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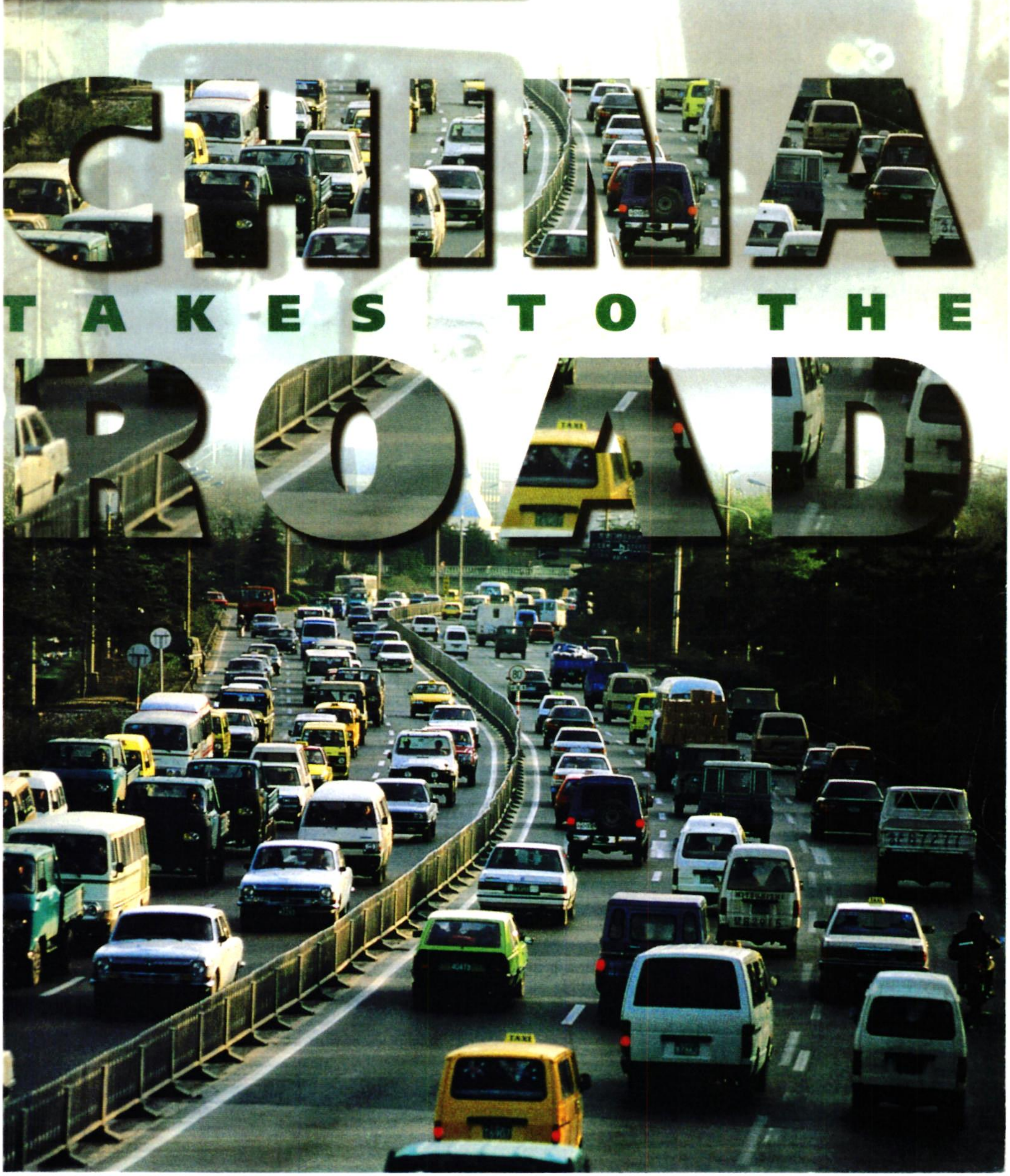
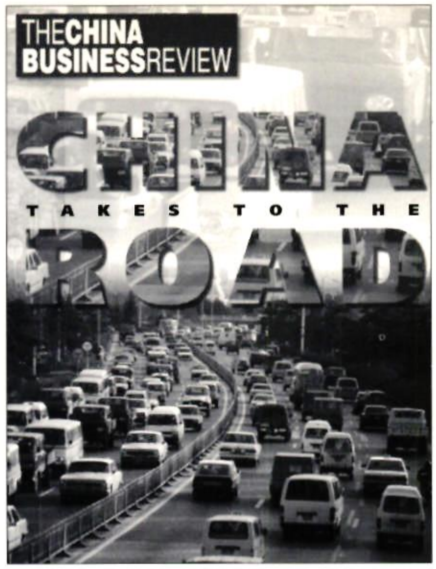
CHINA TAKES TO THE ROAD



1997 NOVEMBER DECEMBER



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MAINLAND COMPANIES SETTLE DOWN IN HONG KONG

The one thing that can be said with some certainty about business in Hong Kong is that it is never dull. The economy either races ahead, earning the government masses of revenue and stock investors large returns; or, the scene of late, the market crashes as the government spends large amounts of money to prop up the currency. Yet when the current wave of panic finally ebbs, no matter what the outcome, analysts will discover that the face of business in Hong Kong is changing, and is becoming noticeably more Chinese—and the language increasingly Mandarin. This metamorphosis predates the handover, and reflects the PRC government's desire to "decolonize" the territory and ensure that Chinese conglomerates benefit from its wealth. The increasing economic integration of Hong Kong and China is also a natural reflection of the growing sophistication of PRC companies and the complementarity of cash-rich Hong Kong and opportunity-rich China.

The influence of mainland firms in Hong Kong is now felt from the stock market to core industrial sectors. Three PRC-backed companies are included in Hong Kong's benchmark Hang Seng Index, while two other indexes have been created specifically to monitor PRC company performance in Hong Kong. These China-concept stocks—red chips, which are stocks of mainland subsidiaries incorporated in Hong Kong, and H-shares, which are issued by State enterprises incorporated in China but listed in the territory—now constitute a significant percentage of turnover and capitalization of the Hang Seng Exchange, although their performance of late has been highly volatile.

Several of the Hang Seng-listed Chinese enterprises have made large, strategic purchases in Hong Kong over the past 12-18 months, and mainland-backed giants such as CITIC Pacific, China Resources, and China Everbright now hold stakes in Hong Kong-British firms that have long held monopolies in such sectors as civil aviation, power generation, and telecommunications. Ostensibly, the new partnerships will give the Hong Kong firms greater potential access to and understanding of mainland markets, sweetening the bitter pill of losing at least some management control over their companies. PRC firms, for their part, will have the opportunity to study Hong Kong companies' management techniques and benefit from their earnings.

The first in the most recent spate of high-profile PRC acquisitions outside the property sector occurred in June 1996, when CITIC Pacific and the China National Aviation Corporation (CNAC) obtained a piece of the territory's flagship air carrier, Cathay Pacific, from Swire Pacific. The agreement reduced CITIC Pacific's interest in Hong Kong Dragon Airlines (Dragonair) from 46 percent to roughly 28 percent and increased CITIC Pacific's share in Cathay Pacific from 10 percent to 25 percent. On completion of the deal, CNAC owned a 36 percent share of Dragonair and became its largest shareholder, leaving Swire Pacific and Cathay Pacific Airway Ltd. together with 26 percent of Dragonair. Meanwhile, Swire's stake in Cathay Pacific dropped from roughly 53 percent to 44 percent.

In January of this year, CITIC Pacific bought 20 percent of China Light & Power (CLP), Hong Kong's largest power company, for HK$16.25 billion ($2.1 billion). CITIC Pacific also received two seats on CLP's board. In June, China Telecom (Hong Kong) obtained a 5.5 percent stake in Hongkong Telecom from Cable and Wireless PLC (C&W), the British parent company. China Telecom (HK), which listed on the Hang Seng in late October, is a subsidiary of China Telecom Ltd., an investment arm of China's Ministry of Posts and Telecommunications, which is, in turn, under the control of China's State Council. Some analysts believe China Telecom may well up its investment in Hongkong Telecom to a level equal to that of C&W, which currently holds 53.5 percent of the company. Other PRC-backed firms, including CITIC Pacific and China Everbright, also hold shares in Hongkong Telecom, making PRC-backed companies among the most important minority shareholders in the company.

Mainland Chinese financial institutions are also very active in Hong Kong, holding a sizable proportion of Hong Kong's mortgage market as well as majority portions of smaller Hong Kong banks, such as Ka Wah Bank, which is roughly 60 percent owned by China International Trust and Investment Corp. Rumors of PRC acquisitions of larger Hong Kong players have been rife for months, but no such deals have been announced.

Now that PRC firms have strong footholds in virtually all core sectors of the Hong Kong economy, many analysts expect mainland entities will direct their attention to investments made solely on the grounds of earnings potential rather than for strategic purposes. It is too early to tell what impact the October turmoil will have on the plans of PRC firms in the territory, but there seems little doubt that the influence of mainland firms will continue to grow.

—Pamela Baldinger

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

Short TAKES

TRACKING RED CHIPS

A reflection of the rising profile of mainland companies in the Special Administrative Region's stock market, the Hang Seng China-Affiliated Corporations (CAC) Index was introduced by Hang Seng Index Services in mid-June to gauge the performance of red chips listed on the Hong Kong exchange. The new index consists of 32 stocks that are at least 35 percent owned by PRC State-owned companies or other government bodies.

SHANGHAI EXPRESS CUSTOMS

Medium- and large-sized enterprises with "good" PRC Customs records now are able to clear imports through Shanghai more quickly. The city's Wusong Customs house established an express window in July that permits approved importers to collect goods immediately upon their arrival and pay Customs duties in person within seven days.

Winter Website Roundup

The following websites should help China-watchers stay abreast of changes in the PRC's business climate:

http://www.asiandevbank.org The *Asian Development Bank (ADB)*'s home page offers free access to selected statistical data on Asia-Pacific countries, including China. In addition, the ADB website includes up-to-date announcements of ADB contract awards and business opportunities, indices of ADB documents available for purchase, and a reference list of articles and books about the development of China's legal system.

http://www.ita.doc.gov/industry/computers/mktchina.html The Department of Commerce International Trade Administration's Office of Computers established this market research page to follow China's information technology (IT) sector. The site currently features updates on IT marketing and translation in China, a sketch of the PRC's computer market, a brief on the Jiangsu Changshu Economic Development Area, and a report on personal computers in China and the country's Golden Projects.

http://www.iebb.com The *Import-Export Bulletin Board (IEBB)* website is most useful for importers and exporters seeking leads on international trade opportunities and information about IEBB's available products and services. IEBB permits free access to a portion of its export, import, and business opportunity lists, but not to its link with STAT-USA—a top-notch source of international trade information. Similarly, an $879 annual "regular" corporate membership (5 users) does not include access to STAT-USA. Users must sign up for the "premium" $1,167 annual corporate membership (5 users) to gain access to the STAT-USA site.

http://www.ccpit.org The *China Council for the Promotion of International Trade* and the *China Chamber of International Commerce* established this site to supplement their ongoing trade, investment, and technology transfer promotion efforts. The site contains trade leads; upcoming trade fairs in China; periodic updates on PRC economic, policy, and trade developments; and the organizations' seven-chapter *China Business Guide*. Access to this website is free.

http://www.Chubb.com/china The *Chubb Group of Insurance Companies* launched this website to provide information on China's insurance industry. In addition to a brief overview of China, the site contains the full text of and commentary on the 1995 Insurance Law of China. Information on risk management for several PRC industrial regions and China's fire codes is also available. Access to this website is free.

—Ann M. Weeks

A Day at the Races

Hong Kong residents have made horse racing, a favorite pastime, into big business. Bets placed at the Hong Kong Jockey Club totaled $11.9 billion during the 1996-97 season. The club's Charities Trust received $161.5 million of the gambling proceeds, while the Hong Kong government earned $1.4 billion in tax revenues from the race track, though bettors' winnings are tax-free.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

美中商贸评论

EDITOR
Kirsten Sylvester

ASSOCIATE EDITOR
Catherine Gelb

ASSISTANT EDITORS
Darlene M. Liao
Ann M. Weeks

BUSINESS MANAGER
Alan R. Kahn

DESIGN/PRODUCTION MANAGER
Jon Howard

RESEARCH ASSISTANT
Adam C. McConagha

1818 N St., NW Suite 200
Washington, DC 20036-5559
Tel: 202/429-0340
Fax: 202/833-9027,
775-2476
www.uschina.org/cbr

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ADVERTISING OFFICES

ASIA:
Godfrey Wu
1305, 13 Fl, CC Wu Building
302-308 Hennessy Rd.
Wanchai, Hong Kong
Tel: 852/2591-1077 Fax: 852/2572-5158
E-mail: mhi@hk.gin.net

NORTH AMERICA:
Alan R. Kahn
1818 N St., NW Suite 200
Washington, DC 20036-5559
Tel: 202/429-0340 Fax: 202/833-9027
E-mail: akahn@uschina.org

Letter FROM THE PRESIDENT

Robert A. Kapp

China, *the* United States, *and the* Rule of Law

If the United States and China are to embark on the path of bilateral rule of law cooperation, they had better do it realistically

As the United States and China continue their search for a more cooperative future, many voices in the United States—in government, academia, and the non-governmental community—continue to press for meaningful US-China cooperation in extending the "rule of law" in the PRC.

From a business perspective, as from other points on the American spectrum, that is a good impulse. By contrast with the "rule of man"—that is, the conduct of society's affairs on the basis of personal relationships rather than on the basis of impersonal public written codes—most US businesspeople would regard the rule of law as the foundation of modern economic life.

The rule of law has automatic appeal in the United States. Few would demur at having all nations of the world living under the rule of law, as we perceive our own nation does. Many Americans might equate the whole idea of "rule of law" specifically with the American social-legal system, perhaps not fully aware of its differences from systems of other modern states. Working with China to strengthen the rule of law, many Americans would agree, might contribute positively to China's further evolution along paths they hope China will travel; help to assure that China's arrival as a world power remains within established international parameters; support American economic interests; and express deeply held American values without falling into another doomed effort to "convert" China by bluntly dictating its domestic behavior.

But if the United States and China are to embark on the path of bilateral rule of law cooperation, they had better do it realistically. This endeavor will not thrive if it does not somehow internalize the realities of China's development, including both the "law without lawyers" legacy and the institutional chaos of the Cultural Revolution era.

Starting Over

China's energetic effort to build functional legal institutions began in earnest in the late 1970s. The Harvard China scholar Du Weiming, writing in the Winter 1996 issue of *Daedalus*, recalls the scene at the end of the Cultural Revolution:

"The Maoist assault on the body politic so fundamentally shook the rigid structure of state socialism that, without the resiliency of Zhou Enlai's government apparatuses, the People's Republic might have degenerated into a lawless anarchy. The delegitimation of all forms of authority in politics and culture created a power vacuum and a dangerous occasion for violence. The main force of the Cultural Revolution was directed against hierarchy. Disappointment at those who had lost their faith in socialist idealism, hatred of those who had abused their privileges, and a desire to settle old scores blinded the fanatical leaders of the Red Guards to all other issues....In a deeper sense, the damages inflicted

upon the value system by the Maoists were the most difficult to heal. The frontal attack not only on party politics and elite culture but also on the 'habits of the heart,' which had been firmly rooted in the old traditions for generations, so thoroughly destroyed the social fabric that the post-Mao reconstruction began with the rudimentary education of etiquette. Even polite expressions such as 'good morning,' 'excuse me,' and 'thank you' had to be reintroduced and relearned as legitimate utterances in social intercourse...." (pp.176-77)

Since the end of the Cultural Revolution, China has promulgated a vast body of criminal and economic law, and major legislation continues to pour forth from the National People's Congress. The training of lawyers has proceeded apace. Still, the complex interrelationship of laws, policies, and regulations issued by a welter of State organizations remains difficult for foreigners and Chinese alike to understand. Uniform application of many laws remains a distant goal.

Building a solid foundation

Many in China are deeply conscious of the burden of building China's legal system. The "change of tracks," as China's massive commitment to the forces and the culture of the market economy is called, actually thickens the dilemma in the short term. In an essay in *The Critical Time: Twenty-Seven Problems in Today's China That Urgently Require Resolution* (Beijing: China Today Press) published (in Chinese) this year, author Cao Feng links the contemporary explosion in crime rates to the transition to a market economy. He notes that the underlying market-economy world view has not yet taken strong root in China:

"The features of the market economy are material interests, autonomy, equality, competition, and openness. These features...of the market economy are its strengths, but they also help breed crime. The sole concentration on material gain can lead some people to act without regard for consequences, for example making counterfeit inferior products, manufacturing and selling drugs, stealing and marketing cultural artifacts, smuggling...and conducting all manner of economic fraud and swindling....Using illicit methods to pursue profit in such ways, economic conduct becomes criminal conduct....

"[T]he autonomy of the individual economic player...gravely weakens the capacity of the government to oversee and supervise....In such a situation, greedy individuals can easily take advantage of lax management and negligent supervision to make a lot of illicit wealth through corruption, theft, bribery, and other criminal activities.

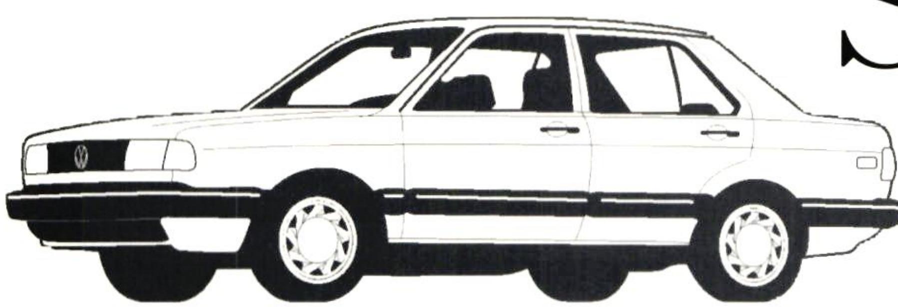
"Third...[t]he market economy offers equality of opportunity and the power to conduct economic exchange on an equal basis, but it also fosters a great deal of practical inequality. When officials and businesses conspire; when authority is traded for money; when bribery breeds more bribery, the unequal economic distribution flourishes. Some people, seeking 'compensation' for their grievances, turn without remorse to crime to seize their share of society's wealth....

"Fourth, the competitive nature of the market economy mercilessly leads some units into serious difficulties, including cessation of production, shutdowns and bankruptcies....As people lose the work that sustains them and their needs go unmet...some lose their spiritual bearings. For self-preservation, some turn to theft, armed crimes, fraud, and even murder." (pp.565-66)

The quotations should remind us of the dimensions of "promoting the rule of law" in China. Simply explaining American legal institutions will not create rapid changes in China's legal system. Similarly, if the pursuit of the "rule of law" becomes just another US target, like market share or an export number, to be achieved in China by a fixed date, the effort could well appear to fail.

Let any rule of law initiative start with small, finite programs, backed by a dependable long-term commitment of real expertise. There's much to be gained in "rule of law" engagement, but it will not be a dilettante's game. 完

Shifting Gears



With more than enough production capacity, China's auto industry is hungry for customers

Wayne W. J. Xing

Though the bicycle and animal-drawn cart remain widely popular in China, automobiles have made steady—if slow—inroads over the past 20 years. In 1978 there was not a single privately owned motor vehicle in China. Today there are close to 3 million. Twelve years ago, China produced 5,000 passenger cars a year. By last year, total output had reached 389,200, a 78-fold increase (*see* Table 1). Moreover, in addition to the 1.54 million motor vehicles (including passenger cars, buses, trucks, and off-road vehicles) produced in 1996, the country made and sold 2.4 million farm transportation vehicles.

Despite such impressive growth, China's auto industry faces numerous roadblocks. The remnants of a centrally planned economy—reflected in central government policymaking—combined with expanding market forces and the resulting decentralization of decisionmaking, have made it difficult for auto makers to respond to market demands. As a result, automobile production over the past three years has slowed considerably—average annual growth rates dropped from 37 percent between 1990-93 to 4.7 percent during 1993-96. The high growth rate of passenger-car investment in the mid-1980s and early 1990s has created a problem of overcapacity in the industry. By the end of 1997, the combined production capacity of the leading car manufacturers will likely reach 900,000 units. Total output for 1997, though, is estimated at no more than 450,000 units, or roughly half of capacity. Such disappointing figures have prompted the central government to reassess its ambitious growth plan for the sector, and promise to force some difficult structural changes upon the industry in coming years.

Who's who in China's auto industry

China launched its automobile industry in 1956 when, with the help of the Soviet Union, First Automobile Works was established to produce the Jiefang ("Liberation") line of mid-size trucks. Until 1978, the industry was under a strict centrally planned system with only two dozen or so automobile assemblers, the largest of which were the First Automobile Works (now First Automobile Works (Group) Corp., known as FAW) in Changchun, Jilin Province, and the Second Auto Works (now Dongfeng Motor Corp., or DMC) in Shiyan, Hubei Province. Today, there are over 120 government-approved asssemblers, consisting mainly of State and joint-venture enterprises.

The leading PRC automobile manufacturers, in terms of both production capacity and the types of vehicle produced, are referred to as the "Big Seven." These are, in addition to FAW and DMC, Beijing Automotive Industry Group Corp. (BAIC), China National Heavy-duty Truck Corp. (CNHTC), Shanghai Automotive Industry Group Corp. (SAIC), Tianjin Automotive Industry Group Corp. (TAIC), and Yuejin Automobile Group Corp. (YAGC). In the passenger-car market, eight firms—six of which are Sino-foreign joint ventures—dominate. These assembly facilities are referred to as the "Big Three" (DMC, FAW, and SAIC), the "Little Three" (BAIC, Guangzhou Peugeot, and TAIC), and the "Two Minis" (Chang An Automobile Co., Ltd. and Guizhou Aviation Industry Corp.) (*see* Table 2).

Supervising the country's automobile industry is the central government's Ministry of Machine-Building Industry (MMI). MMI, through its Department of Automotive Industry, in general is responsible for industry-related investment, project approval, production planning, and overall policy decisions. Except for CNHTC, DMC, and FAW, which are under the direct authority of the State Planning

Dr. Wayne W. J. Xing is editor and publisher of *China Business Update—Automotive*, a monthly newsletter based in Amherst, Massachusetts.

Commission (SPC), all of China's car makers are under direct control of a ministry or a provincial or municipal government. BAIC, SAIC, and TAIC, for example, are under jurisdictions of the respective municipalities of Beijing, Shanghai, and Tianjin. The Guangzhou city government oversees Guangzhou-Peugeot. Chang An and Guizhou are, respectively, under the control of the ministerial-level entities China North Industries Corp. (NORINCO), and China National Aviation Industry Corp. (AVIC).

Foreigners in the Fray

Ever since China opened its doors in the early 1980s, the auto and motorcycle industries have been attractive sectors for foreign investment (*see The CBR*, March-April 1994, p.16). According to statistics provided by MMI's Department of Automotive Industry, by the end of 1996 the total number of automotive cooperative projects, joint ventures, and wholly foreign-owned ventures reached 455, with an estimated $2.5 billion in foreign capital (*see* Table 3). In the 10 years spanning 1986-1995, total investment in the passenger-car industry, including parts and components, reached $3.6 billion. In 1996 alone, 74 automotive joint ventures were set up with foreign manufacturers.

Foreign investment generally has helped the PRC auto sector upgrade its technology and efficiency levels. For example, Shanghai-Volkswagen Co. Ltd., which was established in 1985 and holds a 52 percent share of the domestic sedan market with its 1.8-liter Santana, has recently decided to expand its technology center by investing an additional $98 million in new model development. Meanwhile, SAIC recently teamed up with General Motors Corp. in a $1.5 billion mid-size sedan project and a $50 million technical center. The Two Minis have both recently announced joint-venture deals with Japanese technology providers to improve scale economies in production. Chang An is working with Suzuki Motors to boost production of the 0.8-liter Alto, and Guizhou has partnered with Fuji Heavy Industries Ltd. to expand production of the 0.54-liter Skylark.

Other foreign firms have helped diversify China's auto market. A joint venture between Ford Motor Co. and Jiangling Motors Corp. in Nanchang, Jiangxi Province will introduce the Transit van in December of this year. Ford has recently announced its intention to increase its 20 percent equity stake in Jiangling by another 10 percent. Ford has also set up four auto component joint ventures. Other van or light-bus joint ventures include Fuzhou-China Motors Corp. (China Motors is a Taiwan-based affiliate of Japan's Mitsubishi Motors Corp.), Jinbei-Hiace, Nanjing-Iveco (a joint venture with Iveco, a unit of Italy's Fiat S.p.A.), and Sanjiang-Renault. In addition, Nissan Motor Co. has a 5 percent equity interest in the Zhengzhou-Nissan Automobile Co. to produce Nissan pick-up trucks.

Chrysler Corp.'s joint venture, Beijing Jeep Corp., has been turning out its multi-purpose vehicles since the mid-1980s and now has an annual capacity of 100,000 Jeep Cherokees and lower-end Beijing Jeeps. Although the first vehicle joint venture in China, Beijing Jeep remains short of the minimum annual production capacity (150,000) the central

During 1986-1995, total investment in the passenger-car industry, including parts and components, reached $3.6 billion.

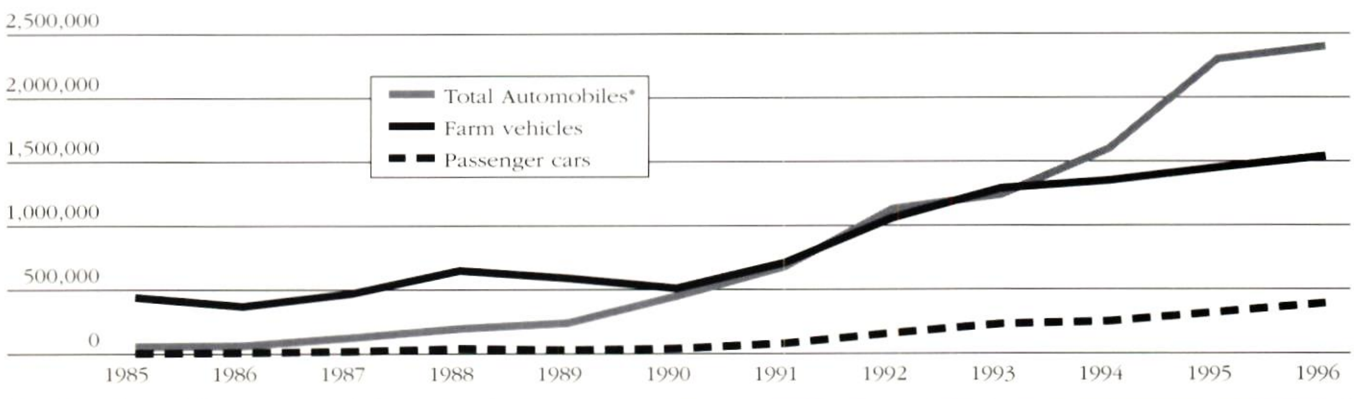
government requires before a company can introduce a new vehicle model. Given the overcapacity in the Chinese sedan market, though, the central government has reportedly advised Beijing Jeep to continue to concentrate on production of sport utility and light vehicles.

Success in Parts and Components

The critical mass of foreign auto makers in China has lured the world's leading auto-parts companies to set up PRC operations. AlliedSignal Inc., Robert Bosch GmbH of Germany, Cooper, Dana Corp., Delphi Automotive Systems, ITT, Lucas Varity Inc., Rockwell, Siemens, TRW Inc., Tenneco Inc., United Technologies Corp., Valeo, as well as leading Japanese and Korean parts companies, have all invested in parts and components joint ventures in China (*see The CBR*, March-April 1994, p.24). Delphi alone has formed more than a dozen joint ventures, and one wholly owned enterprise, to produce engine-management systems, wire harnesses, electric systems, drive shafts, brake systems, steering gears and columns, and generators and batteries.

The Asia Strategic Investment Corp. (ASIMCO), a Beijing-based US investment company, also has contributed

TABLE 1
Automobile and Farm Vehicle Production, 1985-1996



SOURCES: *China Automotive Industry Yearbook; China Business Update—Automotive*
* Includes passenger cars, trucks, buses, and off-road vehicles (except farm vehicles)

GUANGZHOU PEUGEOT: PORTRAIT OF A COMMERCIAL DIVORCE

China's automotive bureaucrats liken PSA Peugeot Citroen's troubled automobile joint venture in Guangzhou to a failed marriage: if two partners do not get along, they should separate. Although optimism pervaded the union at the outset, troubles at Guangzhou Peugeot Automobile Corp. (GPAC) emerged quickly, and by early 1997, the French investors had decided to withdraw from the joint venture. Despite the French pullout, Guangzhou officials insist that the Chinese side will soon find a new "spouse." Foreign enterprises interested in taking Peugeot's place in the partnership, however, would do well to heed lessons from the failed Sino-foreign enterprise. They might also consider Guangdong's tarnished history on auto-related joint ventures, as Peugeot's decision to pull out of GPAC was as much the result of Guangdong's uneven investment environment as the company's own errors.

START-UP MISSTEPS

Peugeot was one of the first foreign auto makers to approach Guangzhou officials in the early 1980s about creating an industrial alliance. Four years of negotiations culminated in the 1985 consecration of the $52 million GPAC joint venture. Peugeot held 22 percent of the company, the National Bank of Paris took 4 percent, and the International Finance Corp. held 8 percent. The PRC investors were Guangzhou Automotive Manufacturing (GAM), with 42 percent; the Guangzhou branch of the Industrial and Commercial Bank of China, with 4 percent; and the China International Trust and Investment Corp. (CITIC) holding the remaining 20 percent. GPAC's 50,000-vehicle production target was to include light trucks, sedans, and station wagons.

Guangdong initially appeared to be a logical site for the new factory. The province had one of the highest standards of living in the country, and had acquired extensive experience with joint-venture projects. Moreover, with Guangdong far from Beijing's watchful eye, Peugeot officials anticipated a greater degree of managerial autonomy than a plant in northern China might enjoy. Local government support for the joint venture also seemed strong.

Yet these apparent advantages could not shield the Sino-French joint venture from its share of difficulties. During the set-up phase, for example, Peugeot discovered that GPAC workers—formerly employed at the GAM bus and truck factory—had inadequate skills. Consequently, Peugeot had to spend more than anticipated both on training PRC workers in Europe and sending French managers to the PRC.

Commitments to localize parts production posed additional stumbling blocks for GPAC. Though the joint venture contract called for GPAC vehicles to reach a 90 percent Chinese content level within 5 years of start up, the French partner found few suppliers of quality parts in Guangdong and was prohibited by Guangzhou officials from sourcing from other regions in China. Peugeot, for its part, was slow to establish its own joint-venture parts manufacturers—a key to Volkswagen AG's success in Shanghai. GPAC thus had to assemble automobiles largely from imported kits, which proved costly when the French *franc* appreciated some 110 percent against the *renminbi* in the late 1980s. The resulting rise in prices of imported parts, together with PRC localization and consumption taxes totaling more than ¥45,000 ($12,000, based on the 1989 exchange rate) per vehicle, substantially raised the final prices of finished vehicles. In early 1990, for example, the company's model 505 station wagon sold for ¥200,000 ($54,000), while Shanghai-Volkswagen Co. Ltd.'s Santana, which was subject to similar taxes, sold for ¥180,000 ($49,000). GPAC's growth slowed as a result.

STIFF COMPETITION

GPAC's troubles were aggravated by such stiff competition from Shanghai-Volkswagen. The Santana had achieved 75 percent local content by 1992, and thus was able to keep production costs and sales prices relatively low. Though GPAC had reached similar levels of domestic content by 1994, its least expensive station wagon presently costs ¥170,000 ($21,000, based on the current exchange rate), compared with ¥135,000 ($16,000) for the least expensive Santana model. Moreover, the quality of both GPAC parts and finished vehicles remained poor. Because the local government objected to sourcing from plants outside Guangzhou, GPAC was forced to use local parts that often failed to meet international standards.

Some of Peugeot's management decisions also contributed to GPAC's competitive weaknesses. The company reportedly repatriated most of its profits and made relatively few changes to its 1980s-era products, whereas Volkswagen reinvested profits and refined its production, introducing a new "Santana 2000" model in the mid-1990s. The GPAC sedan also had problems finding a market niche, as its large engine's high fuel consumption precluded the car's use as a taxi, and its outdated design failed to attract Chinese buyers. When compared with the Audi 100, made in Changchun by a joint venture between Audi AG, a subsidiary of Volkswagen, and China's First Automobile Works (Group) Corp., the GPAC sedan lacked the prestige that status-conscious private or government consumers sought in a vehicle.

GPAC also was not as high of a political priority for Guangzhou officials as was the Volkswagen plant for the Shanghai government. While the Shanghai municipality invested ¥5 billion-¥6 billion ($600 million-$700 million) to aid Volkswagen's endeavor, Guangzhou officials only contributed about ¥1 billion ($120 million) to help GPAC. Further, because of Guangzhou's laissez-faire approach to production and consumption, city leaders were reluctant to prod government officials or enterprises into purchasing GPAC's vehicles. In Shanghai, by contrast, the city's taxi company was one of the largest purchasers of Volkswagen Santanas. Further, 1996 Shanghai municipal rules on engine size for taxis effectively eliminated Volkswagen's competitor in the city, the Tianjin Charade, from the taxi business. Ironically, while GPAC's remoteness from Beijing protected it from central government interference, the southern China venture also did not rank high on Beijing's planning agenda. And the lack of a central government partner meant PRC leaders did little to forestall the joint venture's decline.

PULLING OUT

In 1989, one Peugeot official noted, with what now seems painful intuition, "If we had to make the decision to come to China over again, knowing what we know, we wouldn't come." Even a rise in production of cars and light trucks from about 2,700 in 1987 to a peak of 22,500 in 1992 did not renew French officials' hope for success. By 1994, production had begun to falter, and the venture fell into the red. That year, GPAC produced only 4,485 sedans and station wagons, and 1,241 trucks, and the company recorded losses of ¥100 million-¥200 million ($12 million-$24 million). Though production during 1995 rebounded to roughly 8,000 cars and trucks, GPAC's losses rose to ¥320 million ($39 million). Shanghai-Volkswagen's 1995 profits, on the other hand, reached ¥2 billion ($240 million). In 1996, GPAC manufactured only 2,400 vehicles, and Guangdong officials estimate that production will not reach 1,000 units in 1997.

Though Peugeot decided in February to withdraw from GPAC, the joint venture has not proven a complete failure for the two sides. Peugeot exported thousands of car kits and parts to Guangzhou from France, amassing profits for the home company. The venture imparted valuable lessons that Peugeot can incorporate into the operating plan for its venture in Hubei Province, which continues to produce Citroen vehicles. And Guangdong and Guangzhou authorities are sure to consider the lessons of GPAC as they press ahead with efforts to build up the automobile sector in the province.

Indeed, neither Peugeot's withdrawal from GPAC, nor Guangdong's uneven history in auto production, has diminished foreign investors' appetites for building cars in the province. In fact, Peugeot's pullout created a vacuum for foreign manufacturers seeking a share of China's automobile market, which include Daimler-Benz AG, General Motors' Opel Corp., Honda Motors Co., Ltd., and Hyundai Motors. Though Beijing is promoting Changchun in Jilin Province, Shanghai, and the Wuhan-Shiyan region in Hubei Province as future automobile production centers, and the Ninth Five-Year Plan (1996-2000) does not identify new sites in China for such production, Guangzhou remains on foreign investors' lists as a potential investment location. In addition, PRC import tariffs on finished sedans of 80-100 percent will continue to act as an incentive for foreign companies to establish China-based production facilities rather than merely export to the PRC. And Hong Kong's closer integration with the Guangdong economy could spur further growth in the region, prompting an increase in automobile sales.

In May 1997, Guangzhou officials seriously considered Opel's proposal to fill the vacancy left by Peugeot, but cautioned that the city and Opel were only "dating," and that observers should "wait for them to announce their marriage." With backing from General Motors, Opel possesses the financial might to sustain a program of factory modernization and the production of a late-model vehicle. Opel also could draw on its prior experience marketing Corsa and Astra models in Latin America and Eastern Europe. Should Guangzhou permit parts to be imported from outside the region, Opel would be able to tap some 14 Delphi Automotive Systems parts makers—scattered throughout China's coastal region—to meet local parts requirements. General Motors' plan to manufacture Buicks in Shanghai could also provide an opportunity for Opel to further expand its parts-sourcing base.

Uneven Track Record

Peugeot's automobile venture was not the first to go sour in Guangdong. In 1989, Huizhou officials welcomed the Korean-American representatives of Panda Motors, which promised to inject $1 billion into a plant in the coastal city to build cars for export. But Panda lacked any background in making cars, and appeared to be a front for the Unification Church, which evidently was using the car venture to gain a foothold in China. In 1996, having failed to produce a single car, the venture held an official closing ceremony.

In 1995, Germany's Mercedes-Benz AG, a division of Daimler-Benz, signed an agreement to produce minivans in the western Guangdong city of Zhanjiang, and engines on the island province of Hainan. Projected combined investment for the venture totaled $591 million. Daimler-Benz holds a 45 percent stake, and production capacity is scheduled to reach 60,000 vehicles and 100,000 engines by 1998. The project's viability is presently in question, however. Chinese officials also reportedly have insisted that the German company guarantee the joint venture a return on the investment, and lower production costs. The German company is seeking solutions to keep the venture on track.

Unapproved though locally supported automobile production facilities have further plagued the development of the automobile market in Guangdong. These small plants assemble cars from kits that are imported, sometimes illegally, from a variety of Western manufacturers, and realize quick profits. By the mid-1990s, approximately 70-80 such facilities existed in Guangdong, with most making fewer than 100 vehicles per year. Though the provincial government opposes such activities and claims that many plants have been closed, several factories continue to assemble and sell late-model Western cars, trucks, and related parts in Guangdong, which constitutes about 10 percent of China's total automobile market.

Discerning which way the political winds are blowing for the auto sector in Guangdong also is proving difficult. In March 1997, Guangdong Governor Lu Ruihua declared that automobiles would no longer be considered a "pillar" of the provincial economy. Lu also noted that Guangdong is known more for its light industries and should base its continued growth on consumer electronics, housing, textiles, and other similar sectors. Guangdong auto officials, however, cautioned that Lu's declaration regarding "pillar" status for automobiles targeted the uncontrolled independent assemblers, and was not to be misinterpreted as the province's withdrawal of support for large, officially sanctioned projects in the sector. Officials in Beijing's Ministry of Machine-Building Industry also pointed out that there has been little change of late in Guangdong's automobile investment patterns.

The troubled past for the automobile industry in Guangdong raises doubts about whether any of the potential suitors for Guangzhou's automobile factory are likely to find happiness in a joint-venture marriage. Parts procurement would have to expand beyond Guangzhou's boundaries for any other manufacturer to succeed. More problematic, however, is the current dominance of the Santana. Nevertheless, possessing significant financial reserves, a commitment to quality, and instant access to domestic parts to build a late-model vehicle might be the keys to success in China's large, protected market. And, of course, potential entrants now have the benefit of GPAC's experience from which to learn.

—Eric Harwit

Eric Harwit is assistant professor of Asian Studies at the University of Hawaii, and author of China's Automobile Industry *(M.E. Sharpe, 1995).* *Research for this article was supported by a grant from the University of Hawaii's Center for International Business Education and Research.*

The dramatic increase in domestic production capacity has not been matched by growth in demand among individual consumers.

significantly to the Chinese auto-parts industry. Founded in 1993, ASIMCO has raised $250 million from pension funds, insurance companies, and private investors in the United States, Europe, and the Middle East to fund 13 Chinese auto-parts factories. With an average equity ownership of 58.5 percent, the ASIMCO group now produces such components as brake systems, compressors, diesel nozzles and injectors, friction materials, fuel pumps, gears, horns, ignition coils, jacks, motorcycle wheels and gears, motors, oil seals, piston rings, precision castings, rubber seals, and valves.

Productivity levels in the PRC auto-parts industry, in particular, have benefited from foreign investment. The Tianjin Wix Filter Corp., a joint venture between Tianjin Automotive Filter Factory and Dana of the United States, is a case in point. In 1991, the joint venture's first year of operation, the number of oil filters produced per employee increased by 74 percent over the preceding year. By the end of 1995, with 200 fewer employees and a shorter work week, productivity had increased by 600 percent, according to Kuang-Ming Lin, president of Dana China.

Gauging Demand

The car models selected for priority investment by the central government in the 1980s were meant to replace the influx of imported sedans, which had been forcing the government to spend significant foreign exchange reserves. By the mid-1990s, PRC-made models had begun to replace the imported sedans, used primarily in taxi fleets and by government institutions and companies. The market shares of domestically made cars increased from 33 percent a decade ago to over 70 percent today.

Much to auto makers' dismay, however, the dramatic increase in domestic production capacity was not matched by growth in demand among individual consumers. China's passenger-car market is largely an "institutional" market—buyers are government institutions, State-owned companies, and taxi fleets rather than individuals. In rural areas, according to *China Business Update—Automotive*, in 1996 there was one farm vehicle for every 100 residents; in urban areas, there was one auto for every 400 residents. And despite the fact that the number of privately owned automobiles in China has increased on average by 27 percent annually over the past 10 years, the vast majority of these are trucks, buses, and cargo vans (farm vehicles are not included in this category). Ironically, the small consumer car market in China hinders further efforts to lower sticker prices by expanding production scales. Some experts believe that the rise of a family car in China will not begin until roughly 2005, when the average per capita annual household income is expected to reach ¥60,000 ($7,230). Until then, the typical Chinese family is unlikely to be able to afford a car.

Even if high car prices do not deter individual buyers, heavy auto-related taxes and fees put cars beyond the reach of many potential car owners. Taxes that apply nationwide to the purchase of a new car are a 5 percent consumption tax, a 17 percent value-added tax, and a 10 percent vehicle-purchase tax. But certain regions impose on car buyers more than 20 different taxes and fees, amounting to more than one-third of the retail price of a car, according to recent surveys by PRC government agencies. In some provinces and cities, car buyers are even assessed taxes that go toward family planning and local education programs. The dearth of expressways, highways, parking facilities, and advanced traffic control systems further discourages automobile use in China's major cities.

In light of such circumstances, car maker Shanghai-Volkswagen developed and expanded the Santana model's production capacity to 300,000 units to target the institutional market. Because it started production three years earlier than the rest of the sedan makers, the company secured a sizable consumer base ahead of its competitors. As a result, Chinese partner SAIC has been the least affected by the problem of overcapacity. SAIC's decision to join with General Motors to produce the high-end 3.0-liter Buick Regal is similarly aimed at cementing its strength in the domestic institutional market for luxury cars, as well as competing with imports.

Crafting an Industrial Policy

For better or worse, Beijing has been integrally involved in directing the development of the sector. The eight main passenger-car ventures, for example, have had to satisfy government-imposed local content requirements to qualify for preferential tariff rates on imported components. The government granted these vehicle manufacturers an initial period of three years during which they enjoy a preferential rate of 33.3 percent on imported parts instead of the standard 100-150 percent. After three years, these auto makers were expected to raise their levels of local content to at least 40 percent, to qualify for further tax breaks.

Since 1994, all new auto projects have faced the stiffer localization requirements contained in the State Council's automotive industrial policy (AIP). Under the AIP, auto ventures must start production with 40 percent local content to qualify for 37.5 percent import duties on parts. Auto makers that reach local content levels of 60 or 80 percent may import parts at Customs rates of 30 percent and 20 percent, respectively. Leading companies have already reached a localization level of more than 80 percent.

The AIP, aimed at transforming the auto sector into a "pillar industry" of the PRC economy, epitomizes the govern-

TABLE 2
Sales of the Top Five Automobile Manufacturers in 1996

Enterprise Name	Sales (units)	% change over 1995
1. First Automobile Works (Group) Corp.	200,382	13.7
2. Shanghai-Volkswagen Co., Ltd.	200,031	25.2
3. Tianjin Automotive Industry Group Corp.	152,816	18.1
4. Dongfeng Motor Corp.	139,926	-20.1
5. Beijing Automotive Industry Group Corp.	130,390	-23.2

SOURCE: *CBU—Autostats*

TABLE 3
MAJOR VEHICLE AND ENGINE JOINT-VENTURE AND COOPERATIVE PROJECTS IN CHINA, 1997

LEAD CHINESE PARTNER	LEAD FOREIGN PARTNER	PRODUCT OR MODEL	FORM OF COOPERATION	CAPACITY (UNITS)
Beijing Automotive Industry Group Corp.	Chrysler Corp.	Cherokee jeep	joint venture (JV)	50,000
	Isuzu Motors	Light truck	JV	50,000
	Itochu Corp.	Light vehicle	JV (through stock purchase)	60,000
Chang An Automobile Co., Ltd.	Suzuki Motor Corp.	Alto car	JV (stock option)	150,000
China Aerospace Automotive Industry Group	Mitsubishi Corp.	2.0 liter engine	JV	150,000
China Aerospace Industry Corp.	Renault	Trafic light truck	JV	40,000
China Changfeng Auto Factory	Mitsubishi Motors Corp.	Pajero sport utility vehicle	Technology transfer	5,000
China National Heavy-duty Truck Corp.	Cummins Engine Co. Inc.	Diesel engine	JV	4,000
	Hino Motors, Ltd.	Diesel engine	JV	20,000
	Styre	Styre truck	Tech transfer	10,000
Chongqing Qingling Auto Co. Ltd.	Isuzu	Isuzu truck	Tech transfer	50,000
Dong An Engine Manufacturing Co.	Mitsubishi Corp.	1.3 liter engine	JV	150,000
Dongfeng Motor Corp.	Honda Motor Corp.	Engine	JV	150,000
	Nissan Diesel Motor Co., Ltd.	Bus	JV	5,000
	PSA Peugeot Citroen	ZX/Fookang car	JV	150,000*
First Automobile Works (Group) Corp.	Chrysler	Engine	Tech transfer	150,000
	Daewoo	Engine	JV	300,000
	General Motors Corp. (GM)	S10 pick-up truck	JV	30,000
	Volkswagen AG (VW)/Audi AG	Jetta, Golf, Audi cars	JV	150,000
Fuzhou Auto Works	China Motor Corp. (Mitsubishi Motors affiliate)	Delica van	JV	10,000
Guangzhou Automotive Manufacturing	Peugeot**	Peugeot 505 and 504	JV	50,000
Guizhou Aviation Industry Corp.	Fuji Heavy Industries Ltd.	Skylark car	JV (planned)	100,000
Hainan Auto Industry Corp.	Mazda Motor Corp.	Touring bus	JV	50,000
Hunan Power Engine	Huatai	Diesel engine	JV	40,000
Jiangling Motors Corp.	Ford Motor Co.	Transit van	JV (through stock purchase)	30,000
	Isuzu	Isuzu truck	Tech transfer	30,000
Nanfang South China Motor Corp.	Mercedes-Benz AG	MPV minivan	JV (planned)	60,000
Shanghai Automotive Industry Group Corp.	GM	Buick car	JV	100,000
	AB Volvo	Volvo Coach	JV (planned)	500
	VW	Santana car	JV	300,000
Shanghai Zehai	Freightliner Corp.	Heavy-duty truck	JV	4,000
Sichuan Tourist Coach Factory	Toyota Motor Corp.	Touring bus	JV	20,000
Tianjin Automotive Industry Group Corp.	Daihatsu Motor Co., Ltd.	Charade minivan	Tech transfer	150,000
	Kook Hang	Bus	JV	20,000
	Lion Land Bhd	Minivan	JV	43,000
	Toyota	1.3 liter engine	JV	150,000
	Varity Perkins	Diesel engine	JV	50,000
Xichai Diesel Engine Plant	Volvo	Diesel engine	JV	5,000
Yangzhou Motor Coach Co. Ltd.	Mercedes-Benz	Touring coach	JV	7,000
Yuejin Automobile Group Corp.	Iveco	Iveco van	JV	60,000
Zhengzhou Light Truck Factory	Nissan Motor Co.	Nissan pick-up truck	JV	20,000

SOURCE: *China Business Update—Automotive*
* By 1998
** Peugeot withdrew from the venture in February 1997

ment's prominent role in the sector. Though the industry's decentralization and growing protectionism on the part of the local governments have made it difficult for Beijing to implement the policy, the basic goals—consolidating production and directing foreign investment—remain in place for now. In an example of the sector's lack of economies of scale, China had 124 automobile assemblers in 1994 with an annual output of just over 10,000 units per assembler. The AIP thus lays out a two-stage framework to streamline the vehicle-manufacturing sector. During the first stage, from 1996-2000, the State intends to support reorganization efforts that will lead to the evolution of 2-3 large national enterprise groups, 6-7 key vehicle manufacturers, and 8-10 internationally competitive motorcycle manufacturers (*see* p.19). Other first-stage goals include:

- Motor vehicle production of 3 million units, of which 1.5 million will be passenger cars (in 1996, the targets were reduced to 2.7 million and 1.3 million, respectively);
- Annual capacity of 300,000-500,000 units in each of the 2-3 large enterprise groups;
- Consolidation of the present 3,000 parts and components manufacturers into 300 companies to serve as major domestic suppliers (and product developers) for original equipment manufacturers (OEMs).

During the second stage, from 2000-2010, Beijing will support the reorganization efforts for the formation of 3-4 large, internationally competitive enterprise groups. Other goals for 2010 include:

- Total vehicle production capacity of 6 million units, of which 4 million will be passenger cars;
- Annual production capacity of more than 1 million units from each of the 3-4 automotive conglomerates;
- Formation of 5-10 internationally competitive components groups, which will form a supplier base for the OEMs, the after-sales market (service and parts replacements), and the export market.

The AIP also calls for safety, pollution-control, and energy-saving regulations for automotive products, and "gradual" implementation of the current international automobile safety and environmental approval standards.

Notably, auto parts manufacturing receives significant attention in the AIP, likely because the government realized that this subsector was becoming unable to meet the demands of vehicle assemblers. The policy lists 60 auto parts and components, on the basis of technology level and suitability for mass production, for preferential development during the Ninth Five-Year Plan (1996-2000) period. The listed parts are divided into three groups: Groups I and II consist of the 25 key auto parts and components specific to the passenger-car industry; Group III consists of parts and components that have long been produced domestically but that cannot yet be manufactured on a mass scale. For these 60 parts, the government will contribute funds and encourage foreign participation in their development.

For each of the three high-tech components in Group I—engine-management systems (for gasoline engines), anti-lock braking systems, and safety air bags—one foreign partner is supposed to be chosen to work with a consortium of Chinese companies for development of domestic production facilities. For example, Bosch has signed an agreement with China United Auto Electronics Co., Ltd., a consortium of 15 Chinese auto companies based in the Pudong New Area in Shanghai, to form a 50-50 joint venture to produce engine management systems. For items in Group II, which include filters, pistons and piston rings, radiators, shock absorbers, and steering systems; and in Group III, which include carburetors, distributors, mufflers, seating, and spark plugs, the government intends to support 3-5 leading domestic manufacturers to reach its goal of about 300 large parts suppliers by the end of the century.

The AIP and Foreign Firms

In recognition of the need for foreign auto-related expertise, the AIP encourages foreign investment, though with specific regulations regarding partner selection, joint-venture equity shares, and export commitments. Further qualifying foreign participation in the sector, the policy calls on Chinese enterprises to team up only with foreign firms with "sufficient" management know-how, product development capability, and technology, as well as independent distribution channels and adequate financing. Such criteria are meant to attract large, multinational auto companies to the PRC market.

In an effort to prevent domination by any given foreign manufacturer, the AIP prohibits a foreign vehicle manufacturer from owning more than two joint ventures of the same vehicle type. For example, Volkswagen, with two existing sedan joint ventures in China, is not permitted to establish a third sedan venture. The

AIP also stipulates that a foreign partner in a vehicle or engine joint venture can hold no more than a 50 percent equity share. The AIP requirement that all new assembly ventures begin with 40 percent local content is another example of the policy's goal of improving overall PRC product development capability.

By contrast, foreign investors in the parts industry in general are not limited to a certain percentage of equity ownership, though there are exceptions. Parts manufacturers may even establish wholly owned ventures, such as AlliedSignal's turbocharger plant in Shanghai and Delphi's $50 million steering systems plant, also in Shanghai. Foreign partners in ventures producing high-technology anti-lock braking systems, engine-management systems, and safety air bags, however, may not hold more than 50 percent equity.

Some of the AIP provisions—local-content requirements, preferential treatment for domestic firms, and the restriction on foreign investment levels—are inconsistent with World Trade Organization (WTO) principles, and have received criticism from some foreign firms. Though China considers its auto

THE ABCS OF DRIVING IN BEIJING

As Beijing grows upward as well as outward, more and more expatriates are choosing to drive their own cars around the PRC's sprawling capital rather than relying on taxis or personal drivers. As in the United States, however, taking to the road in Beijing entails clearing several bureaucratic hurdles. The PRC's Public Security Bureau (PSB) enforces uniform driving regulations nationwide, so the process of obtaining a driver's license in Beijing is similar to that of other big cities.

OBTAINING A LICENSE

All foreigners—including tourists—hoping to drive in China must first obtain a PRC-issued driver's license, or risk fines of at least ¥200 ($24). Driver's license applications are available at Beijing's Vehicle Management Department, Foreign Division for Vehicles (FDV), which is under the supervision of the PSB. But FDV issues an application only after receiving copies of a foreigner's passport and home-country driver's license. An expatriate must also submit his or her PSB-issued foreign resident permit (*waiguoren juliu zheng*). Any documents written in a foreign language, including the home-country driver's license, must be translated into Chinese by a language service company approved by China's Foreign Enterprise Service Co. Expatriates without a driver's license from their home country may still obtain a PRC license, but must first pass a driving course, which typically lasts at least six weeks and costs roughly ¥3,000 ($361).

With the application form in hand, the expatriate may proceed to one of three hospitals designated to conduct physical exams specifically for driver's license applicants—Capital Hospital, Xiehe Hospital, or China-Japan Friendship Hospital. After the expatriate passes the physical, which includes blood pressure, color blindness, eyesight, and hearing tests, the hospital will affix its seal, or chop, on a health examination certificate. Applicants not working in China—spouses, students, or tourists—may then return to FDV and pick up their license. Expatriates who are employed in China, however, must also have their companies stamp the application form before heading back to FDV. In either case, the documents required for the final trip to FDV include those needed for the first trip, as well as the driver's license application, health certificate, and two photos.

Expatriates should be aware that they will be required to exchange their foreign-issued driver's license for the PRC license. Thus, expatriates who plan to drive outside of China while on vacation or home leave, for example, will have to return to FDV to trade in their PRC license for their foreign one.

CAR SHOPPING...

After obtaining the PRC license, an expatriate may set off for the nearest dealer to buy a car. Expatriates who are not diplomats and who are in the market to buy rather than lease a car probably will choose to limit their options to PRC-made models, since imported cars carry a duty of 80-100 percent. Only diplomats and others of similar status may purchase imported vehicles tariff-free. Fortunately, joint venture-made automobile prices are falling, after-sales services are improving, and replacement parts are becoming more readily available. Better after-sales service is due, at least in part, to competition among PRC car dealers, who have begun to offer more attractive service packages to lure customers away from rivals. As in the United States, car payments may be made in installments by cash or by check.

An automobile's purchase price is just part of the cost of owning a car in China. Additional costs include a 10 percent sales tax, which is based on the purchase price plus any import duties; an annual highway maintenance fee of ¥900 ($108) per year, payable to the local PSB's traffic management bureau; and a license plate fee of roughly ¥200 ($24). Moreover, all car owners are required by the PSB to purchase automobile insurance. Insurance policies offered by PRC firms generally cost ¥2,072-¥4,145 ($250-$500) a year. Expatriates, however, are exempt from an "urban land occupation" fee of several hundred *yuan* that Chinese car owners must pay.

...VS. CAR LEASING

Expatriates residing in China for an extended period of time may find purchasing a car more cost effective. But to avoid most of the fees associated with owning a car in China, many expatriates lease vehicles, particularly if their stay in the PRC is only a few months long. Currently, there are around 200 car rental and leasing service companies in Beijing. By leasing rather than buying a car, an expatriate is able to avoid insurance and maintenance costs, as all Chinese car-rental companies include accident and theft insurance in the rental price. In addition, rental companies offer replacement cars in the case of breakdowns.

To lease an automobile, an expatriate needs to bring to a leasing company his or her PRC driver's license (foreign licenses are not acceptable), foreign resident permit, and passport. If the leased car is to be used for corporate purposes, the expatriate also must present company documents, such as the firm's registration certificate. The monthly rental charge in Beijing for such joint-venture brands as Cherokee, Jetta, and Santana ranges from ¥6,300-¥6,800 ($758-$818), while daily rental rates for joint-venture vehicles are around ¥330-¥360 ($40-$43).

Though leasing a car may be less of a hassle than purchasing one, prospective lessees must be prepared to put down a large refundable deposit, generally around ¥8,000-¥10,000 ($963-$1,203). All sector an "infant industry," which would make it eligible for longer phase-in periods for certain WTO regulations, the slow negotiations for PRC entry into the WTO have left many foreign auto industry firms in limbo. Late September negotiations between US and PRC negotiators over the content of China's WTO accession protocol, according to official government reports, failed to resolve major issues of relevance to the auto sector.

Humbled Ambitions

The PRC government has run into a number of obstacles since the AIP's introduction in 1994, and has been forced to scale back its goal of making autos a pillar industry. Rather than consolidating the industry, the decision to elevate autos on Beijing's priority industry list spurred provincial investment in the sector, and China today has close to 1,000 automobile assembly and reassembly factories, including both official and unofficial, large and small. Beijing's protective import tariffs also have fueled redundant investment. Because the tariffs have distorted domestic auto prices, automobile assembly has been a profitable business

locations accept payment of deposit charges by cash or check, though only a few locations accept credit card payments.

Inspection Requirements

The final step on the way to driving one's own car in China is the annual vehicle inspection. Conveniently, the inspection date is determined by the last number of a car's license plate. For example, if the license plate's last digit is a "5," the inspection must be completed by the last day of May. License plates ending with a "0," "1," or "2" indicate that the inspection must take place during October, November, or December, respectively. No inspections take place during January or February.

As in the United States, PRC auto inspections entail verification of the car's legal documents, including identification cards for private owners and company stamps for company owners. Inspectors scrutinize such parts as the brakes, gas tank, headlights, and tail pipe. The process can take up to three hours to complete, and costs roughly ¥100 ($12), depending on the city.

—Steven Shi

Steven Shi is associate director of the US-China Business Council's Beijing office.

CONTACTS

Individuals interested in receiving more information about obtaining a driver's license, registering a vehicle, or obtaining an automobile inspection can contact FDV:

Foreign Division for Vehicles
Beijing Vehicles Management Department
No.90, Baiguangying Xi Lu
Chaoyang District, Beijing 100012
Tel: 8610/6490-4379

Automobile rental, sales, and service companies in the Beijing area include:*

Auto Rental Agencies:

Beijing First Rental Co.
28 Xizhimen Nandajie
Xicheng District
Tel: 8610/6605-3019, 1759

Capital Auto Leasing Co.
62 Huayan Bei Lu
Chaoyang District
Tel: 8610/6491-5259, 5253

Civik Taxi Service, Car Rental
B2, Passage 4, Civic Plaza
22 Jianguomenwai Dajie
Chaoyang District
Tel: 8610/6512-3481, 4488, or 6019

Lantian Car Rental Co.
66 Gulouwai Dajie
Xicheng District
Tel: 8610/6205-5888, 6888

Automobile Sales:

Beijing Asian Games Village Automobile Exchange
No.25, Anding Lu
Tel: 8610/6491-5319; 6496-6892, 6863
Fax: 8610/6493-7915

China Yanxing Co.
No.18A, Feng Bei Lu
Fengtai District
Tel: 8610/6886-5203, 3551

Beijing Yilida Materials Exchange Center
Huayuanqiao Beisanxi Lu
Tel: 8610/6845-6102; 6847-5812

China NORINCO Auto Co.
No.10, Chedaogou
Haidian District
Tel: 8610/6763-9133, 1119; 6954-1027

Auto Repair:

Beijing Ritan Garage
Yabao Lu
Chaoyang District
Tel: 8610/6501-5318

Beijing Tianchi Auto Repair Co.
A2 Shaoyaoju, Taiyanggong
Chaoyang District
Tel: 8610/6494-1772

Beijing Wan Xing Auto Service Co. Ltd.
28A Qingnian Lu
Chaoyang District
Tel: 8610/6508-4328
Fax: 8610/6508-4325

San Litun Auto Service Co.
Qingnian Lu, Chaoyang District
Tel: 8610/6500-5456
Fax: 8610/6500-5647

Huayin Auto Service Co. Ltd.
Xiyanwo, Dongsanhuan Nan Lu
Chaoyang District
Tel: 8610/6771-5659

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even for a simple facility that makes less than 100 vehicles a year.

The AIP's goal of establishing nationwide an efficient auto industry has also been thwarted by regional protectionism. It is a common practice, for instance, for a provincial government to protect favored automobile assembly operations located in its province, either by giving local tax breaks for locally procured goods or restricting the use of vehicles made in other provinces (*see* p.10). SPC issued an administrative order last year mandating that local governments rescind all restrictive measures on the use of affordable economy models. But many of these restrictive regulations remain in force. Beijing municipality, for example, continues to limit the use of TAIC's Charade, 1-liter minivans, and low-end Beijing Jeeps on the city's downtown streets to every other day. Taxis, however, are excluded from the rules.

Though high tariffs on imported cars have allowed Beijing to achieve its goal of expanded domestic production, the tariffs have also contributed to the inflow of illegal passenger cars, estimated at 40,000 a year. Despite this pervasive smuggling, and the country's efforts to join the WTO, the central leadership justifies the tariffs on the grounds that the auto sector is an infant industry. China reduced its import tax on automobiles as of October 1, 1997, but only slightly: import taxes on passenger cars went from 100-120 percent to 80-100 percent, depending on the size of engine displacement.

In Search of a Family Car

While the absence of a ready individual consumer market has slowed expansion of China's passenger-car industry over the past three years, farm-vehicle production has accelerated phenomenally during the same period. Total annual output jumped from 1.24 million units in 1993 to 2.4 million in 1996—nearly one million more than the total number of automobiles produced that year. The largest passenger-car manufacturer, Shanghai-Volkswagen, assembled 200,000 sedans in 1996; three of the largest farm vehicle producers, the Beijing-Futian Group, the Jinwa Group, and the Juli Group, in contrast, each turned out more than 250,000 units of three- or four-wheel motor vehicles.

Thus, the answer to the question, "Is there a family car in China?" can be found in the 10 million farm vehicles now on the road. These vehicles, which are diesel-powered and travel at low speeds—typically no more than 50 km per hour—are owned mostly by families in China's rural areas. Motor vehicle ownership in the countryside averages one for every 20-25 families.

The rise of these inexpensive farm vehicles highlights the strength of market forces compared to that of central government support. While heavy government investment helped build the country's passenger-car subsector, with central planners pushing for expansion of passenger-car production capacity, farm vehicle projects have involved little State funding, and have taken their cues largely from the market. Moreover, a sedan in China costs at least ¥100,000 ($12,195) including all taxes and fees, while a farm vehicle can sell for as low as ¥6,000 ($722). Further, farm vehicle purchases incur much lower taxes than automobiles—and run on government-subsidized fuel. Not surprisingly, 80 percent of the passenger cars produced in the country are bought on credit by fleet companies and government institutions, but 99 percent of the farm vehicles are purchased with cash by individuals.

The manufacturers of farm vehicles target rural individual consumers. Current freight transportation needs in rural areas are estimated by the government at roughly 20 billion tons a year, with an annual growth rate of 5-10 percent. Such needs are presently met through a combination of transportation vehicles: 730,000 automobiles, 10 million motorcycles, 10 million tractors, 10 million farm vehicles, and 70 million "rickshaws" and animal-drawn carts. Despite the slowdown of the growth rate of farm vehicles last year, experts believe that demand for these inexpensive farm vehicles—in the form of trucks, pick-ups, vans, and sedans—will steadily increase to 3.5 million units a year by the turn of this century and 5.5 million units by 2010.

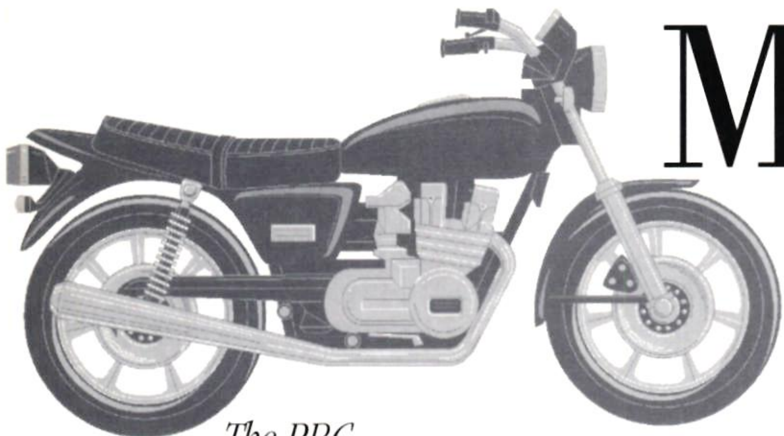
As the market grows, China's farm-vehicle and passenger-car industries are destined eventually to merge into a single motor-vehicle industry. The manufacturing costs of pick-ups and sedans should drop significantly as production volumes rise, eventually making retail prices affordable. At the same time, farm vehicle producers, especially the largest manufacturers, will improve and upgrade their products and move into pick-ups and sedans, either independently or by teaming up with automobile manufacturers.

In fact, automobile and farm-vehicle manufacturers are already joining forces. The BUAMMC-Futian Vehicle Corp. (Futian), the country's largest four-wheel farm-vehicle manufacturer, was formed from the merger of Beijing United Automobile & Motorcycle Manufacturing Co., a leading light vehicle producer, and Zhucheng Vehicle Plant, a small farm-vehicle manufacturer in Zhucheng, Shandong Province. In 1994, the first year of the merger, the company produced 4,000 "Beijing"-brand four-wheel farm vehicles. By 1995 Futian had become the ninth-largest four-wheel farm-vehicle producer in the country, turning out 9,680 units. Last year the company expanded into a shareholding corporation by combining the resources of about 100 companies around the country. The new corporation became the country's top four-wheel farm-vehicle manufacturer in 1996, with output of 26,313. Futian's goal is 55,000 for 1997, according to company president Wang Jinyu. The company's goal for the year 2000 is 450,000 units.

Striking a Balance

After 10 years of significant foreign investment, the country's auto sector now has a production capacity of close to a million passenger cars and another million commercial vehicles. But it will take at least another 10 years before large numbers of ordinary Chinese families purchase cars for personal use. Through the AIP, the Chinese government will try to protect the domestic automobile industry even after China joins the WTO, but the industry will eventually have to rely more on market forces to resolve its many problems. For example, if local protectionism abates, the sector's problem of overcapacity should intensify competition among manufacturers, which could force the industry to reorganize. For consumers, the present overcapacity may help speed up the availability of affordable automobiles.

For the foreseeable future, however, the family car in China will have to be able to function both for business and for personal use. It is safe to predict that on the road to motorization there will be a range of family cars in China. Any model made in China, whether by a Chinese or a joint-venture company, is unlikely to earn the "family car" distinction if it is out of reach of the 200 million rural families. To succeed in China, then, foreign automotive companies should be prepared for some stiff competition down the road. 完



Motorbike Mania

The PRC motorcycle industry is gearing up for growth

Richard Cheng

With construction of paved roads still lagging and transportation needs burgeoning, China would seem a dream come true for motorcycle manufacturers. In fact, China overtook Japan in 1993 to become the world's largest producer of motorcycles. PRC motorcycle output in the 1990s has grown at an average annual rate of 46 percent, reaching 9.3 million units in 1996, of which domestic sales amounted to 8.9 million.

Though production and sales levels have risen sharply, registered motorcycle ownership in the PRC has increased at a slower annual rate—27 percent—and remains surprisingly low. In 1996, less than 2 percent of China's total population had registered motorcycles, in contrast to Indonesia's 5 percent and Thailand's 15 percent. But China's demand for mopeds, motorcycles, and scooters should continue to climb as disposable income rises. Based on a per capita income projection of $1,000 by 2000, annual sales could exceed 13 million units in 2000 and 27 million in 2005.

Paring down

The surge in domestic motorcycle sales in the early 1990s caused a number of small PRC factories to convert operations to motorcycle production. Nonetheless, total production capacity is still dominated by a handful of industrial groups: while more than 118 motorcycle original equipment manufacturers (OEMs) were in operation in China by the end of 1996, the top 10 manufacturers accounted for two-thirds of all domestic production. This structure is in line with Beijing's automotive industrial policy (AIP), which aims to consolidate production into large regional groups. China's Ninth Five-Year Plan (1996-2000) and the AIP call for China's motorcycle manufacturing sector to reorganize into 8-10 major firms by 2000, and into 3-4 groups by 2010. Since 1994, Beijing has prohibited new motorcycle or engine joint ventures, forcing PRC motorcycle manufacturers to rely on existing foreign partners for new technology and designs, particularly for critical components such as engines. The existing joint ventures involving the foreign firms Honda Motorcycle Co. Ltd., Kwangyang Motors, Suzuki Motorcycle Co. Ltd., and Yamaha Motor Corp. are expected to form the core of China's motorcycle industry after the sector's restructuring is complete.

The leading PRC motorcycle manufacturers all have ties with foreign companies through equity joint ventures or technology transfer agreements (*see* Table). The Jianshe Group, for example, a stock company partially owned by China North Industries Co. (NORINCO), has ties to Yamaha. Previously a high-volume producer of low-margin (4-14 percent), old-technology bikes—mainly 50cc, 60cc, and 80cc motorcycles—Jianshe listed on the Shenzhen stock exchange under the name Shenzhen North Jianshe Motorcycle Co. in July 1995. Through the listing, the company raised $60 million to finance its move up the technology curve to produce four-stroke 150cc Yamaha SR150 and two-stroke 100cc Jianshe motorcycles. Four-stroke models typically run cleaner and more efficiently, though offer less power, than two-stroke models.

Jianshe's cross-town rival in Chongqing, the Jialing Group, has ties with Honda. The Jialing Group, also part-owned by NORINCO, is China's second largest motorcycle maker. Jialing and Jianshe are putting the phrase "friendly competitor" to the test, as both companies are seeking to be part of the core group of motorcycle manufacturers after the industry's consolidation.

Richard Cheng is a Hong Kong-based vice president of AT Kearney, an international management consulting firm with over 70 offices worldwide.

Major foreign players

Japanese motorcycle companies have assiduously cultivated relationships in China for nearly 30 years. With one-quarter of all PRC-made motorcycles bearing the Honda brand name or using its

One-quarter of all PRC-made motorcycles bear the Honda brand name or use its technology.

technology, Honda is by far the largest foreign player in the sector. Honda has maintained its dominant position in the Chinese motorcycle market through its three equity joint ventures, two technical assistance partnerships, and two former Taiwan licensees that continue to produce Honda-like motorcycles. Together, over 2.5 million motorcycles, incorporating in some way Honda's designs and technology, were manufactured in China in 1996.

Honda entered the PRC motorcycle market in 1981, when it signed a technical assistance agreement with the Jialing Group. Since 1983, Honda has provided Jialing with technology and engineering know-how for specific Honda motorcycle models. In its second licensing agreement, Honda granted rights in 1984 to Shanghai Ek-Chor Motorcycle Co. Ltd., a joint venture between Thailand's Chia Tai Group and Shanghai Automotive Industry Group Corp. (SAIC), to manufacture Honda's 125cc and 250cc engines. Under the terms of the license, Shanghai Ek-Chor pays Honda $20 per manufactured unit and may produce up to 600,000 units annually. In late 1991, Chia Tai and NORINCO formed Luoyang North Ek-Chor Motorcycle Co. Ltd. to license and produce the 100cc Honda Super Cubs.

Based on the success of its licensing arrangements, in 1992 Honda made its first direct investment in China by forming two joint ventures, Wuyang-Honda Motorcycle Co. Ltd. in Guangzhou, and Tianjin-Honda Motorcycle Co. Ltd. Wuyang-Honda produces the 125cc motorcycle and 125cc scooter, and Tianjin-Honda manufactures Honda's 90cc motorcycle. Output from both ventures is sold primarily on the domestic market, with few, if any, cycles exported.

Seeking to expand its production of Honda cycles in China, in 1993 Chia Tai combined its 50 percent share of Shanghai Ek-Chor and 55 percent of Luoyang North Ek-Chor to form Ek-Chor China, which was then listed on the New York Stock Exchange. The capital raised through the 1993 initial public offering enabled Shanghai Ek-Chor to invest in a new plant in Shanghai's Pudong New Area and almost double its production capacity. In September 1995, Ek-Chor China purchased a majority stake in yet another PRC motorcycle maker, the Ningbo Motorcycle Co. Ek-Chor's stake is in the form of a joint venture with a Thai manufacturer of Suzuki motorbikes, SP International (SPI). The foreign party—consisting of Ek-Chor China, which has an 80 percent stake, and SPI, which has a 20 percent stake—holds 65 percent of the total equity in the Ningbo enterprise. The remaining 35 percent is held by the Chinese partner, Zhejiang Electro-Mechanical Group. The Ningbo venture consists of two factories that produce 50cc and 100cc motorbikes, 750cc police motorcycles, and 90cc scooters. These moves have enabled Ek-Chor China to boost dramatically the production capacities of its three subsidiaries—Shanghai Ek-Chor, Luoyang North Ek-Chor, and Ningbo produced a total of over 1 million units in 1996. As a result of its success in expanding production volumes in China, Honda has seen exports to China fall, from 200,000 units in 1994 to 150,000 units in 1995.

Another strong Asian competitor in the PRC's motorcycle market is Japan's Suzuki, which entered in 1992. Suzuki has an imminent joint venture with the Qingqi Motorcycle Manufacturing (Group) Co. in Shandong Province to produce Suzuki's GS125 and GSX250. Early success enabled Qingqi to obtain permission to list A shares on the Shanghai stock exchange in February 1994, and B shares in June 1997.

Top Motorcycle Producers in the PRC

Motorcycle manufacturer	1996 total production (1,000 units)*	Type of cooperation and partner(s)	Joint Venture Company
Qingqi Group	1,452	JV (motorcycle): Suzuki Motorcycle Co. (Japan) Tech transfer**: Suzuki	Qingqi Suzuki Motorcycle Co. Ltd. —
Jialing Group	1,133	JV (engine): Honda Motor Co., Ltd. (Japan)	Jialing Machinery Factory Co.
Jincheng Group	712	JV (engine): Yamaha Motor Corp. (Japan) JV (motorcycle): Lion Group (Malaysia) Tech transfer: Suzuki	Jincheng Suzuki Motorcycle Co. Ltd. Jincheng Machinery Factory —
Jianshe Group	628	JV (engine): Yamaha	Jianshe Group
Jieda Group	501	Technical assistance: Yamaha	—
Shanghai Ek-Chor Motorcycle Co. Ltd.	499	JV (motorcycle): Chia Tai Group (Thailand) Tech transfer: Honda	Shanghai Ek-Chor Motorcycle Co. Ltd. —
Luoyang North Ek-Chor Motorcycle Co. Ltd.	352	JV (motorcycle): Chia Tai Group Tech transfer: Honda	Luoyang North Ek-Chor Motorcycle Co. Ltd. —
Huari Motorcycle Co.	302	Tech transfer: Derby (Spain), for 50cc scooters starting in 1998	—
Changchun Motorcycle Co.	295	JV (motorcycle): Lion Group	Changchun Motorcycle Co.
Ningbo Motorcycle Co.	281	JV (motorcycle): Ek-Chor China and SP International (Thailand)	Ningbo Motorcycle Co.

SOURCE: Richard Cheng

*The 1996 output figures are for the Chinese parent company, not only the joint venture factories. With the exception of the Ek-Chor Group's Luoyang, Ningbo, and Shanghai plants, which are equity joint ventures involving the parent PRC motorcycle company, all joint ventures are between a foreign partner and a subsidiary of the Chinese parent company, resulting in a single factory or subsidiary of the parent.

**Technology transfers, in most cases, are limited to one specific engine or vehicle model.

In addition to contending with user regulations and licensing fees, foreign motorcycle makers face production requirements.

Jinan Qingqi, a subsidiary of Qingqi Group, has a majority stake in Hainan Xin Da Zou Motorcycle Co. Ltd., which is listed on the Shenzhen market.

Malaysia's Lion Group, using Suzuki technology, has established equity joint ventures with the Jincheng Machinery Factory, part of the Aviation Industries of China (AVIC) in Nanjing, Jiangsu Province; and the Changchun Gasoline Engine Co. Ltd. in Jilin Province. The Jincheng Group, overall, has fared well, and was the third-largest producer in China in 1996, after the Qingqi Group and Jialing Group. Together, Jincheng, Changchun, and Jinan Qingqi produced close to 2 million Suzuki-affiliated motorcycles in 1996.

Japan's Yamaha Motor Co. also is active in China. Yamaha has two engine-licensing agreements with AVIC-affiliated companies, and serves as an adviser to the Jieda Group in Wuxi, Jiangsu Province. Jieda manufactures Yamaha's 90cc, 100cc, and 125cc motorcycle models, and developed its own prototypes for the 90cc and 100cc scooters. Yamaha also established an engine joint venture with the Jianshe Group in Chongqing in October 1992 to produce larger engines for high-end motorcycles.

Taiwan-based motorcycle companies have also taken to the mainland. Though Kwangyang and Sanyang Industry Co., Ltd. initially licensed technology and scooter designs from Honda several decades ago, both companies now manufacture motorcycles based on their own designs. Since the early 1990s, Taiwan has been a competitive manufacturing center for 50cc-150cc scooters that are exported to China, Indonesia, Vietnam, and Latin America. The two companies anticipated in the early 1990s that Beijing would raise local content requirements, which would have prevented exports of fully assembled motorcycles to China. Consequently, Kwangyang and Sanyang established mainland ventures in 1994 to assemble their scooters for the PRC market with locally manufactured components.

The largest European presence in the Chinese motorcycle industry is Italy's Piaggio, which has a moped joint venture in Foshan, Guangdong Province. Piaggio has a 75 percent stake in Piaggio Lyman Foshan Motorcycle Co. Ltd., a partnership with the PRC's Fosti Motorcycle. The Piaggio venture has a 100,000-unit production capacity, and manufacturers 80cc and 125cc motor scooters as well as mopeds. Piaggio, which established the joint venture in China in 1994, has successfully marketed its scooters and mopeds. Other Western motorcycle companies such as BMW and Harley Davidson Motor Co. have not invested directly in China, and are unlikely to be influential participants in future PRC motorcycle sector developments.

Regulatory Roadblocks

Though motorcycle production has accelerated rapidly in the last decade, licensing fees and driving restrictions threaten to slow sales, especially in urban areas. Major cities such as Beijing, Guangzhou, and Shanghai maintain various licensing restrictions to reduce traffic congestion and air pollution, and maintain road safety. In Guangzhou, the municipal government has placed a quota—as low as 3,000 according to some reports, as high as 20,000 according to others—on the number of motorcycle licenses issued each year. Licensing and other locally mandated fees in Guangzhou, such as road maintenance taxes and charges, total ¥28,000 ($3,378)—almost the cost of a motorcycle alone. Wenzhou, Zhejiang Province, also maintains a quota on motorcycle licenses. Zhuhai, Guangdong Province, outright bans mopeds, motorcycles, and scooters from city streets, in an attempt to keep pollution levels low. And in Shanghai, where Shanghai Ek-Chor enjoys preferential treatment, a person can purchase a Shanghai Ek-Chor 100cc scooter for roughly ¥9,000 ($1,086) at a local Shanghai Ek-Chor outlet, and pay ¥11,000 ($1,327) on the spot for a license. A person buying a non-Ek-Chor brand, however, must formally apply for one of the otherwise limited number of motorcycle licenses, or buy one on the black market for at least ¥18,000 ($2,171).

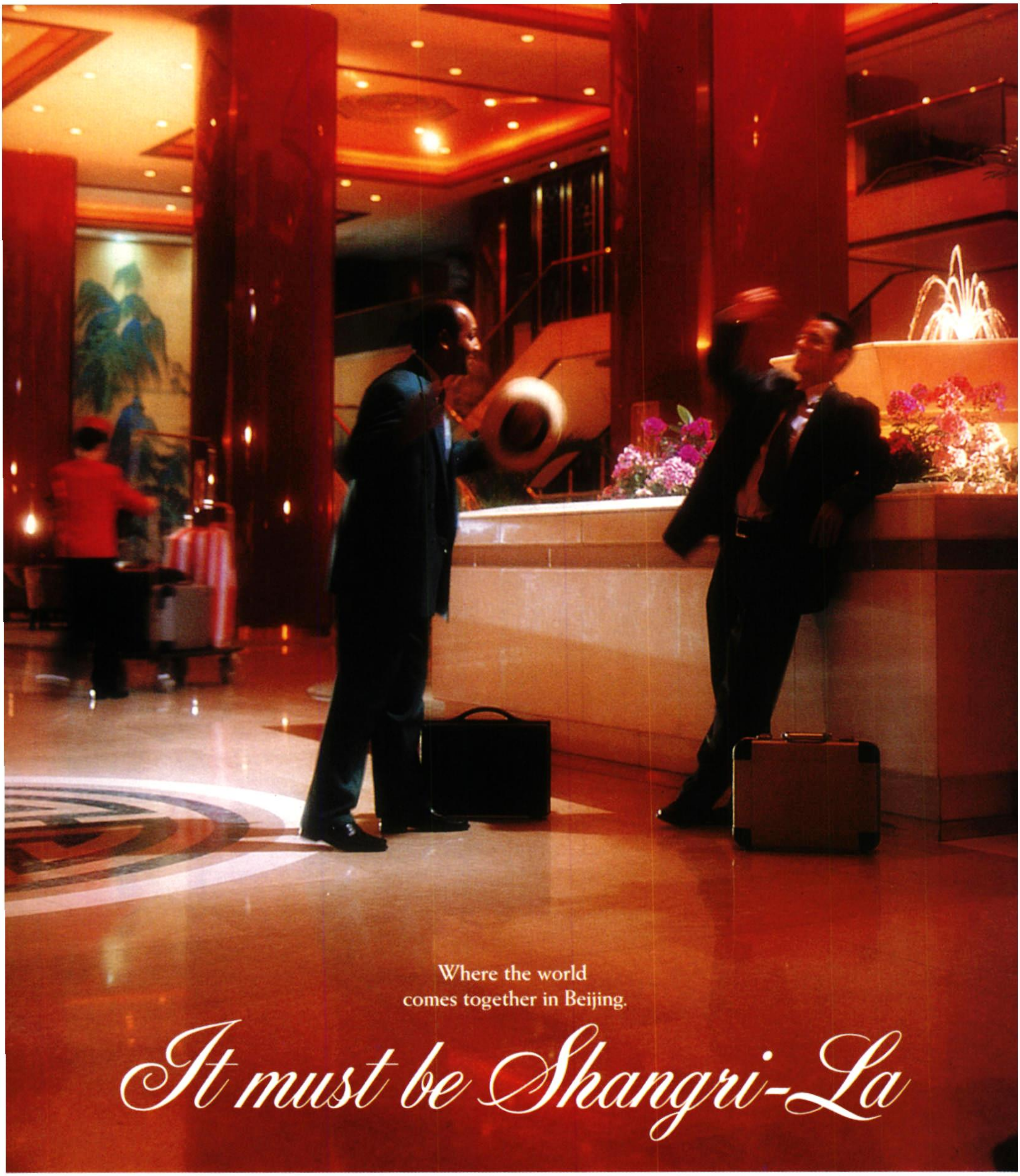
Mopeds face their own set of restrictions. In Shanghai, for example, sales of mopeds—which do not require driver's licenses—had been soaring until last year. But complaints about mopeds clogging bicycle lanes and contributing to pollution prompted the Shanghai government in July 1996 to ban moped sales beginning in January 1997. Other cities such as Nanjing, Guangzhou, and Zhuhai followed suit. Moped sales of such companies as Piaggio have been hard hit by this restriction. But the moped ban has not substantially affected sales in rural areas in southern China, where consumers tend to purchase the higher-priced, higher-end scooters or motorbikes that can transport more goods than a moped. And manufacturers that have diversified into motorcycles and scooters have been shielded from the economic impact of this particular regulation.

Despite the significant restrictions on motorcycles in China's major coastal cities, municipal authorities in most of China's other 100 cities with populations exceeding 1 million are unlikely to restrict motorcycle use, at least in the medium term. In contrast to the coastal cities, the majority of these cities have extremely underdeveloped transportation systems, making motorcycles especially convenient.

Sourcing Components

In addition to contending with user regulations and licensing fees, foreign motorcycle makers face production requirements. In an effort to curb production costs and foster the growth of domestic enterprises, China's central government, over the next 3-5 years, plans to raise the current 40 percent local content requirement of PRC-produced motorcycles to 70 percent and 90 percent for motorcycle components. Although the requirement is not enforced as strictly as similar rules for the automobile industry, virtually all foreign motorcycle producers in China have set up their own component joint ventures or convinced their suppliers to establish operations in the PRC.

Because of low-level manufacturing technology and research and development (R&D) capabilities, most PRC domestic component suppliers and OEMs generally produce parts of lower quality or sophistication than foreign components suppliers. But as the industry in China shifts to larger, cleaner, and more efficient four-stroke engines, major OEMs are likely to rely on imports from their foreign partners or licensors for such engines until they establish their own local plants. Already, OEMs are left with few alternatives to overseas suppliers when they upgrade the quality and performance of their products. For critical components of new motorcycle



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China's motorcycle parts industry is poised to upgrade its technology and improve its efficiency.

models, including carburetors, disk brakes, engines, and transmission systems, OEMs tend to import products from Japan, Korea, and Taiwan.

Leading Chinese motorcycle manufacturers are also actively proposing joint ventures with component manufacturers from Japan and Taiwan, or are investing in existing component joint ventures themselves. Honda's engine joint venture with Jialing, and Yamaha's engine joint venture with Jincheng, are typical examples. Many other components for older or current models are also sourced from one of the numerous foreign suppliers that now have China operations. For example, Jialing sources its carburetors from its joint venture with Japan's Mikuni. Both Qingqi and Jincheng source directly from Mikuni's Japan plant as well as from Zhanjiang Deni Carburetor Co., a joint venture between China's Dongfeng Group and Japan's Keihin Corp. Zhanjiang Deni, located in Guangdong Province, is the largest and most technologically advanced supplier of carburetors in China, producing more than 500,000 units each year. Its customers include the Ek-Chor, Foshan Fosti, and Honda-Wuyang plants.

As more OEMs demand higher quality and lower prices from their suppliers, and as more component joint ventures emerge, China's motorcycle parts industry is poised to upgrade its technology and improve its efficiency. But because of the moderate pace of the industry's restructuring, it will be some time before world-class, large-scale component suppliers emerge in China.

Gaining Momentum

The motorcycle industry should continue its strong growth in the near term. Based on comparisons with Indonesia and Thailand—countries with economic growth, per capita GDP, and motorcycle ownership patterns similar to China's—4.4 percent of the PRC population could own motorcycles by 2000, and 10.6 percent by 2005, translating into 56 and 148 million units, respectively. More conservative estimates, however, put motorcycle ownership at 3.1 percent of the population in 2000 and 6.9 in 2005.

Balancing production capacity with market demand, lowering production and distribution costs, improving product quality, enhancing local R&D capabilities, and improving after-sales services will certainly remain at the top of the agendas of major players in China's motorcycle market in the short to medium term. The willingness of most foreign firms to manufacture motorcycles using domestically produced components should translate into lower production costs and, ultimately, lower purchase prices for consumers. China's motorcycle makers likely will have to improve their design and development capabilities, however, before they will be able to compete effectively in the international market with exports from Japan and Taiwan. In the meantime, China's motorcycle producers likely will maintain their focus on the dynamic domestic market. 完

The Bottom Line on Taxing Reorganizations

A recent regulation clarifies PRC taxation of mergers, reorganizations, and asset transfers

Joyce A. Peck and Tao Jin

After two decades of investing in the PRC, foreign ventures are pursuing ever more sophisticated strategies, including mergers, divisions, reorganizations of ownership shares, and transfers of assets. The PRC State Administration of Taxation (SAT) recently responded to these developments by detailing the tax consequences of such transactions. On May 28, 1997, SAT issued a temporary circular, *Guo Shui Fa [1997] No.71* (Circular 71), which governs the income taxation of restructuring transactions involving foreign-invested enterprises (FIEs) and certain foreign enterprises (FEs). As foreign investors have started to seek more tax-effective methods of consolidating their interests in China in recent years, Circular 71 provides much-needed guidance regarding the taxation of FIEs undergoing restructuring activities. A milestone in SAT's continuing effort to bring the Chinese tax regime into conformity with international tax practices, the Circular appears to provide restructuring FIEs some opportunities to avoid taxable gains. For example, a firm may opt for a tax-free merger in lieu of a taxable reorganization of shares. Similarly, whenever possible, tax-free reorganizations can be used instead of taxable transfers of assets.

FIEs, according to China's 1991 foreign income tax (FIT) law, include equity joint ventures, limited-liability cooperative or contractual joint ventures (CJVs), and wholly foreign-owned enterprises. Circular 71 applies to FIEs approved to operate as stock companies, in addition to the FIT law's list of business forms. Further, SAT has stated that FEs subject to Circular 71 also include foreign firms operating as unlimited-liability CJVs and bank branches that engage in business operations in China.

The Circular, which is effective for taxable years beginning in 1997 or in cases where tax treatments applied in prior years affect the tax treatment for 1997 and later, permits retroactive adjustments that affect the current and future tax treatment of an FIE or FE. Before the Circular's release, foreign investors had to obtain SAT guidance and a tax ruling when undertaking group reorganizations. The FIT law fails to address specifically the taxation of such transactions in China, though the law does mandate tax assessment on property transfers. A few years after the FIT law's release, SAT issued two pieces of legislation clarifying some taxation issues related to reorganizations. *Guo Shui Fa [1993] No.139* (Circular 139) addresses the tax treatment of FIEs that operate as stock companies. *Guo Shui Han [1997] No.207* (Circular 207) provides guidance for achieving tax-free reorganizations on the transfer of equity interests for a group reorganization—for example, moving existing FIEs into an investment holding company. Circular 71, however, is the first piece of legislation to address comprehensively the tax issues that arise in connection with various types of reorganizations.

Joyce A. Peck and Tao Jin are CPAs with Price Waterhouse LLP. Joyce A. Peck, who has advised foreign companies investing in China since 1984, is the managing director of the China Business Center, located in New York, NY. Tao Jin is a senior consultant at the center.

Though Circular 71 addresses "investors" and "stockholders," in practice most FIEs operate not as stock companies with shares and shareholders but rather as Chinese legal entities with "registered capital," or equity, held by Chinese and foreign investors. Reference here is made to "investors" and "equity interests," but the provisions are also applicable to stockholders and stock.

The basic premise of Circular 71, "the continuity theory," holds that, subject to certain limitations, the tax attributes of pre-reorganization enterprises are carried over to the post-reorganization enterprises. Although not explicitly stated, if the reorganization is either a merger or a division, the continuity theory is also applicable to the investors, who will not be taxed on the exchange of interests. Unfortunately, the continuity theory does not pertain to investors involved in equity-interest reorganizations. The failure to treat a reorganization of equity interests as a tax-free transaction for the investors is inconsistent with the treatment of FIEs in the same transactions. The continuity theory also does not apply to asset transfers because, according to Circular 71, the transferee in such a case has a basis in the assets transferred equal to the transfer price, and the transferor's gains are taxable.

TAX-FREE MERGERS

Mergers in China include new-establishment, or "dissolution," mergers, in which two existing entities join to form a new entity; and absorption, or "continuity," mergers, whereby one existing entity is merged into another existing entity. Under either scenario, liquidation—in which a company must be deregistered and terminated—is not required. Although not explicitly stated, mergers are tax-free transactions with respect to both FIEs and investors in FIEs.

Circular 71 clarifies a number of issues relating to the taxation of mergers, including:

■ **Tax holidays and other tax incentives** If a post-merger FIE meets certain criteria for PRC tax holidays or special tax incentives, it is eligible for the unexpired tax holidays and incentives of the transferors. For example, PRC tax holidays beginning from the first profit-making year, under China's FIT law, allow income-tax exemptions for 2 years and 50 percent tax reductions in years 3-5 for production-focused FIEs (though not FEs) with operation periods of at least 10 years. Reduced tax rates also are available to FIEs in certain locations or conducting certain types of business activities. For instance, income tax rates are reduced to 15 percent for FIEs located in any of the five Special Economic Zones. But if the tax holiday terms or the tax rates of the transferors are different, Circular 71 requires the transferee to account for these differences separately—each business unit must continue to calculate its income tax liability on a stand-alone basis after the merger.

For example, FIE A and FIE B, in the same business in the same city, merge into FIE C, to compete better in the marketplace. At the time the companies merge, A is in its first year of a tax holiday, but B has already exhausted its tax holiday. Suppose A generates ¥100 and B generates ¥1,000 of taxable income in the first year after the merger. A's ¥100 income will be exempt from tax because of the continuing tax holiday, but B's ¥1,000 income will be fully taxable. If the business units maintain separate accounting books, the taxable income is based on the actual numbers of each business unit. Otherwise, if C maintains only one set of books, specific ratios may be used to apportion the income among the business units. Acceptable ratios would include the ratios of A or B's revenue, cost, capital, or employees to the total revenue, cost, capital, or employees of FIE C.

A post-merger FIE can be eligible for the unexpired tax holidays of the transferors, in certain cases.

■ **Tax losses** China's income tax law provides for a five-year loss carryforward and no loss carryback. That is, losses may offset profits of the same entity for up to five years after the year the loss was incurred, but cannot be utilized to offset profits earned in previous years. As with tax holidays and tax incentives, Circular 71 allows the merged company to utilize the loss carryforward of the transferring FIEs, subject to the same restrictions—the losses must be utilized by the business activities that originally qualified for the incentive. Losses from one business unit or activity may offset income from another business activity or unit that has a higher tax

To minimize tax costs of a reorganization, taxpayers should carefully select the form of a transaction.

rate. But once the losses are recovered, they are taxable at the higher tax rate in the same year in which the losses are recovered.

For example, FIE D and FIE E merge into a new FIE F, which maintains separate books after the merger for the business previously conducted by D and E. D has a loss carryforward of ¥100 and is eligible for a 15 percent tax rate in a Special Economic Zone. E is subject to a 30 percent tax rate. For the first two years after the merger, the tax payable by F is calculated as illustrated (*see* Table). In this example, the ¥100 loss carryforward as well as the loss of ¥10 generated by D offset E's income in Year 1, but both are recaptured—subject to taxation—in the 30 percent basket in Year 2, when D makes a profit of ¥150. Notably, the recapture of losses only defers rather than reduces the tax. Overall, this is merely a timing difference and the total tax paid over time would be equal to the amount of tax D and E would pay if they reported separately—unless the loss-generating entity is terminated or liquidated before it becomes profitable.

The restrictions for applying tax holidays, reduced tax rates, and loss carryforwards after a merger thus make it difficult—if not impossible—for the merged company to share the tax attributes of its business activities or units.

■ **Amortization and depreciation** The Circular also requires that certain tax adjustments be made to book depreciation and amortization of assets. For Chinese accounting purposes, the underlying assets involved in any type of restructuring must be revalued according to the PRC accounting law and valuation experts. Circular 71's continuity theory, however, does not permit this step-up in the basis for tax purposes. Instead, Circular 71 provides two methods by which FIEs can adjust book depreciation and amortization for tax purposes: on an asset-by-asset basis; or an overall adjustment method, which records over a 10-year period one-tenth of the overall difference between the net revised values after the restructuring and the net historical values of all assets before the transaction. The local tax bureau must approve the adjustment method the taxpayer adopts, and the adjustment calculations must be submitted with the annual tax return. Circular 71 does not state, however, what criteria the local tax bureau will apply in approving a particular method.

Since the overall taxable income of the merged company will be affected by the method selected, the taxpayer should analyze the company's current tax position to determine the more beneficial method. Under the implementing rules for the FIT law, the three categories of depreciation periods in China are 20 years for premises, buildings, and structures; 10 years for trains, ships, machinery, and production equipment; and 5 years for means of transportation other than trains and ships, as well as appliances, tools, and furniture.

Which adjustment method is more favorable to a taxpayer depends on various factors, as illustrated in the following example. Suppose that post-merger FIE A has as its only asset a five-year-old building with no residual value. In connection with the merger, for accounting purposes, the building is revalued and its worth increases by ¥900. When A calculates the annual depreciation on the building, according to the PRC accounting practices, A would add ¥900 to its basis in the building and depreciate the ¥900 over the remaining life of the building, which is 15 years. The increase in book depreciation would be ¥60 per year (¥900/15=¥60). However, for tax purposes, this increase in depreciation is not allowed.

Assume FIE A has a total book income of ¥70 during its first year, which is the starting point for the tax adjustment. Under Circular 71, A must either choose the asset-by-asset method, which would require the company to add back the additional book depreciation of ¥60 to the ¥70, resulting in a taxable income of ¥130; or adopt the overall adjustment method, which would require adding ¥90 (¥900/10=¥90) to the ¥70, resulting in a taxable income of ¥160.

The option an FIE chooses will depend on its current business objectives and tax position. In the previous example, if FIE A has tax holidays or loss carryforwards available, it would probably prefer to use the overall adjustment method since this would maximize taxable income. If FIE A is under the same conditions except that its building has a remaining useful life of less than 10 years, the company may choose the asset-by-asset method. If, however, an FIE has a long list of assets, the overall adjustment method saves the taxpayer time in comparison with the asset-by-asset method.

Tax-free divisions

Foreign investors also can look to Circular 71 for clarifications on how divisions, not just mergers, are taxed in China. Like mergers, divisions do not require liquidation. And although Circular 71 does not state so explicitly, divisions apparently are intended to be tax-free transactions for both the FIEs and the investors in the FIEs.

Two types of divisions are possible in China: new-establishment and spin-off divisions. In a new-establishment division, the original FIE is dissolved and two or more new FIEs carry on the business previously conducted by the original FIE. In the spin-off division, the original FIE continues to exist while part of it is separated into one or more new FIEs. The post-division FIEs inherit the receivables and liabilities of the pre-division FIE pursuant to the agreement between the parties. The agreement also determines the amount of the tax loss carryforward borne by each post-division FIE. As in the case of a merger, in a division of either type, the basis of assets of the pre-division FIE is carried over to the new FIEs and the book-to-tax adjustment of depreciation or amortization occurs during preparation of the annual tax return. Tax incentives and holidays

Table
Calculating the tax payable after FIEs merge

FIE F (A merger between FIEs D and E)	Unit D	Unit E	Taxable Income	Tax Payable
Income Tax Rate	15%	30%		
Income Year 1	(10)	200	(200-100-10)=90	90x30%=27
Income Year 2	150	300	(150+300)=450	(150-100-10)x15%+(300+100+10)x30%=129

SOURCE: Price Waterhouse L.L.P.

are also handled in a manner similar to mergers.

One area that might be good news for FIEs in such cases is that the new enterprises may be eligible for tax holidays that were not available to the original company, subject to an important stipulation: the standard 5-year tax holiday (under which the FIE enjoys years 1-2 tax free, and years 3-5 at a 50 percent rate) is deemed to have begun in the first profit-making year of the *pre-division* FIE. Thus, if the original company was not eligible for a tax holiday, but the new entities are eligible for such treatment, they can enjoy whatever term remains of the holiday.

For example, suppose FIE A is dissolved and FIEs B and C are the new entities created by a division. A did not qualify for any tax holidays. However, after expanding its business scope to include productive activities (such as manufacturing), B meets the criteria for a five-year tax holiday. FIE A had been profitable for 3 years before the division. Since, according to Circular 71, the five-year tax holiday period is deemed to have commenced in the first profitable year of A, B will enjoy only two years of a tax holiday, with a 50 percent tax reduction.

Taxable ownership reorganizations

A reorganization of equity interests is broadly defined in the Circular as a change of investors in an FIE or a change in the amount or ratio of equity interests owned by the investors of the FIE. Such transfers include those of equity interests, such as when an investor in an FIE transfers all or a portion of his or her interest to others; in the case of stock companies, increasing capital by issuing stock to new shareholders; or increasing original or new investors' registered capital.

When an investor transfers his or her equity interest in an FIE, the investor will recognize gain or loss on the transfer. This rule also applies when an FIE operating as a stock company transfers its equity interest in a subsidiary. The gain or loss on transfers of equity interest is the difference between the transfer price and the original cost of the equity interest. The cost is the amount the investor actually paid for the initial investments or the interests (when purchased from another person). The transfer price can take the form of cash or other property. Circular 71 specifically states that since investors' retained earnings or after-tax funds were taxed before the reorganization, they will not be included in the transfer price. Thus, the Circular prevents double taxation.

Circular 207 gives FIEs and FEs some relief regarding transfers of equity interests in a group reorganization.

After a transfer of ownership, each FIE is treated as a continuation of the original enterprise. As a result, the original tax incentives will remain in place and the tax loss carryforward can be utilized by the reorganized FIE within the remaining carryforward period. The tax treatment of the basis of assets for depreciation and the related book-to-tax adjustment for depreciation are the same as those for mergers, under Circular 71 rules.

Circular 71 is a big step toward bringing China into line with standard international practice.

In order to minimize tax costs arising from a reorganization, taxpayers should carefully select the form of a transaction. Instead of using a reorganization of equity interests, the taxpayer should consider a tax-free merger or division. For example, suppose FIE G and FIE H are wholly owned by Investor 1 and Investor 2, respectively. Both enterprises have been very successful and their values have appreciated. To increase the competitiveness of both FIE G and FIE H, Investor 1 and Investor 2 propose to exchange 50 percent of their ownership in each entity. Either of two following methods can be used to achieve this objective; however, one method will incur taxable gains, while the other will not. Under one method, the investors exchange 50 percent of the interest (equity) each holds in its respective FIE. Under Circular 71, the transaction is taxable as a reorganization of equity interests. A second method—a tax-free merger—achieves substantially the same result. Here the investors merge their FIEs G and H into a new entity, FIE J, of which each investor owns a 50 percent interest.

A number of other tax issues concerning ownership reorganizations include:

■ **Non-recognition of gain or loss** Circular 71 does not address situations in which gain or loss is not recognized in a reorganization of equity interests. Circular 207, issued by SAT in April 1997, however, provides foreign companies with the opportunity to transfer their equity interests in an enterprise, at original investment cost, to a company directly or indirectly owned by them, or to a company wholly owned by a common parent. This feature is particularly beneficial to foreign companies that have established investment holding companies in China and wish to transfer equity interests in their existing FIEs to these companies. Prior to the issuance of Circular 207, SAT had approved tax-free FIE transfers to an investment holding company on a case-by-case basis. Circular 207 will facilitate such transfers, which FIEs and FEs would do well to utilize to the greatest extent possible to avoid recognition of gain on transfers of shares.

For example, suppose a US company sets up three FIEs in China, one each in Beijing, Tianjin, and Shanghai. To manage these three FIEs efficiently, the US parent plans to set up a holding company. Under Circular 207, the US parent company can transfer its interests in the Beijing, Tianjin, and Shanghai FIEs at cost to the holding company without incurring income tax.

■ **Reinvestment refunds** Circular 71 addresses reinvestment refunds only for taxable ownership reorganizations. According to China's income tax law, FIEs are allowed a 40 percent refund—or a 100 percent refund if they are technologically advanced or export-oriented enterprises—of income taxes paid if they reinvest profit as registered capital into either an existing or new enterprise. The reinvestment period must be five years or longer. According to Circular 71 and the further clarification of SAT, however, a foreign investor who purchases the stock of a publicly listed FIE using profits from its own FIE (or dividends in the case of a joint-stock company) is not eligible for the reinvestment refund. The only exception is where a foreign investor, holding an interest in an FIE that goes public, purchases shares in the FIE in connection with the initial public offering. This is because issuers of stock must hold any shares for five years—the same length of time required to qualify for a reinvestment refund. According to SAT, this provision distinguishes between stock, which is freely traded on the market, and registered capital.

Asset transfers

A transfer of assets refers to a transfer of all or a portion of an FIE's assets (including goodwill) to another FIE. The gain or loss on transfers of assets must be included in the taxable income of an FIE according to Circular 71. No exceptions to this rule exist.

After a transfer, transferees record the assets acquired at the actual transfer price. If it is difficult to record assets separately, the transferee can record the assets' net book value from the transferor's book. Any difference between the net book value and the transfer price should be recorded as an intangible—such as goodwill—which shall be amortized over a period of not less than 10 years or, if less than 10 years, over the remaining period of the operations.

Whether to record the stepped-up basis for each asset or to carry over the historical basis and record an overall intangible separately depends on both tax and non-tax considerations and would need to be evaluated by the taxpayer. Tax considerations include the depreciation category of the assets, the remaining depreciation period, the transfer price, and the availability of tax holidays or loss carryforwards. Non-tax considerations include the administrative burden of calculating depreciation on the new basis for each asset. The availability of tax holidays and incentives follows the rules concerning mergers, divisions, and ownership reorganizations. A tax loss carryforward cannot be transferred between the transferor and transferee, regardless of whether an FIE transfers all or part of its assets.

Because asset transfers are always taxable, FIEs should consider alternative forms of restructuring. For example, Circular 207 gives FIEs and FEs some relief regarding transfers of equity interests in a group reorganization. If assets other than equity interests are transferred in the same group reorganization, however, the transaction will not qualify under Circular 207, so a gain or loss will be recognized.

Other provisions

The tax laws applicable to FIEs do not apply to an enterprise in which foreign ownership is less than 25 percent after a reorganization. Tax holidays only apply to production-oriented FIEs with an operating period of not less than 10 years. If an FIE changes its status to a non-FIE in connection with a reorganization, and the actual operation period of the pre-reorganization FIE was less than 10 years, the FIE may be forced to repay the balance of any tax reductions or exemptions that were conditioned on being an FIE with a 10-year lifespan. The only exception is when a foreign investor has not withdrawn any equity interests in connection with a reorganization. The rationale is that the non-FIE enterprise steps into the shoes of the previous FIE and is treated as an FIE, so no repayment of taxes is required.

For example, suppose that after nine years of operation, FIE A and FIE B form a new enterprise C, in a dissolution merger. A and B were both 50 percent joint ventures between US companies and PRC State-owned enterprises. After the merger, US investors transfer 60 percent of their interest in C to PRC investors, resulting in a 20 percent US ownership in C. The 20 percent foreign interest disqualifies C as an FIE according to the PRC Equity Joint Venture Law, so C is no longer governed by the tax laws applicable to FIEs. Because the operation periods of A and B were less than 10 years, A and B are required to repay the amount of income tax exempted or reduced over the entire nine years.

If, however, US investors do not withdraw any shares of interest, and a new PRC investor made additional investments in C resulting in 20 percent US ownership, C is still no longer considered an FIE. But A and B are not required to repay any exempted or reduced taxes even though the period of operation before the reorganization was less than 10 years. Thus, foreign investors wishing to withdraw any of their interests in an FIE as part of a reorganization might consider delaying their withdrawal if the pre-reorganization FIE's period of operation is approaching 10 years.

Unresolved issues

Circular 71 raises several fundamental issues that will no doubt become the focus of future dialogues between taxpayers and SAT. For example, in the case of reorganizations of equity interests, tax treatment of FIE investors and the FIEs appears inconsistent, as FIEs are treated as continuous business entities for tax purposes, while investors are required to recognize gain or loss on the transfers. In such a case, a purchaser of an interest in an FIE holds an equity interest with a high basis, but the FIE cannot step up the basis in its assets or be eligible for a new tax holiday. As a result, investors cannot maximize their return on the FIEs.

A step in the right direction

Circular 71 divides restructuring transactions into two categories: tax-free transactions including mergers and divisions; and taxable transactions including transfers of equity interests and transfers of assets. However, Circular 207 provides that certain transfers of equity interests can be made at cost in a group reorganization, so that the transfers will not result in any gain or loss.

Although some issues remain to be clarified, the Circular provides guidance on tax consequences for FIEs and certain FEs that are considering restructuring their operations. Circular 71 is SAT's first major attempt to address in a comprehensive manner the tax issues that arise in connection with different forms of reorganizations. It is a big step toward bringing China into line with standard international practice relating to reorganizations. But Circular 71 is a provisional document. One SAT official has said that the Circular will be changed or finalized when a unified tax code is issued for foreign and PRC enterprises—perhaps within the next two or three years. In the meantime, the Circular represents an important step in China's efforts to adopt a more sophisticated tax regime. 完

Learning by Doing

Setting up a representative office in Shanghai demands patience as well as business smarts

Sheila Melvin

The representative office is by far the most common foreign business form in China. Shanghai, in particular, has seen an explosion in the number of representative offices in recent years, as the city refashions itself as China's financial and commercial center. But popularity aside, establishing a representative office (*dai biao chu*) in China can be an arduous task, requiring the ability to juggle bureaucracy and business (*see The CBR*, January-February 1996, p.30). To prevent misplaced expectations, the China-based foreign company representative, and the folks back at the home office, would do well to understand from the start all of the ins and outs of the process.

A suitable sponsor

The first step is to choose a PRC organization or company to act as a sponsor. Sponsors charge a uniform $1,000 fee and typically are foreign economic and trading enterprises in a similar field of business. The sponsor of the US-China Business Council's representative office in Shanghai, for example, is the China Council for the Promotion of International Trade (CCPIT). While finding a sponsor is generally not a major hurdle, it is important to select one with the authority to sponsor a foreign representative office. One chief representative of a small foreign company proceeded through two-and-a-half months of the registration process with a government-affiliated sponsor only to have the firm's application rejected at the last moment because the PRC organization lacked the sponsoring authority for the foreign company's line of business. To confirm a potential sponsor's authority, the China-based representative can check with the Shanghai Foreign Economic Relations and Trade Commission (known generally by its previous initials, SMERT), which keeps a list of the 47 enterprises in Shanghai approved to act as sponsors.

After securing a sponsor, it is helpful to build a rapport with the individual within the sponsoring organization who is personally responsible for submitting application papers to SMERT. The foreign company representative should try to learn as much as possible from this individual about the registration process, particularly the deadlines by which various forms must be submitted and the distinct responsibilities of the foreign company and the sponsor. As the registration process can be burdensome for the sponsor, the representative should periodically express thanks both to the organization and to the individual who is doing the leg work.

Step by step

The most important part of the registration process is obtaining SMERT approval (*see* Table). The sponsor is responsible for providing the foreign company with a set of application forms and an information sheet that details all of the documents that must be submitted with the application. One set of application forms must then be filled out in type-written English and Chinese and submitted to SMERT. Since Chinese-language typewriters are about as common as sedan chairs in modern Shanghai, this requirement is especially vexing. One way to meet the type-written Chinese requirement is to type the words in Chinese on a computer, cut the words from the printout, paste them onto the forms, and photocopy the forms.

Sheila Melvin is director of the US-China Business Council's Shanghai office, which opened in January 1997.

Because most of the application-related documents must be obtained from or by a foreign firm's home office, it is best to designate one home-office contact person to forward these documents. Once these documents are in hand in China, it is wise to ask the sponsor to review them to make sure that none of the wording can be misinterpreted. For example, CCPIT suggested that the US-China Business Council define itself as a "non-governmental" rather than "private" non-profit membership association, since "private" might lead government authorities to view the Council as less important. After the wording is checked, all accompanying documents must be translated into Chinese by one of three government-approved translation companies—documents translated by a person or entity other than these companies are not acceptable.

Once all the required documents and application forms are compiled, the sponsor submits them to SMERT on behalf of the foreign company. Keeping copies of every single piece of paper submitted, English and Chinese, is crucial because copies must be submitted along with applications for subsequent approvals and registrations.

The sponsor should remain in contact with SMERT on a regular basis throughout the approval process and inform the foreign company when approval is granted. If the foreign company is a major internationally recognized firm and has a sponsor with clout and experience, approval to open a representative office in Shanghai typically takes only a month. For a small, start-up foreign company or a foreign firm with a sponsor that is new to the registration process, approval may take longer. Only once approval has been granted does the foreign firm start to deal directly with SMERT—the representative, not the sponsor, must pick up the representative office certificate from SMERT.

After securing approval, the foreign company can proceed with the process of registering its business with the local bureau of the State Administration of Industry and Commerce (SAIC) and various other government agencies. While seemingly straightforward, the remaining procedures involve endless hours of trips to various government departments that can be miles apart. Though many of these offices are quite efficient, waiting in lines is inevitable. And since applications are rarely, if ever, approved on the spot, at least one return visit to each office is the norm. Often, the first trip is made simply to pick up the application forms and find out what documents must be submitted. To save time, it is a good idea to check the office hours before setting off for the various departments, as their hours are not uniform. On subsequent visits, the foreign representative should bring along every single document that has been submitted to any other bureau—both the original, where possible, and copies—as well as each of the various identification cards and company seals.

Fortunately, for firms that cannot spare the time and effort to complete the business registration process, foreign service corporations offer a welcome alternative. These firms, which specialize in registering representative offices, charge a flat \$1,000 (this fee is separate from the \$1,000 fee paid to the sponsor) to complete all business and tax registration procedures, except those that require the chief representative to appear in person. But a foreign company enlisting a foreign service corporation should still keep an eye on deadlines to ensure that documents are being submitted on time.

Home-office Support

The process of setting up a representative office can be trying, particularly if the foreign company has only one representative in China to handle all set-up tasks. Naturally, home offices of companies that have experience in China and understand the pitfalls of doing business there tend to be able to provide more support—moral and material—to China-based staff charged with setting up a representative office. Representatives of foreign companies that are new to China should provide, at the outset, a detailed explanation of the registration process to the home office. In either case, the timeline for the entire process should be set by the representative in China, with input from the home office. For example, a China-based representative's priorities, as communicated to the home office, might consist of completing registration formalities and locating and furnishing an office within several months, then establishing an accounting system, followed by hiring local staff. The representative and the home office also should agree in the beginning on a comfortable budget and a flexible accounting system so that the China-based representative is not forced to pinch pennies or hunt for receipts. Unexpected costs are inevitable.

The representative should provide the home office with regular progress reports and resist the temptation to complain about every hassle encountered. Home offices, for their part, should realize that a typical day for the China-based representative might include spending two hours begging the Public Security Bureau to grant a work visa, slitting one's hand while repairing a brand new fax machine, cutting and pasting Chinese words onto registration forms only to be told that one of the words is wrong, interviewing several candidates for a secretarial job—and trying to do some substantive work.

Finding a home for the firm's office is no longer one of the most difficult aspects of setting up in Shanghai.

The Office Search

At the same time that the China representative is handling the bureaucratic side of opening an office in Shanghai, he or she cannot ignore other necessities, such as locating suitable office space. But thanks to Shanghai's oversupply of commercial real estate, finding a home for the firm's office is no longer one of the most difficult aspects of setting up in the city. In fact, real estate agencies estimate that there will be 7 million sq m of office space available in Shanghai by the end of 1999. Shanghai is a renter's market and, thus, it is important to remember that prices are negotiable—at least for the foreseeable future. Almost all foreign companies rent rather than purchase office space in Shanghai, not least because there is virtually no secondary market for office space. Used space is not desirable when so many new buildings are opening. The terrific lack of city planning, particularly in Puxi, and the possibility of sudden changes in building management only add to the instability of property values.

For representatives who are new to Shanghai, the first thing to do is to find a suitable real estate agent. Though some agencies may demand from two weeks to one-and-a-half months' rent for their services, the representative should refuse to pay anything. In Shanghai, agency fees are paid by the landlord. A good agent will point out the key business districts and provide insight on how these areas are likely to evolve. In Shanghai, foreign companies have favored Hongqiao in recent years because of its location near the airport. When the new airport in Pudong

Eleven Steps to Establish a Representative Office in Shanghai

Step	1	2	3	4	5
To obtain:	**Approval certificate**	**Business and representative certificates (*daibiaozheng*)***	**Business seals**	**Code registration**	**Tax registration****
Go to:	Shanghai Municipal Foreign Economic & Trade Commission	Bureau of the State Administration of Industry and Commerce	Any shop designated by the Shanghai Public Security Bureau (PSB)	Shanghai Technical Supervision Bureau	No.4 Office of Shanghai Taxation Bureau, Foreign Tax Branch
	No.55, Loushanguan Lu	Chang An Building 1, 4F, 1001 Chang An Lu	Shanghai PSB 185 Fuzhou Lu	16F, Changxing Building, 1219 Changle Lu	West Wing, Good Will Plaza, 29 Jian Guo Zhong Lu
	Tel: 8621/6275-2200	Tel: 8621/6317-1056	Tel: 8621/6329-4000	Tel: 8621/6471-1488, ext. 2631	Tel: 8621/6445-9814
	M-F: 9-11am, 1-5pm	M-F: 9-11am, M-Th: 1:30-5pm	M-F: 9-11:30am	M-F: 8-11am, 1-4pm	M-F: 9am-12pm, 1-4pm
Pay fee (¥) of:	50	900	180-300	200	500
Bring documents:	Certificate of incorporation	Approval certificate (2 copies [*fuben*])	Approval certificate (original)	Approval certificate (original)	Approval certificate (original)
	Annual financial statements or verification of payment of registered capital (copy)	All approval certificate materials (copies)	Business certificate (original and copy)	Business certificate (original and copy)	All approval certificate materials (originals)
	Bank letter of capital balance and credit stature (original)	Completed application forms		Completed code registration application	Business certificate (original and copy)
	Letter requesting approval (original)	Two photos for each representative			Completed code registration application
	Letter from the parent company providing authorization for a chief representative				Business seal
	Chief representative's resume (original, on company letterhead), passport (copy), and 3 photos				Representative certificate (chief representative's)
	Contract to rent or purchase office space				Bank account number
	General introduction to the parent company				Office lease contract (copy)
	Completed "Establishment (extension) of Representative Office of Foreign Enterprises" application (original)				Statement of chief representative's income from headquarters (original, on letterhead)
	Completed "Foreign Personnel and Content Amendment of Representative Offices of Foreign Companies" application				Completed tax registration form

SOURCE: Sophie Zhao, US-China Business Council

*Chief representative must go within 30 days of date printed on approval certificate

**Representative(s) must go in person within two weeks of receiving representative certificate

6	7	8	9	10	11
Bank account	**Health certificate(s)**	**Employment permit (for expatriate employees)**	**Employee residence permit(s)* and long-term visa**	**Customs registration***	**Local staff employment**
Any bank authorized to conduct foreign currency exchange	Shanghai Sanitation & Quarantine Station	Shanghai Labor Bureau	Shanghai Public Security Bureau Entry & Exit Country Management	Customs	Shanghai Foreign Enterprises Services Co.
	1701 Hami Lu	45 Anyuan Lu, Rm. 513	333 Wusong Lu	13 Zhongshan Dong Yi Lu	Tel: 8621/6372-1888
	Tel: 8621/6268-7606	Tel: 8621/6253-1522, 6258-4770, ext. 294	Tel: 8621/6357-6666, ext. 51236	Tel: 8621/6323-0161, 6323-2410, ext. 6447	
M-F: 8-11am, 1-4pm	M-F: 8:30-11am, 1-3pm	M-F: 9-11am, 1-4pm	M-F: 8-11am, 1-4pm	M-F: 8-11am, 1-4pm	China International Intelligence Corp.
					Tel: 8621/6280-5538
					China Star Company for International and Techical Cooperation
					Tel: 8621/6351-2063
250	500	117	1,000 (US citizens)		
Approval certificate (original)	Approval certificate (original)	Approval certificate (original)	Approval certificate (original)	Approval certificate (original)	Approval certificate (original and copy)
Business certificate (original and copy)	Passport	Business certificate (original and copy)	Business certificate (original and copy)	Business certificate (original and copy)	Business certificate (original and copy)
Completed code registration application	Representative certificate	Passport and copy	Passport	Representative certificate (original and copy)	
		Representative certificate (original and copy)	Representative certificate	Health certificate	
		Health certificate	Health certificate	Employment permit (original and copy)	
		Letter (in Chinese) requesting permission, with business seal	Employment permit		
		Two completed application forms with business seal	Temporary residence certificate (original and copy)		
		Three photos for each representative	Two photos		
			Letter requesting permission, with business seal		
			Completed visa application form(s)		

The best way to learn about a building's pros and cons is to talk to current tenants.

is completed, however, Hongqiao's prominence may diminish, since the Hongqiao airport will be used only for domestic flights. Many companies already are relocating from Hongqiao to fast-growing areas such as Pudong's Lujiazui District. The proximity of various neighborhoods to public transportation routes also should be considered. Even if the foreign representative will not be using public transportation, prospective Chinese staff, who tend to commute by bus or subway, find an office located on an existing or future line highly attractive.

Before settling on a space, it is important to confirm with the sponsor that a building under consideration is legally permitted to lease space to foreign companies. And since a building is only as good as the company that maintains it, the representative also should inquire about the building management. Most realtors believe that foreign management companies are more responsive to tenant needs, but the best way to learn about a building's pros and cons is to talk to current tenants. This is especially important in a new building, which may still have such kinks as non-functioning elevators or incomplete paint jobs.

Newness of a building, indeed, is an issue in Shanghai, where several office towers spring up every month. While a new building may be preferable to an old one in the long term, in the short term it can be a drawback, since management companies tend to provide fewer services if there are only a handful of tenants. On the other hand, a foreign company that decides to sign on as one of the first tenants can use this fact as leverage in rental negotiations.

Once a building has been selected, but before the lease is signed, it is a good idea for the representative to meet with the landlord. Such a meeting, which can be arranged by the real estate agent, can serve to demonstrate to the landlord that the foreign company is serious about renting the space, which, in turn, should encourage the landlord to quote the absolute lowest price. The meeting also will enable the representative to establish a personal relationship with the landlord, which may be important down the road.

Meanwhile, the representative should move quickly to obtain approval from the home office, including budget and contract approval. Many an office has been rented out from under a would-be tenant because the parent company dawdled over approving the budget. In addition, the representative should ensure that the foreign company's legal counsel is comfortable with the contract, since Chinese leases differ from those in the United States. Some companies have the PRC office of a US law firm review the lease terms before signing, as such offices are more familiar with Chinese contracts.

In general, short-term leases of around two years are preferable and the foreign representative should, of course, try to include as many options as possible. For instance, the representative should request that the rent remain fixed for two additional years beyond the terms of the lease. If expansion is anticipated, the representative should also insist on the right to have first refusal on adjacent space. The representative also may be able to tack on rent-free months: in Shanghai, renting 200-300 sq m often secures at least two free months. Fixed-price services can be negotiated as well. For instance, if the price of a phone line cannot be reduced, some landlords can be convinced to furnish a second complimentary line. Similar arrangements are possible for parking spaces and air conditioning.

Hiring Issues

Once the foreign company receives all of the approvals necessary to begin conducting business, the China representative can turn to such operational matters as hiring staff. The first decision regarding hiring is when to begin the process. Typically, the representative needs help but is too busy to have time to focus on choosing the right person. As one chief representative put it, "You're new. You hire someone who has no loyalty to you or to the company and you put them in very high stress situations. This isn't always going to work." Another chief representative discussed having hired and fired three secretaries—all during the set-up phase of the office. If a representative can make time to decide what the job responsibilities for a local hire will be and interview people, then it is better to do the hiring in the beginning. However, if job responsibilities have yet to be defined, and the representative is too busy to interview a sufficient number of candidates, it may be best to wait.

All local representative office employees must be retained through one of Shanghai's three foreign service companies. These companies offer placement services and attempt to provide staff with the qualifications requested by foreign firms. If, however, the representative would like to hire someone met through another channel, the foreign company should arrange for approval from one of the service companies. Assuming the prospective hire's current employer agrees to release his or her personnel file (*dang an*), the foreign service company can then represent him or her so that the representative office, in turn, can hire the candidate legally.

Additional Tips

When establishing a representative office in Shanghai, a foreign firm's person on the ground in China may want to keep in mind the advice of a journalist who completed the process: "You probably consider yourself a professional," he opined. "You're interested in your job and you like what you do. Well, forget all that. For the next few months you are a small businessperson. All you do is shop and haggle." Unfortunately, there is considerable truth to these words. A few final tips for the representative to remember:

- Set up a personal savings account. Though a business bank account cannot be set up unless the representative office registration is complete, a personal savings account is quite easy to open. Rather than hassle with traveler's checks and credit card advances, the representative should have the home office transfer money to this account until a business account can be opened;
- Obtain the merchandise lists of office furniture stores from a realtor. Shanghai has an abundance of stores selling every kind of furniture, from antique Chinese to imported Scandinavian. More purchases made from one store can result in a larger discount;
- Check the warranties of office equipment such as photocopiers and fax machines to make sure that the store will send a representative to the office to fix a broken machine rather than require that the machine be serviced at the store. Also bear in mind that the stores that offer the best prices often do not accept credit cards.

Representative offices will continue to be the preferred method by which foreign firms enter China. An understanding and supportive home office and a heavy dose of patience will go a long way toward helping a foreign representative make it through the process of hanging the firm's shingle in China. 完

The Name Game

Geng Cui

Foreign and PRC brands race to build their reputations—and market shares—in China

A topic of debate in China business of late—bottlenecks in the PRC distribution system—appears to indicate a growing preoccupation among foreign marketers with finding new or improved ways to further pry open the China market. In an ever more open and competitive environment, consumer products manufacturers are finding that free samples, giveaways, lotteries, and the "hard sell" are becoming necessary. The marketing efforts of foreign firms have taken on added urgency amidst Beijing's campaign to provide subsidies to certain PRC firms to bolster their competitiveness. Of all the tools at foreign marketers' disposal, brand-name promotion is becoming one of the more popular ways to gain an edge over the competition.

Many companies with internationally recognized products now view China—where many consumers already favor XO cognac and Rolex watches—as a promising source of future sales growth. According to a KPMG Peat Marwick report, for example, the French manufacturer of Louis Vuitton luggage entered China cautiously, setting up only one store initially because marketers were unsure if sales goals were realistic. Such fears were dismissed quickly: Louis Vuitton's store in Beijing outsells many of its European locations, despite the fact that PRC import tariffs of 80 percent make Louis Vuitton prices in China higher than any outlet worldwide. Louis Vuitton has since opened a store in Shanghai.

Moreover, the number of brands in 40 consumer and durable product categories increased 13 percent in China between 1995-1996, according to the 1996 Chinese Consumer Survey, conducted by Beijing-based China Central Viewers Survey and Consulting Center (CVSC). To remain competitive in a market constantly showered with new brands, some foreign companies are choosing to capitalize on the Chinese desire for status symbols. According to a recent Dentsu, Young & Rubicam report, urban young people tend to be more brand conscious than other age groups. The heaviest shampoo purchasers, for instance, are young women aged 12-25, many of whom favor established foreign brands, according to the CVSC survey. Other surveys show that Chinese consumers in general are becoming noticeably more brand conscious and use brand names as a convenient way to select products. The CVSC Survey, for example, revealed a convergence of preferences for certain top brands in China—many consumers now ask for Carrier air conditioners, DKNY stockings, Head & Shoulders shampoo, Jansport backpacks, and even Raid insecticide by name.

Creating an Image

With competition among brands heating up, advertising has become crucial to foreign consumer products' success. In his recent book *Building Strong Brands*, University of California at Berkeley Marketing Professor David Aaker suggests that the key to successful brand-building is to develop a brand identity that effectively conveys what the brand represents. For instance, the marketing efforts of US fast-food companies in China are aimed at selling not only hamburgers and fried chicken, but also a slice of American life. Since turning a new brand into a household name in China does not happen overnight, companies also should consider advertising a product even before it reaches store shelves. While US and European companies tend to begin advertising heavily in China only after securing a distribution network for a new product, many Japanese companies engage in preemptive advertising to introduce and establish brand names long before the products are actually available in China.

Successful advertising in the Chinese market also involves paying particularly close attention to the sentiment conveyed to customers. Louis Tong of Survey Research Group (China) Ltd. (SRG), a division of Nielsen Media Research, Inc., suggests that the most effective advertisements for the China market are those that balance a product's lifestyle images with information on how the product can be used (*see The CBR*, July-August 1997, p.40). Other studies such as those that ap-

Geng Cui is associate professor of marketing at the Howard University School of Business and a consultant in Washington, DC.

peared in the *Journal of Consumer Research* and conducted by Bernd Schmitt, a marketing professor at the China Europe International Business School (CEIB) in Shanghai, indicate that Chinese consumers consider informative or hard-sell commercials boring and prefer messages with striking visual imagery and emotional appeal. For example, one foreign soft drink company recently aired a commercial featuring a young man gazing into a bank of television screens, imagining what might lie ahead of him—graduating from college and enjoying a luxurious lifestyle playing tennis and waterskiing. The advertisement appears to be based on the fact that many young people in China today are optimistic about their future.

Other companies have lined up celebrity endorsements and sporting event sponsorships to promote a certain brand image. The Procter & Gamble Co. has enlisted tennis champion Michael Chang to promote sales of its shampoo in China, and Omega International has signed model Cindy Crawford to assist in the company's marketing of watches in Shanghai. Louis Vuitton plans to sponsor a car race from Dalian to Beijing in May 1998. Meanwhile, foreign toothpaste brands are maneuvering to win an endorsement from China's National Committee on Oral Health, and to be the first to air a commercial demonstration of their products.

But as the importance of advertising has risen, so too have advertising rates. In general, PRC television networks sell air time at set rates. For special occasions, however, the networks auction off air time. A year ago, the PRC distiller of Kongfu brand liquor paid ¥40 million ($4.8 million) for the prime commercial spot during the Chinese New Year celebration program.

The battle for market share

In such product categories as air conditioners, athletic shoes, automobiles, beer, computers, cosmetics, film, and soft drinks, brand proliferation has led to particularly intense competition for market share. China has become the extended battleground for rivalries between global beer, photographic film, and soft drink brands.

In some product categories, foreign brands face stiff competition from joint-venture and PRC brands. In skin-care products, foreign brands such as Lancôme (L'Oréal SA), Oil of Ulan (Procter & Gamble), Pond's (Unilever PLC), and Clinique (Estée Lauder Inc.) vie for consumer attention with such joint-venture and PRC products as Xiafei, Jahwa, and Aupres by Shiseido of Japan. According to an Asian Strategies Ltd. report, there were at least 140 foreign-invested enterprises (FIEs) engaged in cosmetics manufacturing in China by 1995. The PRC's Jianlibao reportedly leads soft drink sales, and Lieb-Haier is one of the most popular refrigerators in China.

Many Chinese brands wield such prominence despite the fact that they spend significantly less on advertising than their foreign counterparts. Many of the established Chinese brand names are made by State- or provincially owned firms, and enjoy a long-standing, loyal customer base because of their long operating histories, reasonable quality, and lower prices relative to newcomers. The CVSC report suggests that although foreign brands overall enjoy better reputations, most domestic brands win hands down in terms of sales volume. The distinction between foreign and domestic brands, however, is becoming less clear. For instance, 90 percent of the household detergent market is dominated by roughly 30 PRC brands, of which most are owned by foreign joint ventures.

Home-court advantage

In recognition of the strength of some PRC brands, many foreign consumer goods companies have formed joint ventures with PRC brands well known to Chinese consumers. Through such ventures, foreign companies aim to reduce the time and advertising expenses

China has become the extended battleground for rivalries between certain beer, photographic film, and soft drink brands.

needed to penetrate the market, expand their price-point portfolio, complement their premium international brands, and gain access to distribution channels. In return, the PRC partners benefit from sorely needed capital, technology, and management know-how. For example, Anheuser-Busch Companies, Inc. bought a 5 percent share of Tsingtao Brewery and an 86.5 percent stake in Wuhan Brewery, reportedly to complement its Budweiser brand and step up its presence in the PRC beer industry.

Some PRC firms, however, have passed up opportunities to form joint ventures, choosing instead to seek success on their own. Popular soft-drink maker Jianlibao has proven to be a fierce competitor to foreign brands while remaining wholly PRC-owned. Once a small township enterprise, Jianlibao, which sponsors the Asian Games and the PRC Olympic team, now commands 41 percent of the soft-drink market. Jianlibao has been endorsed by PRC gymnast Li Ning and plans to enter the US market. The company recently celebrated the grand opening of its US headquarters on the 26th floor of the Empire

State Building, and donated $100,000 for flood relief in the United States.

Building a Reputation

While some PRC brands have succeeded in establishing a name for themselves, others have had to go back to basics. After years of focusing on quantity rather than quality, China's manufacturers have begun to respond to an inundation of consumer complaints about product quality. The China Consumers Association, a nationwide organization, was formed in the 1980s to advocate for consumer rights. With the release of the 1994 PRC Law on the Protection of the Rights and Interests of Consumers, Chinese consumers now have a legal mechanism through which to obtain compensation for faulty products. State agencies responsible for upholding the Consumer Protection Law—such as the State Administration of Industry and Commerce (SAIC) and the State Council's Anti-Counterfeit Office—also are working to boost the quality of PRC products by cracking down on companies that make counterfeit or shoddy goods.

In 1995, PRC authorities launched a campaign at both central and local levels to improve product quality and increase visibility of PRC brand names. To complement the 1993 Product Quality Law, the Beijing Technology Supervision Bureau issued notices in 1995 stipulating that product names appearing on package labels in Beijing conform to national standards (*see The CBR*, September-October 1995, p.32). In addition, the State Technology Supervision Bureau and the State Economic and Trade Commission have initiated a national campaign to select and promote "famous brands." To obtain such status, a company must apply to and receive approval from the technical supervision office of the local economic and trade commission, and the local administration of industry and commerce. In March and June 1997, SAIC awarded "famous Chinese trademark" status to 42 brands, including the Forever bicycle, Hero pen, Jialing motorcycle, Jianlibao soft drink, Little Swan washing machine, Phoenix bicycle, and Tsingtao beer.

Brand Management

Foreign brands hoping to penetrate China's increasingly competitive market should begin with accurate and thorough market research. Foreign companies first should ensure that a product's brand image and message are neither offensive to PRC authorities nor in conflict with Chinese culture. Fortunately, scanner data, retail measurement, and television program ratings such as those provided by SRG are now available, making accurate brand tracking feasible for the first time in China. After establishing a brand name, foreign marketers should carefully "leverage" it—build, manage, and position the name. The Campbell Soup Co., for example, markets its Swanson-brand chicken broth as a cooking aid rather than as a substitute for the home-cooked meals that Chinese deem irreplaceable. While Campbell distributes free recipe booklets and holds in-store sweepstakes to cultivate brand loyalty (*see The CBR*, July-August 1993, p.31), Avon Products Inc., Amway Corp., and Mary Kay Inc. have relied on a personal approach—direct salesperson-to-customer sales—to ensure customer loyalty.

Post-purchase service is another key component of brand management. According to PRC law, however, a foreign firm can service only those products that the firm manufactures in China. While Americans consider buying a new unit more economical than repairing a broken product, Chinese consumers often prefer to have their products repaired. Wu Gaohan of the China Consumers Association observes that Chinese consumers have become more assertive about protecting their interests. Sony, for example, received a barrage of complaints in the early 1990s when PRC consumers learned that the replacement parts for their Sony televisions were not available in China. After stories in the PRC press publicized Sony's lack of after-sales services in China, the company established maintenance centers in Beijing; Shanghai; Chengdu, Sichuan Province; and Guangzhou, Guangdong Province.

In China, perhaps more than in other countries, language is key to a brand-name's success. According to CEIB's Bernd Schmitt, while the phonemic quality of a brand name—how the brand name sounds—is significant to European consumers, the pictorial characteristics of a brand name—how its Chinese characters look in the written language—are more important to Chinese consumers. To capitalize on the illustrative strength of the language, some international brands use advertising strategies based on the visual appeal and meaning of the product's Chinese name. For instance, the insurance company Prudential selected *Pu Tian Shou*, or "long life for everybody under the sky," as its Chinese name. Other companies aim to select a name that highlights the foreign origin of a product to retain its quality-based appeal.

As the purchasing power of Chinese consumers continues to rise, price as a deciding factor will diminish in importance, while quality will remain key.

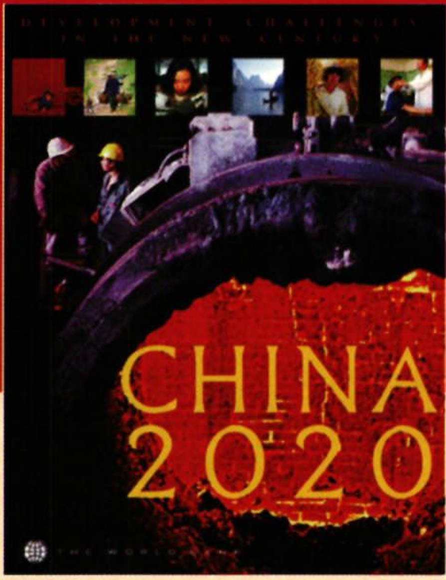
To fend off the onslaught of multinational brands, Beijing is encouraging companies to merge into conglomerates. Some of these new groups combine enterprises with billions of *yuan* in assets and sales. For example, the assets of Shanghai Electric Group total ¥35 billion ($4.2 billion), while those of Shanghai Huayi Group total ¥41 billion ($4.9 billion). But because many of these Chinese conglomerates are merely loose federations of unrelated businesses, they have been unable to produce brands that can compete with joint-venture or foreign brands.

Other problems exist as well. Despite trademark and copyright laws, China still suffers from a multitude of "copycat" products. White Cat detergent, for example, unseated Omo as the top-selling detergent in Shanghai by mimicking Omo attributes, right down to the artwork on the package. As brand competition in China continues to intensify, foreign and PRC marketers alike should register their trademarks in China and secure all available legal protection.

Evolving Strategies

With the proliferation of brand choices, Chinese consumers are becoming more discriminating. As their purchasing power continues to rise, price as a deciding factor will diminish in importance, while quality will remain key. As distribution networks modernize, marketing in China will increasingly resemble marketing in the West, where firms rely on solid market research and target niche consumers.

In the meantime, the Chinese market will continue to attract foreign brands. Retail sales in China, which have been growing at an average annual rate of 20 percent, reached $296 billion in 1996, and are expected to total $346 billion this year. PRC players are quickly learning the rules of the game. As John Naisbitt notes in his book *Megatrends Asia*, whether a foreign product can withstand the test of competition depends to a large extent on its ability to leverage its brand. 完



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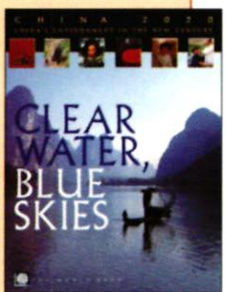

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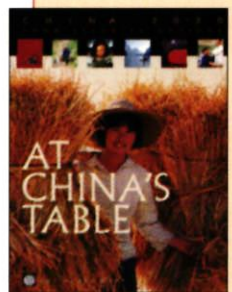

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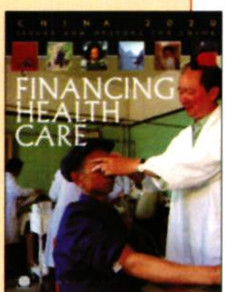

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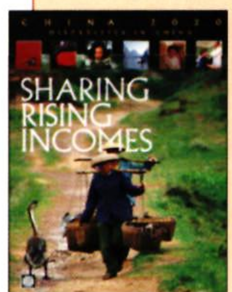

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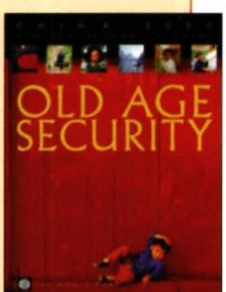

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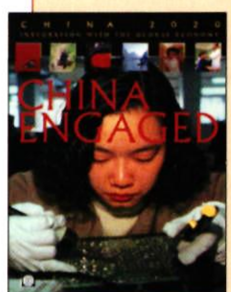

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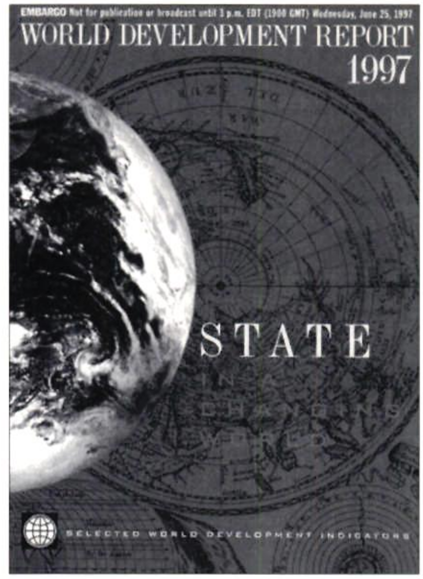
World Development Report 1997: The State in a Changing World



New York, NY: Oxford University Press, 1997. 265 pp. $49.95 hardcover, $25.95 softcover.

Recognizing that a government's actions can and do affect its country's economic and social development, this year's World Bank report seeks to show how *any* government can more effectively contribute to its country's development. In its 20th edition of the annual series on global development, the World Bank provides a framework for addressing how a state can successfully overcome limited resources to manage its many responsibilities, and improve the efficiency of its public institutions.

Though not specifically focused on China, the report is written with transitional economies like China's in mind. The first section analyzes the implications of state policies for development, concluding that the state should complement rather than replace markets and noting that sustainable growth and poverty reduction depend on sound economic policies, well-developed human capital, and an open economy. Part II suggests that a sound legal system and clear property rights should come before deregulation, liberalization, and privatization. Installing institutional mechanisms such as a system of checks and balances, citizen participation, and international cooperative arrangements can "promote further improvements in economic and social welfare." Keeping in mind that implementing such strategies is no easy task, the authors devote the last section to the challenges of initiating and sustaining reforms. The report encourages states to consider carefully the sequencing of reforms, as well as their political costs and benefits. A section on why states collapse brings the report full circle.

Sidebars and tables abound throughout the study, providing context for sometimes abstract and academic concepts. Bar graphs depict the expansion of government spending across geographic regions, for example, and one sidebar outlines the constraints a state's weak fundamentals place on firms. For businesspeople interested in China, the appendix of public finance indicators and the report's traditional table of world development indicators offer insights into how China measures up against other countries—from socioeconomic development and human resources indicators to environmental sustainability and economic performance statistics.

—*Ann M. Weeks*

Ann M. Weeks is assistant editor of The CBR.

China's Management of Enterprise Assets: The State as Shareholder

Washington, DC: The World Bank, 1997. 112 pp. $20 softcover.

China's Management of Enterprise Assets: The State as Shareholder is one of the most up-to-date and comprehensive studies yet on the current status of China's State-owned enterprise (SOE) reforms. Published by the World Bank in August 1997, the study focuses on ownership reform, one of the most sensitive tasks of China's reinvigoration of its State enterprises. Unlike other recent literature on wide-ranging SOE problems, *The State as Shareholder* assesses primarily the progress achieved thus far in PRC reforms of State asset-management regimes. The study also analyzes new problems that have emerged alongside the reforms, particularly the growing vacuum of skilled corporate managers, tax evasion, escalating costs, and the diversion of State assets into private hands.

The World Bank offers insightful and meticulous policy recommendations on ways the PRC can develop an asset-management system that would tackle such problems but assure that public enterprises retain a central role in PRC industry. Four chapters detail crucial components of such a system—a legal framework, strong corporate governance practices, international-standard accounting systems, and organizational structures. The chapter on reforming the complicated SOE organizational structure might prove the most interesting to foreign business readers. This chapter provides a clearer picture of the changes relevant to foreign firms looking to participate in SOE asset transfers or even privatization.

In addition to its assessment of major problems relating to SOE reform and its detailed policy recommendations, the study offers readers no less than two dozen case studies of the asset-reform experiences of both Chinese and foreign-invested State enterprises. Most of the cases illustrate creative experiments, from the establishment of property rights transaction centers to State-asset operating companies and land transfers. The cases also reveal that China has proceeded much further in ownership and asset restructuring than many readers might have thought.

With the dwindling of the State's role in the economy, and the gradual removal of the ideological constraints surrounding private ownership, there is reason to believe that foreign companies could benefit from China's State asset reform. *The State as Shareholder* provides a useful set of tools to evaluate the changes that have already occurred, and those still to come.

—*Qin Chen*

Qin Chen is a Business Advisory Services intern in the US-China Business Council's Washington, DC office.

World Trade and Customs Directory,

Spring 1997, Vol.1, No.1

Washington, DC: Arrowhead World Regulatory Directories. 1,189 pp. $399 Subscription, 2 issues/year.

World Intellectual Property Directory,

Fall 1997, Vol.1, No. 1

Washington, DC: Arrowhead World Regulatory Directories. 705 pp. $399 Subscription, 2 issues/year.

Both the *World Trade and Customs Directory* and the *World Intellectual Property Directory* aim to be one-stop, comprehensive sources of information about government officials and agencies. Each directory covers more than 100 economies, including China, Hong Kong, and Taiwan. In addition to providing recent population figures and one-sentence descriptions of the government and legal systems, the directories contain such data as the rank of China as a US export market in 1995 (13th) and the estimated entertainment software piracy rate in China in 1996 (97 percent). Each country chapter concludes with summaries of US government reports.

The real value of these two books lies in their comprehensive listings. The *World Trade and Customs Directory*'s chapter on China, for example, provides names and contact information for officials at all relevant bureaucratic levels including the State Planning Commission, the Ministry of Foreign Trade and Economic Cooperation, the General Customs Administration, and the ministries of agriculture and machine-building. The section on the PRC's General Administration of Customs is particularly useful for its listings of working-level officials in ports from Dalian to Zhuhai. Similarly, the *World Intellectual Property Directory*'s China chapter lists the officials in the PRC Patent Office, the State Administration of Industry and Commerce, and the IP-related ministries.

Their comprehensiveness makes these two directories more convenient to use than such other sources as the CIA's *World Fact Book* and Chinese-language volumes on ministerial organizations. They are also scheduled to be updated semi-annually (in the spring and fall), and the cost of the reference set covers both volumes. Given the sometimes rapid changes in organizations and personnel, such regularly scheduled updates should prove immensely valuable.

—Iain McDaniels

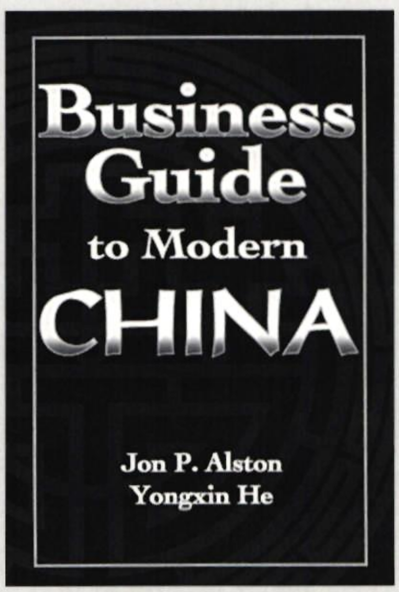
Iain McDaniels is a Business Advisory Services associate in the US-China Business Council's Washington, DC office.

Business Guide to Modern China

by Jon P. Alston and Yongxin He. East Lansing, MI: Michigan State University Press, 1997. 192 pp. $29.95 softcover.

A beginner's guide to conducting business in China, *Business Guide to Modern China* provides practical advice and analysis to foreigners entering China for the first time. Though seasoned veterans of the China market may find this nuts-and-bolts guide less useful, readers unfamiliar with China will find the book a good starting point.

The book's overviews on negotiations, business etiquette, and preparation for living in China are most valuable, as they provide sound, up-to-date advice. In particular, Alston and He provide worthwhile background on Chinese negotiating style and logic, and stress the importance of time, patience, and bringing the right kind of negotiating team to the table. For example, the authors maintain that Chinese negotiators tend to use delays and claims of weakness to gain the upper hand. The chapter on business etiquette lists useful tips for gift-giving, attending banquets, and interpreting body language. The chapter on living in China is especially useful for its suggestions on how to choose the right employee for a PRC



posting. The authors cite patience, willingness to learn, flexibility, self-confidence, and at least some Chinese language training as essential for any China-based expatriate. Not only will these qualities help the employee adjust to expatriate life in China, but they will also increase the likelihood of a successful assignment.

In contrast to the strength and quality of the "how-to" information, the authors' descriptions of China's current laws, political environment, labor issues, and investment vehicles lack timeliness and, in some cases, accuracy. For example, many of the publications suggested for further reading are from the 1980s and early 1990s, though PRC labor laws and major tax regulations have changed significantly since then.

Despite its limitations, *Business Guide to Modern China* remains a useful source of information on Chinese business etiquette and culture.

—Meredith Singer

Meredith Singer is manager of Business Advisory Services in the US-China Business Council's Washington, DC office.

MOFTEC Vice Minister Speaks to Council Members in Beijing

Ministry of Foreign Trade and Economic Cooperation (MOFTEC) Vice Minister Sun Zhenyu reassured Council member-company representatives during a September 19 Council Issues Luncheon in Beijing that China still welcomes foreign investment. The aim of new investment guidance policies, Sun explained, is to help investors avoid redundant and unproductive investments. According to Sun, the central government, realizing its mistake in withdrawing in their entirety the tax breaks for imported capital equipment, plans to reinstate the exemptions for high-tech investors, though the definition of "high tech" is still under discussion.

At the September 26 meeting of the Council's Financial Managers Group, Li Shuguang, the principal architect of China's bankruptcy law, explained the current merger and acquisition drive in China and its implications for foreign investors. Li said that the average liability-to-asset ratio of State-owned enterprises (SOEs) is 82 percent, and many SOEs have debts that exceed their total assets. For these companies, there is no alternative to bankruptcy or absorption by a stronger enterprise able to shoulder debt payments. Mergers are encouraged only when the failing enterprise has some hope of marketing its products if given financial or managerial assistance. Li said that the government's attempts thus far to solve the SOE problem through managerial reform have caused unemployment to rise to 20 million in the cities and 120 million in rural areas, as SOEs have failed to rebound and become sources of new employment.

Liu Yajun, a MOFTEC Foreign Investment Administration official, also spoke at the meeting and addressed the current policy regarding taxes on capital equipment. Liu reiterated that a policy offering tax benefits to new high-tech projects was in the works, but he did not elaborate on the policy's details. Also speaking at the financial management meeting, Li Zhiyong of the Industrial and Commercial Bank of China (ICBC) explained the benefits of the "main bank" relationship that ICBC offers to some US investors in China.

ICAC Commissioner Visits Washington

At an informal gathering in Washington attended by Council staff and company representatives, Hong Kong Independent Commission Against Corruption (ICAC) Commissioner Lily Yam expressed her optimism about ICAC's ability to continue combating corruption effectively in post-handover Hong Kong. Established in 1974 in response to public outrage at Hong Kong's corruption problems, ICAC is now "on top" of corruption in the Special Administrative Region, according to Yam. The commissioner further remarked that ICAC has been successfully fighting corruption through its "effective, efficient, and clean public service." Since foreign investors will leave Hong Kong if they are unhappy, she added, Hong Kong must maintain its reputation as a lawful and safe place to do business. Moreover, because Hong Kong is viewed by many as a gateway to China, ICAC's success should contribute significantly to efforts to make the "one country, two systems" experiment work.

Transparency International ranked Hong Kong second on its 1996 list measuring Asian countries' ability to fight corruption. Hong Kong has been able to advance closer to the top of the list, said Yam, because ICAC has promoted an open and transparent legal framework and increased the commission's educational efforts. Yam also commented that Hong Kong will require continued assistance from law enforcement agencies around the world to carry out anti-corruption investigations. Hong Kong signed an extradition treaty with the United States that gained Senate approval in late October.

Shanghai Group Talks Supply Management

Member-company representatives based in Shanghai, Guangzhou, and Singapore attended a meeting of the Shanghai office's Procurement Managers Working Group on September 11. Arvid Pedersen, Singapore-based director of Asia-Pacific Corporate Purchasing for United Technologies Corp. (UTC), led the dinner discussion. Pedersen shared his experiences in structuring a supply-management system for China, highlighting corporate interaction with global commodity teams and UTC's efforts to establish a database of potential suppliers in China. Other member company representatives offered their own views on the subject, and discussed the difficulties of securing cooperation on corporate purchasing from independent-minded units or joint ventures. The working group also discussed how to conduct a quality audit of a supplier in China.

Hong Kong Highlights Work Place Safety Issues, State Enterprise Reform

The Council's Hong Kong office hosted a Legal Committee meeting on September 15 that featured Andy See of Clifford Chance, who discussed the health and safety obligations of PRC-based foreign-invested enterprises to their workers.

At a breakfast meeting on September 25, J. Timothy Rucquoi-Berger, deputy general manager of China Liaoning Ltd., addressed the issue of State enterprise reform. Rucquoi-Berger has visited some 200 Liaoning factories on behalf of the provincial government, and has worked on the restructuring of five enterprises. He noted that each province and municipality has its own strategies for reforming State enterprises. In Liaoning, for example, the leadership is working on creating a provincial holding company that will be listed overseas, with the aim of using proceeds to further enterprise restructuring at home.

Adam C. McConagha

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 *July 15-September 15, 1997*

Foreign or Hong Kong party/Chinese party — **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Allstate Corp. (US)
Opened office in Beijing. 7/97.

Advertising and Public Relations

CHINA'S INVESTMENTS ABROAD

Hairun International Advertising Co. Ltd., a joint venture with the PRC Ministry of Internal Trade
Will open its first US-based advertising agency in Los Angeles. 8/97.

INVESTMENTS IN CHINA

Universal Outdoor China Inc., a unit of Universal Outdoor Inc. (US)/Beijing Chaofan Advertising Co., Tai Yi Advertising Co.
Formed advertising joint ventures in Anshan and Dalian, Liaoning Province. $5 million. 8/97.

Agricultural Commodities and Technology

INVESTMENTS IN CHINA

Kemira Agro, a unit of Kemira Oy (Finland)/Zhanhua Enterprises Group Co. (Guangdong)
Established fertilizer joint venture to produce phosphoric acid and NPK compound fertilizer in Zhanjiang, Guangdong Province. (Finland:55%-PRC:45%). 8/97.

Mitsui & Co. Ltd. (Japan), Sachiku Corp. (Japan)/Dehui Cereals and Edible Oils Purchasing and Marketing Corp. (Jilin)
Formed joint venture to process high-quality rice in Dehui, Jilin Province. 8/97.

Trans-Continental Leaf Tobacco Corp., a wholly owned subsidiary of Standard Commercial Corp. (US)/Guizhou Nanming Leaf Tobacco Co. Ltd.
Finalized agreement to form a tobacco-processing joint venture in Guiyang, Guizhou Province. 8/97.

Banking and Finance

OTHER

China International Capital Corp., a joint-venture investment bank among Morgan Stanley Group Inc. (US), the government of Singapore, and China Construction Bank
Will set up an investment banking subsidiary in Hong Kong. 9/97.

Goldman Sachs Asia LCC, a division of Goldman, Sachs and Co. (US), China International Capital Corp., a joint venture among Morgan Stanley Group Inc. (US), the government of Singapore, and China Construction Bank
Announced that they would underwrite L.L.C. China Telecom Hong Kong Ltd.'s initial public offering. 9/97.

Bank of New York (US)
Selected by China Southern Airlines Co., Ltd. as the depositary for the airline's global initial public offering. 8/97.

HongkongBank (HK)
Opened its first Beijing branch. 8/97.

Martin Currie (UK)/China Securities Corp.
Formed Heartland Investment Consulting joint venture to research investment opportunities in China's interior. 8/97.

State Street Mansion House Investment Services Ltd., a joint venture between State Street Global Advisors (US) and Mansion House Group Ltd. (HK)
Established venture capital fund for aviation-related projects in China. $1 billion. 8/97.

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

Chemicals, Petrochemicals, and Related Equipment

CHINA'S IMPORTS

Mitsui & Co. Ltd. (Japan)/Dalian Chemical Industrial Group Co., Ltd. (Liaoning), Henan Lianhua Gourmet Powder Group Corp.
Signed contracts to supply the two Chinese companies with 850,000 tons of sulfur over a seven-year period. 7/97.

INVESTMENTS IN CHINA

Ajinomoto Co., Inc. (Japan)/NA
Formed joint venture in Henan Province to manufacture a full range of amino acids for use in pharmaceutical and nutritional supplement production. (Japan:60%-PRC:40%). $6 million. 9/97.

BASF AG (Germany), Headway Group (Taiwan)
Will build a polyurethane system house in Nansha, Guangdong Province, with annual production capacity of 10,000 tons. (Germany:70%, Taiwan:30%). 9/97.

Bayer AG (Germany)/Shanghai Zhongxi Pharmaceutical Co.
Will establish a joint venture to produce pesticides. (Germany:70%-PRC:30%). 9/97.

DSM Fibre Intermediates Corp., division of DSM NV (Netherlands)/Nanjing Chemical Industry Group (Jiangsu)
Will form a joint venture to manufacture caprolactam. 9/97.

Elf Atochem S.A., division of Elf Aquitane (France)/Wuhan Organic Chemicals Industry Corp. (Hubei)
Agreed to form a joint venture to produce benzyl chloride and its derivatives, such as phenylacetic acid, in Wuhan, Hubei Province. The venture's annual production capacity for benzyl chloride will be 15,000 tons. 9/97.

Yukong Ltd. (S. Korea)/NA
Will set up a joint venture to produce acrylonitrile butadiene styrene (ABS) resin in Shenzhen, Guangdong Province. 9/97.

Akzo Nobel (Japan), Kayaku Akzo (Japan)/Tianjin No. 2 Chemical Plant
Formed Tianjin Akzo Nobel Peroxides Co. Ltd. joint venture to produce 2,000 tons of peroxides annually. (Japan:80%-PRC:20%). 8/97.

Central Chemical Co. (Japan)/NA
Founded Central Chemical Co. Ltd. joint venture to produce plastic resin containers in Zhengzhou, Henan Province. (Japan:27.8%-PRC:72.2%). $2 million. 8/97.

Imperial Chemical Industries (UK), Nippon Polyurethane Industry (Japan)/Shanghai Tianyuan Chemical Works
Won approval to build a polyurethane plant in Shanghai that will have an annual production capacity of 150,000 tons. (UK:50%, Japan:25%-PRC:25%). $400 million. 8/97.

Rhone-Poulenc Animal Nutrition, a subsidiary of Rhone-Poulenc S.A. (France)/Tianjin Bohai Chemical Industry Group
Established Bohai (Tianjin) Rhone-Poulenc Methionine Co. Ltd. joint venture to produce methionine in the Tianjin Economic Development Area. (France:30%-PRC:70%). $36 million. 8/97.

General Electric Co. (US)/Yanshan Petrochemical Corp.
Formed joint venture to make bisphenol-A. The plant will have an annual capacity of 62,000 tons, with 45,000 tons used to make polycarbonate resins and the remainder for epoxy resins. (US:35%-PRC:65%). 7/97.

Hercules Inc. (US)/Yanshan Petrochemical Corp.
Signed agreement to form a joint venture to manufacture hydrogenated hydrocarbon resins. 7/97.

Rade Management Corp. (US)/Dong'e Chemical Industrial Group Co. (Shandong)
Agreed to establish chemical joint venture in Shandong Province. (US:70%-PRC:30%). $24 million. 7/97.

Tomen Corp. (Japan), Mitsubishi Heavy Industries Ltd. (Japan)/Zi Jiang Group
Will form a polyethylene film joint venture in Shanghai with an annual production of 10,000 tons of polyethylene terephthalate (PET) film for use in labeling. (Japan:40%-PRC:60%). $43 million. 7/97.

OTHER

Procter & Gamble China Ltd., a subsidiary of The Procter & Gamble Co. (US)
Announced long-term contract with a joint venture owned by Rhone-Poulenc S.A. (France) and Beijing Eastern Chemical Group to supply chemicals to Procter & Gamble's China operations. 8/97.

Consumer Goods

INVESTMENTS IN CHINA

Givaudan Roure Roche Group (Switzerland)/Shanghai Sun-Ve Pharmaceuticals Ltd. Co.
Formed Shanghai Givaudan Roure Roche Group joint venture to produce essences and perfumes in the Zhangjiang High-Tech Park of the Pudong New Area in Shanghai. The venture will have an annual production capacity of 1,000 tons. $7.5 million. 9/97.

Procter & Gamble China Ltd., a subsidiary of The Procter & Gamble Co. (US)/Qinghua University
Will open a research and development center in Beijing in 1998.

Nippon Electric Glass Co. (Japan), Nissho Iwai Corp. (Japan)/NA
Will form a joint venture to manufacture and sell glass for 29-inch color television tubes in Hebei Province. (Japan:49%-PRC:51%). 8/97.

Samsung Display Devices Co., a subsidiary of the Samsung Group (S. Korea)/Shenzhen SEG Electronics Co. (Guangdong)
Will establish a joint venture to produce color picture tubes for televisions and color-display tubes for computer monitors. 8/97.

Electronics and Computer Software

INVESTMENTS IN CHINA

Dell Computer Corp. (US)
Announced plans to build plants in China to produce personal computers. 9/97.

Maxtor Corp., a subsidiary of Hyundai Electronics Industries Co. Ltd. (S. Korea)
Will build a disk-drive manufacturing plant in Dalian, Liaoning Province. $150 million. 9/97.

Digital Video Systems, Inc. (US)/Panyu Tian Le Electrical Appliance Manufacturing Co. Ltd. (Guangdong)
Formed Panyu DVS Electrical Appliances Manufacturing Co., Ltd. joint venture to manufacture digital versatile disk systems and video CD players in China. (US:51%-PRC:49%). 8/97.

Matsushita Electric Industrial Co. (Japan), Compeq Manufacturing Co. (Taiwan)
Formed joint venture in Guangzhou, Guangdong Province, to produce copper-clad laminates for use in the production of printed circuit boards. (Japan:55%, Taiwan:45%). $11 million. 8/97.

Motorola Inc. (US)
Will expand Leshan-Phoenix Semiconductor Co., the company's semiconductor and integrated circuit manufacturing joint venture in Leshan, Sichuan Province. $200 million. 8/97.

Viagold Inc. (US)/Beijing Economic and Technological Investment Co.
Established China Silicon Valley Development Co. Ltd. joint venture in the Beijing Economic and Technological Development Zone. (US:75%-PRC:25%). $25 million. 8/97.

LG Chemical Ltd., division of the LG Group (S. Korea)/ Yongxing Chemical Plant (Ningbo)
Established Ningbo LG Yongxing Chemical Co. joint venture to produce acrylonitrile butadiene styrene (ABS) for use in the production of electronics. (S. Korea:75%-PRC:25%). $80 million. 7/97.

Perfect Treasure Holdings Ltd. (HK)/Beijing Meitian Computer Software Technology Ltd.
Formed Beijing Meitian Technology Ltd. joint venture to produce application software and set up stores to sell software and Internet services. (HK:51%-PRC:49%). 7/97.

Perfect Treasure Holdings Ltd. (HK)/Tianjin Jinke Electronic Ltd.
Formed Tianjin Jinke Electrical Industrial Ltd. joint venture to manufacture telephone systems with recording and security devices. (HK:60%-PRC:40%). 7/97.

OTHER

Hewlett-Packard Co. (US)/Shanghai Alliance Ltd.
Established a computer-leasing joint venture in which Shanghai Alliance will lease Hewlett-Packard computer products to companies in China. $15 million. 8/97.

Sunsoft Co., a subsidiary of Sun Microsystems, Inc. (US)/Shenzhen SEG Electronics Co. (Guangdong)
Signed letter of intent to cooperate in developing China's information technology sector. 8/97.

Elo Touchsystems, a subsidiary of Raychem Corp. (US)/Tiko TouchSystems (Beijing)
Signed agreement giving Tiko TouchSystems exclusive rights to distribute the California-based company's products in China. 7/97.

Engineering and Construction

INVESTMENTS IN CHINA

Korea Heavy Industries & Construction (Hanjung) (S. Korea)/ Zhangping Building Material Co. (Fujian)
Formed Zhangping-Hanjung Cement Co. joint venture to build two cement plants in Zhangping, Fujian Province, each with an annual production capacity of 1.6 million tons. $500 million. 9/97.

Road King Infrastructure Ltd. (HK)/Hunan Provincial Expressway Development Co.
Formed joint venture in Hunan Province to build and operate a 75.6 km-long expressway linking Changsha and Yiyang. (HK:43%-PRC:57%). $72.4 million. 9/97.

Asia Pacific Concrete Inc. (Canada)/NA
Signed memorandum of understanding to form a joint venture to produce roller-compacted and ready-mix concrete for a large dam project in southern China. 7/97.

Silver Grant International Industries Ltd. (HK)
Will build two sections of State Road 320 and set up and operate two toll roads in Jiangxi Province. $7.6 million. 7/97.

OTHER

Morgan Construction Co. (US)
Formed Morgan-China Ltd. subsidiary to operate technical and sales support offices in Beijing, Hong Kong, and Shanghai. 9/97.

Otis Elevator Co., a unit of United Technologies Corp. (US)/CITIC Development Co. Ltd., Tianjin Tai Kang Industrial & Commercial Co.
Formed Otis China Ltd. joint venture to manage Otis's five operations in China. 9/97.

Environmental Technology and Equipment

CHINA'S IMPORTS

Alanco Environmental Resources Group (US)
Will supply Guangzhou Paper Ltd. with eight Charged Dry Sorbent Injection (CDSI) industrial air pollution control systems. $1 million. 7/97.

INVESTMENTS IN CHINA

Cheung Kong Infrastructure Holdings Ltd. (HK)
Bought a 49% stake in the Xiejiang water treatment plant in Jiangmen, Guangdong Province. $12.9 million. 8/97.

OTHER

Environmental Resources Management (ERM) (US)
Opened offices in Shanghai and Guangzhou, Guangdong Province. 9/97.

MASJV, a joint venture between Mayreder Corp. (Austria), and Alpine Corp. (Austria)/Shanghai Tunnel Engineering Corp.
Won bid to build three tunnels and two underground piping stations for the Yellow River water diversion project in Shanxi Province. 9/97.

WANLONGJV, a joint venture between Imtpregillo Co. (Italy), and CMC Corp. (Italy)/NA
Won bid to build four tunnels, one aqueduct, two culverts, a flood-control gate, and a 460 m canal for the Yellow River water diversion project in Shanxi Province. 9/97.

Food and Food Processing

CHINA'S IMPORTS

Food Extrusion Inc. (US)
Will begin shipping "stabilized rice bran" and "rice bran soluble" products to SunJoy Enterprises, a subsidiary of Shanghai AIC Corp. 8/97.

INVESTMENTS IN CHINA

The Black Bear Brewing Co. (US)/Yiyang Brewery (Hunan)
Formed joint venture to produce and distribute Black Bear beer in China. 9/97.

General Mills, Inc. (US), Want Want Holdings Ltd. (Singapore)
Agreed to establish joint-venture snack-food company in China. (US:50%, Singapore:50%). 8/97.

New China-Hong Kong Brewery Co. (HK)/Changchun Brewery Co. (Jilin)
Will build a joint-venture brewery in Changchun, Jilin Province. (HK:60%-PRC:40%). $29.5 million. 8/97.

Sun-Rype Products Ltd. (Canada), The Lion Group (Malaysia)
Will establish a joint venture in Shanghai to manufacture, distribute, and market in China and Hong Kong a line of premium fruit juices under the Sun-Rype brand name. 8/97.

Peace Mark Holdings (HK), Overseas Treasure Holdings (HK)/North Anhua Group
Will set up a food and beverage distribution joint venture in China. (HK:91%-PRC:9%). $32.8 million. 7/97.

Pillsbury Co., a subsidiary of Grand Metropolitan PLC (UK), Lady Chong's Peking Dumpling Ltd. (HK)
Formed joint venture to manufacture, distribute, and sell Chinese dumplings in China. 7/97.

Taisho Pharmaceutical (Japan)/NA
Will form a joint-venture company to produce and market Taisho's Lipovitan D diet drink in China. (Japan:60%-PRC:40%). 7/97.

OTHER

Tianjin Jin-Mei Beverage Co. Ltd., a joint venture between The Coca-Cola Co. (US) and China National Council of Light Industry
Launched the marketing of Smart, a five-flavor line of carbonated soft drinks created for the Chinese market. 8/97.

Wuxi Zhongjia American Ginseng Natural Tonics Co., a joint venture between Chai-Na-Ta Corp. (Canada) and China National Pharmaceutical Foreign Trade Corp.
Obtained license to import and sell health-food and pharmaceutical products in China. 7/97.

Machinery and Machine Tools

INVESTMENTS IN CHINA

LG Machinery Co., a subsidiary of the LG Group (S. Korea)/NA
Formed LG-Tonghwa Jhi-Leng Ltd. joint venture to manufacture absorption coolers and heating-cooling machines in Qingdao, Shandong Province. (S. Korea:55%-PRC:45%). $20 million. 9/97.

Brighton Technologies Corp. (US)/Shenyang Blower Works (Liaoning)
Will provide a Gantry milling machine to the Shenyang manufacturer of air blowers and air compressors. 7/97.

Metals, Minerals, and Mining

CHINA'S INVESTMENTS ABROAD

Capitol Oil Corp. (US)/China Metallurgical Corp.
Acquired a 90% stake in the Recsk Ore Mine in Hungary. $44 million. 8/97.

China Everbright Group
Bought 7.5% of Hong Kong-based Angang Steel Co. $34.8 million. 8/97.

INVESTMENTS IN CHINA

British San Kung Group (UK)/Xinjiang Nonferrous Metal Geological Prospecting Bureau
Formed China Xinjiang San Kung Mining Industry Co. Ltd. joint venture to prospect in north Xinjiang Uygur Autonomous Region. $100 million. 9/97.

Southwestern Gold Corp. (Canada), Global-Pacific Minerals Inc. (Canada)/Geological and Mineral Resource Technological and Development Co., a subsidiary of the Ministry of Geology and Mineral Resources
Formed Black Dragon Mining Co. Ltd. joint venture to explore an area in Heilongjiang Province. 8/97.

Fukuda Metal Foil & Powder Co. (Japan)/NA
Announced plans to double production this year at its electrolytic-copper foil joint venture in Suzhou, Jiangsu Province, and increase investment and employment by 50%. $32 million. 7/97.

Packaging, Pulp, and Paper

CHINA'S INVESTMENTS ABROAD

The Lion Group (Malaysia)/Pulp & Paper Industry Co. Ltd.
Signed agreement with the Sabah state government (Malaysia) to establish a joint-venture forest plantation and a pulp and paper mill in Sabah, with a production capacity of 750,000 tons of pulp and 225,000 tons of paper annually. (Malaysia:40%-PRC:60%). 8/97.

INVESTMENTS IN CHINA

Hansol Paper Co., a subsidiary of the Hansol Group (S. Korea)/NA
Will set up a joint-venture plant in Jinzhou, Liaoning Province, to manufacture color offset book paper with an annual production capacity of 100,000 tons. (S. Korea:50%-PRC:50%). $100 million. 8/97.

Perfectech International Ltd. (HK)/NA
Formed joint-venture company to manufacture packaging materials in Zhuhai, Guangdong Province. $3.9 million. 8/97.

Petroleum, Natural Gas, and Related Equipment

INVESTMENTS IN CHINA

Pan-China Resources, a subsidiary of Sunwing Energy Ltd. (Canada)/SINOPEC
Signed agreement to develop 90 sq km in the Dagang oil field in Hebei Province. Total oil production is expected to peak at 36,000 barrels per day by 2003. 9/97.

Amoco Chemical Asia Pacific Ltd., a subsidiary of the Amoco Corp. (US)/Fu Hua Group Holding Co., China Chemical Fiber Co.
Received approval to establish Amoco Zhuhai Chemical Co. joint venture to build and operate a petrochemical facility in Zhuhai, Guangdong Province. (US:80%-PRC:20%). $400 million. 8/97.

Enron Oil & Gas China Ltd., a subsidiary of the Enron Corp. (US)/SINOPEC
Will jointly develop oil and natural gas resources in the Chuanzhong Block of Sichuan Province. 8/97.

Exxon China Inc., a subsidiary of Exxon Corp. (US)/Fujian Petrochemical Co. Ltd.
Will form a multi-billion dollar joint venture to construct a new petrochemical complex and triple the Chinese company's oil refining capacity to 240,000 barrels per day. (US:50%-PRC:50%). 8/97.

Husky Oil Ltd. (Canada)/SINOPEC
Signed contract to increase oil production and recovery from China's Pucheng oil fields. $72 million. 8/97.

Pharmaceuticals

INVESTMENTS IN CHINA

SmithKline Beecham PLC (UK)/Shanghai Institute of Biological Products
Formed joint venture in the Pudong New Area to manufacture genetically engineered vaccines including Havrix, a hepatitis A vaccine. 7/97.

Ports and Shipping

CHINA'S INVESTMENTS ABROAD

NA (Italy)/China Ocean Shipping Co.
Will set up joint venture in Naples, Italy, for transshipment of containers to and from the Mediterranean and Black seas. 8/97.

INVESTMENTS IN CHINA

Mitsui O.S.K. Lines Ltd. (Japan)/NA
Formed joint venture in Shanghai to handle all facets of sea and air cargo operations, including warehousing and land transport. (Japan:44%-PRC:56%). $1 million. 8/97.

Kawasaki Heavy Industries Ltd. (Japan)/China Ocean Shipping Co.
Agreed to form Nantong Ocean Ship Engineering Co. joint venture to build bulk carriers and tankers in China. 7/97.

Power Generation Equipment

INVESTMENTS IN CHINA

Bina Puri Holdings Bhd, Tenaga Sdn Bhd (Malaysia)/ Kunming Caishitan Reservoir Development Co. (Yunnan)
Will form a joint venture to build the Kunming Caishitan Reservoir Hydropower Project in Kunming, Yunnan Province. (Malaysia:60%-PRC:40%). $46.8 million. 8/97.

Kretam Holdings Bhd (Malaysia)/Dehong Electrical Corp.
Launched Husong He Power Development Co. Ltd. joint-venture hydropower project in China. (Malaysia:60%-PRC:40%). 8/97.

National Power PLC (UK)
Will acquire a 70% stake in the 145MW Yichang Yihua cogeneration project in Hubei Province. (UK:70%-PRC:30%). $72.4 million. 8/97.

Shaw Power Services, a subsidiary of the Shaw Group Inc. (US)/China Baoyuan Industry and Trade Co., a subsidiary of China National Nuclear Corp.
Will form a joint venture in Dalian, Liaoning Province to manufacture pipes for electric power plants. (US:60%-PRC:40%). 8/97.

Property Management and Development

CHINA'S INVESTMENTS ABROAD

China Everbright Holdings
Will take a 10% stake in Kumagai Gumi (Hong Kong) construction and property development group. $45.5 million. 8/97.

INVESTMENTS IN CHINA

Hongkong Land Holdings Ltd., a subsidiary of Jardine Matheson Holdings (HK), Rodamco Corp. (Netherlands), Crown Pacific Development (Singapore)
Formed King Kok Investment property-management joint venture to buy and operate a luxury residential development in Beijing. (HK:40%, Netherlands:40%, Singapore:20%). $100 million. 9/97.

China Merchants China Direct Investments Ltd. (HK)
Acquired a 35% stake in the Beijing Cheng Key real estate leasing project in Beijing. $5 million. 8/97.

China Travel Service (HK)/Changsha Broadcasting and Television Development Center (Hunan)
Will build a theme park on a 240-hectare site in Changsha, Hunan Province. $42 million. 8/97.

Pillar Construction, part of the Housing and Development Board (Singapore)/ NA
Will build Singapore Town Development in Nanning, Guangxi Zhuang Autonomous Region, that will cover 150,000 sq m and include 300 apartments and semi-detached houses. $25 million. 7/97.

Trammel Crow International China, an affiliate of Trammel Crow Group, a subsidiary of the Prudential Insurance Co. (US)/NA
Formed China Distri-Park Ltd. joint venture to develop warehouses throughout China. (US:50%-PRC:50%). $200 million. 6/97.

OTHER

Haw Par Brothers Industrial Corp. (Singapore), Singapore Technologies Industrial Corp./Singapore-Sichuan Trade and Investment Committee
Signed letter of intent to explore the possibilities of developing an aquarium theme park in Chengdu, Sichuan Province. 8/97.

Sincere Department Stores (HK)
Agreed to lease 87,188 sq ft of retail space for 12 years from Hong Kong-based Ryoden Property Development's commercial-development joint venture in Shanghai. 8/97.

Telecommunications

CHINA'S IMPORTS

General DataComm, Inc. (US)
Will provide Beijing University of Posts & Telecommunications with scaleable asynchronous transfer mode (ATM) network technology to transmit video signals between Beijing, Guangzhou, Shanghai, and Tianjin. 8/97.

Guangdong Nortel Telecommunications Switching Equipment Ltd., a subsidiary of Northern Telecom Ltd. (Canada)
Signed contract with Tianjin P&T Administration to supply its 75,000-line capacity DMS-100 switching system and build three new exchange bureaus in Tianjin. 7/97.

Jingkoh Integrated Telecommunications Equipment Co., a joint venture between Kohap Group (S. Korea)/Beijing P&T Administration
Selected to install and service Beijing's telegraph office with cutting-edge multimedia computer systems. $3 million. 7/97.

Jupiter Technology Inc. (US)/Pacific Technology Venture Fund-China, Inc., GC Communications of Beijing
Announced partnership to market Jupiter Technology's network access products, including the Voyager Frame Relay system, in China. 7/97.

Boston Technology, Inc. (US)
Will supply Liaoning Province Mobile Communication Co. Ltd. with its AccessNP Network Services platforms, software, and value-added services. $8 million. 6/97.

Cisco Sytems, Inc. (US)
Selected by Beijing P&T Administration to install its StrataCom asynchronous transfer mode (ATM) switches for the city's first metropolitan-area network. 6/97.

INVESTMENTS IN CHINA

AmTec Inc. (US)
Reached agreement to acquire an additional 9.2% interest in its joint venture, Hebei United Telecommunications Equipment Co., increasing its ownership to 70%. 9/97.

CCT Telecom Corp. (HK)/China Communications Systems, Unicom
Formed joint venture to develop a mobile phone network in Shanxi Province. (HK:75%-PRC:25%). $11.8 million. 9/97.

Eternal Summit Investments Ltd., a wholly owned unit of Stime Watch International Holdings Ltd. (HK), Target Wise Development Ltd. (HK)/Beijing Hua Zheng Kang Communications and Technology Co.
Formed joint venture to provide a wireless messaging service in China. (HK:70%-PRC:30%). $5 million. 9/97.

LTC Telecommunications Pte. Ltd., a wholly owned subsidiary of Lion Teck Chiang Ltd. (Singapore)/China Railway Telecommunications Center
Formed joint venture to set up the first phase of a cellular telephone network serving Hainan Island. (Singapore:86%-PRC:14%). $25.1 million. 9/97.

CCT China Ltd., a joint venture between CCT Telecom Holdings Ltd. (HK) and Tesonic International Ltd. (PRC)/Tesonic Industrial Co.
Will form three joint ventures to run several operations owned by Tesonic Industrial. $28.4 million. 8/97.

IPC Corp. (Singapore), Essex Investments Pte. Ltd. (Singapore)/Guangzhou Post and Telecommunication Equipment Corp. (Guangdong)
Formed joint venture to produce mobile phones for the China market with an initial output of 800,000 handsets a year. (Singapore:56%-PRC:44%). $10 million. 8/97.

Andrew Corp. (US)
Will begin building plant to produce base station antennas, Heliax coaxial cable, connectors, and accessories in Suzhou, Jiangsu Province. 7/97.

Pacific Shareholding Ltd. (US)/Shandong Yanggu Electric Cable Group Co.
Will jointly manage an electric cable plant in Shandong Province. 7/97.

Tricom Holdings (HK)/MPT
Launched Guangdong Tricom Telecommunications joint venture serving southern China. $45 million. 7/97.

OTHER

Philips Electronics N.V. (Netherlands)
Launched the marketing of its newly designed GSM mobile phone, the Genie 828, in Beijing, Guangzhou, Hong Kong, and Shanghai. 9/97.

AmTec, Inc. (US)/Government of Hebei Province
Signed agreement forming a long-term partnership for telecommunications and other technology projects in China. 7/97.

GTE Corp. (US)/Shanghai P&T Administration
Announced plans to cooperate on a telecommunications project to improve service in Shanghai. 7/97.

Textiles and Apparel

INVESTMENTS IN CHINA

SinetiMed Latex Sdn Bhd, a subsidiary of Trans Capital Holding Bhd (Malaysia)/Zhongshan Municipal Government (Guangdong)
Will set up a joint-venture factory in Zhongshan, Guangdong Province, to produce gloves for electronics manufacturing. (Malaysia:80%-PRC:20%). 8/97.

Esprit Holdings (HK)/China Resources Enterprise
Set up joint venture to manufacture and distribute clothes and other goods in China. (HK:40%-PRC:60%). $38.7 million. 7/97.

Nisshinbo Industries Inc. (Japan), Choya Corp. (Japan), Marubeni Corp. (Japan)/Shanghai Kaikai Group Co.
Set up Shanghai Kaikai Non-Ironing Garment Co. joint venture to manufacture and market dress shirts. (Japan:40%-PRC:60%). 7/97.

Transportation

CHINA'S IMPORTS

Brighton Technologies Corp. (US)/Chang An Auto Works (Chongqing)
Will provide computer-controlled auto body stamping equipment to Chongqing-based Chang An Auto Works. 7/97.

INVESTMENTS IN CHINA

Kolbenschmidt AG (Germany), The German Investment and Development Co. Ltd. (Germany)/Shanghai Automobile Co. Ltd.
Formed Shanghai Kolbenschmidt Piston Co., Ltd. to manufacture high-tech pistons for use by auto makers in China. (Germany:50%-PRC:50%). $29.8 million. 9/97.

Mitsubishi Motors Corp. (Japan), MCIC Holdings Sdn Bhd (Malaysia)/China Aerospace Automotive Industry Group Co., Shenyang Construction Investment Co. (Liaoning)
Formed joint venture to produce car engines in Shenyang, Liaoning Province. (Japan:25%, Malaysia:24%-PRC:51%). $83 million. 9/97.

The Boeing Co. (US)
Acquired a 9.1% stake in Taikoo Aircraft Engineering Co. in Xiamen, Fujian Province. $11.1 million. 8/97.

Bridgestone Corp. (Japan)/Shanghai Tire
Will set up a joint-venture company to produce tires starting in 1998. The venture will have an annual capacity of 3 million tires. (Japan:50%-PRC:50%). 8/97.

Eaton Corp. (US)
Established wholly owned plant to manufacture transmissions for heavy-duty trucks in the Pudong New Area of Shanghai. $12 million. 8/97.

Manida-Marili Co. (Italy)/Dongfeng Carburetor Co. Ltd.
Formed joint venture to manufacture motion throttle valves for automatic injection systems. (Italy:50%-PRC:50%). $3.5 million. 8/97.

Aisin Seiki Co., an affiliate of the Toyota Motor Corp. (Japan)/Tianjin Automotive Industry Corp.
Established joint venture to manufacture brake cylinders and clutch discs. $11.3 million. 7/97.

OTHER

Taikoo Aircraft Engineering Co. (Taeco), a joint venture owned by Hong Kong Aircraft Engineering Co. (Haeco), Cathay Pacific Airways (HK), Singapore Airlines, Japan Airlines, The Boeing Co. (US), CAAC, and Xiamen Municipal Government
Received license from Boeing to convert passenger aircraft into cargo planes. 9/97.

Miscellaneous

INVESTMENTS IN CHINA

Egana International Holdings (HK)/China Foreign Businessmen's Club, owned by MOFTEC
Formed China Association of Enterprises with Foreign Investment Consultation Co. joint venture to provide consulting services. (HK:49%-PRC:51%). 9/97.

Market Facts, Inc. (US)/All China Marketing Research Co., Ltd.
Will form All China Market Facts Inc. joint venture to provide market research and business information in China. 8/97.

Research International, a wholly owned subsidiary of WPP Group PLC (UK)/South China Marketing Research Ltd.
Will set up a marketing and consulting joint venture in China. (UK:49%-PRC:51%). 8/97.

OTHER

Diners Club International, a subsidiary of Citibank (US)
Opened first representative office in Beijing to provide travel- and entertainment-related services to club members in China. 9/97.

ADVERTISERS IN THIS ISSUE:

GETTING THROUGH TO CHINA

Within the Party, opposition and struggle between different ideas occur constantly; they reflect the class contradictions and the contradictions between the old and the new things in society. If there were neither contradictions nor ideological conflicts through which the contradictions were resolved, the Party's life would come to an end.

—Mao Zedong, *On Contradiction* (1937)

When Chairman Mao was at the prow of China's ship of state,
He sought to change and rearrange the Chinese people's fate.
He liked to think that history would conform to his predictions,
And fostered hectic dialectics, full of contradictions.
But even Mao would not know how to reconcile the tensions,
Between the poles of thought controls and telephone extensions.

For China needs enormous growth in information highways,
But fears that these could also be pornography- and spy-ways.
And so its leaders seek control of basic information,
Trying to restrict both content and dissemination;
Indulging China's massive needs for networks and computers,
While using clout to filter out the spiritual polluters.

This yang and yin for Jiang Zemin is crammed with contradictions,
Between competing calls for more expansions and restrictions.
He seeks to strike a balance, like the famous Lee Kuan Yew,
Who claims that Singapore has found a mixture that should do.
Through censorship and tightened access, Lee suggests a way,
To resurrect Confucius—but *this time* to make it pay.
A set of Asian values, with more sense of obligation,
(Plus suing some for chewing gum or loud expectoration.)

China seeks a formula to have its cake and eat it,
Moving bits while using wits to filter and delete it.
China's leaders have committed to a set of courses,
Which seek to shut the barn doors, but cannot contain the horses.
For using information's not like growing grain or poppies,
The task is not just laying lines, or duplicating floppies;
Technology has changed for good the basis of production;
Wealth is made through information and its reproduction.
And this requires culture change of staggering proportions,
Which simply doesn't lend itself to communist contortions.

China's infrastructure has exploded in its scale;
Its growth in lines and minutes makes most other countries pale.
Just since 1989, when Tiananmen imploded,
China's information infrastructure has exploded—
Switches, fiber, cell sites, handsets, satellites and dishes,
Grow at a pace which is incredibly ambitious.
Not to mention modems, hard disks, CPUs and faxes;
All are more ubiquitous than death—or even taxes.

All these capabilities require a change in habits,
As network nodes and databases multiply like rabbits.
China cannot hope to keep the pace of its expansion,
If it treats these building blocks like termites in a mansion.
You cannot think of bits and bytes like Jeeps or Coca-Colas;
Or pick and choose the daily news like Persian Ayatollahs.
You cannot vet the Internet through careful inter-neatness;
Such censorship will always have inherent incompleteness.

You can't just filter broadcasting according to your wishes,
(For you can't rewrite the menu if you haven't cleared the dishes.)
And thus it's hard to see how this could be a true solution,
Which saves the whole (mum) Chinese soul from spiritual pollution.

So maybe this campaign is just a pose for propaganda,
The rhetoric from someone's bureaucratic memoranda.
Perhaps they really realize that the genie has escaped,
And what we see are reruns of an old show that was taped.

But if, instead, they really think that networks can be corked,
They'd consign Shanghai to be Havana-d, not New York-ed.
If they should try to overdo it, a la Mao Zedong,
Li Peng will do—not Lee Kuan Yew, but rather Kim Il Sung.

For if they slow down networking to try to keep the lids on,
They just might go too far and put the economic skids on.
And that would foment widespread fear and regional resistance,
As well as middle-class dissent with foreign-based assistance.

Perhaps instead of Lee Kuan Yew, they'll learn from Lee Teng Hui,
The type of devolution that they've practiced in Taipei.
By easing up on most dissent and opposition groups,
The Guomindang relies more on its voters than its troops.
But this, I think, will not occur before a tough transition,
As—well beyond the tongue of Deng—all forces reposition.

Yet China has so much to gain from widespread exploitation,
Of all the huge potential from the use of information,
They need (per Mao) "to let a hundred schools of thought contend,"
But not hand out detention when the school year nears its end.
They really need to try "to let a hundred flowers bloom,"
And not clean out the garden like a warden with a broom.

Perhaps between the course of Lee Kuan Yew and Lee Teng Hui,
The PRC will find the key to make its own bouquet.
(Whether you applaud that Taiwanese or Singaporist,
Their records are still better than *Mao's* record as a florist.)
Which leads me to a final observation and conviction:
I'm glad—*and how*—it won't be Mao who'll clear this contradiction.

—*Frederick S. Tipson*

Frederick S. Tipson is a corporate executive and former Senate Foreign Relations Committee staff member who has lived in Hong Kong and traveled often to China. These observations are based on a study, "China and Telecommunications," which will appear in a forthcoming Council on Foreign Relations publication entitled Involving China in World Affairs.