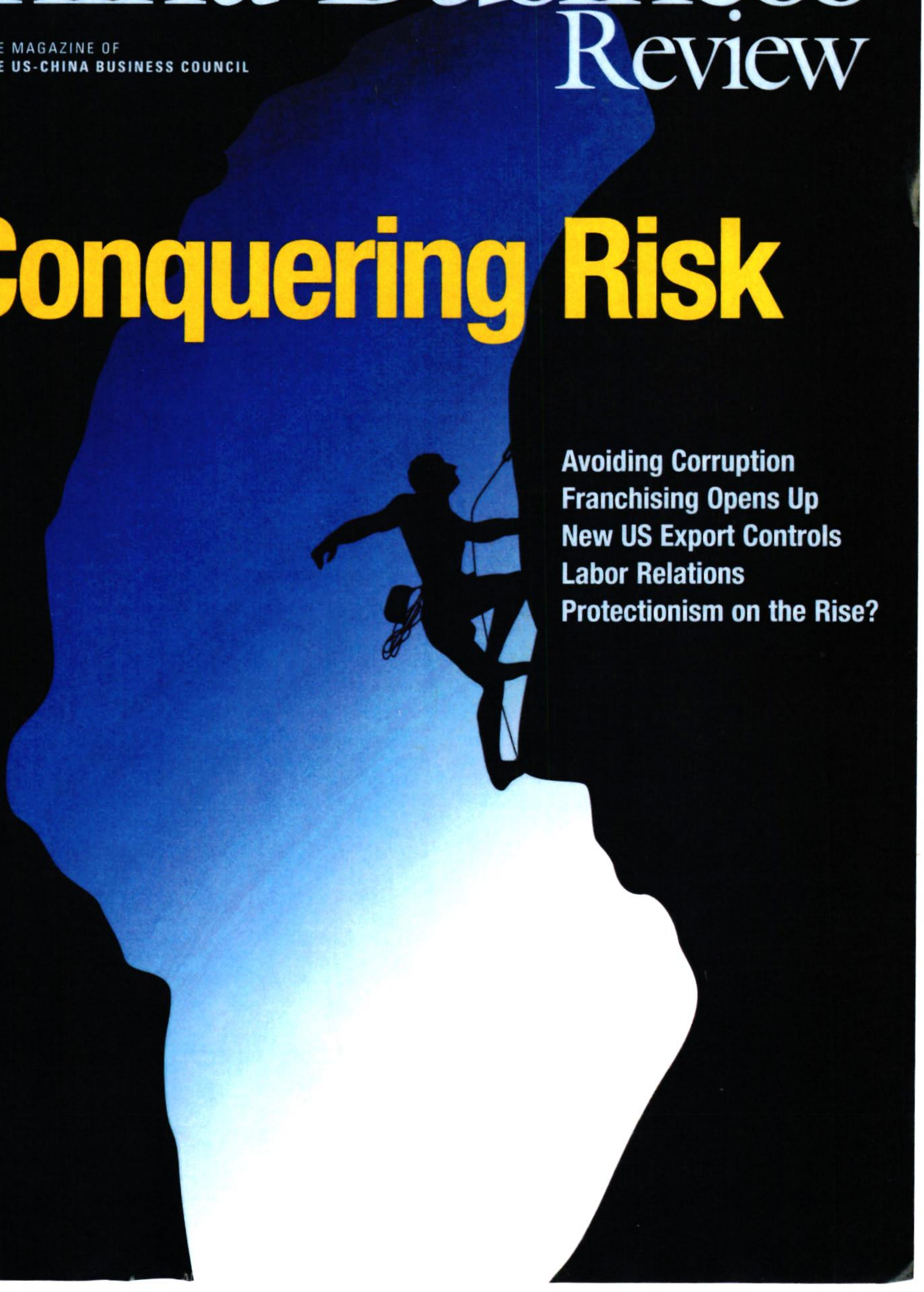
November–December 2006

The China Business Review

THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL

USCBC

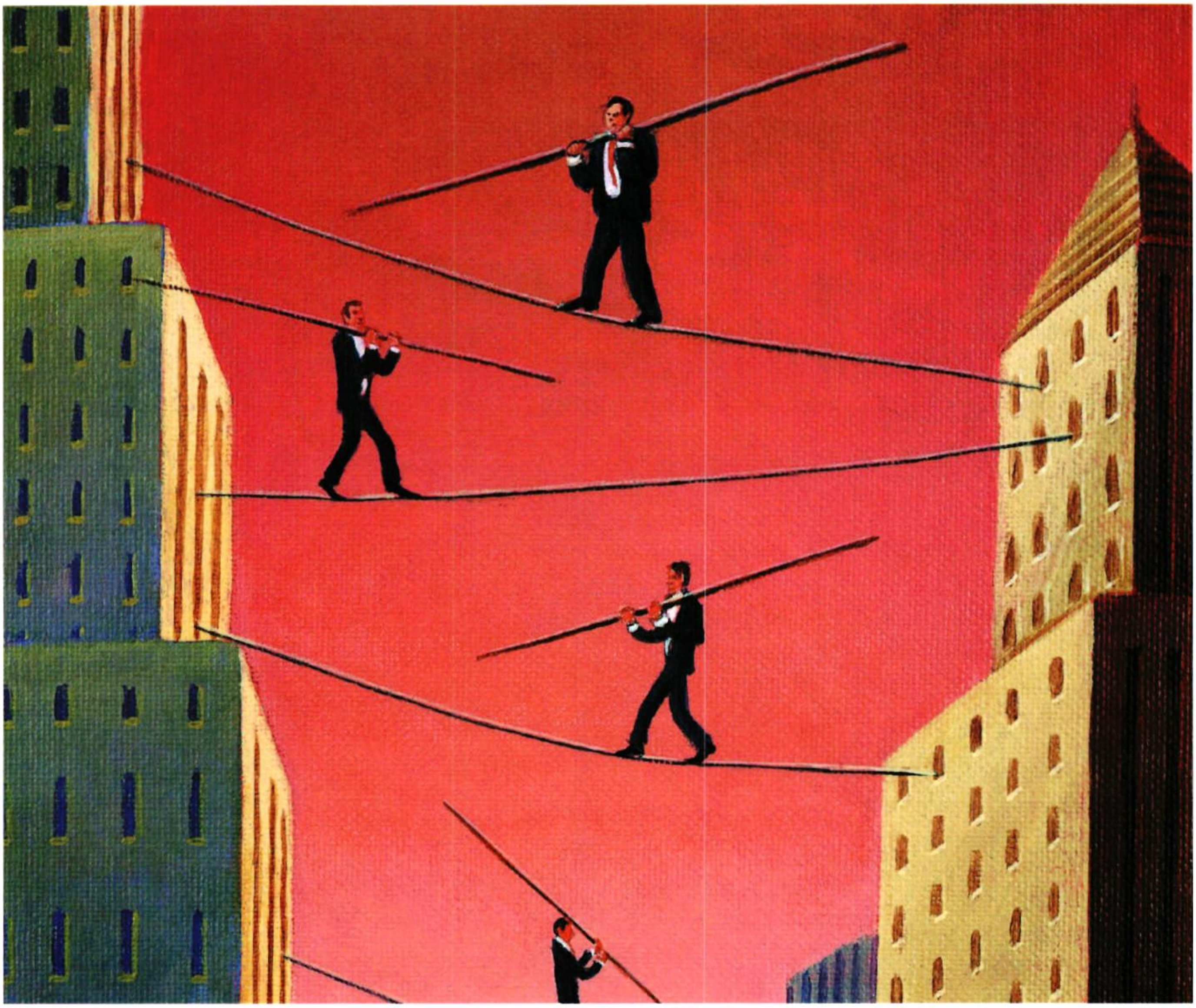


Conquering Risk

Avoiding Corruption
Franchising Opens Up
New US Export Controls
Labor Relations
Protectionism on the Rise?

$22/HK$220

November–December 2006 Volume 33 Number 6



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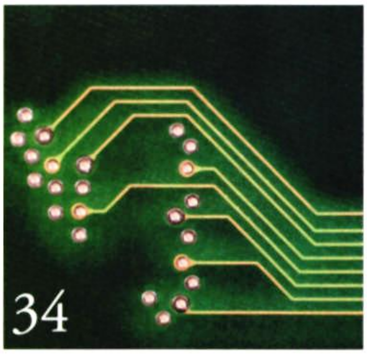
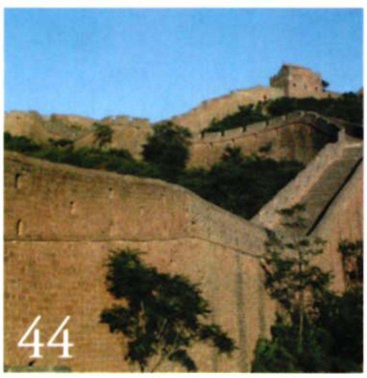
Focus: Business Risk





Features

Departments

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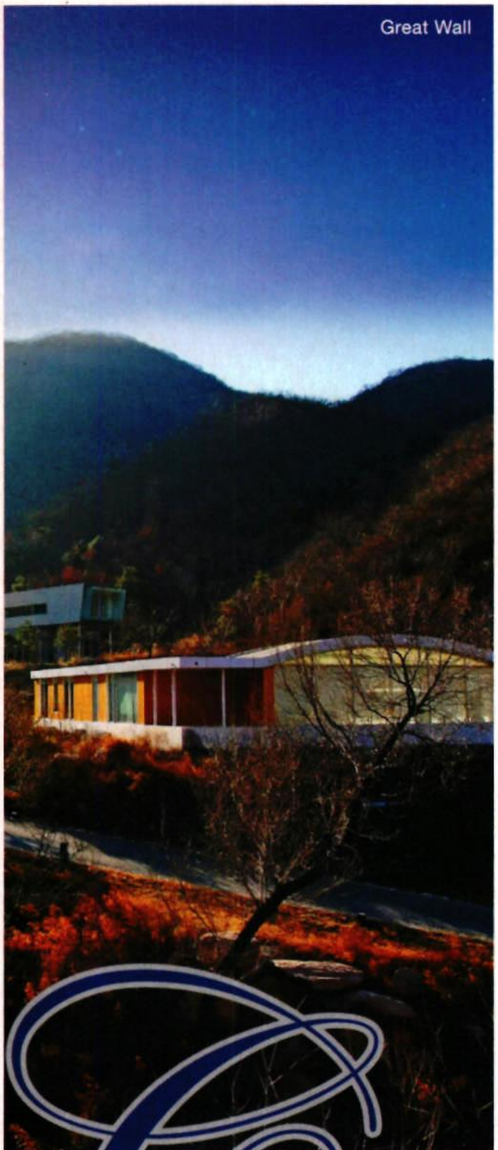
Great Wall


Shenyang

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a. Total No. of Copies	7,643	7,512
b. Paid and/or Requested Circulation		
(1) Paid/Requested Outside-County Mail Subscriptions (Include advertiser's proof and exchange copies)	2,149	2,205
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(4) Other Classes Mailed Through the USPS	164	304
c. Total Paid and/or Requested Circulation [Sum of 15b. (1), (2), (3), and (4)]	4,594	5,169
d. Free Distribution by Mail (Samples, complimentary, and other free)		
(1) Outside-County	729	667
(2) In-County	0	0
(3) Other Classes Mailed Through the USPS	617	400
e. Free Distribution Outside the Mail (Carriers or other means)	975	642
f. Total Free Distribution (Sum of 15d. and 15e.)	2,321	1,709
g. Total Distribution (Sum of 15c. and 15f.)	6,915	6,878
h. Copies Not Distributed	728	634
i. Total (Sum of 15g. and h.)	7,643	7,512
j. Percent Paid and/or Requested Circulation (15c./15g. x 100)	66	75

(Signed) Jesse Marth, Business Manager

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US-China Economic Relations

Senators Charles Schumer (D-NY) and Lindsey Graham (R-SC) announced in late September that they would not seek a vote this year on their bill to impose tariffs of 27.5 percent on imports from China if Beijing does not further revalue its currency. The two senators announced their decision after discussions with the Senate Finance Committee leadership and Treasury Secretary Henry M. Paulson, Jr.

The United States and China announced in late September the formation of a Strategic Economic Dialogue, which will be headed by Paulson and PRC Vice Premier Wu Yi. Paulson described the dialogue as covering long-term "broader themes" in the bilateral economic relationship, under which short-term issues could be addressed.

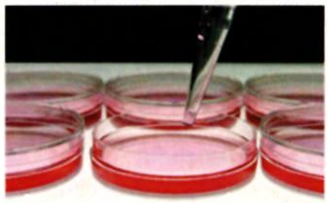
Corruption

Chinese and Indian companies are most willing to pay bribes to do business abroad, according to a Transparency International (TI) report released in October. TI noted that although the United States has "blazed new trails" with the Foreign Corrupt Practices Act (see p.22), it is still more corrupt than several developed countries, including Switzerland, Australia, and Canada.

In a surprise move, the Politburo of the Central Committee of the Chinese Communist Party (CCP) in late September dismissed Chen Liangyu from his post as CCP secretary of Shanghai and suspended his membership in the CCP Politburo and Central Committee. Chen allegedly benefited from and protected individuals involved in a scandal surrounding investment practices at the Shanghai Labor and Social Security Bureau.

R&D

China announced in September that its spending on research and development (R&D) in 2005 was the highest on record, totaling ¥245 billion ($30.6 billion), a 26.4 percent jump over 2004. The figures also show that R&D spending accounted for 1.34 percent of China's GDP.



China's share of global R&D spending is expected to grow from 12.7 percent in 2005 to 14.8 percent in 2007, while that of the United States is expected to decline by 1 percentage point, according to a study by Battelle Memorial Institute and *R&D Magazine*. The report recommended that the United States invest more in math and science education, as well as in pure research, to maintain a competitive edge in science and technology.

Autos

In late September, China temporarily blocked the formation of a World Trade Organization (WTO) dispute settlement panel for the case on auto parts tariffs. The United States, European Union, and Canada had requested the panel to resolve the case, which they initiated last spring. As the *CBR* went to press, the WTO Dispute Settlement Body was expected to establish the panel in late October.

The PRC State Information Center forecasted in early October that China's auto sales could hit 7 million this year, which would constitute 10 percent of worldwide auto sales. In 2002, 3.2 million autos were sold in China.

Banking & Finance

The nonperforming loan (NPL) ratio of Chinese commercial banks dropped 1.1 percentage points from January to June to 7.5 percent, the China Banking Regulatory Commission announced in early October. NPLs totaled ¥1.28 trillion ($160 billion), of which 82 percent is held by state-owned commercial banks.

China Conference Calendar

China-related events near you

November–December 2006

Please confirm dates and venues with the organizer prior to attending events. To suggest an event for our next issue, send your event announcements to Jesse Marth (jmarth@uschina.org). You can also post your events on the *China Business Review*'s website at www.chinabusinessreview.com/conference-calendar.php

Legal and Financial Strategies for Doing Business in China

NOVEMBER 6–7

Examines key regulations, policies, and trends affecting US businesses in China
Location: New York: Helmsley Hotel
Organizers: Atlas Information Group, Inc., Structured Finance Institute
Contact: Lynne Strauss
Tel: 914-686-8855
E-mail: lynne@atlas-sfi.com
www.atlas-sfi.com

The IET International Conference on Wireless, Mobile and Multimedia Networks

NOVEMBER 6–9

Features academic lectures on China's wireless multimedia networks
Location: Grand Metropark Hangzhou Hotel
Organizers: Institute of Engineering and Technology, Hangzhou Dianzi University
Contact: Li Baoyu
Tel: 86-10-6825-9365
E-mail: libao@libao-tour.com.cn
http://icwmmn06.njtu.edu.cn/

Paperworld China

NOVEMBER 13–15

Trade fair for manufacturers and suppliers of office automation equipment, office supplies, and accessories
Location: Shanghai New International Expo Center
Organizer: Messe Frankfurt (HK) Ltd.
Contact: Estelle Ni
Tel: 86-21-5292-9222 x 202
E-mail: estelle.ni@china.messefrankfurt.com
www.messefrankfurt.com.hk

China International Travel Mart

NOVEMBER 16–19

The primary bilateral tourism promotion event under the US-China Joint Commission on Commerce and Trade
Location: Shanghai New International Expo Center
Organizers: China National Tourism Administration, Shanghai Municipal People's Government, General Administration of Civil Aviation of China
Contact: Sun Keqiang
Tel: 86-10-6520-1304
E-mail: citm@cnta.gov.cn
www.citm.com.cn/en/index.php

Eighth International Conference on Signal Processing

NOVEMBER 16–20

Presentations and discussions covering theory, design, and applications of signal processing
Location: Guilin, Guangxi
Organizer: The Chinese Institute of Electronics
Contact: Zhou Mengqi
Tel: 86-10-6816-0825
E-mail: zhoumq@public3.bta.net.cn
http://icsp06.njtu.edu.cn/index.htm

Bauma China 2006

NOVEMBER 21–24

International trade fair for construction machinery and equipment and building material machines
Location: Shanghai New International Expo Center
Organizers: Munich Trade Fairs International; China Council for the Promotion of International Trade (CCPIT), Machinery Sub-Council; China Construction Machinery Co. Ltd.; China Construction Machinery Association
Contact: Chin-Ying Sung
Tel: 49-89-9492-0288
E-mail: info@bauma-china.com
www.bauma-china.com

China Beauty and Cosmeceuticals 2006

NOVEMBER 27–28

Presents the latest trends in product development and looks at PRC policies and regulations governing the industry
Location: Shanghai: Howard Johnson Plaza Hotel
Organizer: INC Global Conferences
Tel: 65-6220-2577
E-mail: marketing@inc-global.com
www.inc-global.com

Cityscape 2006

NOVEMBER 27–29

Examines market entry strategies for the civil construction,

architecture, and landscape design industries
Location: Guangzhou Jinhan Exhibition Center
Organizer: Citi Expositions Ltd.
Contact: Frank Huang
Tel: 86-20-3887-1528
E-mail: frank.huang@citiexpo.com
www.clexpo.com

Second Annual China Private Equity Investing Forum

NOVEMBER 28–29

Addresses top issues dealmakers face in China and offers networking opportunities
Location: Harvard Club of New York City
Organizer: Strategic Research Institute
Contact: Cristin Singson
Tel: 925-825-8738
E-mail: csingson@srinstitute.com
www.srinstitute.com

Automechanika Shanghai

NOVEMBER 30–DECEMBER 2

International and domestic exhibitors representing a mix of parts, components, and maintenance equipment products
Location: Shanghai New International Expo Center
Organizer: Messe Frankfurt (Shanghai) Co. Ltd.
Contact: Fiona Chiew
Tel: 852-2238-9939
E-mail: fiona.chiew@hongkong.messefrankfurt.com
www.messefrankfurt.com.hk

Second National Symposium on Mergers and Acquisitions in China

DECEMBER 5–6

Covers topics from investment vehicles to dispute resolution and includes presentations from corporate counsel, investment bankers, and consultants
Location: New York: Roosevelt Hotel
Organizer: American Conference Institute
Tel: 888-224-2480
E-mail: customercare@americanconference.com
www.americanconference.com

2006 Printed Circuit and Electronic Assembly Fair

DECEMBER 6–8

International conference covering global marketing issues, processing, and materials
Location: Dongguan, Guangdong: Guangdong Modern International Exhibition Center
Organizers: Hong Kong Printed Circuit Association Ltd., Association Connecting Electronics Industries, CCPIT Guangzhou
Contact: Audrey Systma
Tel: 847-597-2811
E-mail: audreysystma@ipc.org
www.hkpca-ipc-show.org/

China Eco Expo

APRIL 4–6, 2007

Conference and trade show introducing international environmental expertise and technologies to the Chinese market
Location: Beijing International Convention Center
Organizers: Global Eco Expo, China International Conference Center for Science and Technology, China Society for Environmental Sciences
Contact: Marc Merson
Tel: 818-906-2700
E-mail: info@ecoexpo.com
www.ecoexpo.com

Event Wrap-Up

WASHINGTON

September

Issues Luncheon: Discussion with Timothy P. Stratford and Claire Reade, Office of the US Trade Representative (USTR)
Featured Stratford, assistant USTR for China, and Reade, chief counsel for China Trade Enforcement, who reported on their recent meetings in China and discussed the role of the chief counsel.

October

Issues Luncheon: The New US-China Strategic Economic Dialogue
Featured US Department of the Treasury Undersecretary for International Affairs Timothy D. Adams

Roundtable Luncheon on Government Affairs Hiring in China
Featured Yancy Molnar, senior manager for International Government Affairs at DaimlerChrysler Corp., and Becca Gould, vice president for Government Relations at Dell Inc.

BEIJING

August

Luncheon with USTR Susan C. Schwab
Schwab spoke on her recent meetings with PRC Minister of Commerce Bo Xilai and discussed US trade policy toward China to more than 180 guests. The luncheon was cosponsored by the US-China Business Council (USCBC) and the American Chamber of Commerce-Beijing.

SHANGHAI

August

Dinner with USTR Officials
Featured Stratford, Reade, and Assistant USTR for Intellectual Property Rights Victoria Espinel

September

Roundtable on Labor Unions in China
USCBC staff and member companies discussed recent developments concerning labor unions in China.

Best Practices Luncheon: Executive Leadership in Joint Venture Companies
Kevin Wale, president and general manager of the General Motors China Group, discussed successful executive leadership practices in joint venture companies. Cosponsored by USCBC and the Center for Global Business Leadership at the J. Mack Robinson College of Business, Georgia State University.

October

China Operations Conference
The members-only conference included presentations and panel discussions on China's financial sector and economy, human resources and labor issues, corporate social responsibility, US-China trade relations, government relations, and China's legislative calendar for the 11th Five-Year Plan (2006–10).

Upcoming Events

WASHINGTON

Issues Luncheons
November 16, 2006
December 14, 2006
January 18, 2007

Forecast 2007

Reception and Conference
February 7–8, 2007
For more information, see p.49

XIAMEN, FUJIAN

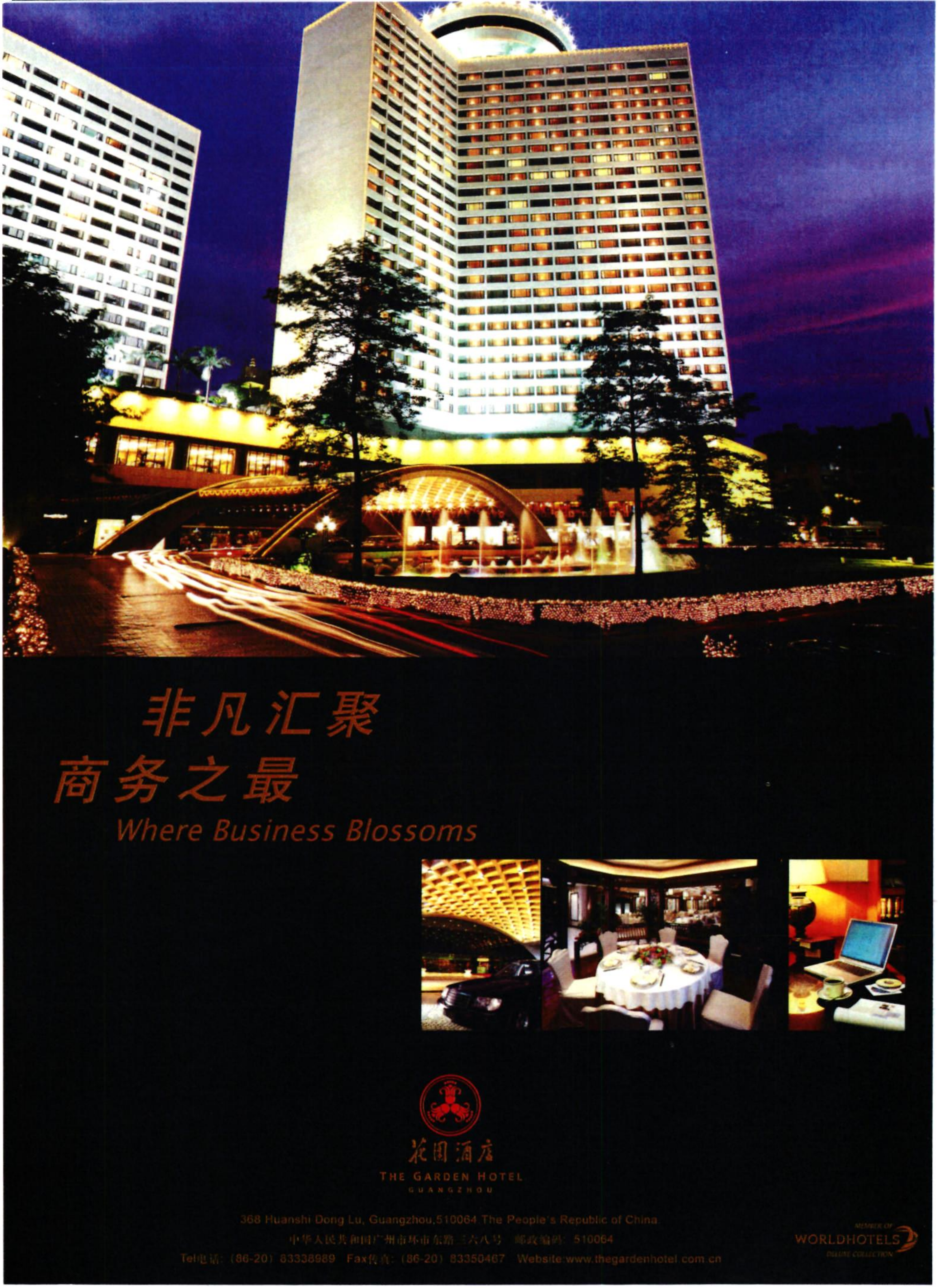
September

Reception
Cosponsored by USCBC, the Boeing Co., and UPS, the reception featured provincial delegates attending the 10th China International Fair for Investment and Trade in Xiamen and USCBC member company representatives.

Vivien Fang

PRC Vice Premier Wu Yi greets John J. Haley, USCBC board director and president and CEO of Watson Wyatt Worldwide, in Xiamen, Fujian.

Wu greets Robert Poole, USCBC vice president of China Operations, in Xiamen.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PRC Government Structure

CENTRAL COMMITTEE OF THE CHINESE COMMUNIST PARTY

General Secretary
Hu Jintao

Central Military Commission Chair
Hu Jintao

Politburo Standing Committee Members (by rank)
Hu Jintao
Wu Bangguo
Wen Jiabao
Jia Qinglin
Zeng Qinghong
Huang Ju
Wu Guanzheng
Li Changchun
Luo Gan

President Hu Jintao

Vice President Zeng Qinghong

NATIONAL PEOPLE'S CONGRESS

Standing Committee

Chair Wu Bangguo

Vice Chairs
Cheng Siwei
Ding Shisun
Fu Tieshan
Gu Xiulian
Han Qide
He Luli
Ismail Amat
Jiang Zhenghua
Li Tieying
Lu Yongxiang
Raidi
Sheng Huaren
Uyunqimg
Wang Zhaoguo
Xu Jialu

Secretary General Sheng Huaren

NPC Committees

Directors

Agriculture and Rural Affairs Liu Mingzu

Education, Science, Culture, and Public Health Zhu Lilan

Environment and Resource Protection Mao Rubai

Financial and Economic Affairs Fu Zhihuan

Foreign Affairs Jiang Enzhu

Internal and Judicial Affairs He Chunlin

Legal Affairs Yang Jingyu

Ethnic Affairs Doje Cering

Overseas Chinese Affairs Chen Guangyi

CHINESE PEOPLE'S POLITICAL CONSULTATIVE CONFERENCE

Chair Jia Qinglin

Supreme People's Court
President Xiao Yang

Supreme People's Procuratorate
President Jia Chunwang

STATE COUNCIL

Premier
Wen Jiabao

Vice Premiers
Huang Ju, Hui Liangyu, Wu Yi, Zeng Peiyan

State Councilors
Cao Gangchuan, Chen Zhili, Hua Jianmin, Tang Jiaxuan, Zhou Yongkang

Secretary General
Hua Jianmin

Offices of the State Council*
Foreign Affairs Office Liu Huaqiu
Legislative Affairs Office Cao Kangtai

THE 28 MINISTRIES AND COMMISSIONS

Commission for Science, Technology, and Industry for National Defense Zhang Yunchuan	**Ministry of Culture** Sun Jiazheng	**Ministry of Justice** Wu Aiying	**Ministry of Railways** Liu Zhijun	**National Population and Family Planning Commission** Zhang Weiqing
Ministry of Agriculture Du Qinglin	**Ministry of Education** Zhou Ji	**Ministry of Labor and Social Security** Tian Chengping	**Ministry of Science and Technology** Xu Guanhua	**People's Bank of China** Zhou Xiaochuan
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Ministry of Commerce Bo Xilai	**Ministry of Foreign Affairs** Li Zhaoxing	**Ministry of National Defense** Cao Gangchuan	**Ministry of Supervision** Li Zhilun	**State Auditing Administration** Li Jinhua
Ministry of Communications Li Shenglin	**Ministry of Health** Gao Qiang	**Ministry of Personnel** Zhang Bailin	**Ministry of Water Resources** Wang Shucheng	**State Ethnic Affairs Commission** Li Deksu
Ministry of Construction Wang Guangtao	**Ministry of Information Industry** Wang Xudong; **China Post** Liu Andong	**Ministry of Public Security** Zhou Yongkang	**National Development and Reform Commission** Ma Kai	

OTHER KEY ORGANIZATIONS UNDER THE STATE COUNCIL*

China Banking Regulatory Commission Liu Mingkang	**General Administration of Customs** Mou Xinsheng	**State Administration for Industry and Commerce** Zhou Bohua	**State Food and Drug Administration** Shao Mingli
China Insurance Regulatory Commission Wu Dingfu	**General Administration of Press and Publications** Long Xinmin	**State Administration of Radio, Film, and Television** Wang Taihua	**State Forestry Administration** Jia Zhibang
China Securities Regulatory Commission Shang Fulin	**General Administration of Quality Supervision, Inspection, and Quarantine** Li Changjiang	**State Administration for Religious Affairs** Ye Xiaowen	**State Intellectual Property Office** Tian Lipu
Development Research Center of the State Council Wang Mengkui	**General Administration of Sports** Liu Peng	**State Administration of Taxation** Xie Xuren	**State-Owned Asset Supervision and Administration Commission** Li Rongrong
General Administration of Civil Aviation of China (CAAC) Yang Yuanyuan	**National Bureau of Statistics** Xie Fuzhan	**State Electricity Regulatory Commission** Chai Songyue	**Xinhua News Agency** Tian Congming
	National Tourism Administration Shao Qiwei	**State Environmental Protection Administration** Zhou Shengxian	

Sources: US-China Business Council files, PRC government websites

* Not comprehensive

Managing Business

Risks

Wise companies prepare for—and minimize their exposure to—risks when investing in China

Jay Hoenig

On the surface, China appears to be one vast market with a strong central government. But deeper down, China is a conglomerate of disparate markets that vary in their levels of economic and social development—from modern municipalities like Shanghai and Beijing, where officials are used to dealing with foreign investors, to the less-developed "Wild West." Though the central government has been taking steps to improve overall business operating conditions by instituting a stronger rule of law, building a more modern financial system, and creating a more transparent business environment—especially since China joined the World Trade Organization (WTO) in 2001—development and implementation remain uneven across the country.

As a result of this inconsistent investment environment and China's rapid economic growth, the country provides foreign companies not only with enormous business opportunities—but also with enormous risks. Companies seeking to make their first investment in the country or expand their existing presence must be fully aware of the risks of doing business in China and prepare to take appropriate measures to mitigate those risks. Though foreign companies in China face legal, financial, political, social, and environmental risks, they can employ strategies to prevent them.

Legal and regulatory risks

Regulatory risk in China is high. Although many sectors of China's economy have become more market oriented, numerous restrictions and a massive bureaucracy still hinder full implementation of regulations and make the approval process unpredictable. Moreover, the interpretation of PRC regulations tends to vary from place to place, and, in some cases, several authorities or departments are responsible for implementing the same regulations. Because companies must consult all of the relevant authorities—and often incur additional costs for doing so—the cost of doing business in China is frequently higher than companies expect. These issues, coupled with a recent rise in policies aimed at pro-

Jay Hoenig *is president of Hill & Associates China and is based in Shanghai.*

tecting domestic companies from foreign competition—especially in engineering and construction, legal services, and banking—create risks and obstacles that few foreign companies are aware of until too late.

Foreign-invested enterprises (FIEs) that plan to operate or invest in China or partner with a Chinese company need to understand how the regulations apply to them before entering into any agreements. Many FIEs wisely seek legal and regulatory advice from experienced professional firms in China. The Chinese business landscape is littered with unsuccessful ventures that tried to save money by "going it alone."

Using China's judicial system also involves risk. Because of China's WTO membership and growing pressure from foreign investors for greater transparency and rule of law, China increasingly recognizes overseas arbitration awards and rulings. It is, however, still risky for companies to rely solely on the PRC judicial system to protect their interests. Few judges in China understand and have significant experience in handling commercial disputes; many are susceptible to pressure from local interest groups and governments. Even after receiving a favorable ruling, some companies have reported enforcement problems. For example, companies often find that authorities fail to implement judgments in bankruptcy proceedings.

In a relatively opaque environment, careful preparation to avoid legal problems in the first place is the best solution. Companies can minimize legal risk by conducting due diligence on the legal and financial background and reputation of key joint venture (JV) partners, acquisitions, senior managers, vendors, and suppliers before entering a formal relationship. Companies should also conduct pre-employment screening of all employees. Finally, companies may also wish to check the reputation of local government officials before committing to a particular locale.

Social and cultural risks

Business ethics and corporate governance

The concept of business ethics is still fairly new in China. In China's changing economy, material gain, with little regard for how it is acquired, is often the measuring stick of individual success. Also, in many privately owned Chinese companies, one individual—usually the chair of the company—is still the only person responsible for all corporate governance issues. Rank-and-file employees generally defer to management without question, creating an environment without internal controls or where such controls are routinely overlooked or circumvented. Such environments are breeding grounds for fraud, corruption, nepotism, and other unethical behavior.

The legal system is ill-equipped to keep pace with this tide of misdirected entrepreneurship. Extraterritorial compliance regimes, such as the US Foreign Corrupt Practices Act and the Sarbanes-Oxley Act, exacerbate the risk for foreign companies operating in China. US companies must comply with these laws or face stiff fines from their own government, in addition to any penalties from the PRC government, which also monitors foreign companies (see p.22).

To prevent ethical breaches, companies should institute ethics training programs and perform due diligence on partners, vendors, and investment targets. New senior-level employees and their immediate family members should undergo a thorough background check to determine their overall reputation, potential for conflicts of interest, and to make sure their lifestyle and wealth position are reasonably in line with their current position. In addition, employees who routinely come into contact with intellectual property (IP) or financial information should receive a summary pre-employment screening to verify their résumé details. Pre-employment screening can include several levels of research—including public domain information gathering, employment application verification and character reference checks and more in-depth screening.

Investors should assess the corporate culture of a potential partner during the early due diligence process and, if necessary, make a comprehensive internal control program with division of responsibilities a part of the partnership or investment.

Transparency

Chinese businesses are accustomed to operating behind closed doors, out of view of the justice system, investors, and potential partners. Many financial, human resources, procurement, and subcontracting transactions in China lack transparency and documentation, which makes it difficult to determine what information is accurate and what is exaggerated or even false. Often, knowledge of the financial and market health of a potential Chinese company is connected to one specific individual, such as the

Minimize legal risk by conducting due diligence on the legal and financial background and reputation of key partners, acquisitions, senior managers, vendors, and suppliers before entering a formal relationship.

company's founder or CEO. This situation further hinders a full assessment of the company.

Before discussing a deal, foreign investors should verify that the individual's and company's history and reputation align with what has been presented by conducting thorough due diligence. Companies should also aim to understand the true nature of a potential partner's ownership structure, political connections, and hidden power brokers (see the *CBR* July–August 2003, p.28).

Partners and suppliers

Prospective business partners in China will often freely admit that they are looking to the foreign partner to supply capital and technology. Though there are usually legitimate reasons for a foreign investor to supply capital and technology, investors must be cautious in this area. Many foreign investors have reported that, shortly after setting up a JV, competition sprang up: A relative or friend of the local partner's general manager set up a duplicate factory that competes with the JV. Family connections also often exist between the purchasing manager, general manager, or other local managers and the preferred vendors. It is therefore unsurprising that vendors and suppliers routinely collude in tender-rigging arrangements and other corrupt practices, and purchasing managers have been known to demand kickbacks from suppliers or otherwise steer business to particular companies for personal gain.

Some FIEs hire firms to screen and audit vendors. These firms determine whether suppliers are legitimate and whether they would create a conflict of interest, lead to collusion between a company's employees and its vendors, or result in other undesirable situations or actions.

Relationships

Relationships or connections (*guanxi*) were once touted as the secret ingredient to success in China. Over the past five to eight years, the market has become more regulated, making *guanxi* less important than sound business sense in many areas. But "*guanxi* vendors" still approach foreign investors, claiming to be well-placed individuals or companies able to help the foreign investors accomplish business goals through their connections. *Guanxi* often presents a double-edged sword to potential investors, as these connections may not exist, may be used by the vendors themselves to accomplish very different aims, or may actually be a reputational liability for the foreign investor (see the *CBR* May–June 2004, p.48).

Guanxi often presents a double-edged sword, as these connections may not exist, may be used by the vendors to accomplish very different aims, or may actually be a reputational liability for the foreign investor.

Investors must exercise skepticism with these consultants and determine whether their *guanxi* is real and what its true value may be through detailed background checks.

Social accountability

Though China has relatively robust laws on labor rights and health and safety, working conditions vary enormously across China, especially between rural and urban areas. The reputations of some FIEs have been damaged in the past when subcontractors operated unsafe facilities or employed child laborers without the FIEs' knowledge. Many manufacturers that have previously worked with multinational corporations are sensitive to social accountability issues and recognize the potential for increased productivity with improved labor conditions.

To prevent labor problems in the workplace, companies can educate and evaluate potential suppliers and subcontractors through social accountability training and Social Accountability 8000 audits, which assess compliance with international norms of working conditions (see the *CBR* March–April 2004, p.44). Some companies use risk-control firms that specialize in inspecting, auditing, and investigating facilities to ensure that suppliers enforce corporate codes of ethics and social accountability.

Crime and corruption risks

Corruption

The concept of "conflict of interest" is not widely understood in China. As a result, embezzlement, kickbacks, and other forms of fraud and corruption are widespread. Corruption is not limited to government officials; it is equally pervasive in the private sector. In a 2005 Transparency International study that measures the perceptions of international businesspeople on global corruption, China scored 3.2 on a scale of 0–10, where zero is "highly corrupt" and 10 is "highly clean."

Internal controls and ethics policies are key methods for reducing the likelihood of corruption. Any company considering operating in China must prepare to invest the resources necessary to ensure that such controls and policies are effective. Foreign investors, however, should understand that it is impossible to avoid such problems completely in China. They must also recognize that investigations of employee, supplier, or partner behavior will be an inevitable cost of doing business in the country.

Intellectual property

Both Chinese and foreign companies suffer as a result of weak IP protection in China. According to US government statistics, about 20 percent of consumer products in China are counterfeit. Despite vocal and policy support from the PRC central government, the concept of IP sovereignty has taken a long time to filter down to the provincial and local levels. Though China's WTO entry and the WTO Agreement on Trade-Related Aspects of IP Rights have made fighting counterfeiting a priority, the problem is likely to persist in China for some time.

Local and provincial authorities are often best motivated to crack down on counterfeiters when FIEs can demonstrate how counterfeiting of their brands affects their ability to employ local Chinese workers. If the manufacturer relocates to another province or country to avoid counterfeiters, the region will lose jobs. And when FIEs plan to leave a region, even corrupt officials are likely to take steps, if only to minimize the loss of revenue in kickbacks or bribes they receive from counterfeiting syndicates.

Foreign investors are well advised to evaluate the types of manufacturing operations they wish to bring to China. Investors that must bring in technology will need to develop robust IP protection programs and apply information security technology to separate sensitive information that could be used to create competition from other information required to run the business. They must also regularly monitor supply and distribution networks and the marketplace. In some cases, companies may wish to manufacture products that require high levels of proprietary research and development outside of China, in places with better IP protection, until China's IP protection improves significantly (see the *CBR* January–February 2006, p.18). A thorough IP risk assessment must be conducted to determine the likelihood of IP leakage and what impact it would have on the company, the brand, and the company's customers.

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Money laundering

Much of the capital fraudulently obtained by individuals in positions of power finds its way out of China via investment vehicles and private bank accounts. Foreign investors should conduct due diligence inquiries on potential Chinese partner companies and their personnel before investing to ensure that they do not become unknowing accomplices to such laundering activities.

Rewards come with risk

Companies that plan to operate or invest in China can expect great opportunities in one of the most rapidly growing economies on the planet. But great risks are also inherent in most China ventures, and an overreliance on trust, opaque risk transfer strategies, and luck have caused the downfall of numerous companies operating or investing in China.

To succeed in capturing opportunities and securing competitive advantage, foreign companies must manage their risk strategically and conduct appropriate due diligence on every aspect of their business. Companies that focus on maintaining the integrity, security, and resilience of their business will experience smoother and more efficient operations, greater transparency, and higher investment returns. These companies will become brand leaders in the Chinese market and the standard bearers of their industry. 完


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The Foreign Corrupt Practices Act Dilemma

US companies in China must walk a fine line to comply with US law while following common Chinese business practices

Patrick M. Norton

Widespread corruption in China puts many US companies between the proverbial rock and a hard place. They must often choose between bribing PRC officials to facilitate business—thus risking criminal penalties under the US Foreign Corrupt Practices Act (FCPA)—and refusing those payments and losing the business. Compounding their dilemma is the fact that US companies must also compete with Chinese and foreign competitors that are not subject to similar risks.

A hard place: Corruption in China

China's leaders have long acknowledged that widespread corruption is one of the country's main problems and have repeatedly vowed to eliminate it. The PRC government has reported that tens of thousands of corrupt officials are punished each year (see p.24). These numbers, though shocking, represent only the officials who are caught; few doubt that the actual number is much higher. Despite repeated government campaigns designed to reduce corruption, no one can be certain that the situation is improving. Some contend that it is deteriorating.

A rock: FCPA in China

The FCPA prohibits US companies, individuals, and foreign companies listed on US capital markets from paying bribes to foreign officials to obtain business. It also requires US issuers (all companies, domestic or foreign, registered under US securities laws to sell securities on a US exchange) to maintain accurate books and records that do not, among other things, misrepresent bribe payments. Violations are punishable by millions of dollars in civil and criminal fines, and individuals can and do go to prison (see p.26). When violations become public, companies usually shoulder many indirect costs, including loss of reputation and customers, a decline in share price, and shareholder lawsuits.

Although the FCPA took effect in 1976, the number of investigations was limited until the 2001 Enron scandal and the passage of the 2002 Sarbanes-Oxley Act redirected attention to corporate corruption both domestically and abroad. The most prominent cases in the 1980s and 1990s involved US arms sales to the Middle East; China did not appear on the radar of FCPA investigations until 2004.

In April 2004, Lucent Technologies, Inc. announced that it had dismissed four senior executives in China for apparent FCPA violations. Later that year, the General Electric Co. (GE) reported that its newly acquired US subsidiary InVision Technologies, Inc. had been fined $800,000 for paying kickbacks to government officials in several Asian countries, including China, prior to GE's acquisition. Then, in May 2005, Diagnostic Products Corp. (DPC), a California-based manufacturer of medical equipment, agreed to pay fines of $4.8 million for kickbacks paid by its Chinese subsidiary to Chinese doctors and hospital administrators. DPC was also required to "disgorge" to the US government all of the profits of its Chinese subsidiary over the preceding 10 years, plus interest. These three cases awakened a previously complacent US business community in China to the real risks posed by FCPA. Since the DPC case, at least five more publicly listed US companies have announced that they are under investigation by US authorities for possible FCPA violations in China: Schnitzer Steel Industries Corp.; Fidelity National Information Solutions; BearingPoint, Inc.; FARO Technologies, Inc.; and Avery Dennison Corp.

FCPA problems for US businesses in China

Although many of the problems confronting US businesses in China are common elsewhere, the frequency and number of FCPA problems are magnified by the PRC government's unusually large role in many sectors of the economy. The numerous government approvals still required of foreign companies before they can conduct trade and investment activities in China create a system in which many opportunities exist for officials to demand improper payments. A large part of the PRC economy, moreover, remains in the hands of state-owned enterprises (SOEs). Because US enforcement agencies consider SOE officers and employees to be "foreign government officials," business relationships that are private in most countries are transformed in China into government relationships with FCPA risks.

Bribes

Bribes in China can take many forms. Some are payments to a government official in a red envelope full of cash—the traditional Chinese *hongbao*—in exchange for the award of a government contract, issuance of a business license, or other similar concessions. Others take the form of kickbacks. For example, in the healthcare industry underpaid doctors and hospital administrators commonly inflate the purchase price of medical supplies by at least 5 to 10 percent and require the supplier to pay the difference back to them in cash. Also common are indirect payments or gifts, which can include lavish foreign trips for officials and their spouses and tuition payments for an official's child at a university abroad.

Bribes of this type are easy to identify, and the participating parties understand that they are committing illegal acts under PRC law and the FCPA. There is a more or less explicit *quid pro quo*: Pay the bribe, get the business, and take the risk of violating both local law and the FCPA; or refuse to pay and lose the business. For most US companies, the choice is not difficult because the FCPA clearly proscribes bribes of this sort, and violators may be punished severely. Most US companies therefore categorically prohibit these types of bribes.

Agents and distributors

The use of local agents or distributors is often the best sales approach for US companies to navigate the difficult Chinese market. From an FCPA perspective, the use of agents is reasonably straightforward. US companies understand that they are generally responsible for their agents and may be vicariously liable for an agent's acts. Chinese agents also typically understand agency relationships. A US company, moreover, can generally require the agent to enter into contractual representations, warranties, and covenants. If the agent breaches these undertakings, the company will have the right to terminate the agent—a significant incentive in most cases for the agent to comply. Finally, if the amount of the agent's commission is commercially reasonable, he or she will have limited opportunity and motivation to divert part of it to a government official.

Relationships with distributors are more complex. By definition, distributors are independent parties that make purchases and sales for their own account. Many Chinese distributors understandably resist US suppliers' demands to include, in contracts to be performed entirely in China, limitations on the conduct of their business that are stipulated in US law. US suppliers find it difficult to control the actions of independent Chinese distributors operating in the local Chinese market. Many US companies have long argued that, under these circumstances, they should not be held vicariously liable for the distributors' actions under the FCPA.

Recent media reports, however, allege that some US companies have exploited the situation by intentionally routing

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improper payments to PRC government or SOE officials through ostensibly independent local distributors to insulate the companies from FCPA liability. Other cases appear to be more a matter of turning a blind eye: US companies do not scrutinize the actions of their distributors for fear of what they may find.

In the InVision case, the US Department of Justice (DOJ) indicated that these approaches will no longer work and that a US company will be considered vicariously liable under the FCPA if the company knows, with a "high probability," that its independent distributors are making improper payments to government officials to secure sales of the US company's products and if the company has failed to set up internal controls to prevent these activities. The DOJ has not offered further guidance, however, on what level of knowledge will engage liability or what level of due diligence is sufficient to negate an inference of knowledge. The basic idea is nevertheless clear: Companies attempting in good faith to control their distributors will not be found liable, but companies that knowingly abuse the situation or take a "head-in-the-sand" approach will be prosecuted.

Investments

FCPA risks in investments in China may take many forms, but three in particular are worth noting.

First, recent FCPA decisions, including InVision, indicate that US companies may succeed to the FCPA liabilities of companies they acquire. US companies making acquisitions in China must, accordingly, conduct due diligence on target companies to identify potential FCPA violations. If due diligence discloses such violations, DOJ has indicated that it expects the acquiring company to cooperate with both US and foreign law enforcement authorities, ensure appropriate discipline of wrongdoers, disclose any improper pre-acquisition payments, and adopt an effective compliance and internal controls program.

Second, a US company making an acquisition in China must take into account the difficulties of bringing a PRC company, long accustomed to doing business the Chinese way, into full compliance with the FCPA. If the new subsidiary does not comply with FCPA standards, the US parent company may find itself held accountable. Many Chinese companies, however, rely on sales methods that do not comply with FCPA standards. Bringing the business into compliance may jeopardize the profitability that made it an attractive acquisition target in the first place.

US underwriters of listed PRC companies on US markets face a similar dilemma. Once the PRC company qualifies as an issuer under US securities laws, it is subject to the FCPA. If it fails to comply, the company will face serious US criminal and securities law penalties after it lists. But, as in the previous case, bringing the company into compliance may hurt the profitability on which the listing was based.

Third, foreign investment in China still requires numerous government approvals—especially in sectors such as financial services and telecom, where foreign investment is

Corruption in China

PRC government officials, including most managers and executive officials at state-owned enterprises (SOEs), are members of the Chinese Communist Party (CCP). The CCP Central Commission for Discipline Inspection (CCDI) is responsible for investigating charges of official corruption against party members. CCDI has the authority to determine various forms of administrative punishment, including expulsion from the CCP and the dismissal from any government position that would inevitably follow.

Each January, CCDI announces statistics for its corruption investigations and the resulting disciplinary actions for the previous year. In 2005, the most recent year for which statistics are available, CCDI reported that it had conducted 147,539 investigations and punished 115,143 party members. The majority of punishments were administrative, but 15,177 cases were referred to judicial organs for prosecution as criminal matters. Statistics announced for previous years are similar.

In late 2005 and early 2006, CCDI began two new antibribery campaigns. First, it launched a campaign against "commercial bribery." In July 2006, CCDI announced that it had punished 416 civil servants and 1,603 state employees through the first six months of 2006. The 15 "key cases" involved ¥560,000 ($70,000) to ¥10.7 million ($1.3 million). In each case, the convicted official was sentenced to more than 10 years in prison. One was sentenced to death for embezzling about $2 million. CCDI has also recently established an inspection tour system to evaluate the administrative performance of government officials and SOE managers. In the first six months of 2006, CCDI reportedly took administrative steps against more than 10,000 officials.

The PRC National Audit Office (NAO) also conducts periodic investigations of government offices and SOEs and regularly announces the results. In its most recent report, dated July 2006, NAO announced that it had audited 184 "units" (*danwei*) in the first half of 2006 and uncovered the "illegal use" of ¥22.3 billion ($2.8 billion) and the "waste" of ¥9.9 billion ($1.2 billion). NAO referred 98 cases to judicial or other disciplinary bodies.

Finally, the China Banking Regulatory Commission (CBRC) has jurisdiction to investigate corruption in the banking sector. In August 2006, CBRC announced that from February through the end of July, it had punished 1,887 bank employees for "hundreds of crimes" involving more than ¥8 billion ($1 billion) and claimed to have solved 242 of these cases and recovered ¥516 million ($64.8 million) in cash, according to PRC news reports.

—*Patrick M. Norton*

still restricted. In these deals, foreign investors must often pay substantial premiums to obtain adequate corporate governance rights, such as management and financial control, and must also typically partner with SOEs to ensure that PRC legal and policy limitations on foreign equity participation are observed. These transactions are complicated, involving large amounts of cash—most of it from the foreign investor—passing through various hands. Under these circumstances, some of the funds inevitably risk being diverted to individual government or SOE officials to obtain the necessary government approvals or SOE cooperation. If the US investor is not vigilant, it may find itself held accountable under the FCPA for these diversions.

Entertaining PRC officialdom

Business entertainment is pervasive in Chinese culture, and many government officials consider it a perquisite of office. Business transactions that might take place in a government office in other countries will often occur in a restaurant in China. Regular entertainment of business partners at SOEs is a matter of common courtesy and sound business relations. Because SOE officers and employees are treated as "foreign government officials" for FCPA purposes, their entertainment also comes within the purview of the FCPA.

Conspicuous consumption is also a notable feature of Chinese business culture. A company, foreign or domestic, must demonstrate its respect for a government official or an SOE executive by treating him or her to an indulgent meal. A delicious but inexpensive dinner is insufficient; indeed, it can be counterproductive because it will cause all parties to lose face.

This poses a conundrum for US companies: When is entertainment sufficiently lavish to satisfy the demands of Chinese business culture but not so excessively lavish as to trigger FCPA liability? The vagaries of both Chinese culture and US and PRC law do not yield clear answers to this question, and legal counsel spend an inordinate amount of time attempting to devise reasonable answers.

The impact of the FCPA on US business in China

Complying with the FCPA in China is a severe problem for many US companies because the playing field is uneven. In China, virtually any payment by a US company that violates the FCPA will also violate PRC law. Thus, in theory, Chinese and other foreign companies are subject to the same constraints. In practice, however, enforcement of PRC antibribery laws is sporadic at best. The central government has repeatedly announced enforcement campaigns only to have local ministries and officials respond with token enforcement. As a result, many observers, foreign and domestic, believe that Chinese and other foreign companies pay bribes and kickbacks in China with only limited risks under PRC law.

Other foreign companies have also long operated in China with no limits on bribery or other forms of corruption under the laws of their home countries. Years of diplomatic lobbying by the United States finally resulted in the 1997 Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Officials in International Business Transactions and the 2003 UN Convention Against Corruption. Under these treaties, the major capital-exporting and trading countries agree to outlaw foreign bribery by their companies. Few countries, however, have adopted or enforced the domestic laws necessary to implement these undertakings. In 2006, OECD, the US Department of State, and Transparency International criticized, among others, the United Kingdom, Ireland, the Netherlands, and Japan for their failure to enforce antibribery laws against their companies. There are no public reports of any non-US company being investigated, much less prosecuted, by its home government for paying bribes in China.

The result: US companies must adhere rigorously to US antibribery standards or risk significant civil and criminal fines, jail sentences for individual corporate officers, damage to share prices, loss of local business, and potential shareholder suits, while Chinese and other foreign competitors operate with virtual impunity. Even in the less tangible area of business entertainment, other foreign companies are freer to develop *guanxi* with PRC officials—so integral in Chinese business practices—than US companies, which must constantly evaluate their entertainment practices with an eye to FCPA compliance and are thus at a competitive disadvantage. Though there is no meaningful way to quantify the amount of business that US companies lose as a result of these discrepancies, it is likely substantial.

Minimizing FCPA risks in China

Compliance programs

The best measures for avoiding FCPA problems in China are the same as anywhere. A US company must start with a rigorous internal compliance program that sets out clear standards and procedures for its employees in China and then implement that program. An effective program bans

The Foreign Corrupt Practices Act

Antibribery provisions in the Foreign Corrupt Practices Act (FCPA) make it unlawful for US individuals and companies to bribe foreign officials. More specifically, they prohibit "issuers," "domestic concerns," and "officers, directors, and employees" of domestic concerns from "paying or offering to pay" "anything of value" to an "official of a foreign government" for the "corrupt purpose" of inducing the official to "act" so as to "obtain business" or "an improper advantage."

"Issuers" refers to all companies, domestic or foreign, registered under US securities laws to sell securities on a US exchange. The inclusion of both "issuers" and "domestic concerns" and their employees effectively encompasses all US nationals and business enterprises of any kind. The FCPA also applies to foreign individuals who take an action in the United States in furtherance of a bribe. "Official of a foreign government" includes not only civil servants but any officer or employee of an "instrumentality" of a foreign government, which is interpreted to cover state-owned enterprises.

The antibribery provisions are administered by the US Department of Justice. Companies may be fined up to $2 million per violation or twice the amount of any gain or loss resulting from the bribe; individuals may be fined up to $250,000 and imprisoned for up to five years.

The FCPA also includes "books and records" provisions that require US issuers to keep books and records in such detail and sufficiently clearly so as to reflect accurately the transactions in question. Willful recording of a bribe as something else, such as a "commission," may constitute a crime. These provisions create particular risks for foreign issuers and for US issuers doing business through foreign subsidiaries. Even in cases where the payment of a bribe may lack a sufficient connection with the United States to establish US criminal jurisdiction under the antibribery provisions, "knowing" failure to record the bribe properly may violate the books and records provisions and give authorities the power to investigate and prosecute the issuer.

The books and records provisions are administered by the US Securities and Exchange Commission. Companies may be fined up to $25 million per violation; individuals may be fined up to $5 million and imprisoned for up to 20 years for each violation. Small civil fines can also be authorized.

—Patrick M. Norton

bribes and kickbacks; specifies procedures for engaging agents and distributors, including due diligence and standard contract terms; provides guidance for entertainment of officials; sets procedures for whistleblowers to report possible FCPA violations without fear of retribution; and lays out investigation procedures.

Perhaps the most difficult—and most important—feature of a compliance program in China is training local personnel to follow these standards and procedures. Most managers and salespeople at US companies' China offices are locals accustomed to Chinese business practices. They generally understand company policies that prohibit the payment of bribes and kickbacks. They may also find more confusing limitations on forms of entertainment that are standard practice in China or how they are expected to apply standards to relations with Chinese agents and distributors that deal with PRC government and SOE officials. Under these circumstances, a training program must be tailored to the Chinese environment by including presentations—or at least interpretations—by native Chinese speakers who understand the FCPA. Local personnel must also have the opportunity to discuss the day-to-day problems they encounter in their businesses to understand how the company expects them to handle those problems.

No compliance program is perfect. But having a carefully designed program in place will minimize the likelihood that problems will arise in the first place. Equally important, the existence of a solid program ensures that any problems that do arise are aberrations—and will be recognized by US enforcement authorities as such—that can be isolated and remedied.

Due diligence and contractual protections

Many other FCPA problems can be avoided by conducting appropriate due diligence and adding contractual clauses to protect against problems that are not identified by due diligence. Contrary to the perceptions of many US businesses, it is often possible to obtain extensive background information on prospective Chinese partners, agents, and distributors. A number of companies, both Chinese and international, provide such investigative services.

It is also advisable to include standard representations, warranties, and covenants in contractual agreements that present FCPA risks. Drafting these clauses can sometimes be challenging, but the difficulties are not insuperable. Some Chinese object in principle to complying with US laws under a contract that will be performed wholly in China. This understandable resistance can typically be softened by making the contract apply to "all applicable corruption and antibribery laws" or similar generic terms and by defining those terms in ways that include both PRC laws and the FCPA. Alternatively, the Chinese parties may acknowledge that the US party has informed them of its obligations under the FCPA and will act "so as not to cause the US party to violate the FCPA."

When is entertainment sufficiently lavish to satisfy the demands of Chinese business culture but not so excessively lavish as to trigger FCPA liability?

The "local law" and "bona fide expenditure" defenses

The FCPA recognizes that some forms of business entertainment are appropriate and provides two "affirmative defenses" for entertainment expenditures. US companies must ensure their expenditures fall under one or the other.

First, under the "local law defense," payments or gratuities that are "lawful under the written laws of the country" are permissible. China's written laws, however, are not helpful. Under applicable regulations, PRC officials are required to reject or hand over to the government any gift valued at ¥200 ($25) or more and gifts from one source whose value exceeds ¥600 ($75) in a year. Officials are also prohibited from accepting meals that may "influence their decisions," though it is not specified what kind of meal would likely have this effect. As a result, the local law defense in China is narrow and provides little comfort for US companies.

The FCPA also authorizes "bona fide expenditures" to promote products or perform contracts with foreign governments. This standard is more flexible and vaguer than the local law defense. US enforcement authorities have stated that any travel and entertainment expenditures may not be "too lavish" or "unreasonable," though they have declined to provide more specific guidance. As a result, US companies must devise entertainment policies subject to the risk that US authorities will, if the occasion arises, disagree with what the companies have determined to be "reasonable" in China.

FCPA investigations in China

When credible allegations of FCPA violations in China do arise, US companies must be prepared to act promptly and effectively because US enforcement authorities may later regard undue delay or mishandling of credible allegations, even if inadvertent, as attempts to cover up violations. Companies should place responsibility for conducting investigations in the hands of in-house counsel and auditors and

Continued on page 39

The Changing China Trade Landscape: Myth and Reality

With 1.3 billion people, China is not only the most populous nation in the world, and the largest emerging market, but also the second largest economy in terms of purchasing power – an extraordinary transformation from being a closed state to becoming a major creator of prosperity on the world stage. Multinational companies seeking access to its potential would do well to seek the services of a knowledgeable guide.

Examining the profit repatriation myth

In an environment characterized by change, concerns around profit repatriation are not surprising. Rumors abound that "it's impossible to take profits out of China," or that "banks in the home country are unwilling to exchange renminbi." However the reality is threefold:

First, working out a strategy for profit maximization and subsequent repatriation is a technical tax and legal issue that requires professional guidance – and should not conflict with your company's articles of association.

Second, should you make the decision to repatriate profits, China has had a system of current account convertibility since 1996, enabling foreign companies to have their banks arrange remittance of RMB funds in the foreign currency of their choice.

Third, there are major incentives to reinvest profits in China. Incentives are applicable only if your profit remains in China and that the re-investment remains in the business for five years.

Exploring the foreign investment myth

In the last two years, China's performance has been legendary on multiple levels. With annual growth rates as high as 10%, the process of its accession to the World Trade Organization (WTO) and an increasingly sophisticated employment market has all been accomplished within a tightly regulated framework. The reality is, the Chinese government has been incrementally introducing changes to foreign currency regulations, in an effort to make it easier for multinational companies to conduct business.

The Pudong Nine Measures Pilot Program

In October 2005, the State Administration of Foreign Exchange (SAFE) and the Shanghai Pudong City Government (SPCG) jointly introduced a pilot program to relax foreign currency restrictions on qualified multinational companies (MNCs). The program, termed the "Pudong Nine Measures," enables MNCs with regional headquarters located in the Pudong New Area to run corporate treasury functions more effectively from China. Pudong is Shanghai's hyper-modern new area, the centerpiece of which is the Lu Jia Zui financial district.

The key benefit for MNCs is the introduction of foreign currency cash pooling using inter-company entrust loans. Previously prohibited foreign currency hedging instruments are also available. The reforms also made Pudong significantly more attractive as a potential location for MNCs to set up shared service centers (SSCs) providing treasury functions.

Beyond the Nine Measures

The results were so successful, the government decided to introduce additional FX regulatory reforms.

In April 2006, two of the Pudong Measures, namely permission to open multiple foreign currency accounts, and simplified approval and reporting requirements for non-trade transactions were made available to all companies. The effect of these reforms is that it is now simpler and easier to open foreign currency accounts as SAFE approval is no longer required.

The reforms also positively affect international trade flows, since shipping and logistics companies may now purchase foreign currency to make overseas payments for freight and related service fees. These companies may now also collect RMB from domestic customers, rather than only foreign currency, dramatically improving the efficiency of fee collections, as China's RMB clearing system is far superior to its foreign currency counterpart.

Similarly, export companies now have more choice when paying freight charges and related service fees. Rather than route payments through domestic shipping companies, they now pay directly to the ultimate service provider, the overseas freight company.

Finally, these reforms give companies substantially more choices on collection channels and bank selection.

But the best is yet to come. Under China's agreement with the World Trade Organization, on December 11, 2006, geographic restrictions on local currency business for foreign financial institutions will be lifted. Foreign financial institutions licensed for local currency business in one region of China may service clients in any other region that is open to such business. RMB financing can be offered by licensed foreign banks all over the country. This further loosening will create more balance between buyers and sellers within the country, and a more level playing field globally.

Citigroup China: Separating myth and reality for multinational corporations

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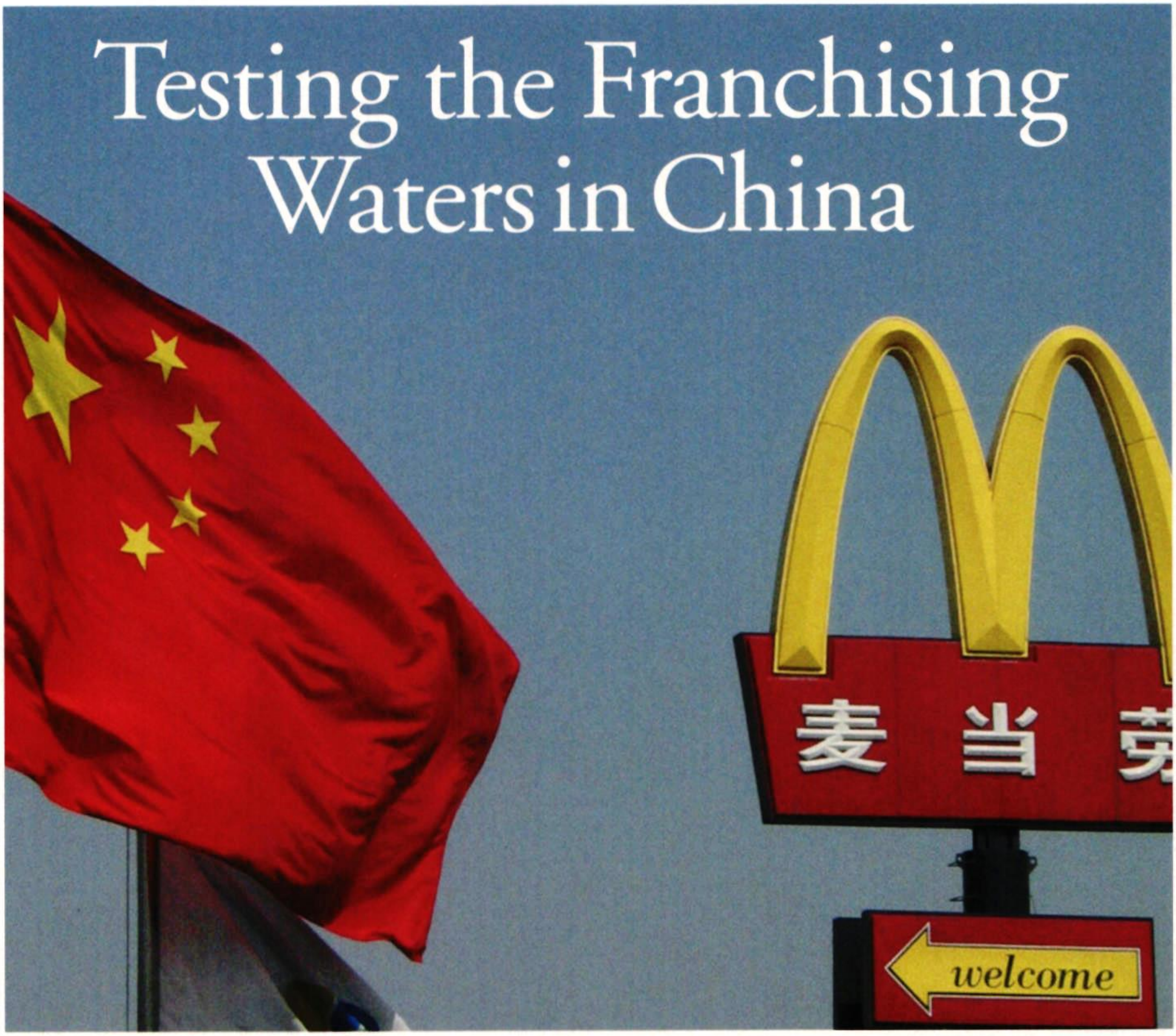
Testing the Franchising Waters in China



China is an enticing market for foreign franchisors—but its uncertain regulatory environment can make franchising risky

Rebecca Ordish

With a population of more than 1.3 billion people and a growing middle class that is set to top 200 million by 2009, China has been described as "the mother of all franchise markets." International franchisors, such as Burger King Corp., Super 8 Motels, Inc., and Uniglobe Travel International LP, have determined that China's market is too big to ignore and have launched their franchising plans in China over the last year. In many ways, franchising is the perfect fit for China, which has many budding and ambitious entrepreneurs eager to acquire business know-how, management experience, and a brand name.

The size of the prize

Compared with the long history of franchising in Western countries, franchising is a relatively new business model in China and appeared for the first time in the 1990s. The model is based on a business relationship in which the franchisor (the owner of the business providing the product or service) assigns to the franchisee (independent parties) the right to market and distribute the franchisor's goods or services and to use its associated business name for a fixed period of time. After more than a decade of rapid development and growth, the franchise model has been adopted in a variety of industries across China and has played an active role in the development of the Chinese economy. By the end of 2005, more than 2,320 chains were using franchises, a 10.4 percent jump over the previous year, according to the China Chain Store and Franchise Association (CCFA), a quasi-government organization responsible for China's franchising and chain-store industries. More than 50 industries in China use franchising, employing more than 1.8 million people in almost 170,000 stores. In 2005, the proportion of franchises in the retail sector rose from 33 to 49 percent. The continued growth of China's consumer base provides a potentially lucrative opportunity for foreign franchisors.

By the end of 2005, more than 2,320 chains were using franchises, a 10.4 percent jump over the previous year.

This exciting new market is not without risks, however, as General Mills, Inc., owner of the Häagen-Dazs ice cream brand, discovered last year after it failed to closely supervise one of its local franchisees in Shenzhen. The franchisee was discovered to have been manufacturing ice-cream cakes that officials assumed were counterfeit given the small factory's unsanitary conditions. The factory did not have a hygiene license and was run out of a small apartment in which the toilet was right next door to the food processing room. Active monitoring on the part of the franchisor could have prevented this unfortunate situation. Instead, the incident had a serious impact on the Häagen-Dazs brand and its image in China. Difficulties with quality control in China, combined with the country's weak legal system, uncertainty in the franchising regulatory environment, and intellectual property (IP) risks make it necessary for foreign franchisors that want to plunge into this market to design their strategies carefully.

The chain store approach

Many of the familiar foreign franchise giants are visible in China. According to a survey report released in September 2005 by CCFA, 14 of the top 20 brands in the United States have entered the Chinese market. Yum! Brands, Inc., which operates the KFC, Pizza Hut, and Taco Bell franchises, has been in China since 1987 and has gained substantial experience in navigating the country's regulatory minefield. Until recently, however, all of its stores were company-owned chain stores rather than traditional franchises because it was concerned about IP protection and an inadequate legal framework. Now, Yum opens company-owned stores and operates them directly for 12 months or until they become profitable, after which it trains franchisees in the stores before delegating full responsibility to the franchisee. This process allows franchisees to avoid struggling with the initial set-up of the store—they are simply given a store that is already profitable, while learning valuable business operation skills along the way. Yum also recently reduced the franchising fee fourfold to as low as ¥2 million ($250,000) for its KFC franchises in second-tier cities to encourage rapid growth outside major cities.

McDonald's Corp. has adopted a similar, albeit slower, approach to franchising in China: All of its company-owned stores operate with a local partner. Peter Tan, president of the China branch of the McDonald Development Co., claimed in 2002 that "McDonald's will begin franchising only after relevant regulations and laws are defined in China." And true to Tan's word, McDonald's only started to consider franchising last year after new franchise regulations were introduced.

New business model

As mentioned above, franchising is a new business model in China and requires a great deal of education at all levels of involvement—from the authorities who enforce the regulations to the franchisees, managers, employees, suppliers, and consumers. The Chinese parties are usually confused about the difference between chain stores and franchises, a confusion compounded by the fact that the same quasi-government body, CCFA, is responsible for both industries. Chinese franchisees also do not understand the significance of the "system" they are acquiring and often question why they need to pay such high fees up front to obtain access to the system and the brand name. It is thus important for companies to localize a franchising model in China to ensure success.

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Because China's new franchising measures do not adequately protect the franchisor's IP, franchisors must take steps to tightly control their IP and enforce confidentiality obligations.

Eastman Kodak Co., with more than 5,500 photo printing stores in China, has led the way by teaming up with local banks to allow prospective franchisees to pre-qualify for business loans.

Improvement in regulatory environment

In China, a business activity that is not expressly allowed by a regulation is generally considered prohibited. As recently as the end of 2004, China lacked formal regulations that allowed foreign companies to franchise in China, and foreign franchisors could not directly engage in commercial franchising. For foreign franchisors that wanted to target the Chinese market, the only option available was to partner with a local franchisee that had import and export licences. This approach generally left foreign franchisors in China with a lack of control over their brands and limited profit because they had to share it with the Chinese partner.

All of this changed, however, on February 1, 2005, when the PRC Ministry of Commerce's (MOFCOM) Administrative Measures on Commercial Franchising took effect and replaced the 1997 Interim Measures for Regulating Commercial Franchise Operations, which did not explicitly allow foreign entities to franchise in China. The new measures, which were issued on December 31, 2004, were part of China's World Trade Organization commitments to open up its franchising sector to foreign-invested enterprises (FIEs). The rules clearly allow FIEs to compete in the Chinese market. Since most of the measures apply to all Chinese legal entities, they ostensibly create a more level playing field for domestic and foreign franchisors, with a few important exceptions (see Box).

Protecting brand integrity and IP rights

Since IP forms the basis of a strong franchise system, its protection is a key issue for franchisors that wish to enter the Chinese market. It is no secret that piracy is common in China, and enforcement of IP rights a daunting challenge. Recovery of a trademark, once it has been used or registered by another party (including a franchisee) in China, can be costly and time-consuming, as evidenced by Starbucks Corp.'s fight to recover its Chinese name in 2004. The name, Xingbake, was already registered as a trade name by a Shanghai-based company, which resulted in an expensive and drawn-out litigation process. Although Starbucks initially won the case, the

New Franchising Rules: A Step in the Right Direction

Although the 2005 Administrative Measures on Commercial Franchising have cleared the way for foreign-invested enterprises (FIEs) registered in China to engage in franchising, the measures fall short on one key issue: whether a foreign company can directly engage in cross-border franchising agreements with Chinese franchises without establishing a wholly foreign-owned enterprise (WFOE) in China first. Indeed, the measures include a unique provision—not used anywhere else in the world—that requires all franchisors to operate at least two stores in China for a minimum of one year before starting franchising operations.

Although the provision is intended to protect Chinese franchisees from the unfamiliar waters of franchising, many companies consider it an overly burdensome requirement that essentially prohibits foreign companies from operating franchises without first either opening two stores in China and running them for a year or entering into a joint venture with a local partner. This requirement poses a significant hurdle for most foreign franchisors, which often have no wish to, or cannot, enter the Chinese market directly and usually prefer to appoint a master franchisee to manage their China operations. Burger King chose the first option and recently opened its first two stores in Shanghai, with an eye to setting up franchises after a year of successful operations.

In addition, FIEs are subject to a registration requirement that does not apply to local franchisors. Before an FIE can begin franchise operations in China, it must obtain approval from relevant authorities—usually from the authority that first approved its establishment and then from the local administrations of industry and commerce (local franchisors only need to include franchising in their business scope). Once registered, it must submit an annual report to the same authorities detailing the activities of its franchise operations and the performance of franchisee contracts. Although these requirements for foreign companies do not conform to the World Trade Organization's national treatment

New franchisors considering conducting business in China must also understand that China's underdeveloped regulatory environment presents a number of possible pitfalls.

Chinese party filed an appeal with the Shanghai Higher People's Court in January 2006.

Because China's new franchising measures do not adequately protect the franchisor's IP, franchisors must take steps to tightly control their IP and enforce confidentiality obligations. And because enforcing IP rights can be difficult in China, these added measures must be, in many cases, even tighter than those usually used in the franchisor's home country. Franchisors must ensure that a comprehensive IP protection strategy is in place before entering the Chinese market, a key to becoming a leader in China's fledgling franchise market.

Foreign franchisors should also carefully select their franchisees and conduct appropriate due diligence on all potential partners. This procedure should not only cover the usual financial and business experience checks, but also attempt to identify whether the potential franchisee has a solid track record on IP management, which could include testing its awareness of the value of IP. Franchisors must also carefully train their franchisees on the importance of IP protection and maintaining uniform standards. For example, Super 8 opted to set up special schools to help train staff in China, an unnecessary step in other countries in which it operates.

Should franchisors enter now or later?

There is little question that the Chinese market offers potential financial benefits for successful franchises, but new franchisors considering conducting business in China must also understand that China's underdeveloped regulatory environment presents a number of possible pitfalls.

Although the new MOFCOM measures are definitely a step in the right direction for franchising in China, how the franchising regulatory system will evolve and be implemented remains unclear. MOFCOM has indicated that the tentatively titled Commercial Franchise Regulation, which the PRC State Council has been deliberating for several years, is slated to replace the 2005 measures late this year and clarify present legal ambiguities. Franchisors may consider waiting until the end of 2006 to gauge how the regulatory environment develops—and whether the regulation will override the current measures. 完

principle, pending regulations may resolve these issues in the near future.

Franchisors must disclose *all* information requested by the franchisee

The measures also detail a disclosure regime aimed at protecting potential and current franchisees. In addition to a broad list of information that the franchisor must provide to the franchisee at least 20 days before the execution of the franchise agreement, the measures contain a "catch all" provision that allows the franchisee to request the franchisor to disclose "other information," a term that is left undefined. The right to information appears not to be restricted to information required to make a decision on franchising, but rather is an open-ended right reserved for the duration of the agreement. Failure to comply with the disclosure provision could prove costly—the measures stipulate fines of up to ¥30,000 ($3,774) and possible cancellation of the franchisor's business license. The measures also state that the franchisor must compensate the franchisee for any losses caused by inadequate disclosure and misrepresentations of information, though the types of information are not defined.

Franchisors must ensure supply quality

Finally, the franchisor is responsible for guaranteeing the quality of all goods from its appointed suppliers. Companies usually strive to ensure quality, but in most places it is not a legal requirement for which they can be held liable. Thus, to guarantee the uniform look, feel, and taste of its franchisees' products, without opening itself to liability, the franchisor must establish quality control systems for all of its suppliers' goods. Obviously, this requirement could pose many new difficulties and extra expense for franchisors setting up in China. Foreign companies will be watching to see whether new franchising rules expected late this year address these issues.

—Rebecca Ordish

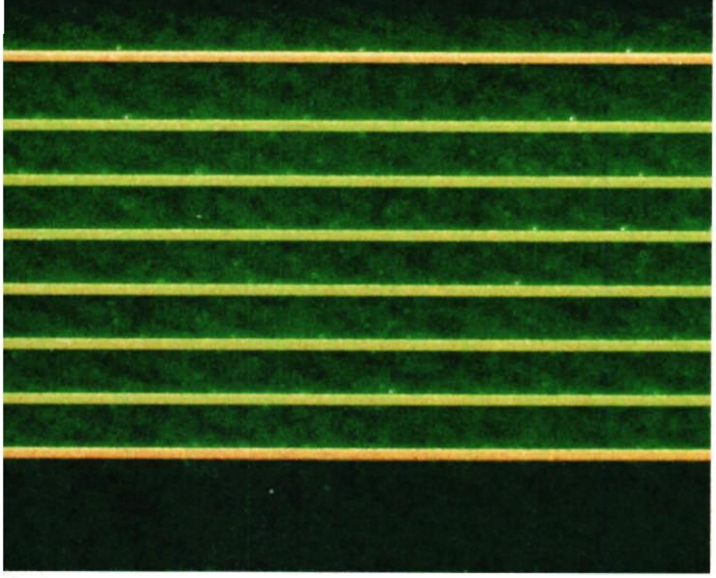
US Moves to Revamp Its Export Controls

Peter Lichtenbaum and Grace Parke Fremlin

The Bush administration's proposal in July to revise the US Department of Commerce's (DOC) controls on US high-tech exports to China has sparked a vigorous debate. Indeed, several major trade associations, including the US-China Business Council [the publisher of the *CBR*] and the US Chamber of Commerce, have called upon the administration to suspend the proposal. The debate is hardly surprising, given the different perspectives within the United States on recent developments in China. On one hand, China has become an important destination for US high-tech goods and a key component of US multinational enterprises' global supply chains. On the other, many US policymakers consider China a potential military threat in certain contexts because of the growing size and capability of its armed forces. Reflecting these concerns, the proposal seeks to promote the export of high-tech items for civilian end uses while tightening controls on exports for known military end uses.

Any analysis of the administration's proposal should take into account the following three considerations. First, the proposal's economic impact will vary significantly

Will the Bush administration's July proposal promote trade and enhance national security?



depending on the industry concerned. Thus, each sector or company should look at the proposal in its own context. Second, the economic impact will also depend on how the administration ultimately finalizes and implements the rule. Third, because many of the exports to be restricted for military end use are available from foreign suppliers, the economic effect of the new control and its contribution to national security will depend on whether the administration can persuade other key supplier countries, such as Japan, South Korea, and members of the European Union, to adopt similar measures.

The administration's goals

The proposal is intended to update US export control policy to respond to two significant developments related to China's explosive economic growth. First, China has become a major and growing destination for US exports and has been integrated into the global supply chains of many US multinational corporations. At the same time, China is also an intensely competitive market, where US exporters face fierce competition from Chinese, Japanese, South Korean, and European rivals. Although US exports to China have increased markedly in recent years, an enormous—and growing—bilateral trade deficit persists. The proposal thus aims, in part, to promote high-tech exports to China.

Second, China's remarkable economic transformation is allowing the country to expand and upgrade its armed forces rapidly. In a 2006 report to Congress, the US Department of Defense concluded that China has "the greatest potential to compete militarily with the United States and field disruptive military technologies that could over time offset traditional US military advantages." As a result, US policymakers are concerned that the PRC military could exploit certain high-tech goods exported from the United States to undermine US national security, and the proposal accordingly aims to tighten restrictions on certain sensitive items exported for military end use.

The July proposal thus strengthens the focus of the US export-control regime on the end use of the item being exported. Current US regulations already contain some end-use elements, of course. Most sensitive items on the Commerce Control List (CCL) maintained by the DOC Bureau of Industry and Security (BIS), except those controlled only for "antiterrorism" purposes, currently need a license for export to China. Certain controlled CCL items, however, do not need a license if they are exported for purely civilian use. Meanwhile, nonsensitive items require licenses if exporters know that the items will be used in a program for weapons of mass destruction (WMD), including nuclear, chemical, or biological weapons, or for missile delivery systems. Current regulations, nevertheless, are largely premised on the perception that the Chinese economy is a state-controlled monolithic entity and not the diverse economy that it is now, in which private enterprises generate more than half

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of economic production, according to the World Trade Organization's April 2006 Trade Policy Review of China.

Promote high-tech trade with China

The proposal

To make it easier to export to reliable end users in China, the Bush administration has proposed a "validated end user" (VEU) program. The VEU program would relieve companies that export dual-use goods and technology to PRC entities on a recurring basis of the burden of seeking a license for each shipment. Exports classified under specific, approved CCL categories could be sent to a VEU without a license, even when one would normally be required. To qualify for VEU status, PRC-based companies could file an application with BIS, or US exporters could seek VEU status on behalf of their PRC customers. The application process would require BIS to evaluate PRC-based companies on several factors, including a demonstrated record of exclusively civilian activities, past compliance with US export controls, capability to comply with VEU requirements, and corporate relationships with US or foreign companies. The US government would also consider the status of China's export-control system and China's adherence to multilateral export-control regimes in the application process. VEU status would be granted to a PRC company only for specific categories of controlled items, and PRC end users would need to accept periodic onsite compliance reviews conducted by the US government.

This proposal could yield potentially large benefits. In addition to relieving US exporters of licensing burdens for their routine exports, it would enable the US government to devote more resources to analyzing license applications in more complex cases. Moreover, the program would create a market incentive for PRC companies to strengthen their export-compliance programs and to focus on civilian activities so that they can qualify for the VEU program and receive US manufacturing technology more quickly than their domestic competitors. Finally, while the proposal would be a significant innovation in US export-control policy, European countries and Japan already have similar programs that provide a one-time review and bulk licensing for civilian end users. The proposal would thus help promote a more level playing field for US exporters.

Industry concerns

Whether the VEU program will benefit exporters depends on the industry in question. The VEU proposal could substantially reduce the licensing burdens of industries that export a significant amount of controlled commodities to a limited number of known, reliable entities in China, such as affiliated companies, foreign-invested or wholly owned subsidiaries, and companies wholly independent from PRC government control. A good example is the US semiconductor equipment industry, which supplies controlled manufacturing equipment under export licenses to a discrete number of PRC foundries.

Conversely, the program would be less valuable to industry sectors whose products either do not need an export license or, like the most sophisticated machine tools, will not be approved for export. Firms that sell to a fairly large number of customers, such as some computer companies, might also not benefit significantly from the VEU program because they would lack sufficient incentive to obtain VEU status for any particular customer, given the effort required to do so. Finally, companies in some PRC industry sectors, such as aerospace, which has a largely military heritage, would find it

End-User Certification from MOFCOM

Apart from the "validated end user" program and the new military end-use control, the Bureau of Industry and Security (BIS) of the US Department of Commerce (DOC) has also proposed that exporters be required to obtain end-user certificates from the PRC Ministry of Commerce (MOFCOM) for all items exported to China that exceed a value of $5,000 per single Export Control Classification Number entry. Currently, BIS requires a MOFCOM certificate only for exports of sensitive items that are controlled for "national security" purposes on the Commerce Control List.

Under the 2004 End-Use Visit Understanding with the PRC government, the US government has the right to conduct post-shipment verifications in China only when MOFCOM has issued an end-use certificate to the US exporter. Such post-shipment verifications play an important role in facilitating US government approval of licenses for the export of sensitive commodities, as they help deter the diversion of those commodities to inappropriate end uses. Thus, even though this proposed requirement could impose another administrative burden on US exporters, the administration deems it necessary to ensure that US exports of sensitive items do not harm US national security.

The impact of the requirement could be significant, however. Reportedly, only 35 of the 1,303 licenses granted for export to China in fiscal year 2005 had listed values of less than $5,000. Moreover, it is far from clear whether MOFCOM will dedicate the necessary resources to provide a greatly increased number of end-user certificates. The China Arms Control and Disarmament Association, a PRC-based nongovernmental organization, recently expressed concern that MOFCOM would be "overloaded" by having to issue so many certificates.

—Peter Lichtenbaum and Grace Parke Fremlin

more difficult to qualify for VEU status because they may not have a demonstrated record of purely civilian activities.

US industry has raised several specific concerns about the proposal, each of which could diminish the value of the VEU program as a tool to promote exports and reduce regulatory burden. First, industry has expressed concern that a denial of VEU status could act as a "red flag" and result in future export license denials or tougher licensing requirements. In supplementary guidance published on its website, however, BIS has stated that "an end user's failure to obtain VEU status would not trigger a new license requirement and would not preclude approval of licenses for exports to that end user ... [L]ack of approval of a VEU application would neither add to nor take away from the licensing requirements otherwise applicable to exports to a given end user." Moreover, VEU denials would likely be rare, as most VEU applications would be filed by companies that have long and positive track records with BIS and that would have engaged in informal consultation with BIS personnel and other US government staff. This issue may thus be insignificant in the end.

Second, certain industries have also voiced concerns that BIS would not apply VEU authorization to many items that are controlled for export to China. In particular, it is uncertain whether and to what extent intangible technology, such as development and production technology for machine tools and computers, would be authorized for export to VEUs, even though the proposal allows such authorizations. With many US companies manufacturing sophisticated goods at wholly owned subsidiaries in China, the omission or limitation of technology from the VEU program would significantly reduce its utility.

A third area of concern focuses on practical issues that could arise from the VEU certification process. Depending on how BIS implements the program, the administrative burden required for PRC end users to become certified could be fairly significant and may deter some companies from applying. In addition, a free-rider problem exists because all US exporters would benefit once a PRC entity obtains VEU status. Some US companies have suggested that they may not invest time and money to secure VEU status for their customers, as their US competitors would stand to benefit without bearing any cost. PRC entities that act on their own to secure VEU status could find the process challenging, given their lack of familiarity with US regulatory practices. Finally, both BIS and the PRC Ministry of Commerce (MOFCOM) would need to ensure that they had adequate staff in China to administer the certification process. BIS personnel would need to visit VEU candidates, before and after certification, and MOFCOM assistance would be important to facilitate such visits. It is unclear whether those resources would be available given MOFCOM's recent criticism of the proposed rule.

The VEU program would relieve companies that regularly export dual-use goods and technology to PRC entities of the burden of seeking a license for each shipment.

Strengthen controls on exports for known military end uses

The proposal

The administration has also proposed to strengthen controls on specific items that can materially enhance PRC military power. This proposal has its roots in a 2003 agreement among key exporting countries that are members of the Wassenaar Arrangement. The countries agreed to restrict exports of unlisted dual-use items to states subject to a UN arms embargo or to a regional arms embargo to which the member adheres if exporters are informed that the item is destined for military end use. Under the July proposal, certain items that do not currently require a license for export to China would need a license if the exporter has "knowledge" that the items are destined for a military end use in China.

This new control has three major elements. First, the proposal applies to 47 different CCL product categories. The items covered that are of particular economic significance include certain types of bearings, various high-tech machine tools, certain encryption software, certain high-speed computers, and certain types of aircraft navigational equipment, among others. Second, the proposal defines "military end use" as "incorporation into, or use for the production, design, development, maintenance, operation, installation, or deployment, repair, overhaul, or refurbishing" of a munitions item. Thus, a license would be required if the exported item was destined to help make a defense article. A license, however, would not be required simply because the customer was part of the PRC armed forces. For example, a license would not be necessary for the sale of bedsheets to the armed forces.

Third, under the definition in current BIS regulations, "knowledge" that items are destined for a military end use would exist where an exporter has "positive knowledge" that the military end use is substantially certain to occur and also where the exporter is aware of a high probability of such military end use. Knowledge could be inferred from the exporter's conscious disregard or willful avoidance of relevant facts.

Industry concerns

US industry is concerned that the new controls would impose significant new regulatory burdens on US companies and provide no real benefits to US national security. In particular, industry has argued that the proposal may become a unilateral control because many of the listed products are widely available not only from other Wassenaar Arrangement member states, but also in some cases from third-country or even indigenous Chinese producers. In the absence of evidence that other key countries will adopt similar controls, this initiative may foster the perception that the United States is moving unilaterally to tighten controls, thereby rendering US suppliers less reliable to their Chinese customers.

If other key suppliers do not adopt the proposed controls, this would indeed be a significant concern, as it would increase the economic costs to US industry and yield little national security benefit. Accordingly, BIS has encouraged interested parties to provide specific examples of foreign and Chinese production of listed items during the comment period and is mounting a campaign to encourage key suppliers in Europe and Asia to implement similar measures. While some countries, such as Japan and South Korea, are likely to be sympathetic, the administration will have a harder time persuading European governments.

Second, industry has raised concerns regarding specific product categories that would be subject to the new controls. One example involves encryption software. Because certain strong encryption software has already been decontrolled for export to China under a separate license exception, the rule would anomalously subject a *lower* level of encryption software to a higher level of control. Industry is also concerned that the range of high-speed computers subject to the rule would widen over time as the capabilities of such computers increase. BIS will need to carefully consider these product-specific issues.

Third, the "knowledge" standard in the proposed rule, which relies on the existing regulatory definition, has also been criticized. US exporters are concerned that they will need to undertake additional due diligence on their customers to protect themselves from second-guessing by government regulators. They note that the administration had consistently said, before it published the proposal, that the rule would be limited to situations where the exporter actually knows that the export is destined for a military end use.

It is difficult to assess how significant an impact the "knowledge" standard will have on US exporters. Other BIS-administered export-control programs that use the same standard—such as the WMD knowledge-based control—have not significantly disrupted US exports and have been valuable tools in the protection of US national security. Rather than deterring exports, these requirements have been factored into export compliance plans as part of customer and sales screening. In addition, the overall volume of trade subject to the proposal will likely be small, given the limited number of products to which the proposal applies.

Finally, US industry is concerned that determining whether a PRC customer is making a munitions item, as defined under the US International Traffic in Arms Regulations, can be difficult because the regulations are ambiguous. This may lead US exporters to forego sales opportunities in China.

Prospects

The administration's proposal to revise export-control measures vis-à-vis China reflects the need to update US export-control policy in light of rapid economic and military changes in China. Some industries are positioned to derive significant regulatory relief from the VEU program. In contrast, other industries are understandably concerned that the rule may lead their customers to perceive them as unreliable. In the intensely competitive Chinese marketplace, US exporters cannot afford to be placed at a disadvantage if there is no corresponding benefit to US national security.

BIS has requested comments on the proposed rule and has emphasized in briefings that it will consider those comments carefully. As a result, companies may well see changes to the rule before it is finalized. In particular, BIS may clarify the list of items subject to military end-use control, the scope of equipment and technology that will be authorized under the VEU program, and how other aspects of the rule will be implemented.

Though the administration has a fair amount of control over the success of the VEU program, the military end-use control depends critically on whether the United States can persuade key supplier countries to take a similar approach in implementing the 2003 agreement reached under the Wassenaar Arrangement. In a world where production is often globalized, it is impossible to impose significant unilateral controls effectively.

Finally, frank discussion with China will be important as the administration moves forward. In the past, China has claimed that US export controls are a major contributor to the large US trade deficit with China, and the PRC government has recently criticized the proposal. Chung Quan, a MOFCOM spokesperson, argued that the proposal imposes "unreasonable obstacles" to trade and is based on a "Cold War mentality." Even if China does not consider this issue to be sufficiently important to affect its dealings with the United States on other bilateral issues, and even though the economic impact of the proposal is likely to be small, the PRC government may be concerned that the proposal would stigmatize China politically. The administration will need to evaluate China's concerns in the context of the overall bilateral relationship as it finalizes revisions to the rule. 完

The Foreign Corrupt Practices Act Dilemma

Continued from page 27

guarantee that records, including those stored in computers, are preserved. Boards of directors or their audit committees must be advised when appropriate. Companies must also consider whether to bring in outside counsel and auditors because US enforcement agencies view outside investigations as more credible than those conducted entirely in-house.

FCPA investigations in China will nonetheless present practical difficulties. Business records can only be effectively examined by lawyers and accountants fluent in written Chinese. Individuals, both in the US company and outside of it, will often be uncooperative or simply confused about how to respond to questions regarding their conduct. Even Chinese quite fluent in English may be apprehensive about answering legal questions in any language other than Chinese. The conduct itself is often only clearly explicable in the context of the different norms of Chinese business behavior. Interviewers, therefore, should be familiar with Chinese business methods and have some facility in the Chinese language.

A silver lining?

In sum, compliance with the FCPA presents significant challenges to US companies doing business in China. At a minimum, companies must maintain constant diligence and managerial attention to keep their China operations in line with standards that often clash with local practices.

Though complying with the FCPA almost certainly costs some US companies significant business opportunities, the application of FCPA standards may have some positive results. Many PRC and SOE officials now understand that US companies cannot and will not pay kickbacks or other forms of bribes. Some SOEs and government authorities reportedly no longer demand these bribes from US companies. US companies that benefit most are ones whose sales do not depend significantly on the ability to pay bribes—typically companies with unique products, trademarks, or similar advantages. Companies that sell more commoditized products may also be freed from demands for bribes, but they may well lose sales to less scrupulous competitors.

US authorities' enforcement of the FCPA may also force the PRC government to enforce its own laws, creating a "blowback effect." The PRC media has given extensive coverage to US companies' public announcements of FCPA investigations that involve payments in China. The DPC case, in particular, attracted a great deal of public attention, causing the Chinese media to ask why the PRC government was not enforcing its own antibribery laws. One suspects that similar questions were asked within the PRC government.

US authorities' enforcement of the FCPA may also force the PRC government to enforce its own laws, creating a "blowback effect."

The media coverage seems to have had two effects. First, a host of PRC regulators soon appeared at DPC's doors in Tianjin demanding to review the relevant company records. These officials appeared to be satisfied that DPC had already been punished appropriately under US law and showed more interest in the Chinese parties involved. Whether this move led to any action against those Chinese parties is unknown. It seems reasonable to expect, however, that if other companies facing FCPA charges are made public, they will also receive inquiries from PRC authorities.

Second, after the DPC case's widespread publicity in PRC and Western media, China adopted new programs to crack down on corruption, most notably in the healthcare sector. Whether these programs were a direct result of the US cases is uncertain, but the FCPA may be having precisely the effect that its proponents have long sought: encouraging the government of a developing country to clean its own house. Though this may be small consolation for US companies that must live with the short-term risks of FCPA compliance in China, it may be a significant and welcome accomplishment in the long run. 完

Labor Relations in Focus

The PRC government's efforts to better protect workers' rights spring from worries about China's social stability

Victorien Wu

Since ascending to their leadership positions during the 2002–03 transition, PRC President Hu Jintao and Premier Wen Jiabao have expressed considerable concern about China's social stability and have emphasized the importance of balancing the country's development. This shift in policy priorities is not altogether surprising. PRC government statistics suggest that social unrest has grown significantly over the past few years. Beyond rural protests against illegal government seizures of agricultural land, worker demonstrations against wage arrears and other bread-and-butter issues have also made the headlines. Moreover, the number of labor disputes channeled through government-sanctioned dispute resolution processes has risen sharply in recent years.

In this context, the PRC government has undertaken several initiatives to demonstrate its resolve to better protect workers' rights. These have included the draft Labor Contract Law, issued for public comment last spring, and the renewed campaign by the All-China Federation of Trade Unions (ACFTU) to unionize workers in foreign-invested enterprises (FIEs). These, along with the government's other labor-related campaigns, may mark the beginning of a more vigorous effort by the PRC government to mend labor relations in China.

The broader political agenda

Hu and Wen have, in comparison to their predecessors, placed a greater emphasis on helping those who have been left behind in China's reform efforts. Most notably, in December 2002, soon after he became secretary general of the Chinese Communist Party (CCP), Hu signaled a shift away from the policy direction set out by his predecessor Jiang Zemin, by taking the CCP leadership to visit Xibaipo village in Hebei. There, Hu recalled the Xibaipo Spirit of modesty, plain living, and hard work that Mao Zedong had called for in 1949. He also urged his colleagues to help build a "moderately well-off society" (*xiaokang shehui*), clearly suggesting that the CCP should tackle China's growing socioeconomic inequalities.

Hu's efforts to shift the CCP's policy agenda gained crucial momentum at the third plenum of the 16th CCP Central Committee in late 2003, when the Central Committee approved a key document that contrasted visibly with Jiang's report to the 16th CCP Congress in 2002. The document, named the Decision on Several Issues in Perfecting the Socialist Market Economy, paid more attention to the wide range of problems that have arisen as a result of China's reform efforts. It also emphasized "social development" as an integral component of the CCP's agenda.

Subsequently, in a speech to top cadres in February 2005, Hu said that building a "harmonious society" (*hexie shehui*) should be a priority for the CCP and the PRC government. He observed that "social conflicts are emerging in great numbers" and encouraged his colleagues to "balance different interests" and maintain "social equity and justice." Wen later echoed Hu's message in the PRC Government Work Report delivered at the March 2005 session of the National People's Congress when he declared that the government must "properly balance the interests of all quarters and ensure that everyone shares the fruits of reform and development."

These policy priorities are set to dominate and shape the PRC government's agenda for at least the next few years. Indeed, the CCP leadership has decisively rallied around Hu's "harmonious society" doctrine. In mid-October, the sixth plenum of the 16th CCP Central Committee—the CCP's first plenum to focus more on social development rather than political or economic issues—formally endorsed Hu's "harmonious society" doctrine, signaling broad support among China's top policymakers for Hu's agenda.

Equally important, China's 11th Five-Year Plan (2006–10) indicates that the government will strengthen its efforts to construct a "harmonious society" and focus on social justice and the issues that most affect people's livelihoods. The specific goals of the plan include ensuring the use of labor contracts, improving labor dispute resolution mechanisms, protecting the legal rights of workers, and more closely supervising the labor market and the implementation of labor laws and regulations.

Rising labor disputes

The stress on building a "harmonious society" and better protecting workers' interests arises from signs that China's social stability is being tested. In early 2006, the PRC Ministry of Public Security announced that more than 87,000 "mass social disturbances" had occurred in 2005, up 6 percent from 2004 and 50 percent from 2003. More than 3.7 million people were involved in such incidents in 2004, but the ministry did not provide a comparable figure for 2005. The rise in the reported number of such disturbances, as well as widespread media reports of some of these incidents, have almost certainly raised concerns among China's policy elites about social unrest in general. The Chinese Academy of Social Sciences revealed in its 2004 *Blue Book of Chinese Society* that more than half of the Chinese experts it interviewed believed that it is "possible" or "very likely" that China would face a "comprehensive social crisis."

Although the PRC government has not provided a rural-urban breakdown of its statistics on social unrest, other official statistics indicate the scope of worker discontent. In particular, the number of reported labor dispute cases has risen considerably in recent years. According to the PRC Ministry of Labor and Social Security (MLSS), roughly 314,000 labor disputes were submitted to government-sanctioned mediation and arbitration committees in 2005 alone (see Table 1). This figure is more than double the number of cases submitted in 2000 and nearly 10 times that of 1995. The number of workers involved in disputes also grew from 467,000 in 2001 to 740,000 in 2005. According to MLSS, employees filed roughly 94 percent of cases in 2005, with the remainder filed by employers. Disputes over wages, benefits, and social insurance accounted for 65 percent of all cases, while 18 percent arose from conflicts over the termination of labor contracts. The remainder stemmed from workplace injury, training, and layoffs. Interestingly, MLSS statistics show that the more economically developed coastal regions of China account for the majority of labor dispute cases. In 2005, 62.4 percent of dispute cases were submitted in Beijing, Guangdong, Jiangsu, Shandong, Shanghai, and Zhejiang. While this may reflect the concentration of businesses along coastal areas, it also shows important pockets of disaffection in the regions that have benefited most from China's economic reforms.

Although the PRC government could take comfort in the fact that more than 90 percent of these cases are ultimately settled through the government-sanctioned dispute resolution process, it has chosen to take a starker view of these statistics. In its 2005 statistical report on labor disputes, MLSS

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Table 1: Labor Dispute Cases in China, 2001–05

Year	Number of cases	Number of workers involved
2001	155,000	467,000
2002	184,000	610,000
2003	226,000	801,000
2004	260,000	765,000
2005	314,000	740,000
% change	**102.6**	**58.5**

Source: PRC Ministry of Labor and Social Security (MLSS)

Table 2: Outcomes of Labor Dispute Cases, 2001–05 (% of cases)

Year	Employer wins	Employee wins	Both partly win
2001	21.0	47.7	31.3
2002	15.1	47.2	37.6
2003	15.3	49.0	35.6
2004	13.8	47.7	36.4
2005	12.9	47.5	39.6

Source: MLSS

interprets the fact that more cases were settled through arbitration rather than mediation as evidence that labor disputes tend to be highly contentious. MLSS has also chosen to interpret the higher success rate of workers in dispute cases as a sign that "infringement of workers' rights continues to be a prominent problem" (see Table 2).

The PRC government's wariness may be justified. According to the Congressional-Executive Commission on China (CECC), workers may face important obstacles in submitting cases through the government-sanctioned dispute resolution process. First, workers do not have union representation during mediation, the initial step in dispute resolution. Second, the cost of submitting a dispute to the next stage of the process—arbitration—can be as high as ¥420 ($52.40), about half the average monthly wage of a Chinese worker. Though this may not be a problem for collective dispute cases, it presents a significant barrier to workers who seek to file individual cases. Finally, if both mediation and arbitration fail to solve the dispute, workers can file a lawsuit in court, but the costs of litigation can be prohibitive. These obstacles may discourage workers from using the dispute resolution process, and the reported number of dispute cases may not indicate the true magnitude of labor frictions.

Beyond statistical evidence that suggests the number of labor dispute cases is rising, there have been press reports of some worker demonstrations turning violent.

- In June 2004, 5,000 Shenzhen workers clashed with police over wage arrears.
- In January 2005, more than 1,000 workers in Shenzhen marched against the loss of severance pay, resulting in blocked roads, traffic jams, and violence.
- In July 2005, 3,000 migrant workers at a garment factory in Guangzhou rioted over inadequate pay.
- In September 2005, more than 100 workers at a shoe factory in Guangzhou battled police and smashed vehicles over unpaid wages.

It is unclear whether these violent incidents are representative of labor demonstrations in China. Indeed, the PRC government has not released statistics on the number and scope of labor-related protests. Nevertheless, these incidents highlight the potential explosiveness of labor discontent and likely heighten the PRC leadership's worries about labor relations in China.

Policy responses

Over the past several years, the PRC government has tried to improve the protection of workers' rights. In particular, the State Council and MLSS have issued directives to clear wage arrears for migrant workers whose previously ambiguous legal status and inadequate access to legal channels made them susceptible to abuse. The problem of unpaid wages for migrant workers may be particularly important because of their large numbers—officially estimated to be 120 million—and because the problem appears to be widespread. According to a State Council survey report released in April 2006, 51 percent of rural migrant workers reported "sometimes" or "frequently" having difficulty getting paid on time, and 76 percent said that they had not received overtime pay owed to them.

Over the past two years, the PRC government has also focused on promoting the use of labor contracts. The existing Labor Law requires labor contracts between employees and employers. But according to a National People's Congress survey in 2005, less than 20 percent of small and medium-sized enterprises use labor contracts, and the State Council survey report indicates that 46 percent of migrant workers lack labor contracts. In May 2005, MLSS issued a circular that directs employers of migrant workers to adopt labor contracts. Earlier this year, it launched a campaign to promote the use of labor contracts in all enterprises, with the goal of ensuring that at least 90 percent of all employees in China have contracts by the end of 2007.

Two responses have caught the attention of foreign investors: the draft Labor Contract Law and the renewed ACFTU campaign to unionize workers in FIEs. Observers have widely noted that many provisions in the draft Labor Contract Law appear to favor workers. For example, the draft law would require employers to seek the permission of the trade union before terminating any labor contract and to negotiate the terms of mass layoffs that involve more than 50 employees. The draft law also indicates that if an employer and an employee disagree over the interpretation of a labor contract, the ambiguity should be resolved in favor of the employee.

Meanwhile, ACFTU has reenergized its efforts to establish trade unions in FIEs, claiming that its campaign is in response to the need to better protect the rights of FIE workers. Some labor experts have noted, however, that as more Chinese are finding employment in private and foreign-invested companies, ACFTU may have undertaken this campaign to boost its membership and revenue. (Enterprises that have trade unions must appropriate a sum equal to 2 percent of their total monthly payroll to the trade union each month.) In 2004, ACFTU announced a campaign to recruit 6.6 million workers every year until 2008. This is presumably translating into a greater effort to establish unions in private firms and FIEs as the state-owned sector shrinks.

Whether these various measures will succeed in better protecting workers' rights is unclear. In general, implementation of national laws and regulations, as well as campaigns initiated from the top, are easily thwarted by local authorities intent on boosting their GDP and thus reluctant to strictly enforce central government directives that may hinder local economic growth (see the *CBR* September–October 2006, p.52). Indeed, as in the area of intellectual property rights and environmental protection, observers have noted that the primary reason for the weak protection of workers' rights is not an inadequate legal framework, but rather the poor enforcement of China's existing labor laws and regulations. CECC notes in its 2006 annual report that "the Chinese government's failure to implement existing labor regulations ... renders most of the protective aspects of Chinese labor law ineffective." For example, even though MLSS regulations require provincial authorities to review their minimum wage levels every two years, MLSS reported that at least four provinces were noncompliant in 2006.

In late 2004, MLSS began to establish a system of labor inspection to ensure local compliance with China's labor laws and regulations. Whether such a system will achieve its intended goal is unclear because it delegates inspection authority to the local labor and social security bureaus—whose mandate, in the first place, is to enforce the laws and regulations.

Foreign investors' concerns

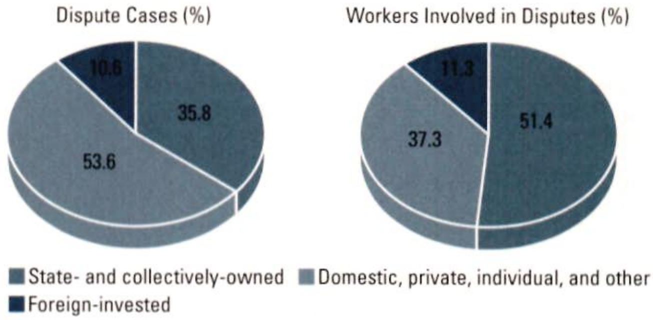
Available statistics suggest that FIEs account for a disproportionately small share of labor dispute cases, given that they provide one-third of China's industrial value-added output and more than half of its exports (see Figure). This may be because US and other foreign investors tend to bring their international human resources practices and environmental health and safety standards, which often exceed local requirements, to their China facilities. Nevertheless, the steps that the PRC government has taken to strengthen labor rights have caught the attention of foreign investors in China. In general, foreign companies and business associations have affirmed the PRC government's goal of protecting workers' rights. The growth of social unrest in China could harm the business climate, and uniform enforcement of labor laws and protection of workers' rights could help level the playing field for all firms operating in China. At the same time, however, foreign companies have also expressed concerns about some aspects of recent government moves.

Foreign companies and business associations have affirmed the PRC government's goal of protecting workers' rights.

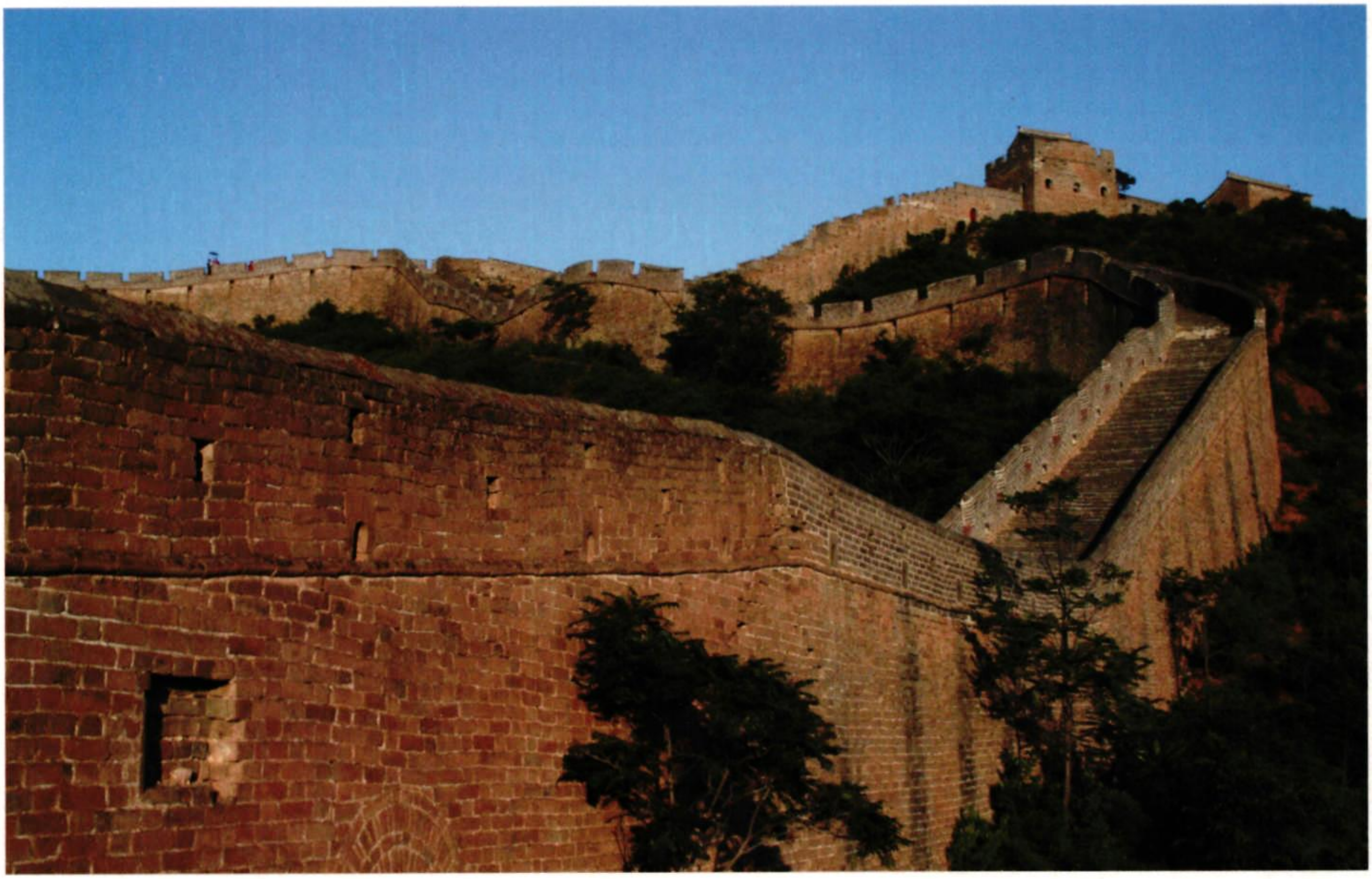
For example, they have noted that certain provisions of the draft Labor Contract Law might conflict with international practices in human resources management and deprive employers and employees of the flexibility necessary to handle employment relationships effectively. The draft law, for instance, requires employers that use a labor service company to sign only one fixed-term contract with the employee. At the end of the contract, the employer must hire the employee directly. If it does not, the employer cannot use a labor service company to hire a different person for the same position. This may prevent employers from finding the best person and may result in fewer job opportunities for Chinese workers. Thus, the law could have the unintended consequence of negatively affecting Chinese workers, and for companies that uphold China's laws and regulations, including US and other foreign firms, the Labor Contract Law, if implemented in its current form, could make operating in China more cumbersome.

As the PRC government finalizes the Labor Contract Law and undertakes other initiatives to address widespread grievances among China's workers, foreign businesses hope that their concerns will be taken into account. In the meantime, better enforcement of existing laws and regulations would go a long way toward removing the difficulties that Chinese employees face in their workplaces. 完

Labor Disputes by Enterprise Type, 2003



Source: MLSS



Signs of More Protectionist Times?

If economic nationalism gains strength in China, foreign companies may have to make a greater effort to succeed there

Jan Borgonjon and James A. C. Sinclair

When China's economic reform era began in 1979, the PRC government recognized that China needed foreign direct investment (FDI) to modernize its economy and to bring in adequate capital, technology, and management expertise. Since then, the country has become relatively open to FDI compared to many of its Asian neighbors, including Japan and India. For the first time, China was the world's leading recipient of FDI in 2003, and it has remained a top recipient ever since. According to the PRC Ministry of Commerce (MOFCOM), aggregate FDI in China reached $270 billion in 2005. The number of foreign-invested enterprises (FIEs) in China reached 280,000 by the end of last year, accounting for more than half of the country's exports and nearly one-third of its industrial value-added output.

In part to spark more foreign investment, China entered the World Trade Organization (WTO) in 2001 and offered significant concessions on import tariffs and market access. In some sectors, such as financial services, China's concessions went so far that, if ever fully implemented, PRC officials and companies thought that domestic companies might be unable to cope.

In recent years, however, some Chinese companies, officials, and academics have begun to question the role and utility of FDI in China, and calls for the development of strong domestic industries have grown louder. If economic nationalism—the protection of domestic economic interests—gains strength, it will likely affect the operations and expansion of foreign companies in China.

Economic nationalism is not a new concept in modern Chinese politics. Its most extreme manifestations occurred during China's Great Leap Forward, launched in 1957 to ramp up production of key industrial and agricultural products in an effort to overtake Great Britain and the United States in terms of output. The concept has gained strength again in the last few years, albeit in a more moderate form, and can be seen in the following examples.

Efforts to strengthen domestic companies

In the first few months of 2006, the PRC government issued several policy documents—including China's 11th Five-Year Plan (2006–10) and the National Guidelines on Medium- and Long-Term Program for Science and Technology Development (2006–20)—that called for the development of strong Chinese enterprises, technology, and brands and emphasized the need for China to reduce its dependence on foreign technology. Though the documents contain only general information, making their implications for foreign companies unclear, they clearly reflect the belief among PRC policymakers that China must create standards that will be adopted internationally and develop homegrown innovations if it is to become a serious competitor in the global market. Toward this end, China aims to use policy to promote domestic technology companies. Though foreign companies might benefit from some of these measures (particularly those meant to deepen China's pool of science and technology talent and enhance intellectual property rights protection), possible moves by the PRC government in this area in the form of exclusionary government procurement policies, tax policies, or other financial support may undermine healthy competition and the principle of national treatment.

Support for reduced foreign participation in the economy and the development of domestic industries is already affecting certain sectors. For example, the 2004 Automotive Industry Development Policy has strengthened the protection of China's domestic auto industry (see p.48). The same is true of the 2005 Steel Industry Development Policy, which prohibits foreign majority stakes in the sector. And although regulators have not issued a formal policy in the chemical sector, foreign investors have found it increasingly difficult to negotiate majority stakes in large or "strategic" projects.

In the field of standards, China has already taken steps to support domestic industries and technologies. For example, China has introduced its own compulsory product certification system (China Compulsory Certification) and is developing a homegrown third-generation communications standard—time division synchronous code division multiple access (TD-SCDMA). The country also maintains many standards that remain relatively relaxed. For instance, some standards permit higher toxicity levels in certain chemical products than are allowed in many other countries. This is because, according to discussions between the authors and officials involved in standards drafting, tightening these standards would create technical barriers that would push many domestic companies out of their markets and leave foreign companies dominant.

Fear of foreign monopolies

Domestic complaints are growing in sectors in which foreign companies—such as Eastman Kodak Co. in consumer photography, Tetra Pak International SA in food packaging, and Cisco Systems, Inc. in Internet networking equipment—already dominate their markets. The draft PRC Antimonopoly Law (AML), which was approved by the State Council in June and, as the *CBR* went to press, was still being reviewed by the Standing Committee of the National People's Congress, would make such dominance more difficult. The law would subject large acquisitions that could lead to market monopolies to the approval of the AML Enforcement Authority and prohibit market leaders from using their dominance to limit competition.

Because multinational corporations (MNCs) are generally large by nature, they are more likely to find themselves subject to antitrust investigations than small and medium-sized enterprises. And because most MNCs in China are foreign-invested, the AML may affect foreign companies more than Chinese companies. This is especially worrisome because the draft does not clearly define key terms such as "dominance," "market share," and "unfair prices," thus allowing officials considerable room to interpret the law.

Also, of direct relevance to foreign investors, the Regulations on the Acquisition of Domestic Enterprises by Foreign Investors, which took effect in September 2006 and will be incorporated into the AML, provide antitrust grounds, among other grounds such as economic security and the protection of traditional Chinese brands, that could be used to restrict foreign ownership and operations.

Encouraging tech transfer and domestic R&D

Some PRC officials and companies have expressed concern that the transfer of technology from foreign to domestic companies is falling short of expectations. They believe that foreign companies choose not to transfer their latest and most advanced technology to Chinese firms, that transferred technology comes at too high a price, and that such technology is not fully assimilated.

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In July 2006, MOFCOM and several other agencies jointly issued an opinion that promotes tech transfers from foreign to domestic companies. Of note, the opinion encourages MNCs to set up research and development (R&D) centers in China, to cooperate with Chinese parties on R&D projects, and to put the results of these R&D projects into production within China.

Meanwhile, there is a growing belief within the PRC government that Chinese companies and research institutes must become more innovative if the country is to sustain growth. China's national guidelines for science and technology development call for a reduction in China's dependence on imported technology from the current level of 54 percent to 30 percent or less by 2020. (Developed countries average 10 percent, according to the Chinese Academy of Sciences.)

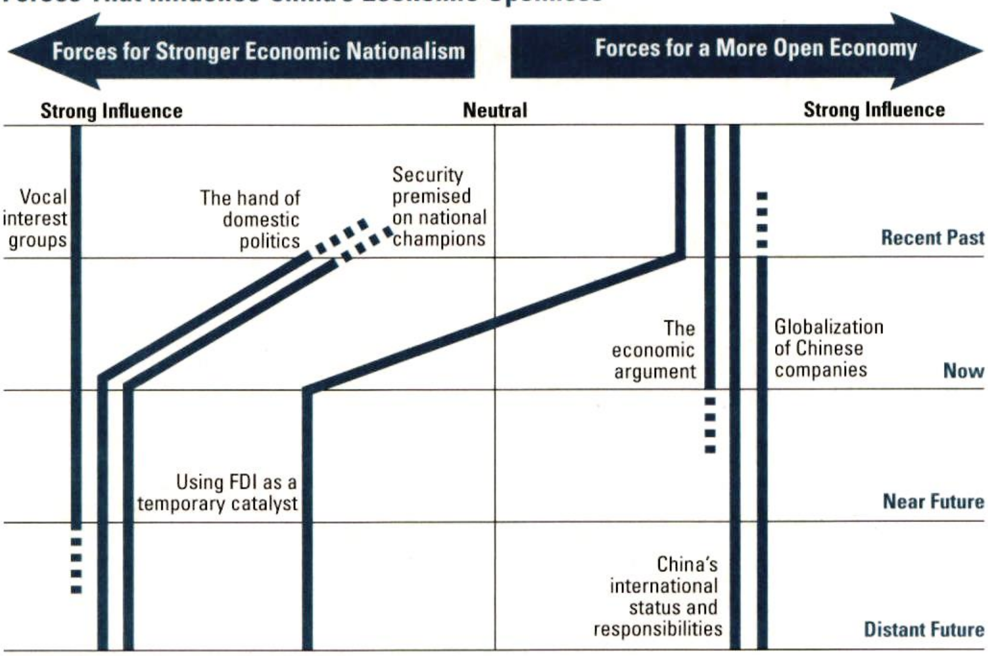
Building up domestic brands

Many Chinese would like to see Chinese companies strong enough not only to hold their own in the domestic market, but to compete internationally. Though Chinese companies—such as Haier Electronics Group Co., Ltd. and Lenovo Group Ltd.—are gaining brand recognition abroad, their brands are not always well known in overseas markets. The current impetus behind building Chinese brands was demonstrated by Lenovo's rebranding strategy following its acquisition of IBM Corp.'s personal computer unit in May 2005, an acquisition that was strongly encouraged and supported by the PRC government. Although Lenovo has the rights to the IBM brand name for five years, Lenovo was keen to rebrand IBM products and eliminate any perceived connection or influence. Lenovo first changed the brand name to "IBM ThinkPad by Lenovo" and soon after changed it to "Lenovo ThinkPad." Dropping the IBM brand name may have been premature, since Lenovo is little known outside China, and even Lenovo retail outlets inside China reference the IBM brand name to attract customers.

Government procurement

In some cases, the PRC government uses the government market to support domestic industries and technologies, for example in the case of China's wireless local area networks (WLAN) encryption technology. In 2003, the PRC government announced a regulation that required all WLAN equipment sold in China to comply with its homegrown standard—WLAN Authentication and Privacy Infrastructure (WAPI). The following year, in response to international concerns about hampering global trade, the PRC government suspended the regulation indefinitely. In December 2005, however, China proposed a government procurement policy that gives "preference" to equipment using WAPI technology. The International Standards Organization (ISO) rejected WAPI as an international standard in March 2006 in favor of the Institute of Electrical and Electronics Engineers' 802.11i standard (designed largely by Intel Corp.), which prompted China to file an appeal with the ISO in April. China still gives preference to WAPI-compliant products for government procurement, though the effect so far appears limited. Early last spring, the PRC government also announced plans to draw up a procurement catalogue that would provide discounts for products with domestic technology and preference to domestic products in general.

Forces That Influence China's Economic Openness



Note: FDI = Foreign direct investment
Source: InterChina Consulting

Forces for stronger economic nationalism

Some of China's economic planners and large state-owned enterprises (SOEs) have generally regarded foreign participation in China's economy as a catalyst for the country's development. They consider foreign participation more economical and expeditious than self-development but want such participation only as long as it is necessary and beneficial. In their view, tightening of the Open Door policy has always been just a matter of time, despite China's economic circumstances being quite different now from when the policy was originally conceived.

Among the strongest drivers behind reducing foreign participation in China's economy are

Chinese companies themselves, particularly SOEs and their government backers, as well as privately owned companies that have aligned their interests with those of government officials. These groups are feeling increasingly embattled by foreign companies in China, and they seek less competition and less pressure for good corporate governance—including transparency and accountability.

Domestic politics also plays a role. Many Chinese have increasingly focused nationalistic sentiment on the economy instead of on more delicate issues such as relations with Taiwan or Japan. China's emergence as a global economic power has given much of the country—at all levels of society—a strong sense of confidence. In some ways, it is politically beneficial for the PRC government to align with this nationalistic sentiment toward the economy and politically difficult to resist or even disregard it.

Finally, many PRC government and military officials have noted that economic rivalry is a proxy for security rivalry. Holders of this view do not expect foreign companies to transfer their latest and most advanced technology to China, since, these officials believe, foreign companies must wish to advance their own countries. In this light, many PRC officials do not accept the argument—often voiced by MNCs in China—that MNCs' huge operations, thousands of employees, and tax payments in China make them effectively Chinese.

Many of these officials are pushing for China to develop its own financially and technologically strong "national champions." Not only are these national champions expected to enhance China's global competitiveness, but they are expected to remain more loyal to the domestic economy in times of crisis than their MNC counterparts. The current drive for consolidation in sectors such as steel, cement, and coal could produce just such national champions.

Meanwhile, FDI in China's strategic industries—such as telecom, energy, and steel—remains extremely sensitive, as any level of foreign control in these industries would be regarded as a threat to China's sovereignty and security. Should the PRC government ever feel isolated or threatened, observers can expect to see national security exerting a strong, albeit not necessarily enduring, influence on economic policy.

Forces for a more open economy

The main counterforce to the reemergence of economic nationalism is external: China's current generation of leadership is sensitive about China's international status. Because the international community is expecting China—as a major economic power—to become an increasingly responsible global player, a shift toward greater protectionism would be challenged by the international community and would undermine China's standing in the world.

Moreover, as Chinese companies globalize, they need access to international markets. Outbound Chinese direct investment is already sizeable, reaching about $15–20 billion in 2005 (including investments by Chinese subsidiaries listed in Hong Kong), according to InterChina estimates, and continues to grow rapidly. Many factors are driving Chinese companies to invest overseas, including the acquisition of raw materials, technology, and brands, as well as access to new customers. Protectionist measures in China could easily provoke countermeasures by other countries and thus reduce Chinese companies' access to international markets. PRC analysts recognize that an overly protectionist policy that reduced FDI in China, or even spurred divestment from China, would likely reduce the competitiveness of certain sectors and increase unemployment. For instance, though Chinese machine tool builders object to the higher cost of foreign control systems, China needs imported control systems to develop its manufacturing industry.

Increased protectionism could also reduce the availability of consumer products and choices. Protectionist policies that lower the standard of living of China's emerging middle class could trigger political backlash.

> Many Chinese would like to see Chinese companies strong enough not only to hold their own in the domestic market, but to compete internationally.

Consequences for foreign companies

After 27 years of the Open Door policy, China has an excess of capital, and many domestic companies believe that they have sufficient management experience to succeed without foreign partners. Though Chinese companies are still playing technology catch-up with their foreign counterparts, the government has now prioritized domestic R&D over technology transfer from foreign companies. As a result, the belief that FDI has served its purpose as a catalyst is gaining momentum in China. This belief is being bolstered by Chinese companies that face strong foreign competition in their home markets, the opinion in political and military circles that China needs to build national champions as a matter of national security, and the increasingly widespread, nationalistic call for more independent domestic industries. For the next five to ten years, the forces that favor economic nationalism are likely to remain strong.

During this period, foreign companies will probably experience greater difficulty investing in large, visible projects in certain strategic sectors—such as the auto, steel, energy, financial services, telecom, and information technology sectors—where barriers to access are already being erected. Moreover, the overall investment environment may change, and investors may see a tightening of regulations and the promulgation of standards that favor or protect Chinese companies. For the foreseeable future, it is quite possible that China's door will not remain as open as before. Foreign companies will have to become more active and creative to obtain the warm welcome they used to receive more readily.

Foreign companies should take these changing attitudes into account when managing their image, relations, and lobbying in China. First, based on their specific circumstances and objectives, FIEs should determine the profile or image they wish to project. Many foreign companies will wish to maintain a low profile in which they refrain from making aggressive statements, such as claims of large market share and announcements of plans to make large or multiple acquisitions or increase market share significantly. Second, in addition to government relations, foreign companies must become more sophisticated when handling public and media relations, since the economic and political environment in China may become even more complex.

Forces for and against economic nationalism will surge and ebb over the next few years, and both will play a role in policymaking. Of course, some factors will have more influence than others depending on the specific issue, wider context, and exact timing. The economic benefit of the Open Door policy has been so great, however, that China is hardly likely to reverse it fully. Thus, despite the recent rise of economic nationalism, China is unlikely to significantly restrict overall market access for foreign companies or express strong antiforeign investment sentiment. 完

Case Study: China's Auto Industry

Prior to China's World Trade Organization (WTO) entry, PRC auto policy mandated a maximum 50-50 equity share split between foreign and Chinese partners. Many foreign automakers saw this as a temporary restriction that would eventually be lifted, given the global trends toward industry consolidation. Indeed, China's WTO commitments seemed to open the auto sector further to foreign investors, although the 50-50 equity share rule for car production remained (it was lifted only for engine manufacturing joint ventures).

Even with equity share limits, China's auto industry has been characterized by the strong presence of foreign automakers. Until 2002–03, Chinese automakers that had partnered with foreign companies over the last two decades had limited independent capacity and showed little intent to develop their own brands or technology.

The situation changed dramatically in 2003–04, however. First, the 2002–03 market boom—in which cars were selling rapidly at very high margins—provided huge cash inflows for Chinese partners to reinvest in brand and product development. Second, a few homegrown competitors, in particular Chery Automobile Co., Ltd. and Geely Group, achieved good reputations domestically after developing cheap, reliable models that were well suited to the emerging, and ultimately sizeable, low-end market. In part because of the perceived reluctance of foreign automakers to transfer state-of-the-art technology to China, Chinese automakers launched a successful political campaign to win support for the development of a domestic car industry. The campaign coincided with the growing awareness in political and economic circles that China should generally augment its strengths in manufacturing with technology and brand development.

For China, the 50-50 equity share restriction has sheltered Chinese automakers from foreign competition while allowing them to gain technology and experience from foreign automakers—until the Chinese automakers were ready to take over the reins themselves. The 2004 Automotive Industry Development Policy reiterates the 50-50 equity rule and further restricts foreign automakers' access to the Chinese market by, for example, limiting the number of ventures they may establish and forcing the localization of component production. The policy is supported by the 11th Five-Year Plan (2006–10), which provides a wider development framework for nationalistic economic measures. For example, Chapter 11 of the plan, which focuses on China's manufacturing industry, stresses the importance of strengthening independent innovation in the auto industry; developing auto engines, auto electronics, key assemblies, and main components with domestic intellectual property; raising the market share of domestic-brand passenger vehicles; and encouraging mergers and acquisitions among domestic companies to establish giant enterprises with capacities of more than 1 million vehicles. During the March 2006 session of the National People's Congress, many strong voices called for the development and protection of a Chinese auto industry.

As the end of 2006 nears, it is clear that the whole Chinese auto industry, including the established state-owned automakers, regards the development of independent brands and technologies as its key strategic objective. This has even led Chinese automakers to acquire automotive technology overseas, such as Shanghai Auto Industry Group's acquisition of Ssangyong Motor Co. and Nanjing Automobile Group's acquisition of MG Rover Group Ltd. Foreign carmakers now find themselves in a rather difficult position—having to work with a Chinese partner that is a potential, or actual, competitor without the possibility of establishing their own fully controlled ventures in China.

—Jan Borgonjon and James A. C. Sinclair

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Sales and Investment

July 16–September 15, 2006

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor.

Compiled by Andrew Bagnell

Advertising, Marketing & Public Relations

INVESTMENTS IN CHINA

AGA Resources Inc. (Canada)/ Beijing New-Element Co., Ltd.
Will form marketing promotion joint venture in Beijing. (Canada:51%-China:49%). $187,500. 09/06.

Agriculture

INVESTMENTS IN CHINA

Asahi Breweries, Ltd., ITOCHU Corp., Sumitomo Chemical Co., Ltd. (Japan)
Established agricultural production and business WFOE in Shandong. 09/06.

Automotive

CHINA'S EXPORTS

Shandong Jindalu Vehicle Co., Ltd.
Will provide 500 XEBRA electric vehicles to US-based Zero Air Pollution. 08/06.

CHINA'S IMPORTS

Bayerische Motoren Werke AG (Germany)
Will sell its Rover brand to Shanghai Automotive Industry Corp. $21 million. 08/06.

UQM Technologies, Inc. (US)
Will supply permanent magnetic propulsion motors and generators to Shenzhen-based Chitron Electronics, Inc. for use in the development of hybrid electric buses. 08/06.

CHINA'S INVESTMENTS ABROAD

Iran Khodro Industrial Group/Chery Automobile Co., Ltd. (Anhui)
Signed agreement to produce Chery-brand automobiles in Iran. 09/06.

INVESTMENTS IN CHINA

Iran Khodro Industrial Group/Youngman Automobile Group Co., Ltd. (Zhejiang)
Will form joint venture in Shandong to produce Samand-brand automobiles. (Iran:30%-China:70%). 09/06.

Autoliv, Inc. (Sweden)
Raised its stake in Nanjing Honggouang-Autoliv Safety Systems Co., Ltd. from 50% to 70%. 07/06.

Bayerische Motoren Werke AG (Germany)
Established WFOE, BMW (China) Automotive Trading Co., Ltd., to sell imported BMW- and Mini-brand vehicles. 07/06.

Fiat SpA (Italy)/Chongqing Heavy Vehicle Group, Shanghai Automotive Industry Corp.
Will form joint venture, SAIC Iveco Commercial Vehicle Investment Co. Ltd., to manufacture heavy-duty trucks and diesel engines. $152 million. 07/06.

Westport Innovations Inc. (Canada)/Beijing Tianhai Industry Co. Ltd.
Will form joint venture, BTIC Westport Inc., in Beijing to manufacture liquefied natural gas fuel tanks for vehicles. (Canada:50%-China:50%). $800,000. 07/06.

Aviation/Aerospace

CHINA'S EXPORTS

Xi'an Aircraft Co. (Shaanxi)
Delivered two Xinzhou-60 aircraft to Laos and the Republic of Congo. 07/06.

CHINA'S IMPORTS

Rolls-Royce Group plc (UK)
Will provide and maintain Trent 1000 engines for Air China Ltd. $800 million. 09/06.

General Electric Co. (US)
Will supply engines for 10 China Southern Airlines Co., Ltd. planes. $240 million. 08/06.

Rolls-Royce Group plc (UK)
Will maintain and supply Trent 700 engines for Hainan Airlines Group Co., Ltd. $250 million. 07/06.

Banking & Finance

CHINA'S IMPORTS

Lipman China, a subsidiary of Lipman Electronic Engineering Ltd. (Israel)
Will provide 20,000 point-of-sales units to China UnionPay Co., Ltd. 08/06.

NCR Corp. (US)
Will sell more than 1,000 ATMs to CCB. 07/06.

CHINA'S INVESTMENTS ABROAD

CCB (Beijing)
Will purchase Hong Kong-based Bank of America (Asia) Ltd., a subsidiary of Bank of America Corp. $1.24 billion. 08/06.

INVESTMENTS IN CHINA

Axa Investment Managers (France)/Shanghai Dragon Investment Co., Ltd., Shanghai Pudong Development Bank Co., Ltd.
Signed MOU to establish an asset management joint venture. 08/06.

Moody's Corp. (US)
Received MOFCOM approval to acquire a 49% stake in China Chengxin International Credit Rating Co., Ltd. 08/06.

Royal Bank of Canada/China Minsheng Banking Corp. Ltd. Beijing), China Three Gorges Project Corp. (Hubei)
Will form fund management joint venture. (Canada:30%-China:70%). 08/06.

ICAP plc (UK)/China Foreign Exchange Trade System & National Interbank Funding Center (Shanghai)
Won CBRC approval to form joint venture, Shanghai CFETS-ICAP International Money Broking Co., Ltd., to provide voice broking services for the money, bond, and derivatives markets. 07/06.

OTHER

Citibank China, a unit of Citigroup, Inc. (US)
Received CBRC approval to provide qualified domestic institutional investors services. 08/06.

Tokyo Stock Exchange, Inc. (Japan)/Shenzhen Stock Exchange (Guangdong)
Reached an agreement to study cooperation in product development and information technologies. 08/06.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Amerityre Corp. (US)
Provided manufacturing license to Qingdao Qizhou Rubber Co., Ltd. to produce polyurethane elastomer retreads. $400,000. 08/06.

INVESTMENTS IN CHINA

Velsicol Chemical Corp. (US)/Wuhan Youji Industries Co., Ltd. (Hubei)
Will form joint venture to produce plasticizers and benzoate esters in Hubei. 09/06.

Akzo Nobel NV (the Netherlands)/Feixiang Chemicals Co. Ltd. (Jiangsu)
Formed surfactants joint venture in Jiangsu. (the Netherlands: 50%-China:50%). 08/06.

BASF AG (Germany), Huntsman Corp. (US)/Shanghai Chlor-Alkali Chemical Co., Ltd., Shanghai Hua Yi Group Co., Sinopec Shanghai Gao Qiao Petrochemical Corp.
Launched facility in Shanghai to produce diphenylmethane diisocyanate and other chemicals. $1 billion. 08/06.

The Dow Chemical Co. (US)
Will purchase the remaining 50% stake in SAL Petrochemical (Zhangjiagang) Co. from joint venture partner Asahi Kasei Corp. 08/06.

Dow Corning (Zhangjiagang) Co., Ltd., a joint venture between Dow Corning Corp. (US) and Wacker Chemie AG (Germany)
Will construct a siloxanes production facility in Jiangsu. $600 million 08/06.

Solvay SA (Belgium)/Zhejiang Lantian Environmental Protection Hi-Tech Co., Ltd.
Will form joint venture, Zhejiang Lansol Fluorchem Co., Ltd., to produce and supply hydrogen fluoride. (Belgium:30%-China:70%). $60 million 08/06.

BASF AG (Germany)/Sinopec (Beijing)
Will expand their joint Jiangsu-based chemical project, BASF-YPC Co. Ltd. $500 million. 07/06.

Hon Hai Group (Taiwan), Sinar Mas Group (Indonesia)/Shanxi Lanhua Coal Industry Group Co., Ltd.
Will form joint venture in Shanxi to produce methanol and other petrochemical products. $1.8 billion. 07/06.

L'Air Liquide SA (France)/Tianjin Soda Plant, a subsidiary of Tianjin Bohai Chemical Industry Group
Will form joint venture to build a gas separation plant to provide oxygen, nitrogen, and argon in Tianjin. $103.1 million. (France: 55%-China:45%). 07/06.

Titan Petrochemicals Group Ltd. (Hong Kong)
Will purchase the remaining 62% stake in its onshore oil and petrochemical storage facility in Fujian from Sky Sharp Investments Ltd. and Quanzhou City Quangang You Lian Investment Co., Ltd. $28.5 million. 07/06.

Distribution, Logistics & Related Services

INVESTMENTS IN CHINA

Toyota Tsusho Corp. (Japan)/Changchun Lujie Logistics Co., a subsidiary of China FAW Group Corp. (Jilin)
Will form joint venture, Toyota Lujie Logistics (Shanghai) Co., to distribute Toyota-brand vehicles in Eastern China. 09/06.

Yang Ming Marine Transport Corp. (Taiwan)
Will establish logistics WFOE Ming-Jiang (Shanghai) International Logistics. 09/06.

American Oriental Bioengineering, Inc. (US)
Acquired Heilongjiang Qitai Pharmaceutical Ltd., a distributor of pharmaceutical products in China. $4 million. 07/06.

The Tosoh Corp. (Japan)
Established Tosoh Logistics Warehouse Co., Ltd. in Guangzhou through its WFOE Tosoh Logistics Corp., Inc. 07/06.

OTHER

Alereon, Inc. (US), RTI Industries Co., Ltd. (Hong Kong)
Signed agreement under which RTI will distribute Alereon's ultrawide band technology solutions in China. 08/06.

Compound Solutions, Inc. (US)/Hangzhou Zhongmei Huadong Pharmaceutical Co., Ltd. (Zhejiang)
Signed agreement under which Compound Solutions will distribute the antioxidant CoQ10 in North America and Europe for Zhongmei Huadong. 08/06.

Grupo Modelo, SA de CV (Mexico)/Tsingtao Brewing Co., Ltd. (Shandong)
Signed an agreement under which Grupo Modelo will be the exclusive distributor of Tsingtao beer in Mexico. 08/06.

DHL Worldwide Network SA/NV (Belgium)/Shanghai Airport Authority
Signed MOU to explore the feasibility of building a DHL North Asia hub in Shanghai. 07/06.

Education

INVESTMENTS IN CHINA

Ma Foi Management Consultants Ltd. (India)
Will open its education skills and training arm, the Ma Foi Academy, in Shanghai. 08/06.

Electronics, Hardware & Software

CHINA'S EXPORTS

Lenovo Group Ltd. (Beijing)
Will provide maintenance and warranty services for IBM Global Services (China) Co., Ltd., a subsidiary of IBM Corp. $28.8 million. 07/06.

CHINA'S IMPORTS

Optibase Ltd. (Israel)
Will provide advanced video technologies to Henan-based Zhengzhou VCOM Electronic Technology Co., Ltd. and China Netcom. 09/06.

Virtek Vision International, Inc. (Canada)
Will supply laser marking systems to an unnamed Chinese manufacturer. $1.7 million. 08/06.

INVESTMENTS IN CHINA

Barco NV (Belgium)
Will purchase remaining 20% stake in its joint venture, Beijing Barco Leyard Electric Technology Co., Ltd. 09/06.

Fuji Photo Film Co., Ltd. (Japan)/SVA Electron Co., Ltd. (Shanghai)
Will form joint venture, SVA-Fujifilm Opto-Electronic Materials Co., Ltd., to manufacture color filters. (Japan:25%-China:75%). $100 million. 08/06.

Shinwa Co., Ltd. (Japan)
Completed a strategic software merger with Shandong-based Langchao Group. 07/06.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquified natural gas; MII: Ministry of Information Industry; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State-owned Assets Supervision and Administration Commission; SEZ: special economic zone; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

Tata Consultancy Services Ltd. (India)/Beijing Zhongguancun Software Park Development Co., Ltd., Tianjin Huayuan Software Area Construction and Development Co., Ltd., Uniware Co., Ltd. (Beijing)
Will form joint venture, Tata Consultancy Services (China) Co. (India:72.22%-China:27.78%). $12.6 million. 07/06.

OTHER

Qualcomm Inc. (US)/Semiconductor Manufacturing International Corp. (Shanghai)
Signed a turnkey chip manufacturing and testing agreement. 07/06.

SVOX AG (Switzerland)/Beijing Infoquick Sinovoice Speech Technology Corp.
Will form partnership to provide speech embedded software for business travelers. 07/06.

Energy & Electric Power

CHINA'S IMPORTS

Gamesa Wind (Tianjin) Co., Ltd., a subsidiary of Gamesa Corporación Tecnológica SA (Spain)
Will supply 601 wind turbines to Longyuan Electric Power Group Corp. $308 million. 09/06.

INVESTMENTS IN CHINA

Honiton Energy Ltd. (UK), REpower Systems AG (Germany)/North Heavy Industries Group Corp. (Inner Mongolia)
Will form wind power joint venture in Baotou, Inner Mongolia. (Germany:50.01%-UK:16.65%-China:33.34%). 09/06.

Electric Power Development Co., Ltd. (Japan)/Science City Development Public Co., Ltd. (Guangdong), Shanxi International Electricity Group Co., Ltd.
Will form joint venture to develop wind power projects in Shanxi. (Japan:30%-China:70%). $217 million. 08/06.

OTHER

Keppel Integrated Engineering, a unit of Keppel Corp. Ltd. (Singapore)/China National Environmental Protection Corp. (Beijing)
Signed MOU on a strategic partnership in the biomass and sludge treatment market in China. 09/06.

Environmental Equipment & Technology

INVESTMENTS IN CHINA

United Envirotech Ltd. (Singapore)/Guangzhou Ling Hai Sui Wu Co., Ltd. (Guangdong)
Will form joint venture, Guangzhou Linhai Envirotech Co., Ltd., to manage industrial wastewater in Nansha Development Zone. (Singapore:40%-China:60%). $3.5 million. 08/06.

Food & Food Processing

INVESTMENTS IN CHINA

Cargill, Inc. (US)
Acquired the remaining stake in its xanthan gum joint venture, Zibo Cargill Huanghelong Bioengineering, from its partner, Shandong Huanghelong Group. 08/06.

China Resources Snow Breweries, a joint venture of China Resources Enterprise, Ltd. (Hong Kong) and SABMiller plc (UK)
Purchased Zhejiang Yinyan Brewing Co. and Anhui Huabei Xiangwang Brewery. $60.3 million. 07/06.

Forestry, Timber & Paper

CHINA'S IMPORTS

Metso Corp. (Finland)
Won contract to rebuild a newsprint machine for Guangzhou Paper Co., Ltd. $19.2 million. 08/06.

Infrastructure

CHINA'S EXPORTS

China Roads and Bridges Corp. (Beijing)
Will construct a road for the Gashena-Weldiya road construction project in Northern Ethiopia for the Ethiopian Roads Authority. $44.5 million. 07/06.

INVESTMENTS IN CHINA

Salcon Zhejiang (HK) Ltd., a subsidiary of Salcon Bhd (Malaysia)/Haining Water Investment Ltd. Group (Zhejiang)
Will form joint venture to produce and sell treated water to Haining City, Zhejiang. $11.25 million. (Malaysia:60%-China:40%). 09/06.

China Water Affairs Group Ltd. (Hong Kong)/Zhoukou City People's Government (Henan)
Will form joint venture to engage in the water supply and sewage businesses in Zhoukou, Henan. (Hong Kong:60%-China:40%). $6.3 million. 07/06.

Insurance

OTHER

Aviva-COFCO Life Insurance Co., Ltd., a joint venture between Aviva plc (UK) and COFCO (Beijing)
Received license to operate in Changsha, Hunan. 07/06.

CITIC Prudential, a joint venture between Prudential plc (UK) and CITIC Group (Beijing)
Received license to operate in Hangzhou, Zhejiang. 07/06.

Internet/E-Commerce

CHINA'S IMPORTS

BilltoBill Ltd., a subsidiary of Oriel Communications Ltd. (Australia)
Will provide online payment services to Guilin Brilliant Pearl Comfort International Travel Service Co., Ltd. 08/06.

INVESTMENTS IN CHINA

CDC Corp. (Hong Kong)
Will purchase mobile services provider Beijing Timeheart Information Technology Ltd. $24.5 million. 08/06.

Telstra Corp. Ltd. (Australia)
Acquired a 51% stake in SouFun.com Ltd. $190 million. 08/06.

OTHER

Tribal Internet Marketing BV (the Netherlands)
Will collaborate with Baidu.com, Inc. to provide marketing support in China. 08/06.

Electronic Arts Inc. (US)
Licensed its first online video game for distribution in China through its partner, Guangdong Tian Yue Network Technology Development Co., Ltd. 07/06.

Light Industry/Manufacturing

INVESTMENTS IN CHINA

Groupe SEB (France)
Will acquire majority stake in Zhejiang Supor Cookware Co., Ltd. 08/06.

Machinery & Machine Tools

OTHER

Salim Group (Indonesia)/China National Machinery Industry Corp. (Beijing)
Signed a memorandum of strategic cooperation in project contracting, consultation, examination, and design. 09/06.

Media, Publishing & Entertainment

CHINA'S IMPORTS

Newspaper Direct Inc. (Canada)
Provided rights to Beijing Founder Easiprint Co., Ltd. to print and distribute foreign newspapers in China. 08/06.

INVESTMENTS IN CHINA

Media Contacts, a unit of Havas (France)/Allyes Information Technology Co., Ltd. (Shanghai)
Will partner in China and operate under the Media Contacts' China branch. 07/06.

Medical Equipment & Devices

OTHER

PerkinElmer Inc. (US)/PRC Ministry of Health
Entered an agreement under which PerkinElmer will help expand neonatal screening for genetic diseases in seven provinces. 07/06.

Metals, Minerals & Mining

CHINA'S IMPORTS

Aztec Resources Ltd. (Australia)
Signed long-term iron ore supply contract with CITIC Australia Commodity Trading Pty Ltd., a subsidiary of CITIC. 08/06.

Centrex Metals Ltd. (Australia)
Will supply 1 million tons of hematite ore annually for five years to Baotou Iron & Steel (Group) Co., Ltd. 07/06.

Centrex Metals Ltd. (Australia)
Will supply 1 million tons of hematite ore annually for five years to Shenyang Orient Iron and Steel Group. 07/06.

Fortescue Metals Group Ltd. (Australia)
Will supply 3 million tons of iron ore annually for 10 years to three unnamed Chinese companies. 07/06.

CHINA'S INVESTMENTS ABROAD

Hunan Nonferrous Metals Corp. Ltd.
Purchased a 9.8% stake in Compass Resources NL of Australia. $22.9 million. 08/06.

INVESTMENTS IN CHINA

Gindalbie Metals Ltd. (Australia)/Anshan Iron and Steel Group (Liaoning)
Will build iron pellet plant in China as part of the Karara iron ore project. $180 million. 09/06.

Midas Holdings Ltd. (Singapore)/Jinchuan Group Ltd. (Gansu), Heilongjiang Province Investment General Corp., Harbin Investment Group Corp., SASAC Harbin branch (Heilongjiang)
Will form joint venture, China Northeast Light Alloy Co., to manufacture aluminum and magnesium alloy products. (Singapore:30%-China:70%). $127 million. 09/06.

Sino Gold Ltd. (Australia)
Will form joint venture, North Mountain Joint Venture, with unnamed Chinese company to mine gold and copper in Xinjiang. 09/06.

Lone Star Technologies Inc. (US)
Will purchase a 40% stake in Hengyang Valin MPM Steel Tube Co., Ltd., a unit of Hunan Valin Tube and Wire Co., Ltd. $132 million. 08/06.

Matsubishi Metal Industry Co., Metal One Corp., Miyazaki Seiko Co., Ltd., Nippon Steel Corp., Nippon Steel Trading Co., Ltd., Sanyu Co., Ltd., Toyota Tsusho Corp. (Japan)
Will establish a cold press steel wire manufacturing and sales WFOE, Nippon Steel Bar and CH Wire (China) Co., Ltd., in Jiangsu. $1.4 million. 08/06.

McVicar Resources Inc. (Canada)
Acquired a 51% stake in the Dahemian Gold Property in Henan from Xingang Yitong Mining Corp. 08/06.

OTHER

Glencore International AG (Switzerland)/Qitongxia Aluminium Group Co. (Ningxia)
Signed MOU to determine the amount and price of shares for a Glencore stake in Qitongxia. 08/06.

Packaging & Labeling

INVESTMENTS IN CHINA

Fung Choi Printing Ltd., a unit of Fung Choi Media Group Ltd. (Singapore)/Haier Group Co. (Shandong)
Will form joint venture, Yantai Haier Packaging Co., Ltd., to research, develop, and produce cardboard boxes and other packaging materials. (Singapore:45%-China:55%). $1.3 million. 07/06.

Petroleum, Natural Gas & Related Equipment

CHINA'S EXPORTS

Sinopec (Beijing)
Won contract to upgrade the Shazand Refinery in Iran. $2.8 billion. 08/06.

Sinopec (Beijing)
Won contract to supply natural gas to Macao for 15 years. 07/06.

CHINA' IMPORTS

EurOrient Financial Group (US)
Won contract from the Rizhao Municipal Government to design, construct, finance, operate, market, and maintain a natural gas receiving terminal in Rizhao, Shandong. $965 million. 09/06.

CHINA'S INVESTMENTS ABROAD

Korea National Oil Corp. (South Korea), OAO Lukoil (Russia), Petroliam Nasional Bhd (Malaysia), Uzbekneftegaz State Holding Co. (Uzbekistan)/CNPC (Beijing)
Signed production sharing agreements to explore and develop potential natural gas deposits in the Aral Sea. 09/06.

PetroChina (Beijing)
Will purchase a 67% stake in Canada-based PetroKazakhstan, Inc. $2.74 billion. 08/06.

Petróleos de Venezuela SA/CNPC (Beijing)
Signed MOUs to jointly develop Venezuela's Orinoco oil belt and explore an oil field in Venezuela's Sumano region. 08/06.

Sinopec (Beijing)
Purchased a 25% stake in Omimex de Colombia, a subsidiary of US-based Omimex Resources Inc. $400 million. 08/06.

INVESTMENTS IN CHINA

Husky Oil China Ltd., a unit of Husky Energy, Inc. (Canada)/CNOOC (Beijing)
Signed a production sharing contract to explore deepwater blocks 29/06, 35/18, and 50/14 in the South China Sea. 08/06.

Magnus Energy Group Ltd. (Singapore)
Purchased a 75% stake in an oilfield in Jilin from Songyuan Yongda Oilfields Exploration and Technology Co. $26.6 million. 08/06.

The Hong Kong and China Gas Co., Ltd. (Hong Kong)/Shanxi Provincial Government
Signed framework agreement on the development of local coal-bed methane in Shanxi. $100 million. 07/06.

Pharmaceuticals

OTHER

Centocor, Inc. (US)/Shanghai Genomics, Inc.
Will collaborate on research concerning inflammatory signaling pathways. 07/06.

Ports & Shipping

CHINA'S EXPORTS

Bohai Shipbuilding Heavy Industries Co., Ltd. (Liaoning)
Will build two suezmax tankers for First Olsen Ltd., a joint venture between Ganger Rolf ASA and Bonheur ASA. $147.4 million. 09/06.

Dalian New Shipbuilding Heavy Industry Co., Ltd. (Liaoning)
Will build four container ships for Denmark-based A.P. Møller-Mærsk A/S. 09/06.

Qingdao Qianjin Shipyard (Shandong)
Will build four tugboats for Denmark-based A.P. Møller-Mærsk A/S. 09/06.

COSCO (Beijing)
Will convert two 7,629 roll on/roll off carriers for Ångfartygs AB Bore. 08/06.

CHINA'S IMPORTS

Nippon Yusen Kabushiki Kaisha (Japan)
Signed 25-year contract to transport iron ore from Brazil to China for Liaoning-based Beitai Iron & Steel Group Co. 09/06.

Advertisers in this Issue

INVESTMENTS IN CHINA

Alewijnse Holding BV (the Netherlands)/China Changjiang National Shipping (Group) Corp. (Hubei)
Will establish joint venture in Wuhan, Hubei, to manufacture marine electrical products. (the Netherlands:50%-China:50%). $253,000. 09/06.

I.M. Skaugen ASA (Norway)
Will establish WFOE, Skaugen Marine Construction Co., Ltd., in Shanghai. 09/06.

A.P. Møller-Mærsk A/S (Denmark)
Purchased a 33.9% stake in COSCO Ports (Nansha) Ltd., a unit of COSCO Pacific Ltd. 08/06.

COSCO Shipyard Group, a joint venture between SembCorp Marine, Ltd. (Singapore) and COSCO (Beijing)
Will construct a floating storage and offloading unit at its Zhoushan shipyard in Zhejiang. $74.8 million. 08/06.

Yang Ming Marine Transport Corp. (Taiwan)
Purchased a 38.1% stake in a dock-loading and -unloading venture in Chongqing. $5 million. 08/06.

Rail

CHINA'S IMPORTS

Jilin Midas Aluminium Industries Co., Ltd., a unit of Midas Holdings, Ltd. (Singapore)
Will supply aluminum alloy extrusion train car body profiles to Hebei-based CNR Tangshan Locomotive and Rolling Stock Works for the Beijing-to-Tianjin High-Speed Train Project. $24.5 million. 08/06.

Compagnie Financière Alcatel (France)
Will build a signaling system for line 6 of the Shanghai Metro underground train network. $37.9 million. 07/06.

Real Estate & Land

INVESTMENTS IN CHINA

Ascendas Group (Singapore)
Acquired a 52,000 m^2 industrial property project in Nanjing, Jiangsu. 09/06.

Warner Bros. Entertainment Inc., a subsidiary of Time Warner, Inc. (US)/Shanghai Shimao Co., Ltd.
Signed entertainment property development contract. $252 million. 09/06.

New World Land, a unit of New World Development Co., Ltd. (Hong Kong)
Will build a commercial project and a residential project in Changsha, Hunan. $37.5 million. 08/06.

Ascott Residence Trust (Singapore)
Will purchase Somerset Olympic Tower in Tianjin from Realand Pte Ltd. $47.25 million. 07/06.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co., Ltd. (Guangdong)
Will construct commercial-use wideband CDMA/high-speed downlink packet access network in Spain for Vodafone Group plc. 08/06.

Huawei Technologies Co., Ltd. (Guangdong)
Will supply CDMA2000 network equipment to US-based Leap Wireless International Inc. 08/06.

ZTE Corp. (Guangdong)
Will supply third-generation terminals to Canada-based TELUS Corp. 08/06.

CHINA'S IMPORTS

Oy Nokia AB (Finland)
Will provide digital network equipment to China Mobile. $735 million. 09/06.

Oy Nokia AB (Finland)
Will provide mobile phones to China Postel Mobile Communication Equipment Co., Ltd. $1.9 billion. 09/06.

Tianjin Create Co., a subsidiary of China Wireless Communications, Inc. (US)
Will provide and maintain a second server cluster and first work station cluster for Tianjin University. 09/06.

Telefonaktiebolaget LM Ericsson (Sweden)
Finalized contracts with China Mobile under which Ericsson will provide GSM network equipment and technical support. $550 million. 08/06.

INVESTMENTS IN CHINA

Smart SMS Corp. (US)/SOBA International Group (Beijing)
Will form joint venture to offer text messaging service throughout China. 09/06.

China Mobility Solutions, Inc. (Canada)
Will acquire controlling stake in Beijing Topbiz Technology Development Co., Ltd. 08/06.

Motorola, Inc. (US)/Huawei Technologies Co., Ltd. (Guangdong)
Will establish a joint R&D center in Shanghai. 07/06.

OTHER

Motorola, Inc. (US)/Shanda Interactive Entertainment Ltd. (Shanghai)
Formed partnership under which Shanda will provide games for Motorola's E680 g model handset. 07/06.

Textiles & Apparel

INVESTMENTS IN CHINA

Aditya Birla Group (India)/Hubei Jing Wei Chemical Fiber Co.
Will form joint venture, Birla Jingwei Fibers Co., Ltd., to manufacture viscose staple fiber. (India:70%-China:30%). 09/06.

Benetton Group SpA (Italy), Hembly International Holdings Ltd. (Hong Kong)
Will form joint venture, Benlim Ltd., to sell Sisley-brand clothing and accessories in China. (Hong Kong:50%-Italy:50%). 09/06.

Tourism & Hotels

INVESTMENTS IN CHINA

Vantage Hospitality Group Inc. (US)
Established two joint venture membership hotel chains, China's Best Value Inn and the Lexington Collection. 08/06.


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