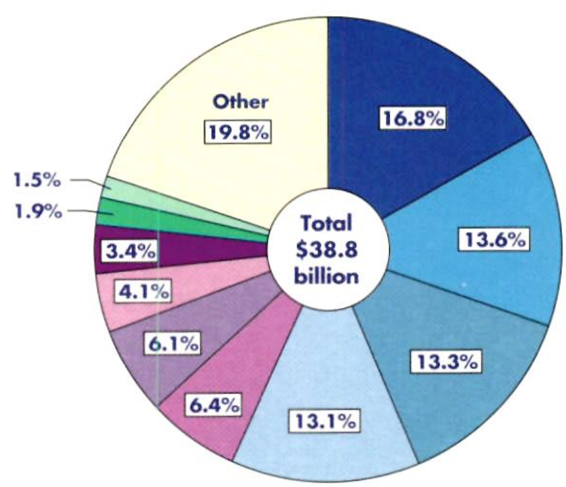
HTS #		Million $
84	Power generating equipment	1,920.3
88	Air & spacecraft	1,910.6
31	Fertilizer	944.1
85	Electrical machinery & equipment	919.4
52	Cotton, yarn & fabric	650.0
90	Medical & surgical equipment	385.8
87	Vehicles, except railway or tram	316.0
28, 29	Chemicals, inorganic & organic	272.8
39	Plastics & articles thereof	184.8
10	Cereals	170.1



SOURCE: US Department of Commerce

Top US Imports from the PRC, 1994

HTS #		Million $
85	Electrical machinery & equipment	6,522.4
64	Footwear & parts thereof	5,259.1
95	Toys	5,150.5
61, 62	Apparel	5,085.6
42	Leather & travel goods	2,488.4
84	Power generating equipment	2,365.5
94	Furniture	1,593.1
39	Plastics & articles thereof	1,337.7
90	Medical & surgical equipment	728.4
67	Down & feathers	566.4



SOURCE: US Department of Commerce

■ **Meredith Gavin**

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

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

SALES AND INVESTMENT January 15 - March 5, 1994

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

Accounting and Insurance

OTHER

SAP Asia, a unit of SAP AG (Germany)/Orient Overseas Container Line (HK)
Will license SAP's R/3 Financial Accounting System to OOCL offices in Asia, Europe, and the United States. 2/95.

Barnes & Thornburg (US)
Will open office in Beijing. 1/95.

Agricultural Commodities and Technology

CHINA'S SALES ABROAD

China National Forestry Products Corp./Marubeni Corp. (Japan)
Will sell wood chips. $54 million. 1/95.

OTHER

ADB/Agricultural Bank of China
Will provide loan and grant for agricultural projects in northern China. $100.8 million. 1/95.

Banking and Finance

OTHER

Banque Indosuez (France)
Opened branch office in Guangzhou. 2/95.

Bank of Nova Scotia (Canada)
Opened branch office in Guangdong Province. 2/95.

Barclays de Zoete Wedd Bank (UK)
Opened office in Shanghai. 2/95.

Bank of Montreal (Canada)
Will open branch office in Guangzhou. 1/95.

Banque Nationale de Paris (France)
Will open branch office in Guangzhou. 1/95.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Texaco Inc. (US)/Ministry of Chemical Industry, SINOPEC
Will sell gasification technology to retrofit nine fertilizer plants in China. $500 million. 2/95.

Itochu Corp. (Japan), Mitsui Engineering and Shipbuilding (Japan), Osaka Gas Engineering (Japan)/Baoshan Iron and Steel Corp.
Will sell desulphurization equipment. $13 million. 1/95.

INVESTMENTS IN CHINA

Monsanto Co. (US)/Jiangsu Chemical Pesticide Group Co.
Formed joint venture to produce and sell heat-transfer fluids in Jiangsu Province. (US:60%-PRC:40%). 3/95.

Honeywell Inc. (US)/Yueyang General Petrochemical Works
Signed letter of intent with the Yuehua SBS & BUT Distributed Control System Upgrade Project. $400 million. 2/95.

NA (Japan), NA (Japan)/Shanxia Paint Corp. Ltd. (Sichuan)
Established a car paint production joint venture in Chongqing. $7.1 million. 2/95.

NA (US)/NA
Established Jindi Petrochemical Corp. Ltd. joint venture to produce liquefied petroleum gas. $30 million. 2/95.

Japan Synthetic Rubber Co. (Japan)/Jilin Chemical Industry Co.
Will jointly produce ABS resin. 1/95.

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

Sandoz Ltd. (Switzerland)/Tianjin Chemical Co.
Established two joint ventures to produce dyestuffs for the domestic and export markets. $30 million. 1/95.

Consumer Goods

INVESTMENTS IN CHINA

Whirlpool Corp. (US)/Shanghai Narcissus Electric Appliance Co.
Established Whirlpool Narcissus (Shanghai) Co. joint venture to manufacture washing machines. $29.5 million. (US:55%-PRC:45%). 3/95.

Kao Corp. (Japan)/Shanghai Yu Long Enterprise
Will invest in Kao Corp. Shanghai joint venture to produce hair- and skin-care products. $15 million. 2/95.

Robert Bosch Gmbh (Germany)/Shenzhou Group Corp. (Guangdong)
Created Bosch-Shenzhou Gas Appliances Co. Ltd. in Guangzhou to produce gas appliances. $19.7 million. 2/95.

Samsung Group (S. Korea)/Xiangxuehai Electric Appliance Corp.
Established Suzhou Samsung Electronics Co. joint venture to produce refrigerators, air conditioners, microwave ovens, and other appliances. $42.5 million. 2/95.

Yamaha Corp. (Japan)/Guangzhou Piano Manufacturing
Established Yamaha Pearl River Piano joint venture to produce pianos. (Japan:60%-PRC:40%). 2/95.

Amway Asia Pacific Ltd. (HK)/Escada Industrial Corp. (Guangdong)
Opened Amway (China) Co. joint venture to manufacture home-care products for Guangdong and Fujian provinces. $100 million. 1/95.

Ralston Purina Co. (US)/Beijing Battery Factory
Will jointly manufacture batteries. $12 million. 1/95.

Whirlpool Corp. (US)/Beijing Snowflake Electric Appliances Group Corp.
Established the Beijing Snowflake Electric Appliances Co. joint venture to produce refrigerators and freezers. 1/95.

OTHER

Polaroid Corp. (US)
Will open offices in Beijing, Chengdu, and Shenyang. 2/95.

Adidas AG (Germany)
Opened representative office in Shanghai. 1/95.

Outdoor Technology Group (US)
Opened office in Beijing. 1/95.

Electronics and Computer Software

CHINA'S IMPORTS

System Software Associates (US)/Linde-Xiamen Forklift Truck Corp., a Sino-German joint venture
Will install a computerized operation management system. $600,000. 2/95.

CMEC Electronics (Xian) Co. Ltd. (UK)/Xian No.2 Radio Factory
Established Xian Qingzhu Electronics Co. Ltd. joint venture to produce electronic components. $26.2 million. 1/95.

INVESTMENTS IN CHINA

Motorola Inc. (US)/Leshan Radio Co. (Sichuan)
Formed semiconductor production joint venture. $27.8 million. 3/95.

Motorola Inc. (US)/Panda Electronic Group (Jiangsu)
Agreed to establish joint venture to produce and sell personal computers. 3/95.

Alphatec Electronics (Thailand), Microchip Technology (US)/Shanghai Huaxu Microelectronics Corp.
Formed joint venture to assemble and test computer chips. $75 million. (Thailand:51%, US:4%-PRC:45%). 2/95.

Digital Equipment Corp. (US)/Hunan Computer Factory
Will establish joint venture to manufacture and market application-specific integrated circuits. 2/95.

NEC Corp. (Japan)/Changjiang Computer (Group) Co. (Shanghai)
Will establish joint venture to produce IBM-compatible PCs, workstations, printers, and point-of-sale machines. 2/95.

Sanyo Electric Co., Ltd. (Japan)
Established Sanyo Electric (China) holding company to provide administrative services for its subsidiaries and facilitate investment in new firms. 2/95.

Sharp Corp. (Japan)/Wuxi Electronics Instrument and Meter Industry Corp. (Jiangsu)
Formed Wuxi Sharp Electronic Components Co. Ltd. joint venture to manufacture and sell monochrome liquid crystal display (LCD) panels. $12 million. (Japan:80%-PRC:20%). 1/95.

OTHER

MapInfo Corp. (US)/China Siwei Surveying & Mapping Technology Corp.
Developed Chinese-language desktop mapping software. 3/95.

IBM Corp. (US)/China National Grain Information Center
Will jointly computerize and network the inventory management system of China's grain warehouses. 1/95.

Engineering and Construction

INVESTMENTS IN CHINA

Armstrong World Industries (US)/Shanghai Advanced Building Materials
Will produce and market mineral fiber acoustical ceilings. 2/95.

Chia Xin Cement (Taiwan), Universal Cement (Taiwan)/Nationwide Construction Materials
Formed joint venture to build and operate two ready-mixed concrete production plants in Shanghai. $12 million. (Taiwan:25%, 25%-PRC:50%). 2/95.

Honeywell Inc. (US)/NA (Tianjin)
Will construct a manufacturing plant to produce heating controls for apartments and commercial buildings in China and other Asian countries. 2/95.

Marubeni Corp. (Japan), Nihon Cement Co. Ltd. (Japan)/Hebei Construction Investment Co., Qinhuangdao Funing Cement Development Corp., Qinhuangdao Port Office
Established Qinhuangdao Asano Cement Co. Ltd. joint venture in Hebei Province to produce cement. $193 million. (Japan:70%-PRC:30%). 2/95.

China Resources Metal and Minerals Co. Ltd. (HK), Sumitomo Corp. (Japan), and Ube Industries Ltd. (Japan)/NA (Guangdong)
Formed Dongguan Huarun Cement Factory Ltd. joint venture to produce and process finished cement. $85 million. 1/95.

Environmental Technology and Equipment

INVESTMENTS IN CHINA

CH2M Hill International, Ltd. (US)/China International Engineering Consulting Corp.
Established CIECC/CH2M Hill Environmental Associates joint venture to carry out projects identified in China's Agenda 21 plan. $20 million. 2/95.

OTHER

Global Environment Facility/Ministry of Forestry
Will provide loans for afforestation project and management training on five nature reserves. $334 million. 1/95.

NA (Germany)/NA (Anhui)
Provided loan for drinking water supply projects in four cities. $23 million. 1/95.

Food and Food Processing

INVESTMENTS IN CHINA

Anheuser-Busch Asia Inc., a unit of Anheuser-Busch Cos., Inc. (US)/Zhongde Brewery (Wuhan)
Purchased an 80 percent stake in Zhongde Brewery and renamed it Budweiser Wuhan International Brewing Co. 2/95.

Kirin Beverage Corp. (Japan), NA (Japan)/Wuxi Old Canal Beverage & Food Factory
Created Wuxi Kirin Beverage Co. Ltd. joint venture to produce soft drinks. $7.5 million. (Japan:50%, 16.7%-PRC:33.3%). 2/95.

NA (Australia)/NA (Hebei)
Formed Hebei Lima Foodstuffs Co. Ltd. joint venture to produce enzymes. $13 million. 2/95.

Hiram Walker Wines & Spirits Ltd., a unit of Allied Domecq PLC (UK)/Qingdao Huaguan Wines & Spirits Co.
Established joint venture to produce wine and liquor in China. $99.8 million. 1/95.

OTHER

Beck's (Germany)
Will open representative office in Beijing. 2/95.

7-Eleven, a subsidiary of President Chain Store Corp. (Taiwan)
Will open chain stores in China. 1/95.

Foreign Assistance

Overseas Economic Cooperation Fund of Japan (Japan)/MOFTEC
Will provide loans to the power, transportation, port construction, chemical, and other sectors. $1.4 billion. 1/95.

Machinery and Machine Tools

INVESTMENTS IN CHINA

GE Drive Systems, a unit of General Electric Co. (US)/Shanghai General Rectifier Plant
Established GE Shanghai Drive Systems Co. joint venture to manufacture, sell, and service industrial drive systems. $6.9 million. (US:51%-PRC:49%). 2/95.

NA (Japan)/Changzhou Forestry Machinery Factory (Jiangsu)
Established joint venture to manufacture heavy-duty front loaders and related equipment. $30 million. (Japan:40%-PRC:60%). 2/95.

Sumitomo Electric Industries Ltd. (Japan), Sumitomo Electric Singapore Co. (Singapore)
Established Sumitomo Electric (Wuxi) Co. Ltd. wholly foreign-owned enterprise to manufacture magnetic coils. $9 million (Japan:70%,Singapore:30%). 2/95.

Medical Equipment and Devices

OTHER

Swank Optical, a subsidiary of Swank Inc. (US)
Opened an optical store in Shanghai. 1/95.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

Custom Coals Co. (US), MRI (Australia)/China Coal Construction & Development Corp.
Will jointly lay a 500-mile underground pipeline between Shaanxi and Shandong provinces and construct a coal washery and port facilities. $888.6 million. (US, Australia:51%-PRC:49%). 2/95.

Marubeni Co. Ltd. (Japan), Toyo Steel Ball Co. Ltd. (Japan)/Maanshan Wear Resistance Metal Casting Material Co. (Anhui)
Formed joint venture to produce steel balls. $9.2 million. (Japan:10%, 50%- PRC:40%). 2/95.

Pohang Iron & Steel Co. (S. Korea)/China National Ferrous Metals & Materials Corp.
Will jointly produce galvanized steel plates in northeast China. $60 million. (S. Korea:70%-PRC:30%). 2/95.

Chester Environmental Group (US)/Bao Steel (Shanghai)
Will provide engineering design for water systems used in Bao's coke production. $4 million. 1/95.

Hwangs International Holdings Ltd. (US)/China National Nonferrous Metals Industry Corp.
Will establish Yellow River Aluminum Co. Ltd. joint venture to produce aluminum. $188.4 million. (US:49%-PRC:51%). 1/95.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Scott Paper Co. (US)/Shanghai Paper Co.
Formed Scott Paper (Shanghai) Co. joint venture to manufacture paper and sanitary tissue products. (US:56%-PRC:44%). 2/95.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Brown & Root, a subsidiary of Halliburton Co. (US)/Daqing Petroleum Administration Bureau
Will jointly establish a perforating charge API test facility. $640,000. 2/95.

Brown & Root, a subsidiary of Halliburton Co. (US)/Liaohe Petroleum Exploration Bureau
Will establish joint venture to manufacture high-technology flow measurement products. $850,000. 2/95.

Chevron Overseas Petroleum Ltd., a division of Chevron Corp. (US)/CNOOC
Will explore for natural gas in the South China Sea. $30 million. 2/95.

Chevron Overseas Petroleum Ltd., a division of Chevron Corp. (US)/CNOOC
Began drilling oil well in the East China Sea. 2/95.

Royal Dutch/ Shell Group (Netherlands)/China Merchant Holdings, CNOOC, Sinopec, NA (Guangdong)
Will jointly construct an oil refinery and ethylene plant near Daya Bay, Guangdong Province. $6 billion. (Netherlands:50%-PRC:50%). 2/95.

Triton Energy Corp. (US)/CNOOC
Will explore for oil in the Pearl River Basin. 2/95.

Gaz Marine (France), Golden State Import-Export Enterprises (US), Sofregaz (France)/Beijing Gas and Heating Engineering Design Institute
Formed Beijing United Gas Engineering and Technology Co. joint venture. 1/95.

Marathon Oil Co. (US)/CNOOC
Will drill for oil in the South China Sea. 1/95.

Ports and Shipping

CHINA'S IMPORTS

NA (Russia)/NA
Sold 4 diesel-powered submarines. $1 billion. 2/95.

Italimpianti Societa Per Azionj (Italy)/China Harbor Engineering Co., China National Technology Import-Export Corp.
Will sell loading and unloading equipment to the Shanghai Luojing Coal Wharf. $20 million. 2/95.

INVESTMENTS IN CHINA

Nippon Yusen Kaisha (Japan)
Will open wholly owned subsidiary in Shanghai. 1/95.

CHINA'S INVESTMENTS ABROAD

China State Shipbuilding Corp./Tristar Shipping Lines (Pakistan)
Will build joint-venture shipyard at Port Qasim. $120 million. 1/95.

OTHER

American President Lines, a unit of American President Cos. (US), Orient Overseas Container Line Ltd. (HK)
Began trans-Pacific shipping service between Yantian in Fujian Province and California. 2/95.

Power Generation Equipment

CHINA'S IMPORTS

Westinghouse Electric Corp. (US)/Huaneng Power International Inc. (Liaoning)
Will build four generators for coal-fired power plants. $200 million. 3/95.

New World Power (US)/China Changjiang Energy Corp.
Will install a 39MW wind farm for the Fujian Wind I project. $30 million. 2/95.

Westinghouse Electric Corp. (US)/China Nuclear Energy Industry Corp.
Will sell components for two 600MW turbine generators. $24 million. 2/95.

ZOND Systems (US)/Zhejiang Wind Power Development Co.
Signed letter of intent to sell 128 wind turbine generators for the Dachen Island Wind Power Project. $51 million. 2/95.

ZOND Systems (US)/Guangdong Nanao Zhenneng Wind Power Development Co.
Signed letter of intent to sell 54 wind turbine generators for the Nanao Island Wind Power Project. $21 million. 2/95.

Framatome SA (France); GEC-Alsthom, a joint venture between GEC PLC (UK) and Electricite de France (France)/Guangdong Nuclear Power Holding Co.
Will sell two nuclear reactors and build power station near Daya Bay, Guangdong Province. $3.4 billion. 1/95.

INVESTMENTS IN CHINA

AES China Generating Co., a subsidiary of AES Corp. (US)/NA (Shanxi), NA (Jiangsu)
Formed joint venture to build a 2,100MW coal-fired power plant in Yangcheng, Shanxi Province. $1.8 billion. (US:25%-PRC:75%). 2/95.

China Merchants China Direct Investments Ltd. (HK)/Electric Power Development Corp. Yantai (Shandong)
Established the Yantai Hua Shang Power Co. Ltd. cooperative joint venture to acquire a 27 percent share in the Longkou Power Plant Phase II. $40 million. 2/95.

FloWind Corp. (US)/Inner Mongolia Electricity Board
Formed joint venture to build a 100MW wind power plant. $85 million. 2/95.

FloWind Corp. (US)/Zhejiang Wind Energy
Will form joint venture to build a 30MW wind power plant. $29.5 million. 2/95.

InTeSol/Energy Initiatives (US)/Sichuan Electric Power Authority
Signed letter of intent to build a 2X600MW coal-fired power plant. $1.2 billion. (US:84%-PRC:16%). 2/95.

InTeSol/Energy Initiatives (US)/Jilin Province Energy & Transportation Co., Jilin Province Power Co.
Signed letter of intent to build a 2X300MW coal-fired power plant. 2/95.

Westinghouse Electric Corp. (US)/Harbin Turbine Co.
Will jointly manufacture two 650,000KW steam turbines for the Qinshan nuclear power plant. 2/95.

ZOND Systems (US)/Inner Mongolia Electric Power Co.
Signed letter of intent to build a wind power plant. $110 million. 2/95.

Fuji Electric Co., Ltd. (Japan)/Fuchunjiang Hydraulic Machinery Factory
Established Fuchunjiang Fuji Electric joint venture to manufacture, install, and service hydroelectric power plants. $10 million. (Japan:59%-PRC:41%). 1/95.

Property Management and Development

INVESTMENTS IN CHINA

Nissho Iwai Corp. (Japan), Sun Hung Kai Properties Ltd. (HK)/China State Construction Engineering Corp., NA (Guangzhou)
Will build office and shopping center complex in Guangzhou. $310 million. 2/95.

Daewoo Group (S. Korea)
Will build entertainment parks, hotels, hospitals, sports facilities, and apartments around Beijing. 1/95.

NA (Australia)/NA (Yunnan)
Will jointly develop the Jiaozhishan Resort in Luquan County. 1/95.

Topform International Ltd. (HK)/Yimin Department Store Co. Ltd. (Shanghai)
Opened Printemps Shanghai department store. $27 million. 1/95.

OTHER

Beijing McDonald's Food Co. Ltd., a subsidiary of McDonald's Corp. (US)/Beijing Vantone Plaza Real Estate Co. Ltd.
Purchased space to construct restaurant in the Vantone New Work Shopping Mall in Beijing. 1/95.

Telecommunications

CHINA'S IMPORTS

Alcatel SEL AG (Germany), a subsidiary of Alcatel-Alsthom Compagnie D'Electricite (France); Alcatel EL Senalizacion, a Spanish subsidiary of Alcatel SEL AG (Germany)
Will sell rail signal equipment for the Shenyang subway. $26.5 million. 2/95.

Motorola Inc. (US)/Jiangsu Ministry of Posts and Telecommunications, Zhejiang Ministry of Posts and Telecommunications
Will expand and upgrade cellular telephone systems. $150 million. 2/95.

AT&T Network Systems, a unit of AT&T Corp. (US)
Will sell advanced telecommunications equipment to Guangdong Province. $150 million. 1/95.

INVESTMENTS IN CHINA

SGS-Thomson Microelectronics, Inc. (US)/Qinghua University Department of Computer Science & Technology
Will jointly build the Qinghua/SGS-Thomson Center for research and development in Beijing. 2/95.

AT&T Corp. (US)
Established AT&T (China) Co. Ltd., a wholly owned subsidiary, to manufacture high-technology telecommunications equipment, computer hardware, and software products. 1/95.

OTHER

NA (Germany)/NA (Shandong)
Will provide loan to improve rural communication facilities. $31.7 million. 1/95.

Textiles and Apparel

INVESTMENTS IN CHINA

Courtaulds Textiles Co. (UK)/Jiangsu Textile (Group) Corp.
Formed Jiangsu Science & Technology (Fabrics) International Ltd. to produce warp-knitted fabrics for underwear and sportswear. $25 million. 1/95.

Transportation

CHINA'S IMPORTS

Fokker N.V. (Netherlands)/Xinjiang Airlines
Will sell 5 Fokker-50 planes. $76 million. 3/95.

Daimler-Benz AG (Germany)/BOC
Will sell 50 armored cars. 1/95.

Ford Motor Co. (US)/BOC
Will sell 50 armored cars. 1/95.

INVESTMENTS IN CHINA

Balfour Beatty Ltd. (UK)/Guangzhou Metro Corp.
Will build an overhead line system for first phase of Guangzhou subway. $14.3 million. 2/95.

Isuzu Motors (Japan), Kitamura Manufacturing (Japan)/Beijing Automotive Industry Corp., Beijing Chiyu Specified Automobile Factory, Beijing Light Automotive Corp.
Established Beijing Beiling Special Automobile joint venture to build aluminum bodies for refrigerator and freezer trucks. $2 million. (Japan:30%, 20%-PRC:15%, 25%, 10%). 2/95.

Lucas Industries (UK)/Hua Yang (Hubei)
Formed Lucas Huayang Vehicle Braking joint venture in Shiyan to manufacture air brakes. $7.8 million. (UK:60%-PRC:40%). 2/95.

Alpine Electronics Inc. (Japan)/NA (Dalian)
Established Dalian Alpine Electronics Inc. joint venture to manufacture automotive audio components. $6 million. (Japan:70%-PRC:30%). 1/95.

NA (France)/Shanghai Automobile Industry Corp.
Established joint venture to produce magneto starters and generators for Santana, Peugeot, and other cars. $30 million. (France:50%-PRC:50%). 1/95.

SKF Aktiebolaget (Sweden)/Shanghai Bearing Corp.
Established SKF Automotive Bearings joint venture to produce ball bearings. $13.3 million. (Sweden:60%-PRC:40%). 1/95.

Siemens AG (Germany)/Baoshan Iron and Steel Corp.
Established Siemens Manufacturing and Service Center Shanghai joint venture to produce transmission control devices. $11.5 million. 1/95.

CHINA'S INVESTMENTS ABROAD

NA/Tehran Urban & Suburban Railway Co. (Iran)
Will sell equipment to help build the Tehran subway. $400 million. 2/95.

OTHER

Lao Airline Development Joint Co., a joint venture between Laos Aviation Co. (Laos) and China Yunnan Aviation Co.
Began international flight routes between Cambodia, Laos, Thailand, and Vietnam. 3/95.

Austrian Airlines (Austria)/Air China
Began air service between Vienna and Beijing. 2/95.

General Motors Corp. (US)
Opened office in Shanghai. 1/95.

Kowloon-Canton Railway Corp. (HK)/China Railway Container Transport Center, a subsidiary of the Ministry of Railways
Launched joint container shuttle service between Hong Kong and Wuhan. 1/95.

Northern China German Auto, a wholly owned subsidiary of Lotus Automotive Group (Germany)
Opened office and service center in Beijing. 1/95.

Miscellaneous

OTHER

Korn/Ferry International (US)
Opened executive search office in Beijing. 2/95.

Underwriters Laboratories Inc. (US)/State Administration of Import and Export Commodity Inspection
Signed agreement to allow China National Import and Export Commodities Inspection Corp. to test products to UL standards and requirements. 1/95.

Warsaw Automobile Plant (Poland)/Chinese Dongou (Group) Ltd.
Signed barter agreement to export Polish cars to China in exchange for textiles, garments, televisions, medical equipment, and industrial raw materials. 1/95.

ADVERTISERS IN THIS ISSUE