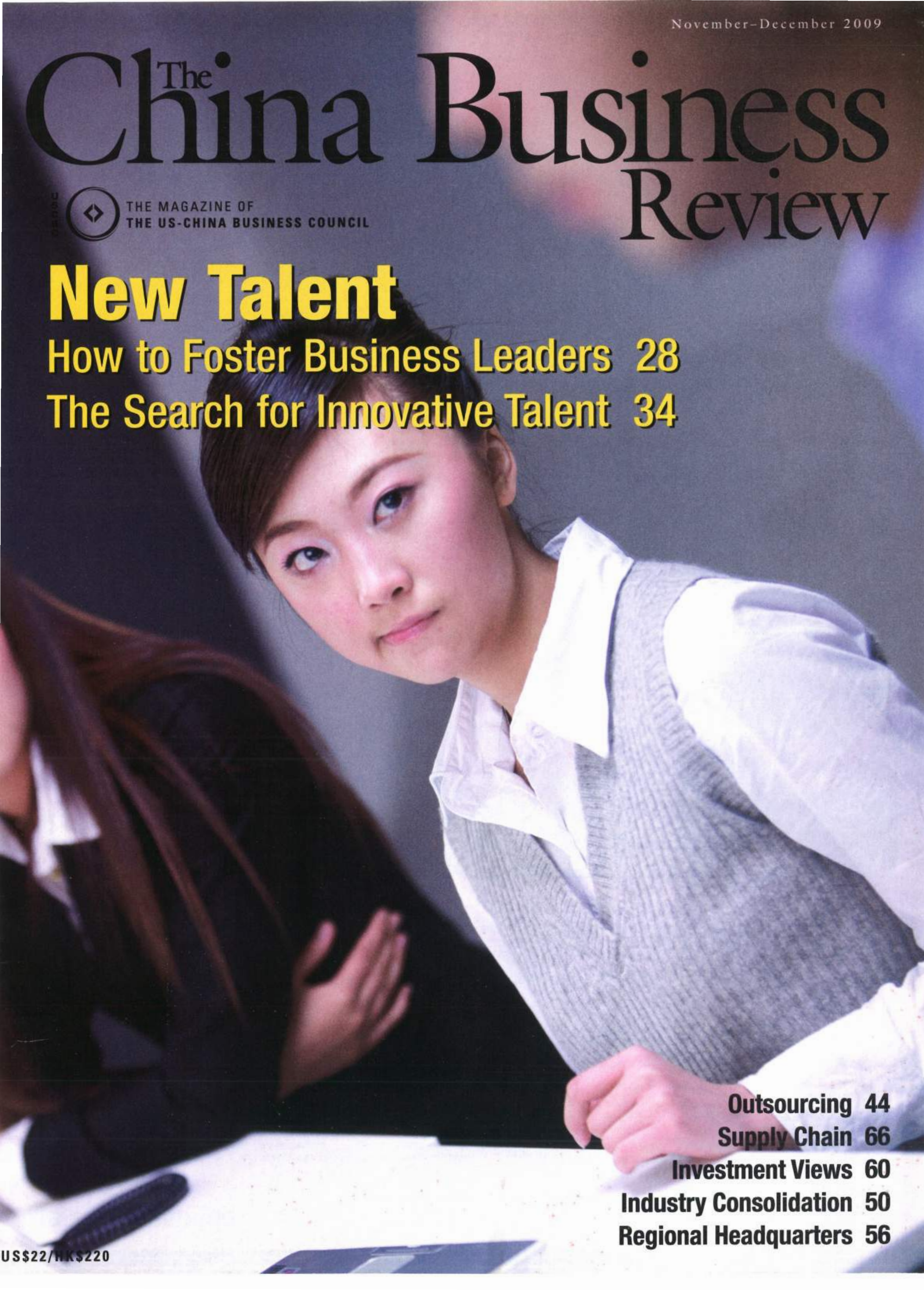
November–December 2009

The China Business Review

THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL



New Talent

US$22/HK$220

China Foto Press

The China Business Review

USCBC THE US-CHINA BUSINESS COUNCIL 美中贸易全国委员会

Focus: Human Resources

Cover design by Paula M. Miller
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Features

Departments

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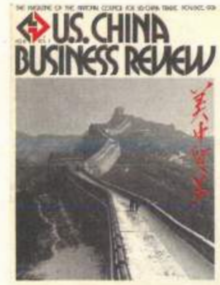
Letter from the Editor



As the *CBR*'s thirty-fifth anniversary year draws to a close, we look back at the last issue of 1974. As in 2009, the world was mired in recession. Clark T. (Sandy) Randt, then USCBC representative to the Canton Fair and later US ambassador to China, reported that attendance was down and business was so slow that some described the Fair as "morbid…grey goods is a disaster area…the Chinese are sitting around with nothing to do…the Fair is really dead."

During the current recession, however, China has been a relative bright spot. The US-China Business Council's annual survey of its membership shows that despite the recession's bite, companies remain optimistic about China (see p.60). The survey also reveals the top 10 problem areas facing companies in China. Locating and retaining qualified staff ranked third this year and has been in the top four for the last five years. Finding experienced managers is a huge challenge in China, and in many cases, companies must develop their own managerial training programs. In this issue, William Byham takes a look at how companies can do just that (see p.28). The lack of experienced managers also affects the field of science and technology in China, and Denis Simon and Cong Cao examine trends in China's science and technology workforce and what they mean for foreign companies (see p.34).

Another top 10 issue facing US companies in China is competition and overcapacity in some industries. Ronald Schramm and Seth Harlem show what industries are likely to consolidate, whether from market forces, government policy, or a combination of both (see p.50). We hope you enjoy these and other articles in this issue.

Virginia Hulme

Virginia Hulme

Statement of Ownership

Statement of Ownership, Management, and Circulation required by the Act of August 12, 1970, Section 3685, Title 39, United States Code, showing the ownership, management, and circulation of the *China Business Review*, published bimonthly by the US-China Business Council, 1818 N St., NW, Suite 200, Washington, DC 20036. Statement reflects position as of September 25, 2009.

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a. Total Number of Copies (*Net press run*)	5,777	5,610
b. Paid Circulation (By Mail and Outside the Mail) (1) Mailed Outside-County Paid Subscriptions Stated on PS Form 3541 (Include paid distribution above nominal rate, advertiser's proof copies, and exchange copies)	1,804	1,661
(2) Mailed In-County Paid Subscriptions Stated on PS Form 3541 (Include paid distribution above nominal rate, advertiser's proof copies, and exchange copies)	0	0
(3) Paid Distribution Outside the Mails Including Sales Through Dealers and Carriers, Street Vendors, Counter Sales, and Other Paid Distribution Outside USPS(r)	1,298	1,186
(4) Paid Distribution by Other Classes of Mail Through the USPS (e.g. First-Class Mail(r))	42	28
c. Total Paid Distribution (Sum of 15b (1), (2), (3), and (4))	3,145	2,875
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(1) Free or Nominal Rate Outside-County Copies Included on PS Form 3541	875	880
(2) Free or Nominal Rate In-County Copies Included on PS Form 3541	0	0
(3) Free or Nominal Rate Copies Mailed at Other Classes Through the USPS (e.g. First-Class Mail)	0	0
(4) Free or Nominal Rate Distribution Outside the Mail (Carriers or other means)	1,445	1,455
e. Total Free or Nominal Rate Distribution (Sum of 15d (1), (2), (3) and (4))	2,321	2,335
f. Total Distribution (Sum of 15c and 15e)	5,466	5,210
g. Copies Not Distributed	311	400
h. Total (Sum of 15f and g)	5,777	5,610
i. Percent Paid (15c divided by 15f times 100)	58%	55%

(Signed) Virginia Hulme, Editor, the *China Business Review*

The China Business Review

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Consumption

China's domestic consumption will likely continue to increase in the next 12 months in response to PRC government stimulus plans. According to a recently released MasterCard Inc. survey, 41 percent of urban respondents and 59 percent of rural respondents plan to spend more over the next year, largely because they expect their incomes to increase, are optimistic about the economy, expect their employment to be stable, and have paid off housing loans. According to the survey, though PRC government policies will likely stimulate domestic consumption, urban Chinese consumers save because social welfare programs—especially for healthcare and education—are inadequate. In rural areas, expected income was the single most important factor considered when planning purchases.

A recently released Goldman Sachs Group, Inc. report found that China accounts for 25 percent of luxury consumption worldwide and that luxury goods sales in China are expected to reach $5 billion in 2009. China is currently the world's third-largest consumer of luxury goods, after the United States and Japan, but Chinese spending on luxuries is forecast to grow 25 percent per year in the next four years, propelling it past Japan to first place by 2015. The majority of the country's high-end consumers are in their 20s and 30s.

Transportation

The PRC Ministry of Railways (MOR) issued ¥30 billion ($4.4 billion) in bonds in September to finance the construction of 32 new rail lines as part of a larger plan to extend China's railway network to 100,000 km by 2020. In addition, China's first railway with private funding kicked off construction in Shanxi in October. The railway, expected to cost ¥2.3 billion ($340 million), is co-funded by the Broad Union Investment Management Group Co., Ltd., the Yufeng Railway Construction Investment Co., Ltd., and the Railway Bureau of Zhengzhou, Henan.

A new expressway between Beijing and Chengde, Hebei, reduces travel time between the cities from four hours to two. Authorities expect the new road to bolster Hebei's tourism industry.

Delta Air Lines, Inc. has scrapped direct flights from Atlanta, Georgia, to Shanghai because of low demand. Instead, it will increase nonstop service from Detroit, Michigan, to Shanghai. Starting in November 2009, Delta will offer five direct flights a week, using the smaller Airbus A330 instead of the Boeing 747.

Investment

The PRC Insurance Law, which took effect October 1, allows Chinese insurance companies to invest directly in commercial real estate for the first time. According to estimates from Jones Lang LaSalle Inc., the influx of domestic real estate investment from Chinese insurers could reach $34 billion.

China Investment Corp. (CIC), a state-owned sovereign wealth fund, plans to invest $2 billion in three distressed-asset US funds, according to *Shanghai Daily*. CIC has invested in a range of companies in recent months. Its wholly owned subsidiary, Fullbloom Investment Corp., acquired about 17 percent of Canada's Teck Resources Ltd. in July and about 11 percent of JSC KazMunaiGas Exploration Production's Global Depositary Receipts in September. More recently, CIC agreed to buy a 45 percent stake in Russia-based Nobel Oil Group for $300 million.

Group Danone and Wahaha Group Co., Ltd. agreed to end their JV relationship, following a series of legal disputes that began in 2006. On September 30, Danone announced that it will sell its 51 percent stake in the Danone-Wahaha JVs to its Chinese partners. As *CBR* went to press, the settlement was subject to PRC government approval.

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Environmental Protection

Bluenext SA, an environmental trading exchange based in France, and the China Beijing Environmental Exchange are developing China's first voluntary carbon emissions reduction standard. The standard will be officially launched at the December United Nations Climate Change Conference in Copenhagen, Denmark, and will cover agriculture, forestry, and large carbon-offset projects.

China is preparing to launch its first domestic carbon market in Tianjin—the Tianjin Climate Exchange (TCX). TCX is a joint venture between the Chicago Climate Exchange, PetroChina Co. Ltd., and the Tianjin Municipal Government. The exchange will auction certified emission reductions and verified emission reductions and will initially focus on major pollutants, such as sulfur dioxide, and chemical oxygen demand. TCX Assistant Chair Jeff Huang says the cap-and-trade scheme is expected to begin in 6 to 12 months.

Autos

China's auto exports have fallen for 12 consecutive months since August 2008 because of the precipitous drop in international auto demand. But China's domestic auto market remains relatively strong. About 2,000 cars are purchased in Beijing every day, and auto sales, including used and low-emission car sales, have jumped in recent months, according to *China Daily*. Luxury-car makers are also doing well in China, with Bayerische Motoren Werke (BMW) AG, Daimler AG's Mercedes-Benz, and Volkswagen AG's Audi all reporting higher sales in 2009.

Ford Motor Co. will build a new manufacturing plant in Chongqing, under its joint venture Chang'an Ford Mazda Automobile Co., Ltd. The 1 million m^2 facility, worth $490 million, will be completed in 2012 and produce the next-generation Ford Focus for the Chinese market. Ford has two plants in China—one in Nanjing, Jiangsu, and another in Chongqing—and expects the third to increase its annual capacity in China to 600,000 units.

China Conference Calendar

China-related events near you

November 2009–April 2010

Please confirm dates and venues with the organizer prior to attending events. To suggest an entry for the next issue, send an announcement to Julia Zhao (jzhao@uschina.org). You can also post listings and view additional entries on the *China Business Review's* website at www.chinabusinessreview.com/conference-calendar.php.

World Scrap Metal Congress

NOVEMBER 2–4

Location: Shanghai: Intercontinental Pudong
Organizer: Terrapinn Ltd.
Contact: Wen Hui Ng
Tel: 65-6322-2754
wenhui.ng@terrapinn.com
www.terrapinn.com/2009/scrap

Truckworld

NOVEMBER 3–5

Location: Shandong: Jinan International Exhibition Center
Organizers: China Council for the Promotion of International Trade (CCPIT); China Association of Automobile Manufacturers; Jinan Municipal Government; Shandong Automotive Manufacturers Association; VNU Exhibitions Asia
Contact: Tom Cao
Tel: 86-21-6247-7668 x919
tom.cao@vnuexhibitions.com.cn
www.truckworldasia.com/en

CONEXPO Asia

NOVEMBER 3–6

Location: Beijing: Jiuhua Exhibition Center
Organizers: Association of Equipment Manufacturers; China Chamber of Commerce for Import and Export of Machinery and Electronic Products
Tel: 1-414-298-4167
info@conexpoasia.com
http://conexpoasia.aem.org/EN

Energy Show

NOVEMBER 3–7

Location: Shanghai New International Expo Center
Organizers: Deutsche Messe; Hannover Milano Fairs Shanghai Ltd.; Shanghai World Expo (Group) Co., Ltd.
Contact: Una He
Tel: 86-21-5045-6700
es@hmf-china.com
www.energyshow.com.cn

Metal Working & CNC Machine Tool Show

NOVEMBER 3–7

Location: Shanghai New International Expo Center
Organizer: Hannover Fairs China Ltd.
Contact: Simon Shao
Tel: 86-21-5045-6700
mwcs@hfchina.com
www.metalworkingchina.com

China Healthcare Congress

NOVEMBER 5–6

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

China Trials: Global Clinical Development Summit

NOVEMBER 8–10

Location: Sofitel Wanda Beijing
Organizer: Lychee Group, LLC
Contact: Jon E. Liong
Tel: 1-732-917-0664
jon.liong@lycheegroup.com
www.chinatrialsevent.com

Info Comm China

NOVEMBER 9–11

Location: Beijing: National Agricultural Exhibition Center (New Hall)
Organizer: InfoCommAsia Pte Ltd.
Contact: Richard Tan
Tel: 65-6841-7478
rtan@infocommasia.org
www.infocomm-china.com

Deepwater Tech Congress

NOVEMBER 11–13

Location: Hainan: Sheraton Haikou Resort
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn/events/Deepwater_Congress/Deepwater_Congress.asp

US-China Business Forum: Green Texas

NOVEMBER 12

Location: Texas: Hilton Austin
Organizers: State of Texas, Office of the Governor; University of Texas at San Antonio, International Trade Center; US Department of Commerce; City of Austin; Austin Chamber of Commerce; Southwest Texas Border Region Small Business Development Center
Contact: Maria Ng
Tel: 1-210-458-2470
maria.ng@utsa.edu
www.texastrade.org

Shanghai International Disaster Reduction Conference & Exhibition

NOVEMBER 13–15

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai International Advertising & Exhibition Co., Ltd.
Contact: Jessie Ren
Tel: 86-21-5179-7073
renjingpeng@meorient.com
http://en.china-disaster.com

World Gas Exchange Asia

NOVEMBER 16–19

Location: Shanghai: Grand Hyatt
Organizers: China Chamber of International Commerce; China Gas Association; Terrapinn Ltd.
Contact: Ya Ling Ng
Tel: 65-6322-2771
yaling.ng@terrapinn.com
www.terrapinn.com/2009/gasexchange

China Hi-Tech Fair

NOVEMBER 16–21

Location: Shenzhen Convention & Exhibition Center
Organizers: China Hi-Tech Transfer Center; Shenzhen Convention & Exhibition Center Management Co., Ltd.
Tel: 86-755-8284-8900
chtf@chtf.com
www.chtf.com/english

Ad:tech Beijing

NOVEMBER 17–18

Location: Beijing International Convention Center
Organizer: Dmg World Media (UK) Ltd.
Contact: Paul Beckley
Tel: 65-6513-0610
paul@ad-tech.com
www.ad-tech.com/beijing

China Intellectual Property Business Summit

NOVEMBER 18–20

Location: Shanghai Marriott Hotel Hongqiao
Organizer: Global Leaders Institute
Contact: Jojo Cao
Tel: 86-21-3251-6084
jojo.cao@globaleaders.com
www.globaleaders.com/en/2009/cipb

China Conference Calendar

International Exhibition of Food & Drink

NOVEMBER 18–20

Location: Shanghai New International Expo Center
Organizer: China International Exhibitions Ltd.
Contact: Lily Zhu
Tel: 86-21-6209-5209
fhc@chinaallworld.com
www.fhcchina.com

International Photovoltaic Solar Energy Conference & Exhibition

NOVEMBER 18–20

Location: Beijing: China World Trade Center
Organizers: PV Solar Committee of China Renewable Energy Society; Euro-China Solar Promotion Association; GruppoImprese Fotovoltaiche Italiane; Global Link International Exhibition (Beijing) Co., Ltd.
Tel: 86-10-8719-4418
ipvsee@solarpromotion.org
www.ipvsee.com

Water Expo China

NOVEMBER 18–20

Location: Beijing Exhibition Center
Organizers: Messe Frankfurt (Shanghai) Co. Ltd.; Chinese Hydraulic Engineering Society
Contact: Stella Yu
Tel: 86-21-6160-8555 x265
stella.yu@china.messefrankfurt.com
www.waterexpo.cn

American Lifestyles Expo: International Technology for Life

NOVEMBER 20–22

Location: Hangzhou, Zhejiang: World Trade Exhibiton Center
Organizers: American Lifestyles Expo Committee; Hangzhou People's Municipal Government; Municipal West Lake Expo Office; Zhejiang World Trade Exhibition Center
Contact: Candi Sterling
Tel: 1-212-620-2601
csterling@amlexpo.com
www.amlexpo.com

Money Fair International Exposition

NOVEMBER 20–22

Location: Shanghai Exhibition Center
Organizers: Shanghai Media Co., Ltd.; ImmixRed LLC
Contact: Jim Prince
Tel: 1-800-341-9488 x531
jprince@moneyfairchina.com
www.moneyfairchina.com

China International Exhibition for Auto Air-Conditioning & Transportation Refrigeration

NOVEMBER 21–23

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai Gehua Exhibition Planning Co., Ltd.
Contact: Ms. Cella
Tel: 86-21-3414-1036
autocoolexpo@163.com
www.autocoolexpo.com

Asian-Pacific International Plastics & Rubber Industry Exhibition

NOVEMBER 24–27

Location: Shanghai New International Expo Center
Organizers: China National Light Industry Council; China Petroleum & Chemical Industry Association; China Chamber of Commerce for Import & Export of Machinery & Electronic Products; China National Light Industry Machinery Corp.; China National Light Industry Machinery Association
Tel: 86-10-6603-9351
applas@applas.com
www.applas.com.cn/applas/english/

China Conference Calendar

Guangzhou International Automobile Exhibition

NOVEMBER 24–30

Location: Guangzhou, Guangdong: China Import & Export Fair Complex
Organizers: China Foreign Trade Guangzhou Exhibition Corp.; CCPIT, Automotive Sub-Council; Guangzhou Automobile Industry Group Co., Ltd.
Contact: Sharon Liu
Tel: 86-20-8666-9126
autogz@fairwindow.com.cn
www.autoshow-gz.com/eng

China International Exhibition for Glass Technology

NOVEMBER 25–27

Location: Guangzhou, Guangdong: China Import & Export Fair Complex
Organizers: China Foreign Trade Center Group; Messe Dusseldorf China Ltd.
Contact: Teddy Dong
Tel: 86-21-5027-8128
teddy@mdc.com.cn
www.allinglass.com.cn

China Sign Fair

NOVEMBER 25–27

Location: Guangzhou, Guangdong: China Import & Export Fair Pazhou Complex
Organizers: Guangzhou Advertising Society; Hannover Fairs China Ltd.; World Expo (Group) Shanghai Modern International Exhibition Co., Ltd.; Chinapromote International Exhibitions Co., Ltd.
Contact: Fancy Wang
Tel: 86-20-8626-6696 x8009
csf@hfchina.com
www.chinasignfair.com

China International Foodstuff Exposition

NOVEMBER 26–28

Location: Guangdong: Guangzhou International Sourcing Center
Organizer: Canton Universal Fair Group Ltd.
Contact: Erica Chang
Tel: 86-20-8735-3299
interfood@faircanton.com
www.faircanton.com/interfood

Marintec China

DECEMBER 1–4

Location: Shanghai New International Expo Center
Organizers: UBM Asia; Shanghai Society of Naval Architects & Marine Engineers
Contact: Stella Fung
Tel: 852-2827-6211
marintec@cmpasia.com
www.marintecchina.com

Call Center Excellence Congress

DECEMBER 8–9

Location: Shanghai: Crowne Plaza Hotel
Organizer: JFPS Group
Tel: 86-21-5172-0000
marketing@jfpsgroup.com.cn
www.callcentercongress.com

Committee of 100 Greater China Conference

DECEMBER 8–10

Location: Beijing: China World Hotel
Organizer: Commitee of 100
Contact: Su Cheng Harris-Simpson
Tel: 86-10-5869-3772
sucheng@cn.committee100.org
http://conference.committee100.org/2009BJ

China Conference Calendar

Shanghai International Trade Fair for Automotive Parts, Equipment & Service Suppliers

DECEMBER 9–11

Location: Shanghai New International Expo Center
Organizers: Messe Frankfurt (HK) Co. Ltd.; China National Automotive Industry International Corp.
Contact: James Yu
Tel: 86-21-6160-8555
james.yu@china.messefrankfurt.com
www.messefrankfurt.com.hk fair_homepage.aspx?fair_id=11

Shanghai International Fisheries & Seafood Exposition

DECEMBER 9–12

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai Gehua Exhibition Service Co., Ltd.
Contact: Ms. Kate
Tel: 86-21-3414-1036
kate@sifse.com
www.sifse.com/en

China Leisure Travel Summit

DECEMBER 10–11

Location: Beijing: Great Wall Kempinski
Organizer: Noppen Co., Ltd.
Contact: Alan Shen
Tel: 86-21-6085-1000
alans@noppen.com.cn
www.noppen.com.cn/events/china_outbound/china_outbound.asp

Guangzhou Hospitality Equipment & Supply Exhibition

DECEMBER 10–12

Location: Guangzhou, Guangdong: China Import & Export Fair Pazhou Complex
Organizer: Guangdong Fo Xing Exhibition Service Co., Ltd.
Contact: Mr. Li
Tel: 86-20-8762-3656
gzhoshow@hotmail.com
www.hoshow163.com

Development & Agency Finance in Asia Conference

FEBRUARY 3–4

Location: Hong Kong: Renaissance Harbour View Hotel
Organizer: Euromoney Seminars
Contact: Winnie Louie
Tel: 852-2842-6995
winnie.louie@euromoneyasia.com
www.euromoneyseminars.com/dafasia10

China Clean Expo

MARCH 29–31

Location: Shanghai New International Expo Center
Organizer: Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Contact: Mark Nee
Tel: 86-21-6437-1178
marketing@cmpsinoexpo.com
www.ubmsinoexpo.com/clean

Expo Build China

MARCH 29–APRIL 1

Location: Shanghai New International Expo Center
Organizer: Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Contact: Mark Nee
Tel: 86-21-6437-1178
marketing@cmpsinoexpo.com
www.expobuild.com

Hotelex Shanghai

MARCH 29–APRIL 1

Location: Shanghai New International Expo Center
Organizer: Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Contact: Mark Nee
Tel: 86-21-6437-1178
marketing@cmpsinoexpo.com
www.hotelex.cn

China (Shanghai) International Boat Show

APRIL 8–11

Location: Shanghai Exhibition Center
Organizer: Shanghai UBM Sinoexpo International Exhibition Co., Ltd.
Contact: Mark Nee
Tel: 86-21-6437-1178
marketing@cmpsinoexpo.com
www.boatshowchina.com

CBR subscribers with online access can now search China Deal Database listings from 2000 to the present at www.chinabusinessreview.com.

Event Wrap Up

WASHINGTON

September

Discussion on Section 421 and Its Implications

Panelists included Brenda Jacobs, counsel at Sidley Austin LLP; Timothy Keeler, counsel at Mayer Brown LLP; Lewis Leibowitz, partner at Hogan & Hartson; and Marguerite Trossevin, founding member of Jochum Shore & Trossevin, PC.

Dinner in Honor of PRC National People's Congress Chair Wu Bangguo

The dinner, co-hosted by USCBC and several other organizations, featured Wu and his delegation, US Secretary of State Hillary Rodham Clinton, and Secretary of Commerce Gary Locke. USCBC was represented by former Secretary of Commerce and USCBC Board Director William Daley, vice chairman of J.P. Morgan Chase & Co.

Roundtable on Intellectual Property Rights (IPR) Enforcement

Luke Minford, China representative at Rouse & Co. International, and Charles Schill, partner at Steptoe & Johnson LLP, discussed handling IPR infringement in China.

USCBC Webinar on Healthcare

Featured Ryan Ong, Business Advisory Services manager at the US-China Business Council (USCBC), and David J. Hofmann, North America market manager at InterChina Consulting.

USCBC Webinar on Foreign Corrupt Practices Act

Featured Patrick Norton, partner at Steptoe & Johnson LLP, and Frederic R. Miller, senior partner at PricewaterhouseCoopers.

October

JCCT 2009 Preview

Deputy Assistant Secretary of Commerce for East Asia Ira Kasoff and Assistant US Trade Representative Tim Stratford met with USCBC members to discuss topics to be addressed at the October 28–29 Joint Commission on Commerce and Trade (JCCT) meetings in Hangzhou, Zhejiang.

BEIJING

September

Working Breakfast with AQSIQ Director General

PRC Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) Director General Wang Xin met with USCBC members to discuss import and export policy developments.

Lunch Briefing with US Acting Under Secretary of Commerce for International Trade

Acting Under Secretary Michelle O'Neill briefed USCBC and American Chamber of Commerce members on her Beijing meetings preceding the JCCT.

October

Reception with US Consumer Product Safety Commission (CPSC) Delegation

CPSC Chair Inez Tenenbaum discussed US-China bilateral cooperation on product safety issues.

SHANGHAI

September

Reception with USCBC President John Frisbie

Frisbie offered brief remarks on the latest bilateral trade developments and introduced Julie Walton, USCBC's new chief representative in Shanghai.

Upcoming Events

WASHINGTON

Issues Briefings

November 19, 2009
December 17, 2009

US-China Business Council Gala

December 2, 2009
Honoring PRC Ambassador to the United States Zhou Wenzhong
Capital Hilton
1001 16th Street, NW

Forecast 2010

January 27 and 28, 2009
For more information, see p.21.

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

USCBC President Meets PRC Leaders and Member Companies in China

US-China Business Council (USCBC) President John Frisbie visited China during the week of September 21 and met with senior PRC officials in Beijing and Shanghai to raise several advocacy points on behalf of USCBC member companies. Frisbie also met with roughly 50 member-company executives to hear their views on the current business environment in China and to brief them on bilateral trade developments in Washington, DC.

One of Frisbie's principal advocacy points was to press for foreign-invested enterprises (FIEs) to be treated as "domestic enterprises" under China's government procurement and indigenous innovation rules. One of the top issues highlighted in USCBC's recently released 2009 member survey and in company meetings in both cities is that FIE products and services made or provided in China are treated as "foreign" rather than domestic and are therefore excluded or disadvantaged in procurement decisions (see p.60).

Although one outcome of the July US-China Strategic and Economic Dialogue was a statement that FIEs should be treated as domestic enterprises in government procurement practices (as they are in the United States), USCBC believes that the PRC central government must issue a written clarification in China to ensure even implementation at the central and local levels.

During his trip, Frisbie also met with Ambassador Jon Huntsman and new Commercial Minister-Counselor William Zarit at a US Embassy reception to introduce Zarit to the business community, along with Consul-General Bea Camp in Shanghai. Frisbie reiterated USCBC's offer to jointly host an event in honor of President Barack Obama during his visit to China in mid-November.

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THE US-CHINA BUSINESS COUNCIL
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USCBC FORECAST 2010
January 27–28, 2010

The Preeminent Conference of Its Kind, Now in Its 29th Year

Available to business executives of US-China Business Council (USCBC) member and prospective member companies

Evening Reception: January 27
6:00-8:00 pm

■ Attended by leading US government officials, PRC government officials, USCBC member company executives, conference speakers, and members of the think-tank and China-watching community.

■ This annual reception is a valuable opportunity to meet and network with a unique mix of people with expertise and insight on China issues.

Conference: January 28
8:30 am-2:00 pm

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China Tweaks Foreign Investment Rules

Recent declines in foreign direct investment into China have prompted the PRC Ministry of Commerce (MOFCOM) and other PRC agencies to announce new efforts that encourage private investment, especially in small and medium-sized enterprises (SMEs), and loosen some foreign-investment restrictions.

PRC Minister of Commerce Chen Deming announced several planned changes to China's foreign-investment policies at the 13th China International Fair for Investment and Trade, which took place September 8–11. According to Chen, China will

- Streamline approval processes and gradually ensure that foreign-invested enterprises (FIEs) receive national treatment;
- Gradually ease ownership thresholds for foreign investment in the services sector (although in the absence of details, it is unclear how important this statement is);
- Accelerate construction of economic and technological development zones to encourage foreign companies to develop the high-tech and services outsourcing industries; and
- Encourage more private investment in new and emerging industries and provide incentives for investment in border areas and central and western China.

Chen also announced China's plans to allow "eligible" FIEs to list on domestic stock exchanges. According to *Caijing*, the Shanghai Stock Exchange will use renminbi (RMB) for valuation, offering a new source of local-currency financing for foreign companies that have not been able to issue bonds or secure long-term loans.

Foreign-invested partnerships

The PRC State Council on August 19 approved in principle draft Administrative Measures for Foreign Enterprises and Individuals Establishing Inbound Partnership Enterprises, which detail the implementation of the Foreign Partnership Law that was passed in 2007.

Though as *CBR* went to press the measures had not yet been published, Reuters reported that the measures allow foreign companies to apply for MOFCOM approval to establish locally registered partnerships. Private equity firms, which currently may provide only advisory services or operate as representative offices, face difficulty raising local RMB funds and stand to benefit from the new regulations. Foreign law firms, which must operate as representative offices under PRC law, will likely also take advantage of the opportunity to form partnerships.

Support for SMEs

Amid growing concern that China's stimulus efforts have focused too heavily on large state-owned enterprises, the State Council on September 22 released Opinions on Further Promoting Small and Medium-Sized Enterprise (SME) Development. The measures aim to

- Encourage government agencies to purchase SME products and services and allow more flexible implementation of social insurance and pension payments;
- Strengthen financial services and expand financing channels for SMEs, as well as improve the SME credit-guarantee system;
- Expand central funding for SME development to encourage technology innovation, structural adjustment, market exploration, and employment;
- Adopt preferential tax policies for SMEs;
- Encourage coordination and cooperation among SMEs to achieve cluster development;
- Encourage SMEs to participate in home appliance replacement programs and explore international markets with export tax rebates and preferential export credit loans;
- Reform government examination and approval systems to reduce administrative burdens;
- Launch training programs to improve SME corporate management; and
- Establish the State Council Working Group for Promoting SME Development to strengthen SME administration and set up a system to monitor and analyze SME statistics.

Private investment

Some of the goals and provisions outlined in these opinions may overlap with the PRC National Development and Reform Commission's Opinions on Encouraging and Promoting Private Investment, which were submitted for State Council approval in early August. According to *Nanfang Daily* and other PRC media, this draft reportedly consists of 20 policies that

- Allow private investment in five previously restricted industries—"basic industry"; infrastructure; financial insurance; culture, education, and healthcare; and public services—with a relatively low market entry requirement, though whether foreign investors would be able to invest as private investors remains unclear;
- Reduce restrictions on the percentage of shares held by private enterprises;
- Speed up the investment approval process by drafting a catalogue of central-government-approved investment projects and allowing some private projects to forego the approval process as long as they file with related government offices;
- Draft rules on personal loans and on opening up the SME bond market; and
- Provide tax breaks for reinvestment and technological development.

完

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

A Fuller Picture

Julie Walton

After spending the past eight years in the Washington, DC, office of the US-China Business Council (USCBC), I recently relocated to Shanghai to become the new chief representative of USCBC's Shanghai office. Having worked with the US-based representatives of USCBC member companies, I find it interesting to work on similar issues with their Shanghai-based colleagues, who often have a different perspective.

What immediately struck me upon arrival is the quest among US companies in Shanghai for information about the direction of PRC government policies, at the central or local levels. The central government influences—in some cases quite heavily—what US companies can and cannot do. Therefore, the "philosophical" questions with which US companies must grapple tend to have a political bent to them: Is the government favoring investment in a particular industry, and if so, for how long? Most important, what happens if the government changes its mind?

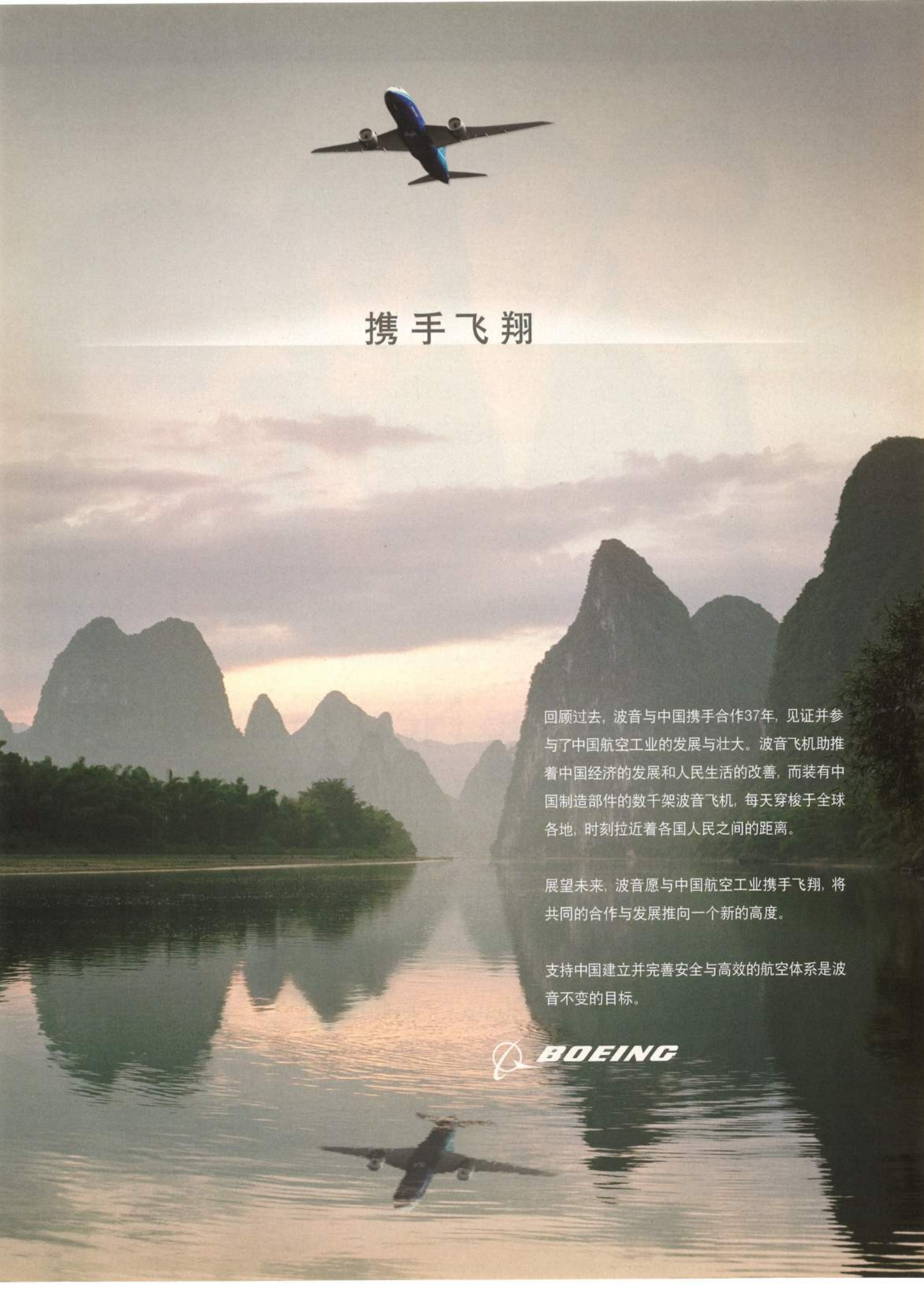
The challenge is assessing the seemingly accurate yet contradictory information that comes from all sides. For instance, the central government boosted the target for electricity generated from solar energy, then restricted the amount of polysilicon produced and removed certain technologies and materials needed in solar panel production from China's list of encouraged imports. (Polysilicon is a key ingredient in photovoltaic panels.) The central government said it wants to move away from low value-added and energy-intensive production but raised the rebate on value-added taxes for certain low-end manufactured products. A new law governing labor contracts took effect nationwide, but local officials hesitate to enforce some of its provisions because of local unemployment concerns during the economic crisis. Trying to stay on top of these policies when one government policy overtakes another at dizzying speed is difficult. In such an environment, it is not surprising that lack of transparency remains a top concern of USCBC member companies year after year (see p.60).

Economic data sometimes just contribute to US investors' confusion. When executives at headquarters read about domestic growth picking up, they wonder why their business units aren't reporting double-digit growth as they had before the economic crisis. The reality is complex, and USCBC staff have spoken with a variety of companies across sectors to try to understand how China's response to and recovery from the global economic crisis affect foreign investors. A few examples highlight this. Sales of home appliances appeared to be up in the past six months, but mostly in less-developed regions that participated in the government-sponsored "Home Appliances to the Countryside Program," which subsidizes rural residents' purchases of white goods. This helped keep retailers afloat but did little to ease tight margins. Moreover, the subsidy recipients are primarily located in third- and fourth-tier cities, where few foreign retailers are established. But in more developed cities such as Beijing and Shanghai, most consumer sales related to retail or home goods have remained low, waiting for the real estate sector to recover.

In another example, one USCBC member company in the engineered materials business noted that it has had little difficulty selling to the telecom sector but much greater difficulty selling the same product to the building materials sector. Why? The central government is aggressively building the third-generation (3G) telecom network and has allocated funds specifically for this task. In contrast, construction of office buildings and new residences has not been a focus of central-government spending. Such examples illustrate that it might be hard for US executives to see the full picture without knowing the background context.

One of USCBC's most valuable services is that we look into these "behind the scenes" types of questions to give member companies the information they need to make sound business decisions. USCBC members also play a valuable role by sharing their experiences and views with each other, thus improving the overall ability of US companies to operate in China. As USCBC's Shanghai office works to serve members, we look forward to exploring these questions, and facilitating conversations among members, to make the operating environment in China just a little clearer. 完

Julie Walton *is the US-China Business Council's chief representative in Shanghai.*


携手飞翔
回顾过去，波音与中国携手合作37年，见证并参与了中国航空工业的发展与壮大。波音飞机助推着中国经济的发展和人民生活的改善，而装有中国制造部件的数千架波音飞机，每天穿梭于全球各地，时刻拉近着各国人民之间的距离。
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Setting up advancement programs will help companies train—and retain—high-potential employees.

Developing the Next Generation of Chinese Business Leaders

To ensure the long-term success of their business in China, companies must learn how to identify and develop high-potential individuals among local staff.

William C. Byham

Most multinational corporations (MNCs) do not have enough local leaders to manage their growing businesses in China. The shortage of good leaders means that CEOs and executives are overstretched. Ideas and opportunities might abound, but there is insufficient leadership talent to execute them.

One strategy to compensate for the lack of qualified local leaders is to fill the gap with expatriate managers, but this is not the best solution for organizations that aim to create sustainable, profitable businesses in China. In most cases, an expatriate assigned to China costs up to five times his or her salary, and few expatriates are fully aware of the cultural nuances of the Chinese market. Hiring expatriates also limits opportunities for local employees to take on greater responsibilities. Companies should therefore aim to develop their own local leaders.

Leadership pipelines and acceleration pools

The top obstacle that MNCs in China face is finding and retaining quality local, high-potential talent. Though high-performing employees may leave if they are not promoted, there is a danger that they will fail if promoted too early.

Build a leadership pipeline...

A leadership pipeline strategy develops leaders at each organizational level within the limits of their capacity and motivation, so that leadership performance—and thus, leadership contribution to the organization—improves each year. A pipeline strategy also grooms a few select people for the next level of management through special training, job experiences, and coaching. It is important that growth positions go to the people who will benefit most—the people with the highest potential for the next level.

...and an acceleration pool

In most rapidly growing organizations in China, the progression of individuals through the leadership pipeline to top positions is too slow to meet the organization's needs and the expectations of the best potential local leaders. Acceleration pools are one way to fast-track the few people with the capacity and motivation to rise to the top relatively quickly.

Acceleration pools, also known as high-potential or high-flyer pools, operate independently of the leadership pipeline. Pool members receive special training and mentoring, as well as the best assignments, enabling them to stretch their skills and show what they can do.

Quick Glance

- Companies operating in China can reduce costs and retain talented staff by developing local, high-potential employees for leadership positions.
- Companies should avoid several common pitfalls when they identify and develop high-potential individuals.
- Companies need to evaluate an individual's strengths and development needs and track the person's progress in all areas.

How to identify high-potential employees

High potentials in China tend to be pragmatic, self-interested, and quick to seize new opportunities. They are ambitious and hardworking and, unlike earlier generations, are willing to take risks. Often, young high potentials in China are viewed by their colleagues as aggressive and overly ambitious, and mentors must therefore guide them through interpersonal relationships with their colleagues and peers. High potentials are prepared to move between unrelated industries or sectors. They understand that they are not building functional competencies but leadership and business competencies. Also, many high potentials have or want overseas exposure—perhaps from overseas education or a foreign work assignment. Yet many employers in China make two mistakes when identifying high potentials:

■ **Mistake 1: Focusing on current performance rather than management potential** Many organizations leave identifying high potentials to the managers' personal judgment. This is a big mistake. Defining the difference between "high performer" and "high potential" can be tricky, and most Chinese managers identify potential based on a person's strong performance, along with some personal biases—for example, the manager prefers a schoolmate, friend, or family member—and gut instincts. But individuals who are competent or even strong in their current job may not perform well at higher levels. Naturally, an individual's sustained business performance should be considered, but not exclusively. Development Dimensions International, Inc. (DDI) has identified 10 leadership potential factors (see p.30).

■ **Mistake 2: Failing to adopt a consistent and accurate process for identifying candidates** Few MNCs in China have a consistent process for identifying high potentials. Most companies say that they want to spread a wide net when they consider candidates, but few achieve this goal. People assigned near the organization's headquarters have a significant advantage, as do graduates of prestigious universities. Managers that make recommendations have different criteria for measuring potential. Thus, senior management is unable to systematically and accurately compare people nominated by different managers.

Affirm readiness and diagnose development needs

Even if an organization can successfully identify high-potential individuals, it may not have an accurate understanding of their specific development needs. Companies cannot develop high potentials in all aspects of leadership and management, because it would take too long and be impossible in the fast-paced China market. Companies must therefore diagnose each person's development needs to focus efforts on areas with the biggest payoff.

An Acceleration Center—a DDI-designed tool that helps employers identify high-potential needs and accelerate development—allows a reliable, consistent standard to be used across the organization. An Acceleration Center mirrors the daily decisions, interactions, and strategic challenges that managers and executives face when making major decisions in an ambiguous environment. The experience allows participants to try on their future roles, accountabilities, and activities in a realistic, simulated business environment. It thus paints an accurate picture of where individuals stand relative to the skills needed at the target leadership level and provides senior management with an accurate and comparable inventory of available talent. In addition, it reaffirms the accuracy of identifying an individual as a high potential.

result, the identified individuals fail to develop or improve. Companies should avoid eight common pitfalls when developing their young high potentials:

■ **No written plans** Individuals often fail to record their development plans. Instead, they try to keep a "mental" plan of what they need to do to develop. Lee Iacocca, former chair of Chrysler LLC, said, "The discipline of writing something down is the first step toward making it happen. In conversation, you can get away with all kinds of vagueness and nonsense, often without even realizing it. But there's something about putting your thoughts on paper that forces you to get down to specifics. That way, it's harder to deceive yourself—or anybody else." He is right. DDI research in the United States has found a strong link between writing a well thought-out development plan and subsequent meaningful development actions. The same relationship applies in China.

■ **Unattainable development objectives** Rather than setting an overly ambitious target of multiple, hard-to-achieve goals, it is better to focus on a plan with only one or two achievable goals per year; once those are accomplished, the individual can move on to new goals.

All too often, high potentials and their organizations fail to use the developmental feedback they receive.

The "day-in-the-life" format of a one-day Acceleration Center also tends to be seen by young Chinese high potentials as extremely fair and valid. Participants find that the stretch experiences from an Acceleration Center deliver well-rounded insights about their strengths and development needs and give them a realistic job preview. When Chinese high potentials receive Acceleration Center feedback, they often describe it as the first time in their career that they have received fair, direct, and constructive feed back. One Chinese high potential who participated in the Acceleration Center commented afterward that he had never realized that a business-unit leader in his company had such a challenging, complex role. Chinese high potentials frequently overestimate their abilities, and Acceleration Center feedback from an unbiased, third-party expert helps each person to fully understand his or her skills as they relate to the organization's leadership needs and challenges.

Common pitfalls

All too often, high potentials and their organizations fail to use the developmental feedback they receive from their boss or even from an Acceleration Center. As a

Senior Executive Commitments

Executives' time, commitment, and follow-through are critical to developing high-potential talent. Senior executives' most important roles are to

■ Articulate and communicate a clear talent strategy for the organization;

■ Develop a talent management framework and identify high-potential individuals;

■ Sponsor and drive the accelerated development of one or more key high potentials;

■ Discuss high potentials' development progress with other senior executives at every possible opportunity; and

■ Be accountable and hold others accountable for realizing talent growth.

—William C. Byham

Leadership Potential Factors

Leadership promise

■ Propensity to lead
■ Brings out the best in people
■ Authenticity

Personal development orientation

■ Receptivity to feedback
■ Learning agility

Balance of values and results

■ Culture fit
■ Passion for results

Mastery of complexity

■ Adaptability
■ Conceptual thinking
■ Navigates ambiguity

Source: *Leadership Success in China: An Expatriate's Guide*, Yue-er Luo, Erik Duerring, and William C. Byham, © 2008, Development Dimensions International, Inc.

Failure to focus on the total person All the common success profile categories—behavior, experience, qualifications, and personal attributes—must be considered when developing talent for a particular position. But some are often overlooked. For example, when auditing development plans for one organization in China, DDI found that 87 percent of the plans focused on technical knowledge and only 13 percent addressed behavior.

Development efforts need to include the acquisition and on-the-job application of new skills.

Insufficient guidance Sometimes development fails because individuals are given development targets but no guidance on how to acquire and apply their targeted skills. It is not uncommon for a person with poor team leadership skills to be assigned to lead a difficult team to learn on the job. A much better system is to provide the individual with behavior-based skill training to develop the skills before the assignment. This way, the individual learns from successes and not failures.

Unused training and skills Development efforts need to include the acquisition and on-the-job application of new skills. In China, employees often attend an MBA or executive MBA (EMBA) program but lack the opportunity to apply what they have learned immediately. This means that many of the new insights and skills, and much of the learning, are often lost. If a mid-level manager attends an EMBA strategic-thinking course but does not have responsibility or involvement in strategic or business planning, development efforts are wasted.

Development unrelated to business Individual development is most easily accomplished when the person's development needs, challenges of the role, and the organization's business drivers are all aligned. If development needs are aligned with organizational needs, there is a much higher chance that management will support the development and that the individual will be motivated to complete the development training.

Lack of supervisor involvement Managers need to be involved early and often to refine and prioritize development goals, help staff seize development opportunities and learn and practice new skills, remove development barriers, and provide coaching and support. If a boss is uncooperative or unsupportive, it will be difficult for the individual to fully develop.

No metrics to track development progress Quantitative measures of job performance and the completion of development goals are critical because they ensure motivation. For many Chinese employees, such quantitative measures of development are never established, making it easy to delay development activities.

How to develop high potentials

Organizations can plan for the challenges ahead on their high potentials' development journey once their specific development needs have been defined. This means having the appropriate development tools, systems, and processes in place. In some situations the choice of how to develop a person will be straightforward; in others, managers must weigh multiple options.

High potentials, their managers, and mentors—and often a human resources representative—should partner to establish a personalized and focused development plan. The direct manager and assigned mentor should help the person refine developmental activities and line up the support

Should Organizations Communicate the Existence of High-Potential Programs?

Some companies prefer an "open" high-potential program that is transparent for all to see and highly formalized. Other organizations opt for a closed program where special development attention is given without disclosing the high-potential status of its participants to the rest of the company.

A major benefit of an open program is that it reinforces high potentials' determination to succeed and reduces their motivation to look elsewhere for career growth. Such programs also make an organization attractive to promising recruits from outside the organization.

The risk with an open development program is the potential for a backlash of resentment and disappointment from those not selected to participate. Companies also need to guard against the development of an elitist culture among those selected for accelerated development, particularly given the importance attached to status and face in China. Proper communication about the program's purpose, objectives, and criteria for entry can alleviate misunderstandings. In addition, the organization needs to be clear with high potentials regarding what their participation means—special development offerings, senior visibility, and short-term assignments—and what it does not mean—guaranteed promotion.

—William C. Byham

needed—for example, the cooperation of another department. The ultimate success of a high potential's development and the program itself will be directly affected by the level and quality of support and the coaching provided.

Developing high-potential talent means exposing people to a range of functions and experiences and increasing their leadership and management responsibilities. Chinese high potential individuals tend to prefer positions that

The ultimate success of a high potential's development and the program itself will be directly affected by the level and quality of support and the coaching provided.

- Raise their profile with key organizational leaders or expose them to an influential group in the community;
- Provide them with skills and experience that will bolster their value and add to the quality of their personal portfolio; and
- Differentiate them from other people in the organization or marketplace.

Companies should challenge high potentials' skills and knowledge. Providing the right level of challenge is important. Challenges must be interesting and stimulating, but not so difficult that high potentials will fail.

Mentoring in China

Mentoring is important in China. Because age and experience are so respected in Chinese culture, young, high-potential employees will greatly appreciate having an older, more senior mentor. Many expatriate managers take a mentoring role to ensure that their high potentials' development remains on track. Other options include using senior Chinese managers as mentors or bringing in external coaches. For example, Asimco Technologies Ltd., which manufactures car components, overcame its retention problems by identifying 25 up-and-coming leaders every year and assigning mentors and specific projects to them. After six years, 90–95 percent of the managers initially recruited were still with the company.

Though effective mentors provide insight and guidance, their main role is to act as a catalyst between the high-potential individual and that person's supervisor. In most cases, the boss has the opportunity to place people in learning situations, send them to training programs, and give them organizational exposure. Too often, however, managers accept responsibility for developing people but become subverted by daily work pressures and pull people out of training programs or fail to follow through on commitments. Providing a mentor, who must report regularly on a high potential's progress, pressures managers to follow through with their commitments.

Assignments and rotations

Formal training must be supplemented by structured, on-the-job assignments. The high potential's manager should set goals, appraise performance, and provide feedback when these assignments are complete. Without sufficient time and resources committed to closely monitor the development progress of a high potential in a rotational assignment, a manager may find it easy to assume the individual is developing when he or she may not be. In China, where job rotations are common, managers must monitor the person's performance closely to ensure development activities have the desired effect.

Make promotion decisions carefully

Promotion decisions are by far the most sensitive staffing calls that organizations make. Promotion criteria and decisions send a clear message about the types of workers and competencies valued by management, and such decisions tend to be irreversible, especially in China. If someone fails to perform well in the new job, for reasons of face, resignation is often the only means of exit. Making the wrong promotion decision can therefore be disastrous. Having a pool of people who have demonstrated technical, interpersonal, and management skills will make future promotion decisions much easier and more successful. 完

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Adjusting Development Programs for China

Compared with high potential individuals elsewhere, those in China have different expectations as learners. Generally, they prefer

- More action learning;
- More application of models and tools, and less theory;
- More links to current and future business challenges;
- A focused, business-relevant context;
- Development that is tied to results;
- Opportunity to network; and
- Formation of business partnerships at different functional and operating levels.

—*William C. Byham*

Since 1999, less than one-third of Chinese students who went abroad to study have returned to work in China.

Creating an Innovative Talent Pool

Though China's pool of scientific talent has expanded in recent years, the country must now focus on raising the pool's quality and using it effectively.

Denis Fred Simon and Cong Cao

Intense international competition and an increased emphasis on innovation as the key to economic and technological leadership has made talent—and its availability, quality, and use—a primary differentiator for countries and companies alike. This helps to explain why over the last decade so much attention has been focused on the training, cultivation, and retention of critical talent around the world.

At the dawn of the twenty-first century, China's leaders concluded that their economic development strategy, heavily dependent on natural resources, fossil fuels, exports based on cheap labor, and capital investment, was no longer viable or attractive. Recognizing that solving the country's talent issue is crucial to China's ability to cope with an intensely competitive international environment and maintain stability at home, they decided to move China toward a "knowledge-based economy." In this new model, innovation and talent are the primary drivers of economic performance and technological advance. China's leaders also understand that a knowledge-based economy requires a talent pool composed of high-quality scientists, engineers, and other competent professionals.

Stronger focus on talent

Millions of Chinese students have received degrees in science, engineering, and management since 1999, when undergraduate and graduate enrollments expanded significantly (see p.40). Government officials have tried to upgrade the existing Chinese science and technology (S&T) workforce and improve research and development (R&D) performance by dispatching many talented individuals overseas for advanced education and research experience to expose them to top international standards of science and technological know-how.

Several developments are driving demand for talent. Exposure to the outside world, particularly Western education and modern technology, appears to have stimulated entrepreneurial activities among many returning Chinese S&T personnel, who seek to convert their newly acquired know-how into new, commercially viable products and services. With government encouragement, multinational corporations (MNCs) are moving up the value chain by upgrading their manufacturing activities and adding substantial R&D capabilities to their China operations. Meanwhile, PRC businesses and officials at all levels seek access to the best and brightest Chinese talent. In fact, the competition for talent in China's business and research environment is growing fiercer each day.

This new, positive orientation toward talent and high-end knowledge seems to be paying off. The country's recent progress and future potential can be attributed to the increasing productivity and performance of the nation's emerging talent. But the question remains: Will there be an adequate pool of *qualified, experienced individuals* who can take on a leadership role in the research environment to enhance R&D productivity and improve prospects for the commercialization of new knowledge?

Quick Glance

- The number of college graduates in China has jumped in the last 10 years, but quality has not kept pace.
- Instilling a culture of innovative thinking and bringing its science and technology human resources up to international standards are China's top priorities in this area.
- Major educational reform, which has barely begun, will be necessary to achieve these goals.

Brain drain and other challenges

Despite high demand for S&T talent, close to one-third of Chinese college graduates over the last three years have been unable to find satisfactory employment. Anecdotal evidence indicates that the quality of these graduates may be lower than employers require: Complaints about the shortcomings of the Chinese talent pool are rampant among local and foreign business executives and government research directors. Based on fieldwork in China during the 2006–08 period and extensive interviews with more than 60 enterprise and government officials, China's talent shortage appears to be the result of four key factors.

First, the numerous overseas study and research initiatives that have occurred in conjunction with China's open-door policy have created a highly undesirable brain drain (see Table 1). The departure of talent constrains domestic access to the country's best and brightest human resources, hindering the progress of China's S&T efforts. Instead of working at Chinese universities or key enterprises, many of China's top scientists and engineers remain employed in the West.

Second, the effects of the education dislocations that occurred during the Cultural Revolution (1966–76) continue to be felt today, as China's R&D sector suffers from limited numbers of seasoned specialists and experienced managers. In response, the PRC government has launched extensive campaigns and a set of policy initiatives, including the most recent "Thousand Talent Program," administrated by the Department of Organization of the Chinese Communist Party (CCP) Central Committee, to recruit back to China large numbers of experienced individuals who can take on leadership roles in China's S&T system.

Third, the changing demographic composition of the scientific community in terms of age and work experience has started to affect the potential for future progress. China's population has begun to age, and the percentage of its workforce reaching retirement age will likely surpass the percentage of those in their college-bound years around 2015–17.

Finally, despite improvements in educational quality, most Chinese S&T graduates do not meet the international quality standards demanded by the advanced economy, which increasingly requires more flexible, technologically sophisticated, globally oriented individuals who can work effectively and ethically across borders and cultures. Almost half of the more than 1 million engineering students who graduated in 2008 completed three-year programs and lack the skills and knowledge of graduates from four- or five-year engineering programs at home and abroad. In contrast to the past, the main talent challenge is developing innovative potential, rather than more graduates.

The quality issues among many Chinese college graduates contribute, at least in part, to significant numbers of graduates having difficulty finding jobs related to their training. This raises questions about the value of their education and knowledge. Interestingly, there seems to have been an idealistic expectation among some PRC officials that a quantitative leap in enrollments would yield substantial qualitative improvements across the talent pool. In reality, China has yet to experience the type of scientific or technological leap forward that the highest levels of the PRC government and the CCP view as politically and economically imperative. It will take time for the desired type of sustained, concerted advance in S&T and innovative outcomes to occur, a fact that leaves Beijing increasingly uneasy in a world where innovation and technological

Table 1: Number of Chinese Students Returning from Study Abroad, 1999–2008 (1,000 persons)

Up to Year	Returned	Dispatched overseas	Returned (%)
1999	320	110	34.38
2000	340	140	41.18
2001	420	140	33.33
2002	583	153	26.24
2003	700	173	24.68
2004	815	198	24.29
2005	933	233	24.95
2006	1,067	275	25.77
2007	1,212	320	26.38
2008	1,392	389	27.96

Note: Numbers and rate are cumulative.
Source: PRC Ministry of Education

advance have become the hallmarks of global leadership in economic, military, and even political terms.

Having a large S&T workforce does not necessarily confer a significant quality improvement in terms of other various metrics associated with S&T progress. Given the size of its population, China still lags behind most developed countries in the number of researchers engaged in R&D activities on a per capita basis. Using this metric, China has a long way to go to catch up with South Korea, Russia, and Singapore. Of China's 758 million individuals in the labor force aged between 25 and 64 years in 2005, only 6.8 percent had attained a tertiary level of education; across the Organization for Economic Cooperation and Development (OECD) countries, the average is 26 percent—almost four times greater. The dramatic increase in student admissions in China in recent years has not been matched by a corresponding increase in government investment in higher education. As a result, China's overall investment in education still ranks among the lowest in the world measured by budgetary expenditure on education as a percentage of GDP and on a per capita basis, further complicating the task of improving quality.

Demographic shifts will influence China's high-end talent pool in S&T and its counterparts around the world in years to come. As an aging society, China will move into a comparatively disadvantageous position vis-à-vis India, which has a younger population. This will likely translate into an edge for India in terms of potential advantages regarding technology progress and economic growth. China must take full advantage of a narrow window of opportunity to create a qualified, highly competent talent pool capable of meeting the country's S&T goals.

What China can do

China can take several actions to ensure that its talent pool evolves in the right direction. First, it must address the structural obstacles to the training and use of the S&T workforce. This includes filling the gap between classroom education and quickly evolving job requirements, attracting qualified high-end talent to leadership positions, and providing continuous on-the-job training to upgrade the existing workforce's knowledge.

A key question is whether China can reduce its current excessive concentration of talent within the country's three technological hubs—Beijing, Shanghai, and Shenzhen, Guangdong. To so do, it must enhance the attractiveness of other regions by creating more highly paid jobs, fostering an environment that offers an attractive lifestyle, and facilitating career growth and providing unique professional development experiences. Despite the government's efforts

Table 2: China's Science and Technology Human Resources, 1999–2008

	Million persons			1,000 persons		1,000 person-years	
Year	Higher education	Bachelor's degrees and higher	Stock of S&T human resources	Total engaged in S&T activities	Scientists and engineers in S&T activities	Total FTE R&D personnel	FTE scientists and engineers in R&D activities
1999	NA	NA	NA	2,906	1,595	822	531
2000	31.5	10.0	25.0	3,224	2,046	922	695
2001	34.0	10.5	26.0	3,141	2,072	957	743
2002	38.0	11.0	28.0	3,222	2,172	1,035	811
2003	42.0	12.0	30.0	3,284	2,255	1,095	862
2004	48.0	13.0	32.5	3,482	2,252	1,153	926
2005	54.0	14.5	35.0	3,815	2,561	1,365	1,119
2006	60.0	16.0	38.0	4,132	2,798	1,502	1,224
2007	67.0	18.0	42.0	4,544	3,129	1,736	1,423
2008	NA	NA	NA	5,000	3,400	1,900	1,600

Notes: FTE = full-time equivalents; R&D = research and development; S&T = science and technology. "Scientists and engineers" refers to persons at senior or mid-level professional positions or with a university or higher degree. "S&T activities and staff" include R&D activities and staff. "Stock of S&T human resources" refers to those trained in S&T related areas at tertiary level regardless of whether they work in S&T.
Source: *China Science and Technology Indicators 2008*; *China Statistical Yearbook of Science and Technology*

to foster more rapid growth and development in western China, a clear trend shows China's talent base moving in just the opposite direction—primarily to Beijing, Shanghai, and Shenzhen, where talent availability is less of a problem. According to the China Association for Science and Technology, in 2004, 58.6 percent of the country's S&T human resources were located in eastern China, 23.0 percent in central China, and only 18.4 percent in the western region. One of China's distinctive attributes is that its second-tier provinces and cities are not necessarily inferior to first-tier coastal regions in S&T development and education. Therefore, more attention should be given to developing local talent and S&T infrastructure in Anhui, Hebei, Liaoning, Shaanxi, Shandong, and Sichuan. Ultimately, these provinces will become important driving forces behind the demand for talented personnel because of their underlying trade and investment strengths.

To remedy some of the present mismatches, the PRC State Council; the ministries of Education, Human Resources and Social Security, and Science and Technology; the People's Liberation Army; and the Communist Youth League have begun to work together to redirect talent resources to areas of immediate need. They have assisted with placement in rural areas and encouraged graduates to find jobs in small and medium-sized enterprises and move to the central and western regions of the country. Another effort focuses on internships. In February 2009, the State Council announced a three-year internship program to place roughly 1 million students at 2,000 Chinese companies.

Second, China will need to further increase its strategic investments in R&D to absorb more scientists and engineers and raise the sophistication and efficacy of their activities. Given the inefficiencies and frustrations associated with domestic institutions and enterprises, an increasing number of skilled young scientists, engineers, and other professionals have decided to work for foreign-owned businesses and joint ventures in China since about 2004. This internal brain drain to foreign-invested enterprises has begun to hinder the build-up of an indigenous innovation capability. Employees in the domestic talent pool are looking for better, more prestigious career opportunities and work experiences, opening the door for MNCs to outsource more of their operations to China. Though China's S&T talent gains from working for MNCs and being exposed to international standards and cutting-edge technology, whether they will eventually become the next wave of technological entrepreneurs remains to be seen. Retention and effective use of the current reservoir of scientific, engineering, and managerial human capital are vital for China's future S&T development.

Third, China needs to more deeply and broadly instill a culture of creativity into its students, S&T workforce, and overall education and R&D environment. The lack of creativity among many Chinese has been attributed to rote learning. Students are seldom encouraged or taught to challenge their teachers, think creatively, take risks, or tolerate failure as a means to progress. Chinese education needs to not only reconfigure the curriculum to accommodate the evolving social, economic, legal, and political environment but also introduce a new pedagogical approach to stimulate more inventive and innovative thinking. Although China has recognized the need to change the educational system to encourage innovative thinking, reform in this area has been slow and uneven.

China's top priority regarding its talent pool will likely be to lift the professional standards of its S&T workforce. This high-level strategic goal requires long-term commitment and

Implications for Foreign Companies in China

The competition for talent in China will increase steadily over the coming years. Foreign companies in China must develop an effective pipeline to recruit, train, develop, and retain critical talent resources, especially at the middle and senior leadership levels, that can drive innovative thinking. They must also make an effective talent strategy a key part of business planning. Foreign firms can establish a critical competitive advantage in this area, as Chinese firms and research institutes still lag in establishing a sophisticated approach to talent recruitment and management.

Extensive career planning, so that high-end talent in China have a roadmap of their professional development and job options, will be key to this effort and could help pre-empt premature departures and turnover. In addition, companies must be clearer about performance-based metrics and incentives (soft and hard) so that employees will understand how their work will be evaluated.

To attract talent, foreign firms need to create talent incubators that address some of the weaknesses in the education system within the context of sustained training programs. Foreign firms should also be prepared to develop a global supply chain for talent—relying on an "anytime, anyplace, anywhere" approach to recruitment. The recruitment process might include developing key databases with information on which Chinese are coming out of the education pipeline in science and engineering in the United States and other countries. Companies should also expand internship and co-op programs to prepare fresh graduates for the real work environment and achievement expectations. Finally, companies must pay more attention to creating a locally developed leadership pipeline of globally oriented, innovative individuals so that the transition of China operations from expatriate-driven to locally led goes smoothly (see p.28). This will be especially important for foreign firms whose Chinese products and services are fully integrated into a global supply chain.

—Denis Fred Simon and Cong Cao

investment, and PRC leaders must take concrete steps now to enhance the chances of realizing China's innovation goals in the future. Convincing top scientists and engineers who live and work abroad to return can help facilitate this transition. Various provinces and cities across China are sending missions to recruit persons of Chinese ethnic origin to leave university and corporate positions overseas to take on attractive, well-compensated positions back in China. In addition, domestic firms such as Alibaba.com (China) Ltd. are addressing their own talent needs. In December 2008, Alibaba received permission from the PRC Ministry of Human Resources and Social Security to establish its own post-doctoral S&T research center, which will launch 13 research programs and recruit 15 post-doctoral researchers.

What does the future hold?

Even taking into account the multiple challenges that PRC leaders must address in cultivating an effective S&T human resource pool, China's science, technology, and managerial base clearly constitutes an emerging source of competitive advantage in economic and technological terms. However raw or immature the Chinese talent pool may be, there are good reasons to believe that China is addressing the present set of shortcomings in a concerted, coherent fashion. The question for China and the rest of the world is not *if* China's talent will become a source of competitive advantage, but, rather, when and under what conditions. The confluence of forces at work indicates that the global S&T community should not discount China's potential as an important source of invention and innovation.

The critical missing piece of China's innovation puzzle, however, seems to lie in better deployment and use of the evolving contingent of S&T talent. The hurdles that must be overcome are as much about workplace environment and performance expectations as they are about macro-strategic issues related to setting the right S&T priorities and providing sufficient funds to ensure a high probability of success.

Some observers have suggested that deep cultural inhibitors stand in the way of establishing a more creative, innovative atmosphere in China. Clearly, culture plays a role to the extent that it helps to shape the operating milieu that represents the face and internal workings of Chinese society. But the more significant underlying shortcomings derive from the still transitional nature of the reforms and incomplete structural changes taking place in the S&T system. In essence, China has yet to fully realize an achievement-oriented set of norms and values that fully defines the framework of performance, compensation, rewards, and incentives. Nor have many Chinese organizations been able to assimilate completely into their own operating environments critically needed notions of personal responsibility and accountability that have long been associated with socio-political and economic advance in the West. These limitations moderate the efficacy of several new policy initiatives and financial investments coming out of Beijing.

China needs to more deeply instill a culture of creativity into its students, S&T workforce, and overall education and R&D environment.

The attractiveness of the Chinese high-end talent pool will remain a magnet for bringing China into the mainstream of world scientific and technological activities and knowledge networks. In some cases, key segments of this pool will become the engine behind the formation of emerging pockets of excellence in Chinese S&T. These pockets of excellence will be characterized by a somewhat different set of operating features and principles than the bulk of China's S&T system. Members of this talent community, large numbers of whom will have spent time abroad, will represent the cutting edge of an emerging wave of Chinese technological entrepreneurs who will help to redefine the operating environment for knowledge creation and innovation in China by bringing into play a number of the key factors frequently associated with successful innovation in the West. Most important, however, this group of high-end talent will be the mechanism through which more foreign collaboration and cooperation occurs. Interested observers of the Chinese S&T scene, therefore, must be able to identify the unique features of these emerging pockets and understand where and how they will appear. Competition for the brainpower that resides in these pockets will become one of the key defining features of the West's interactions with China over the coming decades and could become the primary vehicle for helping to ensure China's role as a stakeholder in global S&T affairs. 完

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China's Workforce Climb

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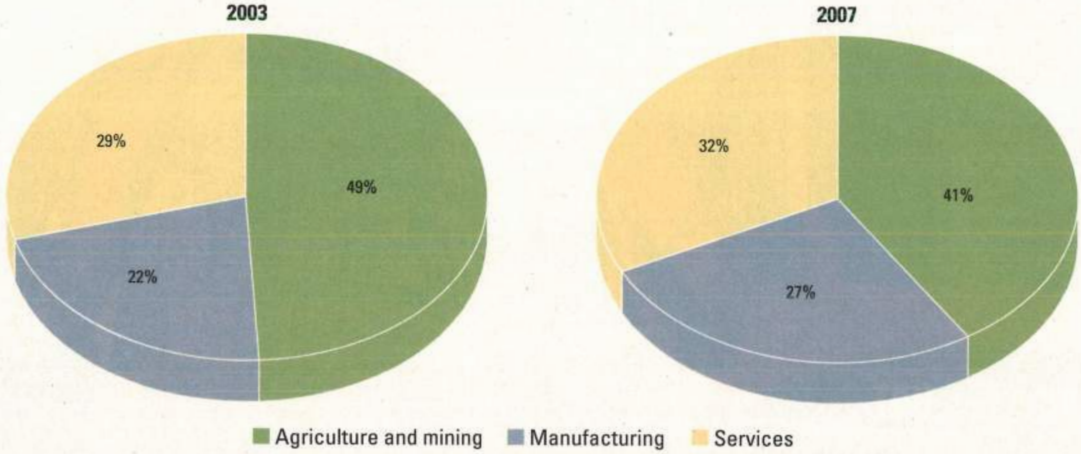
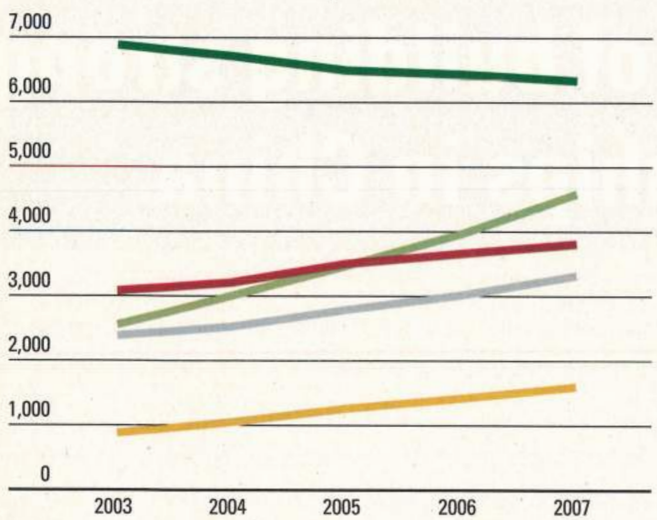
Employment by Industry



Employment in private enterprises has nearly doubled since 2003, while the state sector has shed workers.

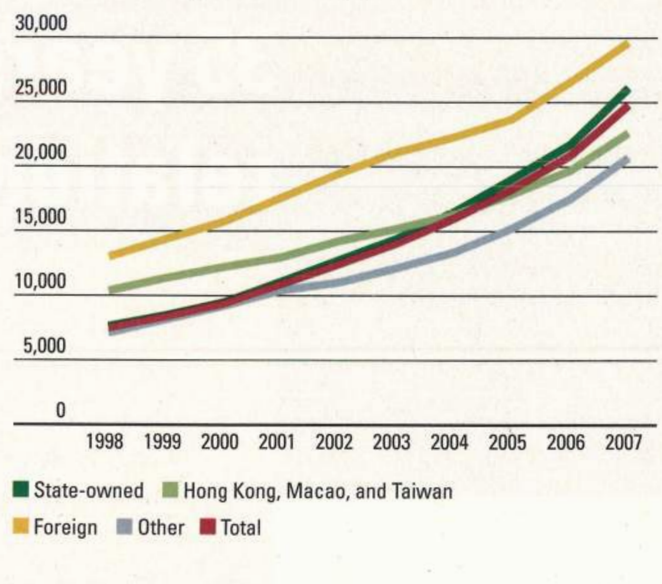
Urban Employment by Firm Ownership, 2003–07 (10,000 persons)



*Note: Foreign-funded enterprises include enterprises that receive investment from Hong Kong, Macao, and Taiwan.

Employees of foreign firms earn more than those of other firms, though state-owned enterprises have narrowed the gap.

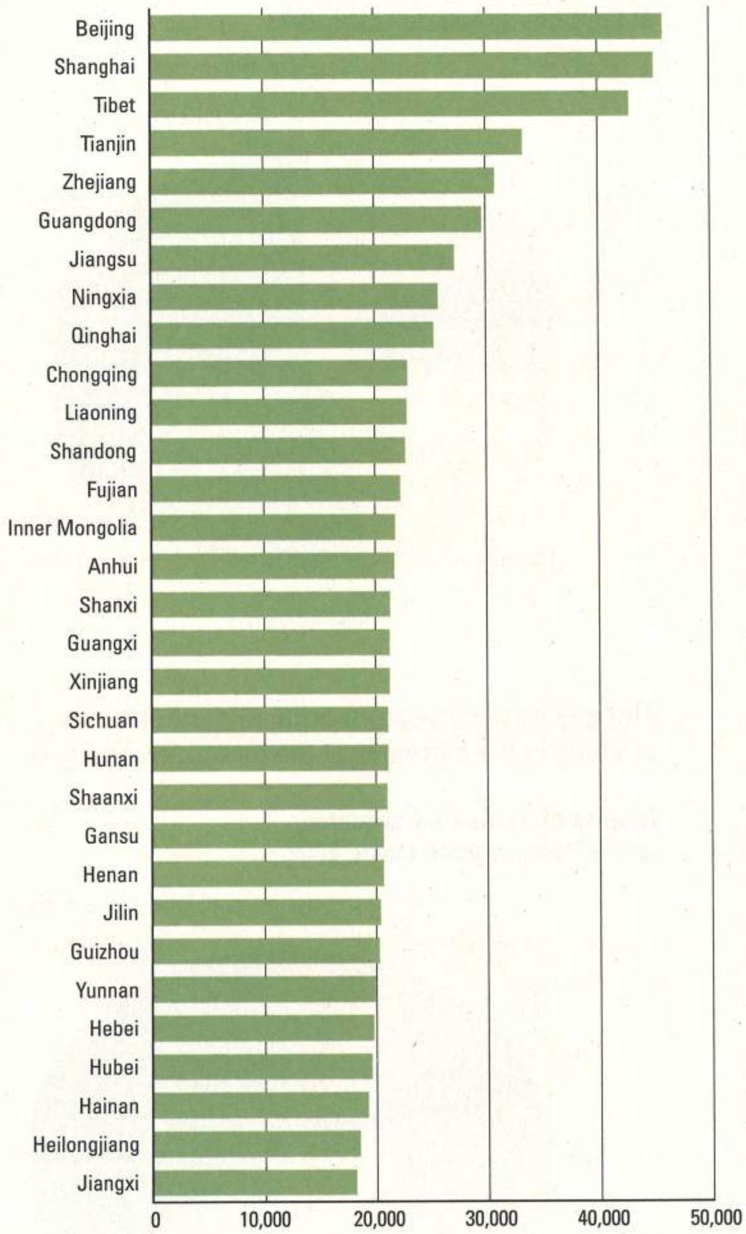
Average Urban Earnings by Firm Ownership, 1998–2007 (¥)

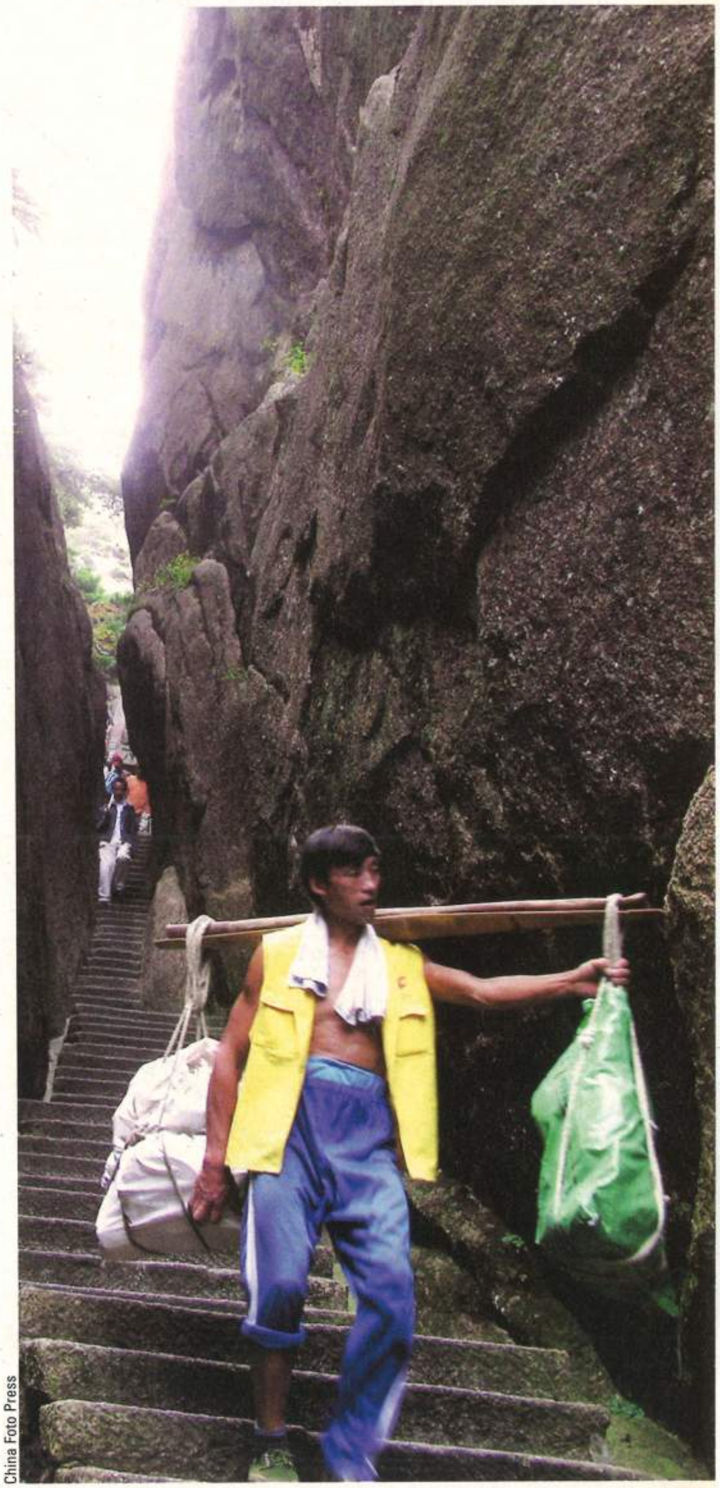


he Value Chain

Workers in eastern China, where reforms and the open-door policy have led to rapid economic growth, generally earn more than workers in central and western China.

Average Urban Earnings by Region, 2007 (¥)





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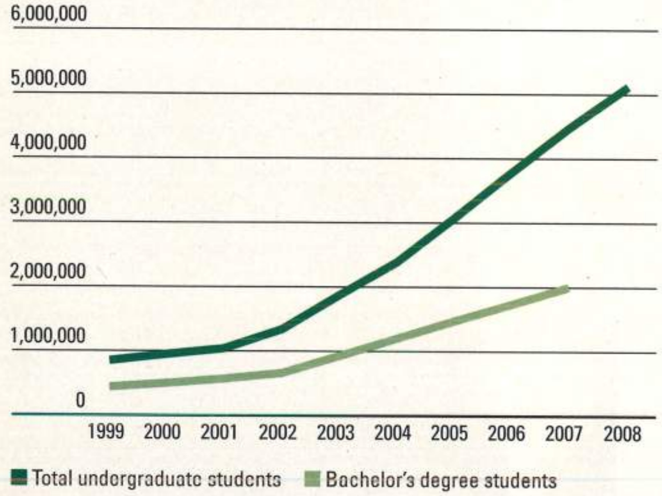
HIGHER EDUCATION

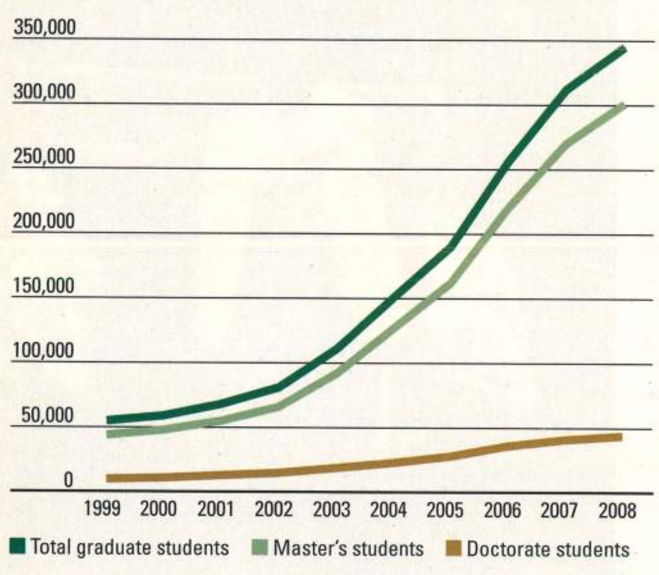
The number of students in nontraditional programs has grown much more quickly than the number of students in four-year programs.

Undergraduate Students in China, 1999–2008



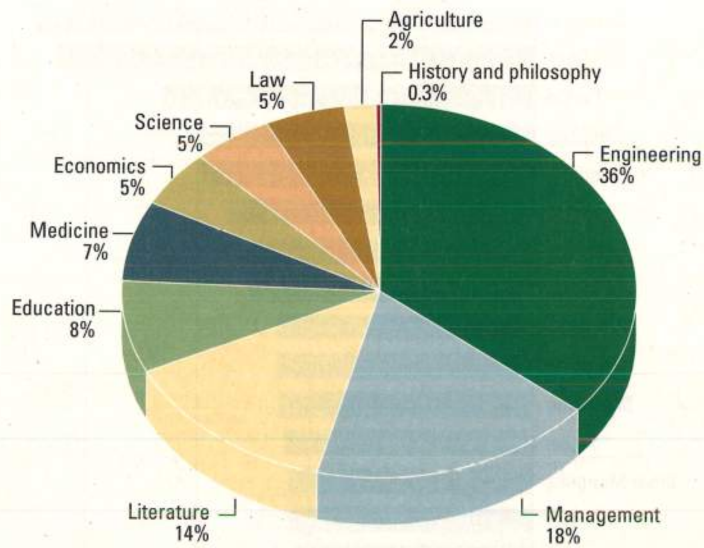
More Chinese students are pursuing advanced degrees, but a relatively small number go beyond a master's degree.

Number of Graduate Students Graduated in China, 1999–2008



More than one-third of China's undergraduates major in engineering, but relatively few study social sciences.

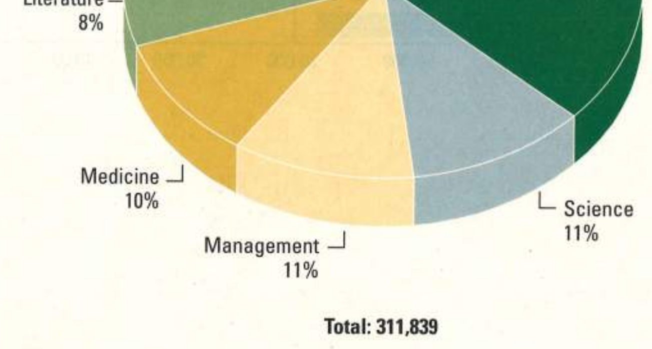
Majors of Students Graduated at the Undergraduate Level, 2007



Total: 4,477,907

The gap between engineering and other fields of study is even greater at the postgraduate level.

Majors of Students Graduated at the Postgraduate Level, 2007



Total: 311,839

Sources: *Educational Statistical Yearbook of China*, PRC Ministry of Education, PRC National Bureau of Statistics, *China Statistical Yearbook 2008*.

China Foto Press

China offers skilled providers at competitive rates.

China's Emerging Role in Global Outsourcing

China's outsourcing providers are improving their quality, setting the stage for the country to become a top world player.

Ning Wright

China has made major strides in laying the groundwork for a diverse and successful outsourcing industry in recent years. Central and local authorities have demonstrated a quiet determination to promote information technology (IT) and other business services industries across the country. They have also launched initiatives to develop education, training, and other supporting infrastructure.

As a result, China is quickly building a strong outsourcing industry, and emerging outsourcing players already have strong credentials. Like India, whose emergence as an outsourcing location was export-driven, China has a strong export platform on which to build an outsourcing industry. But China also has the strength in its domestic market to create a deep services base and has already established strong ties in the Japanese and South Korean markets.

Despite China's significant progress in this area, a few challenges—such as a fragmented outsourcing industry and shortage of people with international business skills—remain. In addition, many domestic and foreign business leaders recognize that China's outsourcing industry could market its strengths to the international community better and that the industry lacks a unified voice to represent it and establish its credentials. Buyers of outsourcing services have a wide array of locations and vendors to choose from and, without realizing the outsourcing strengths of various cities in China, may choose to outsource work to another country instead. Multinational corporations (MNCs) should investigate the opportunities and risks in China's rapidly growing outsourcing industry.

The growth of global outsourcing

Globally, only 10 percent of MNCs outsourced IT work offshore in 2002, but that figure had risen to 70 percent by 2008, according to Oppenheimer Equity Research. Gartner Inc. estimates that by 2012, the worldwide IT services market, which is the largest segment within the outsourcing industry as a whole, will top $1 trillion.

As the outsourcing industry has become increasingly sophisticated, suppliers have also progressed to specialize in niche areas, such as legal services, animation and gaming, e-learning, online tutoring, offshore engineering, high-tech and telecom engineering, and pharmaceutical research and development (R&D). Analysts expect outsourcing and offshoring in these sectors to skyrocket in the coming years. For example, offshore engineering is expected to grow from $10–$15 billion in 2006 to $150–$225 billion by 2020.

Quick Glance

- China's outsourcing industry has several strengths, including government support for the industry, employees with advanced technical and language skills, and competitive wages.
- But the outsourcing industry also has some weaknesses—for example, the level of employees' technical and language skills varies widely across the country.
- Companies that conduct due diligence and manage risks effectively may find China a favorable place for outsourcing.

Development of China's outsourcing market

China's outsourcing market is in its infancy, accounting for a fraction of the $1 trillion-plus global market for offshoring and outsourcing, according to McKinsey & Co. But the market is quickly evolving.

In 2007, China's outsourcing market (including work outsourced within China) weighed in at $15.2 billion, with IT outsourcing and business process outsourcing (BPO) exceeding $9 billion and $6 billion, respectively. Revenues from work offshored to China rose more than 40 percent in 2007, reaching $2.3 billion or 15 percent of the total work outsourced. By 2010, the value of offshore work done in China is expected to more than double, hitting $5.6 billion, or 20 percent of the total.

Gains in China's offshore contracts, largely for IT, far outpace those of the global market. A VanceInfo Technologies Inc. report forecasts China's IT outsourcing growth to soar 30 percent annually from 2009 to 2013, compared with an impressive but more modest 19 percent growth elsewhere in the world for the same period. Oppenheimer Equity Research and IDC, a subsidiary of International Data Group, predict similarly large gains for work outsourced to China—$7.1 billion in 2010, and up to $8.9 billion in 2012, respectively.

China now has more than 6,600 outsourcing firms that provide services for foreign companies, according to the PRC Ministry of Commerce (MOFCOM). These companies generate annual revenues of more than $50 million.

Several studies and rankings track China's progress as a popular destination for outsourcing of IT and other business services:

- In a 2008 IDC report, three Chinese cities made the list of top 10 most attractive Asian Pacific cities for outsourcing. The report forecasts that, by 2011, Shanghai will beat Bangalore for the top spot; Dalian, Liaoning, will rank third; and Beijing will rank fifth.
- China ranked second in the world as an outsourcing destination in A.T. Kearney's 2007 (and 2005) scorecard, which weighs financial attractiveness, people and skills availability, and business environment.
- A 2007 *R&D Magazine* survey of US-based organizations that offshored their R&D work showed that about 18 percent offshored some work to China and 19 percent offshored some work to India.

From East to West

In the past, Japan and South Korea have been the primary clients of China's offshore industry. In 2007, these two countries comprised 52 percent of China's offshore software development market. Chinese services providers are, however, adapting their strategies and expanding globally to win significant contracts from major MNCs. MNC subsidiaries in China account for a large portion of the software development market.

In 2007, North American and European business made up 40 percent of all offshore work done in China and revenues from these sources grew by 61 percent over 2006, compared to a more modest 32 percent increase from Japanese and South Korean markets. By 2010, these Western clients will likely account for 50 percent of China's offshore software market, according to IDC forecasts.

Hong Kong's role

Chinese vendors are beginning to tap Hong Kong to bring in business from banks, insurance companies, and law firms. Hong Kong offers several key advantages: It is an avenue for raising funds, a hub for project management, and a management support center that understands international business requirements and expectations. Chinese vendors can also fairly easily provide

China's 20 Designated Strategic Sourcing Locations

Source: KPMG New Dawn

lower-cost back-office support to Hong Kong-based companies.

China's domestic market

The next wave of customers is likely to come from enterprises that are new to outsourcing, most notably domestic Chinese companies. Already an emerging force, local demand for IT and BPO services in China is projected to nearly double from $10.5 billion in 2006 to $20.6 billion in 2010. According to the National Association of Software and Services Companies (NASSCOM), the main trade body and chamber of commerce of the IT-BPO industries in India, as more Chinese companies recognize the need for outsourcing, complementary skills, local and international experience, and industry practices together with cost saving will be the priority. China's numerous outsourcing services providers are well-positioned to fulfill these needs.

China's strengths

Today, Chinese outsourcing providers work with companies from around the world. Many have signed long-term contracts with blue-chip customers, including Microsoft Corp., Hewlett-Packard Co., and Oracle Corp. Chinese firms provide MNCs with a range of services—from back-office administrative work and customer service requests to increasingly high-end IT, business-process, and knowledge-management activities.

Skill levels have improved steadily. A McKinsey & Co. survey of 75 Chinese software and IT services companies found that the number of Chinese vendors achieving Capability Maturing Model (CMM) level 4 or 5 certification grew by about 39 percent each year from 2004 to 2007. (CMM is a framework for applying quality management principles to software development. Five is the highest level.)

Chinese vendors also offer specific business knowledge in areas such as banking, insurance, and healthcare. Such specialization creates closer links between vendor and client, resulting in higher productivity and profitability for both.

Government support for outsourcing

For several years, the PRC government has emphasized the development of IT as a complement to the nation's strength in manufacturing. The initial focus was on hardware production, but the 11th Five-Year Plan (2006–10) shifted the emphasis toward IT services. A broader strategy through 2020 (China's 15-year plan for the development of science and technology) calls for development of a robust IT economy, driven by science and home-grown innovation, that supports the domestic and global industry and provides higher-value services jobs.

Core to China's services outsourcing initiative is the "1,000-100-10" project, established by MOFCOM in October 2006. With total funding of more than $1 billion, the project aims to double China's services exports by establishing 10 Chinese cities as outsourcing bases, attracting 100 international corporate customers to offshore in these cities, and assisting the development of 1,000 outsourcing vendors that can meet the demands of MNCs. The plan, and its related policies, calls for:

- Funds and incentives to improve training in technical skills and upgrade quality standards to achieve international certification levels;
- A framework to improve intellectual property rights (IPR) protection;
- Improvements in infrastructure to support the outsourcing industry;
- Loans and credit insurance for outsourcing enterprises;
- A ¥4,500 ($660) subsidy to vendors for every new college graduate employed for at least one year;
- Interest rates that favor exporters of software services;

- Priority for software businesses applying for public listings on domestic or overseas exchanges;
- Support for R&D centers set up by domestic businesses with academic institutions; and
- Tax breaks to encourage development outside key outsourcing centers.

Since these details were announced, the PRC State Council has designated 20 cities as services outsourcing hubs (see Map). Some cities that have emerged in recent years as new IT and BPO destinations specialize in certain industries. For example, Changsha, Hunan, is building on its education, research, and training foundation to become a hub for outsourced animation services. Hangzhou, Zhejiang, has positioned itself as a hub for financial services outsourcing. And Dalian is known as an important IT and BPO center for large Japanese companies, including Sony Corp., Panasonic Corp., and NEC Corp.

Advanced technical skills

One of China's strengths in outsourcing is its vast talent pool of skilled technicians and engineers. In 2006, China graduated more than 1.5 million engineering majors, according to the PRC National Bureau of Statistics' 2007 *China Statistical Yearbook*. In comparison, the United States graduated 124,388 engineering and engineering technology majors in 2006, according to the US-based National Science Foundation. (These countries may define "engineering graduates" differently.) Moreover, China produced 41,464 PhD graduates in 2007, of whom nearly 14,500 were in engineering and over 8,000 were in science. Chinese returning home with degrees from top schools in the United States, Canada, and the United Kingdom provide another source of high-quality talent.

Though China has a massive pool of engineers at the entry level, they will need to gain work experience before the market has enough senior project managers (see p.34). ChinaSoft's CEO of IT outsourcing services points out that senior-level program managers and architects still account for a low percentage of the country's domestic outsourcing market workers.

Foreign-language skills

PRC officials and outsourcing companies have recognized the need for advanced English-language skills to win business from Western markets and compete with rival locations in India and the Philippines. The PRC government has made English instruction a strategic priority at universities and even in primary school, where English as a foreign language is mandatory beginning in the third grade.

Another boost to China's outsourcing market is the roughly 2 million Chinese who speak Japanese or Korean, a particularly key consideration in northeastern hubs such as Dalian.

Competitive wages

China also compares favorably in terms of wage costs, although average billing rates vary widely across regions. Wages in Shanghai and Beijing tend to be higher, and wages in second-tier cities—such as Wuxi, Jiangsu, and Chengdu, Sichuan—are lower. Charge-out rates in China are generally 30 percent to 50 percent less than India's prevailing rates. NASSCOM estimated in 2007 that the wage cost of a newly graduated engineer started at $250–$300 per month in China, far less than the average wage cost of $750–$1,000 per month in India. For higher-level IT jobs, the wage gap between China and India is smaller, partly because wages have increased 15 percent annually in China's software industry in recent years.

Challenges for outsourcing to China

Location

As in India, the availability of technical skills, language skills, and other resources in China varies enormously from one location to the next. Many sites within China compete for investment, and companies must understand each region's strengths and weaknesses.

IPR protection

IPR protection is a particularly important issue in outsourcing, especially when vendors have access to sensitive data. Most outsourcing service providers in China have adopted strict security measures to prevent customers' intellectual property from falling into the wrong hands.

Many companies are still concerned about how to protect their IPR, however (see the *CBR*, March–April 2009, p.17). PRC government efforts to resolve the problem, such as promoting the installation of licensed software at enterprises, have led to a reduction in IPR infringement. Since China entered the World Trade Organization in 2001, clearer measures to protect copyrights and patents have also helped, but there is still room to improve IPR enforcement.

Competition and collaboration with India

China's market fragmentation is becoming more pronounced as competition from abroad, especially India, increases. Indian companies, including Infosys Technologies Ltd., Wipro Ltd., and Tata Group, are rapidly establishing footprints in China, bringing with them many years of experience working with large multinational customers.

Some forward-thinking Chinese service providers are already considering how to work with Indian vendors in complementary ways. This collaboration could include sharing human resources and training facilities. Indian and Chinese companies could also team up to provide end-to-end technology jobs—China focusing on its strengths in hardware and India on software. Indian companies could leverage lower costs in China for back-office work, while Chinese firms could gain maturity and experience by serving international clients.

The availability of skills and other resources in China varies enormously from one location to the next.

China: An emerging leader in outsourcing

Because of the PRC government's focus on and investments in technology, education, and infrastructure—and China's strong entrepreneurial culture—the country has emerged as a favorable destination for IT and business process outsourcing. China's large companies and financial institutions are also exploring outsourcing, and they represent an attractive market with considerable potential for companies that provide outsourcing services. Problems and risks still exist in China's outsourcing sector, but companies that understand and manage those risks effectively—by using independent advisors with local and global knowledge and experience and by conducting due diligence—can achieve a competitive advantage.

With today's economic conditions posing severe challenges for business, more companies are positioning themselves for the eventual recovery and evaluating the effective use of external providers to help them support and expand their operations. China has made itself a key location by enhancing skill availability, making focused investments, and addressing IPR concerns. 完

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China Foto Press

China's auto manufacturing industry is ripe for consolidation.

The Coming Wave of Consolidation in Chinese Industries

Companies should understand consolidation trends in China to better handle changes within their industries and take advantage of investment opportunities.

Seth Harlem and Ron Schramm

Consolidation within industries will be a central theme in China's efforts to restructure its industries and promote industrial modernization in the coming years. The significance of consolidation for China and why it is likely to take place are particularly acute questions during the current economic crisis, when firms within certain industries are under great pressure to perform, merge, be acquired, or vanish.

The consolidation process can be thought of as a rationalization within an industry where firms that are not operating at their full potential either go out of business or are folded into more efficient firms. The competitive process generally leads to firms operating at an optimal size within an industry, depending on such factors as market-based or geographic niches. In the early stages of an industry, when companies usually make above-average profits, firms of varying levels of efficiency are able to stay in business. Furthermore, with new entrants the number of firms in the sector surges. Eventually, though, inefficient firms drop out and industries stabilize with fewer, but on average larger, companies. Innovation and regulatory changes put pressure on inefficient firms, and the macroeconomic slowdown will reduce profits; these developments force inefficient firms out of business and are among the major causes of industry shakeouts.

These major causes—combined with government encouragement—set the stage for widespread industry consolidation. China's industries are just beginning this process. As Andy Rice, senior vice president for International Business at the Jordan Co., puts it: "There will be a lot of opportunities from consolidation in China, and many reasons for consolidation to occur." As consolidation unfolds in China, a number of opportunities will emerge that could provide enormous benefits for Chinese consumers, surviving companies and employees, investors, and businesspeople who assist in the process.

Examining China's industrial landscape

To determine the likelihood and readiness of industry shakeouts or consolidations, China Macro Finance, LLC (CMF) recently examined a sample of 10 industries in China: bituminous coal, cement manufacturing, auto parts, motor vehicle manufacturing, metal shipbuilding, dairy products, cotton and chemical fiber, sewage treatment and recycling, pharmaceuticals (original drug manufacturing), and rubber parts. The first five industries were selected because the PRC government has announced plans to consolidate them; the second five industries were selected at random from CMF's database on private Chinese companies (see bottom right).

The 10 industries contained 33,651 companies and totaled 12.3 million employees. The data allow analysis of the current state of particular industries and the future of those industries—specifically the possibility of industry consolidation. Furthermore, combining this information with PRC government consolidation goals highlights opportunities for investors and key due diligence insight for companies seeking healthy, stable partners that will be on the right side of an industry shakeout.

For instance, China's auto industry is one of the industries slated for consolidation. The auto industry revitalization plan, released in March 2009, aims to consolidate many small, regional manufacturers into a group of "Big 10" internationally competitive auto manufacturers. CMF data suggests that the auto industry is ripe for consolidation. How does consolidation in an industry such as auto manufacturing benefit foreign companies? A February *Wall Street Journal* article explained: "The weeding out of [small Chinese auto] companies...could in the short term benefit big foreign auto makers such as Toyota Motor Corp. and Volkswagen AG by reducing competition in the world's second-largest car market after the US. Upstart auto makers have put enormous downward pressure on retail prices for cars in China, hurting foreign players' profitability." Of course, as the article points out, consolidation could also help the remaining domestic companies.

Quick Glance

- Many Chinese industries will likely consolidate in the next few years through a convergence of government and natural-market pressures.
- The consolidation of industries will provide new investment opportunities for companies.
- Companies should track industry trends to ensure they are selecting sound partners and making wise investment decisions.

An analytical look at the consolidation potential

Though Chinese industries appear to follow the same theoretical statistical distributions for firms in an industry found anywhere else in the world, the specific underlying metrics differ and are revealing. Industries around the world tend to have a large number of small firms (1–5 employees) and a small number of large firms, where the latter are responsible for producing the lion's share of industry output. Such a pattern leads to an average firm size greater than median firm size, which in turn is greater than the modal firm size. This pattern also holds for China, but Chinese industries have not yet reached the metric norms that one would expect in a mature, consolidated industry.

CMF's proprietary data on private Chinese companies were used to examine the above 10 industries in China to see how they compare to benchmarks for consolidated industries; CMF reviewed benchmarks indicated by numerous studies across industrialized countries and thousands of companies. Firm size for each Chinese industry was gauged based on the number of employees at each firm. (Number of employees has been shown to be an effective measure for firm size, but results using revenues would be similar.)

The table compares Chinese industry consolidation with international benchmarks (see Table). The row marked "C parameter" is an index of how consolidated an industry is, based on the Zipf statistical distribution model. (C values close to zero suggest great potential for consolidation, while those close to one suggest that the industry has already consolidated. Values lower than one suggest that more consolidation is still possible.) In the United States, where industry consolidation is mature,

China Macro Finance (CMF) Analytics

To provide financial and investment insights on private Chinese companies and industries, CMF collected and analyzed data on 430,000 private Chinese companies for its proprietary financial tool and database, CMF Analytics. The companies covered in CMF Analytics represent 49 percent of China's non-agricultural gross domestic product. CMF covers 39 key industries in the mining, manufacturing, and utilities sectors.

—Seth Harlem and Ron Schramm

"C" is close to one. The C parameter data indicates that each Chinese industry examined has great potential for consolidation.

The figure shows a typical distribution of firms in China's rubber parts industry compared to what a mature, consolidated industry would normally look like (see Figure). The figure reveals that China has too many small and medium-sized enterprises (SMEs) and not enough large firms. China has 44 rubber firms with more than 500 employees; the largest is the Zhongding Group with 9,565 employees. In contrast, the United States has 129 rubber firms with more than 500 employees. The average number of employees in the United States for all industries is around 840 per firm—in China the figure is 239. Over time, the rubber and other industries in China will likely gravitate toward the degree of scale and concentration found in the United States.

Another way of looking at the shortfall in consolidation in China is to use the "80/20 Rule" (or *er ba dinglu* in Chinese), which is used in the West and China. According to this rule of thumb, based on the Pareto statistical distribution model, about 80 percent of output will come from the largest 20 percent of the firms in an industry in a mature, consolidated economy. The table shows that few industries in China exhibit this characteristic. The cement industry falls short by the largest amount with 32 percent fewer firms in the top 20 percent than expected, followed by the sewage treatment and recycling industry down to the auto industry, which is close to what one would expect for the top 20 percent of firms. Interestingly, the bituminous coal industry appears to have an excess of firms at the top, perhaps because of its central role in the historical development of industry in China. Examination of other industries (auto parts, for example) shows an excess of small firms compared to the norm in more mature economies. Though each industry has its own characteristics, the general picture is the same across the industries examined: The industries have too many SMEs relative to large firms, and the largest firms are still too small.

Drivers of China's industrial consolidation

A variety of China-specific factors will lead to greater concentration in Chinese industries in the next five years:

■ **Falling provincial barriers** Since economic reform began, local and provincial governments have built their own enterprises, often protecting them with measures that keep out competitors from other parts of China. For example, the top 10 cement firms in China—including the Shandong Shanshui Cement Group Ltd. and the Conch Cement Co., Ltd.—are located in seven provinces, implying that each province has protected local industry and promoted its own "cement champion." As market forces and the central government pull down provincial walls, several factors—some of which are discussed above—will likely drive a few of these firms to merge. (CMF's research examined the consolidation potential of each industry from a national perspective—not from provincial and local perspectives. Provinces and cities in China that have many small companies in an industry designated by Beijing for consolidation may view such policies as damaging to their economies. Firms operating in consolidating industries in China will need to cooperate with all levels of government and balance central policies with local conditions.)

■ **Tax and legal reforms** In the past, provinces attempted to block consolidation because local officials feared that a local company's acquisition by a company from a different province would reduce the jurisdiction's value-added tax (VAT) revenue. In recent years, however, China has reformed national tax laws to allow VAT to be reallocated based on where in China value is added.

■ **Financial system enhancements** As the country's financial system becomes more sophisticated, new financing modes will make China's vast pool of savings increasingly available for domestic mergers and acquisitions.

■ **Economies of scale** As discussed above, many firms in the 10 industries examined are not large enough to produce goods at low, competitive costs. Compared to more mature industries in advanced economies, China has fewer large enterprises and many more SMEs.

Measures Used to Determine Consolidation Level of 10 Chinese Industries

Industry	Auto parts	Fibers	Cement	Coal	Rubber	Drugs	Dairy	Sewage treatment & recycling	Metals	Vehicles	Average
"C" parameter	0.68	0.67	0.65	0.60	0.60	0.57	0.56	0.53	0.49	0.39	0.57
Median no. employees	130	150	170	200	80	109	117	54	163	631	180.4
Average no. of employees	211	289	236	696	165	289	280	88	476	2,197	492.7
Largest firm (by no. of employees)	17,850	158,288	6,074	NA	9,565	11,089	10,034	698	9,352	10,493	25,938
80/20 Rule shortfall	-19%	-8%	-32%	8%	-21%	-11%	-16%	-26%	-8%	-4%	-14%

Notes: Industries in blue are industries where the PRC government has identified a need for consolidation. The row marked "C" parameter is an index of how consolidated an industry is. C values close to zero suggest great potential for consolidation, while those close to one suggest that the industry has already consolidated. The results indicate that each industry examined in China has great potential for consolidation. NA = not available.
Source: China Macro Finance, LLC (CMF)

■ **Economies of scope** Firms can find economies of scope in producing a wider range of complementary products, but most firms in China produce a limited range of products. Mergers and acquisitions are an excellent way to edge into new product lines.

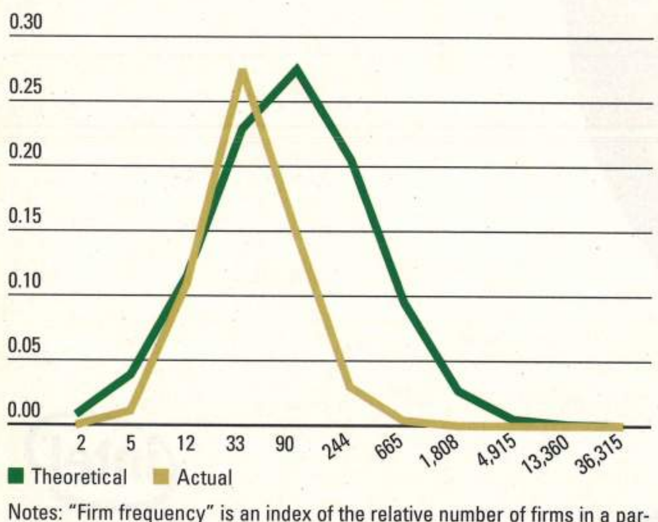
■ **Quality standards** China has leveraged its cost advantage, but quality standards have not kept pace. In the coming years, consolidation will allow for a new focus on quality. Key Principal Partners Corp. Chair John Sinnenberg says: "In markets growing as quickly as some of the markets in China, the ability simply to supply product qualifies one as a supplier. Customers will eventually factor in quality (including on-time delivery), and marginal players will disappear. The problem at the moment is that quality suppliers cannot get paid for their service as their customers are not used to measuring the total cost of quality."

■ **Integration of operations** As some firms move operations and transcend provincial boundaries, other firms will follow their suppliers and customers, consolidating and integrating operations in even more industries.

■ **Rise of Chinese competitors** China hopes to create globally competitive firms to expand sales around the world and to protect domestic industries from foreign competition. Large firms that can generate domestic profits will be best placed to compete globally, particularly in areas such as research and development and marketing.

> Chinese industries have too many SMEs relative to large firms, and the largest firms are still too small.

Theoretical vs. Actual Distribution of Rubber Part Firms in China



Notes: "Firm frequency" is an index of the relative number of firms in a particular size category. A natural log scale is used on the x-axis consistent with the conventional assumption about firm size and distribution.
Source: CMF

The significance of consolidation in China

China's real economic growth in the next few years will rely less on the raw accumulation of resources, such as capital, land, and human resources, and more on productivity improvements realized through technological progress. Part of this progress will occur as a result of industrial consolidation. The merging of firms and the shutdown of inefficient firms will be a major driver of China's economic growth and prosperity. This type of transformation will improve living standards in China and reap returns for foreign and domestic investors in successful companies.

In contrast to Western economies, where consolidation usually occurs as a result of market forces, in China, the government plays a significant role in prescribing certain industries for consolidation—the cement industry being a prime example. The alignment of market forces and government goals will likely drive industry consolidation in China. Nevertheless, private sector firms, such as domestic and foreign private equity and process improvement firms, will see great opportunities no matter what drives industrial consolidation in China. The growth of truly global Chinese firms will profoundly affect China and the rest of the world as global players across a wide variety of industries will find that there are a few very large "new kids on the block."

Greater competition will change the landscape of global business. Previously unrecognized brands will rise to prominence. Consumers will find a new array of products and designs at more competitive prices. Some multinationals will find themselves on the outside looking in as new domestic giants are created in China; others will find themselves part of a process of acquisition-fueled growth, becoming giants themselves. 完

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The Race for Regional Headquarters

Though the regional headquarters policies of China's largest cities have garnered the most attention, smaller cities may offer similar incentives.

Takes Off

Foreign companies should compare local policy incentives to choose the best site for their regional headquarters in China.

James Yong Wang and Tony Zhang

China's major cities have been competing to attract regional headquarters (RHQs) since the late 1990s. In 1999, Beijing was the first city to issue provisions that encouraged foreign-invested investment companies (FIICs) approved at the central level to establish RHQs in the city. (FIICs are companies established to hold and manage foreign-invested enterprises [FIEs] in China for their foreign parent companies.) Shanghai followed in 2002 with a new policy that encouraged FIICs and foreign-invested management companies to apply for RHQ status with lower capitalization requirements. Such competition has gained momentum in recent months, with Beijing and Shanghai updating their local policies to offer greater incentives. Multinational corporations (MNCs) that want to expand their operations in China may find it worthwhile to compare central and municipal incentives for establishing RHQs in different cities.

Quick Glance

- China's central government and main cities have issued policies to attract regional headquarters (RHQs).
- These policies set minimum eligibility requirements but also offer a range of incentives.
- Even outside Beijing, Guangzhou, and Shanghai, companies may be able to negotiate favorable terms with local authorities for establishing an RHQ.

Strict central-level requirements

Since 2004, the Ministry of Commerce (MOFCOM) has allowed FIICs to apply for RHQ certification. Eligibility requirements are relatively strict.

- To qualify as an FIIC, an FIE must have at least \$30 million in registered capital. Its foreign parent company must have at least \$400 million in total assets, invest more than \$10 million in paid-in registered capital, and have already established at least one FIE in China; or it must invest more than \$30 million in paid-in registered capital and have already established at least 10 FIEs in China.
- To apply for RHQ certification, an FIIC must have at least \$100 million in paid-in registered capital, or have at least \$50 million in paid-in registered capital, as well as at least ¥3 billion (\$439.4 million) in total assets and ¥100 million (\$14.6 million) in total profits.

- The RHQ applicant should contribute at least $30 million of its registered capital to establish new FIEs, purchase equity in Chinese companies or FIEs established by its parent or affiliate company, or set up research and development (R&D) centers in China.
- The RHQ applicant must have already established one R&D center in China.

Companies that meet these requirements can take advantage of central-government incentives for RHQs. MOFCOM-certified RHQs may adopt an integrated onshore/offshore foreign-exchange (forex) management system (including integrated management of their onshore FIEs' forex capital), offshore bank accounts to manage the forex capital of offshore affiliates, and approved overseas lending by onshore affiliates. They may also engage in operational and financial leasing, establish finance companies, and provide financial services to invested FIEs. Since these RHQs are approved at the central level, they can make investments anywhere in China regardless of their registration location.

To attract RHQs, Beijing, Guangzhou, and Shanghai have issued new provisons that offer greater incentives.

Lower local-level thresholds

All FIICs approved by MOFCOM are eligible for RHQ certification in Beijing; Guangzhou, Guangdong; and Shanghai. To attract RHQs, the three local governments have issued new provisions in the past five years that offer greater incentives. Though the policies are similar in structure, each city offers different incentives that reflect its economic profile.

Guangzhou joined Beijing and Shanghai in the race for RHQs in 2006, when it issued Provisions for Encouraging MNCs to Establish Regional Headquarters and Sub-Regional Headquarters in Guangzhou. Guangzhou set the lowest requirements among the three cities, allowing FIICs, management companies, R&D centers, and certain manufactur-

Table 1: Local Regional Headquarters (RHQs) Certification Requirements

Beijing	Shanghai	Guangzhou, Guangdong
■ The foreign parent company has at least $400 million in total assets;	■ The parent company has at least $400 million in total assets;	■ The parent company has at least $300 million in total assets;
■ The parent company invests in or manages at least six enterprises, or invests in or manages at least three enterprises and has at least $10 million total registered capital in China;	■ The parent company invests in or manages at least six enterprises or invests in or manages at least three enterprises and has at least $10 million total registered capital in China; and	■ The parent company invests in or manages at least three enterprises and has at least $30 million total registered capital in China; and
■ The applicant company has at least $2 million in registered capital; and	■ The applicant company has at least $2 million in registered capital.	■ The applicant company has at least $2 million in registered capital.
■ The applicant company is the single highest management entity for its parent's China businesses		

Sources: Beijing Municipal Government, Shanghai Municipal Government, and Bureau of Foreign Trade and Economic Cooperation of Guangzhou Municipality

Table 2: Cash Bonuses for Locally Certified Regional Headquarters (RHQs)

Beijing	Shanghai	Guangzhou, Guangdong
■ One-time bonus given in installments over three years: ■ ¥1 million bonus when the RHQ's annual revenue reaches ¥100–¥500 million for the first time; ■ ¥5 million bonus when the RHQ's annual revenue reaches ¥500 million to ¥1 billion for the first time; and ■ ¥10 million bonus when the RHQ's annual revenue reaches ¥1 billion for the first time.	■ One-time bonus of ¥10 million, given in installments over three years, if a foreign-invested investment company RHQ's annual revenue exceeds ¥1 billion for the first time.	■ The Guangzhou government provisions state that it will offer bonuses to RHQs and sub-RHQs that significantly contribute to the local economy but do not specify the standards or detail amount of the bonuses.
■ Cash bonus of up to ¥500,000, awarded to a principal executive of the RHQ for three successive years, based on the amount the executive has contributed to the local government's tax revenue in the past year.	■ One-time bonus of ¥5 million, given in installments over three years, if a management company RHQ's annual revenue exceeds ¥500 million for the first time.	■ Several district governments in Guangzhou have issued their own incentive policies, which include detailed bonuses for RHQs, sub-RHQs, and their high-level executives.
■ Cash bonus of ¥500,000 to a principal RHQ executive if the incremental amount of the RHQ's locally retained income tax ranks in the top 10 in the city.		

Sources: Beijing Municipal Government, Shanghai Municipal Government, and Bureau of Foreign Trade and Economic Cooperation of Guangzhou Municipality ing FIEs to qualify for RHQ certification. (Only FIICs and management companies can become RHQs in Beijing and Shanghai.) Sub-RHQs, which manage only some of a company's FIEs located in China, may also qualify for many RHQ benefits in Guangzhou. In June 2008, Shanghai revised Provisions for Encouraging MNCs to Establish Regional Headquarters in Shanghai, and a notice on implementation followed in December of that year.

Beijing revised its RHQ provisions in May 2009 and issued implementing rules in June that clarified incentive policies, including reduced certification thresholds, various cash bonuses and financial support, and preferential treatment for employees. Beijing offers the largest cash bonuses to RHQs and relaxes requirements for certification if the applicant is a "world-renowned" MNC (see Tables 1 and 2). Though the revised rules improved the city's attractiveness when competing with other locations—including Guangzhou, Hong Kong, Shanghai, and Singapore—Beijing is the only city that requires its certified RHQs to be the MNC's highest management entity in China.

At the municipal level, Chinese employees of RHQs receive preferential treatment when applying for travel to Hong Kong, Macao, Taiwan, and abroad. Senior Chinese managers and technical staff receive preference for permanent resident status in Beijing and Shanghai. Foreign RHQ employees are also given priority when applying for multiple-entry F visas, work permits, or permanent residency permits, depending on their level of employment. RHQs certified in Beijing and Shanghai may receive preferential treatment in customs declaration and quarantine and inspection.

MNCs that are interested in setting up RHQs in other cities may also receive similar preferential treatment.

In practice, district-level governments in Beijing, Guangzhou, and Shanghai may grant certified RHQs preferential treatment, including potential tax holidays, office leasing subsidies, and partial refunds of business tax, individual income tax, and enterprise income tax (see Table 3). Such arrangements may require discussions and negotiations with local governments on a case-by-case basis and are subject to change.

MNCs that are interested in setting up RHQs in cities other than Beijing, Guangzhou, and Shanghai may also receive similar preferential treatment. So far, Nanjing, Jiangsu; Shenzhen, Guangdong; Tianjin; and Xiamen, Fujian, have issued incentive policies to encourage the establishment of RHQs in their cities. Even in cities that have not released incentive provisions, MNCs may still be able to negotiate preferential treatment with local governments. Companies looking to expand or consolidate their China businesses should carefully compare local incentives to identify the most suitable site for their RHQs to take advantage of the best preferential treatment packages. 完

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Table 3: Subsidies for Locally Certified Regional Headquarters (RHQs)

Beijing	Shanghai	Guangzhou, Guangdong
■ One-time subsidy, given in three-year installments, for RHQs established in Beijing after January 1, 2009: ■ ¥5 million subsidy if the RHQ's registered capital is ¥100–¥500 million; ■ ¥8 million subsidy if the RHQ's registered capital is ¥500 million to ¥1 billion; and ■ ¥10 million subsidy if the RHQ's registered capital is more than ¥1 billion.	■ Three-year subsidy of ¥2,400 per day for newly established RHQs that lease offices.	■ Establishment subsidy of ¥5 million for certified RHQs and ¥2 million bonus for certified sub-RHQs.
■ One-time subsidy of ¥1,000 per m^2 (maximum of 5,000 m^2) for RHQ offices established in Beijing after January 1, 2009.	■ One-time subsidy equivalent to the total amount of the above three-year subsidy for RHQs buying or building their own offices.	■ Subsidy of ¥1,000 per m^2 given in three-year installments for newly established RHQs and sub-RHQs buying or building their own offices.
■ RHQs leasing their offices (tentatively limited to Chaoyang District) are entitled to a three-year subsidy as 30%, 20% and 10% of each year's rental, respectively.	■ Subsidy of ¥5 million, given in three-year installments, for foreign-invested investment companies that are newly registered RHQs.	■ Subsidy of up to 30% of the government-published market rental price for newly established RHQs and sub-RHQs that lease offices.

Sources: Beijing Municipal Government, Shanghai Municipal Government, and Bureau of Foreign Trade and Economic Cooperation of Guangzhou Municipality

Survey Reveals Cautious Optimism

Companies responding to USCBC's 2009 membership survey remain optimistic about China despite the economic recession's sting.

US-China Business Council staff

Each year, the US-China Business Council (USCBC) surveys its members on their views of their priorities when doing business with China. The results provide a useful update on business and investment conditions and form the basis of USCBC's work on behalf of its members.

This year's survey was conducted in June 2009, when global economic data was still looking dim. Though survey responses indicate that US companies have seen the recession's impact on their China operations, China has remained a bright spot for companies in the midst of the global slowdown.

Familiar business problems in China remain unresolved, however. Business licensing, market access in services, the ability to navigate China's standards-setting system, and the protection of intellectual property rights (IPR) remain areas in which foreign companies face problems. In addition, companies again cited protectionism in China as one of their top 10 concerns, noting in responses to separate questions a trend in PRC policies that seems to favor domestic industries over foreign competitors.

Given the overarching themes that dominate the survey results and the unique situation created by the global recession, much of this year's survey report focuses on members' views of these broader topics.

Global economic recession and its impact on China operations

Over the years that USCBC has surveyed its membership about China's business climate, companies have consistently reported that China is a priority in their global strategic plans. Though the global economic recession may have curbed China's growth temporarily, the 2009 survey shows that companies remain optimistic about their prospects in this important market. In fact, senior executives in China reported increased pressure from global headquarters to boost their China performance to compensate for reduced sales in the United States and other markets.

Quick Glance

- The US-China Business Council's annual survey shows US companies' top issues remain largely the same as in 2008, with approvals, the economic downturn, and human resources topping the list.
- Few US companies have been boosted by China's stimulus package, though some are benefitting from the general recovery of China's economy.
- Many respondents reported that China operations were more profitable than the company as a whole.

Reduced sales, investments, and staff

The majority of survey respondents indicate that the global economic decline has affected their companies' China operations (see Figure 1). Seventy-five percent report reduced sales because of the recession (though more than half project China sales to increase in 2009), and almost 70 percent note that they have reduced or delayed planned investments in China.

Thirty-seven percent of respondents report that they have decreased their employment levels in China to address the downturn. Of those who reduced their employment rolls, more than half cut staffing by 5 percent or less. Less than 20 percent of those cutting staff made reductions of more than 10 percent. These cuts were felt across the board for Chinese and foreign employees alike: 67 percent of respondents reduced their expatriate work force in China along with cuts for domestic employees.

While sales, investment, and staffing reductions affected many companies, shutdowns or pull-backs from the market did not. Only 2 percent of respondents indicated that they closed manufacturing facilities in China.

Stimulus not stimulating US companies—yet

China has taken well-publicized steps to mitigate the effects of the recession on its domestic economy. Its almost

$600 billion stimulus package, announced in November 2008, includes projects to develop infrastructure and healthcare, as well as revitalization plans for industries that are important to the overall strength of the country's economy.

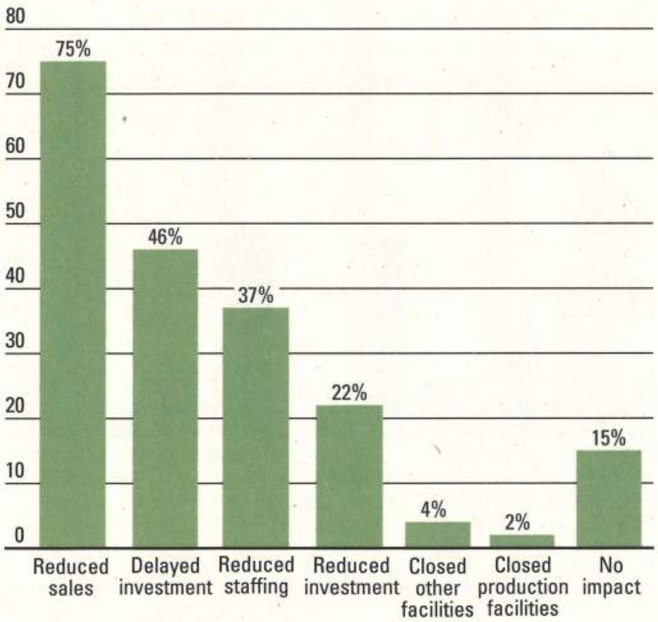
USCBC members have mixed views on whether China's stimulus will benefit their companies. Forty-five percent of respondents were at least somewhat optimistic that they will gain business due to the stimulus package, but almost 40 percent reported that it was too early to tell, even though seven months had passed since the first large injection of capital. Most companies reported not feeling a direct, tangible impact. More than 70 percent reported that they had not had any increases in sales or contracts related to the stimulus package.

Whether companies benefit directly from the stimulus package, however, depends largely on the sector in which they operate. For details on USCBC's subsequent follow-up discussions with member companies on this topic, see the full USCBC 2009 Member Priorities Survey Results.

Optimism prevails despite concerns

Despite the stimulus package's limited benefits for foreign companies to date, many companies report an uptick in sales growth due to China's general economic recovery, which was spurred, in part, by the significant monetary expansion in the first half of 2009. USCBC members remain optimistic that their investments in China will prosper, and they continue to plan for the future development of the China market.

Figure 1: How has the global economic decline affected your company's operations in China?



Note: Multiple responses allowed.
Source: The US-China Business Council (USCBC)

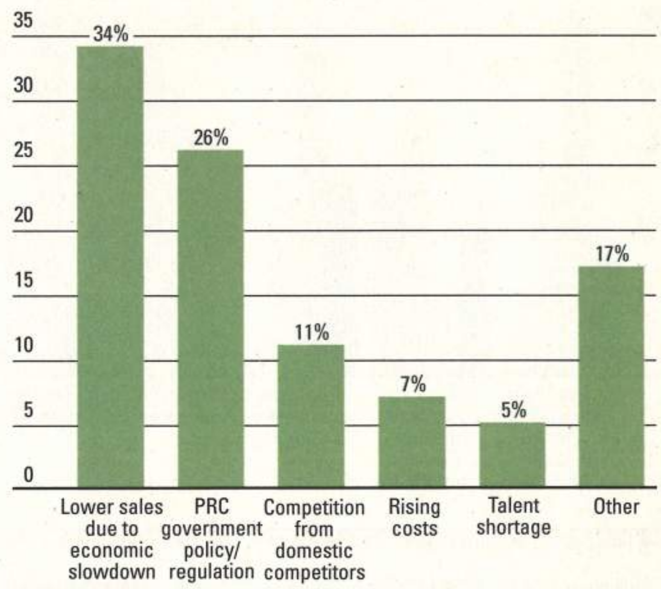
USCBC members view China as an important part of their companies' operations. The numbers bear this out: Just under 90 percent of respondents indicated that China is the top or among the top five priorities for their companies' global strategic planning.

This commitment to the market, however, appears to be based on solid returns. Three-quarters of respondents report that the revenue from their China operations rose in 2008, despite the onset of a recession, though at a slower rate than in previous years. Further, more than half of respondents expect their 2009 revenue to increase. Only one-third of respondents note they expect a fall in income as the recession continues. And nearly half plan to increase their resource commitment in China in the coming year—accelerating their investments, executive time, expenditures, and head count in the market.

Profitability also remained relatively healthy in 2008, despite the downturn. More than 80 percent of survey respondents reported that their China operations are profitable in general. When comparing profits in 2007 and 2008, 45 percent of respondents reported that the profitability of their companies' China operations increased, 22 percent said profitability remained unchanged, and one-third reported a decrease in profitability. The performance of companies' China operations was better than the company overall for almost half of the respondents—a figure comparable to previous years.

That said, the recession has affected the bottom line of USCBC members' operations. One-third cited lower sales due to the economic slowdown as the primary restraint on their profitability in China (see Figure 2). Other factors also played a role in limiting profitability, including PRC policies and regulations.

Figure 2: For your company, the primary restraint on increased profitability in China is...



Source: USCBC

Overall, USCBC members remain confident: 93 percent of respondents were optimistic or somewhat optimistic about the five-year outlook for their companies' businesses in China.

Top 10 business issues in China

As part of USCBC's annual survey, respondents are asked to assess how the issues related to their top concerns have changed in the previous year—whether the issues have improved, remained unchanged, deteriorated, or new problems have appeared. In 2009, companies reported that most of their top concerns saw little movement in the previous year—many respondents identified six of the top ten as unchanged (see Figure 3). Two issues received the most reports of deterioration: the economic downturn and protectionism risks. The remaining two issues—standards and conformity assessment and competition and overcapacity—were almost evenly divided between unchanged and deteriorated.

1. Administrative licensing, business, and product approvals

The virtually endless licensing and approval process remains a constant challenge in China. Companies' global business models are geared toward leveraging China's market scale, but their ability to implement those plans is hindered by bureaucratic barriers to expansion and paperwork burdens for continuing operation.

Half of this year's survey respondents indicated that there had been no changes to the difficulties they faced in the previous year, and more than 30 percent reported that the situation had deteriorated or that new problems had been identified.

2. Economic downturn's impact on China operations

Since the global economic downturn did not begin until after the completion of USCBC's 2008 survey, the survey had not previously asked about the impact of the global recession on companies' operations in China. Unsurprisingly, those that cited the downturn's effects in the 2009 survey primarily cited a negative impact: 64 percent reported deterioration or new problems.

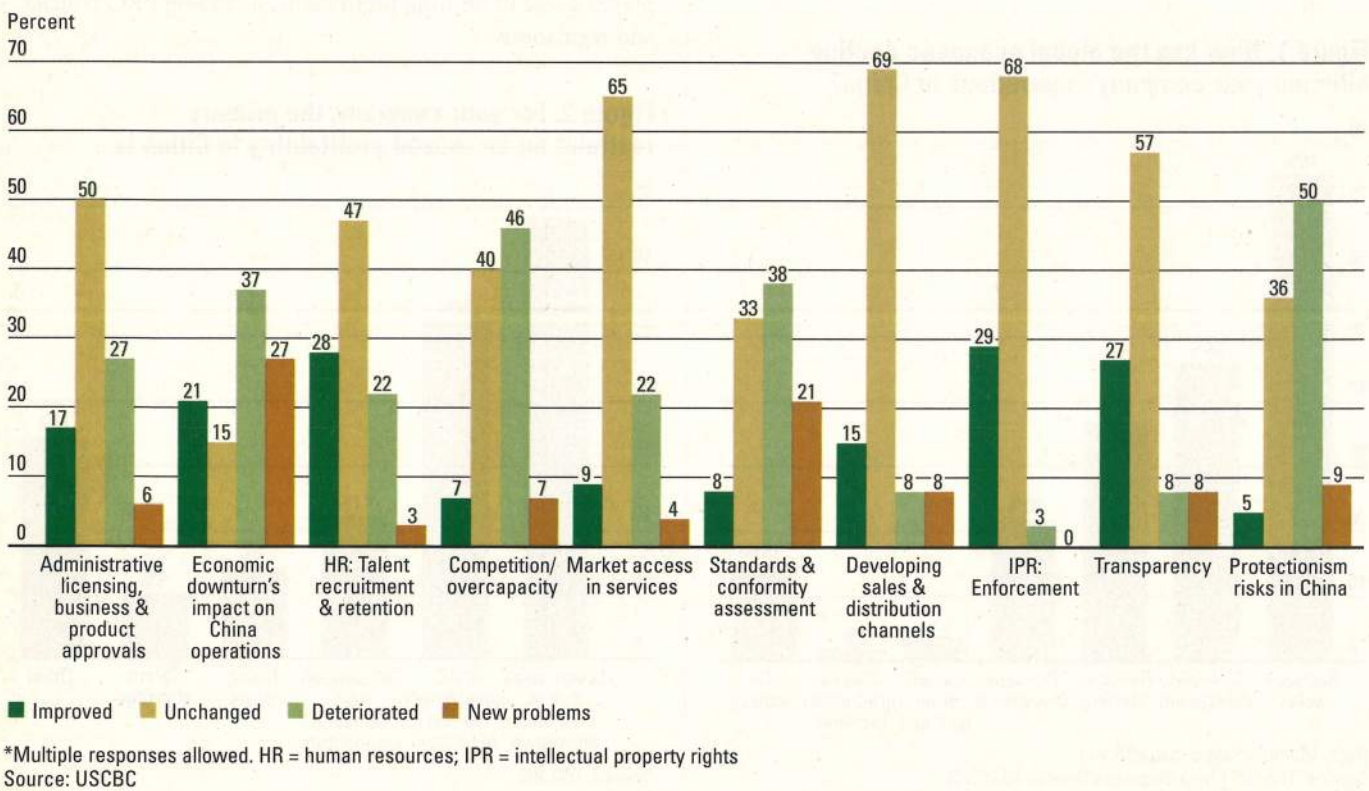
3. Human resources: Talent recruitment and retention

Difficulties in locating and retaining qualified employees in China have been a recurring problem for USCBC members (see the *CBR*, July–August 2008, p.20). The issue has been at or near the top of USCBC's annual survey for the last four years. As in 2008, human resources was cited broadly as a problem—that is, many respondents noted human resources as their second, third, fourth, or fifth top concern, rather than ranking it first.

4. Competition and overcapacity in China's market

Competition and overcapacity in China has been another recurring issue in the top 10 list, with 86 percent of respondents indicating that there have been no changes in the previous year or that the situation has deteriorated. As noted in last year's survey report, though US companies in many sectors retain a significant technological

Figure 3: Progress on USCBC Members' Top 10 Priorities* (%)



*Multiple responses allowed. HR = human resources; IPR = intellectual property rights
Source: USCBC

edge, the ability of Chinese companies to draw on support from local officials and national domestic policies that encourage "indigenous innovation" and national champions assists them in gaining market share. In addition, the ability of domestic companies to acquire ready financing from state banks—coupled with a traditional emphasis on fixed-asset investment as a major driver for economic growth—contributes to almost chronic overcapacity in many industries.

5. Market access in services

China's services market is expected to provide significant opportunities for growth, but regulation hinders the ability of foreign companies to fully access it. Sixty-five percent of survey respondents reported that they saw no progress in market access in services in the past year and 22 percent of respondents reported that the situation had deteriorated. New regulations on express delivery are of particular concern, but existing regulations that favor domestic companies over foreign ones and restrict foreign investment remain problematic in financial services, healthcare, and standards and conformity testing.

6. Standards and conformity assessment

Standards and conformity assessment returned as a top 10 issue after a year below the mark. The vast majority of 2009 survey respondents indicated that standards development did not improve over the last year. Most respondents were fairly evenly divided between seeing no changes (33 percent) or deterioration in the process (38 percent). Twenty-one percent of respondents experienced new problems. One respondent put it bluntly, "We are concerned about [the] trend toward China-specific technical standards that favor domestic companies."

7. Developing sales and distribution channels

Most respondents—about 70 percent—noted that they had seen no changes in this area in 2009, likely because of

> The virtually endless licensing and approval process remains a constant challenge in China.

the global economic recession. But some companies saw glimmers of growth—15 percent saw improvements in the development of their sales and distribution channels over the previous year.

8. IPR enforcement (Tie)

IPR enforcement—a long-standing challenge for USCBC members—continued its slow drop in the rankings, but the issue remained a top concern. Almost 70 percent of respondents noted no changes in China's IPR protection regime in the past year, and most of the remaining 30 percent said there had been some improvements, continuing the slight trend of progress seen in the last four years.

Those improvements were not exclusively due to the PRC government's actions, however. USCBC members report that Chinese companies are beginning to seek protection of their own rights—a positive sign.

8. Transparency (Tie)

Transparency covers the full extent of a country's rule-making system, including the drafting of new laws and regulations and the solicitation of public comments, government decisionmaking on policies and licensing, and the availability of information on costs and markets. Transparency concerns are also related to a host of other issues that affect companies' daily operations, such as administrative licensing, uneven enforcement, standards, IPR protection, and investment policy.

While almost 60 percent of respondents saw no progress on transparency in the previous year (with respondents noting particular difficulty in getting information on China's stimulus package projects), 27 percent reported improvement since 2008.

10. Protectionism in China

Half of the respondents to this year's survey cited deterioration in the fight against protectionism in China, and another 36 percent felt the situation remained unchanged from previous years. 完

The US-China Business Council (USCBC), publisher of the China Business Review, *is the leading organization of US companies engaged in business with the People's Republic of China. Founded in 1973, USCBC provides extensive China-focused information, advisory and advocacy services, and events to more than 200 US corporations operating within the United States and throughout Asia. This article is adapted from* USCBC 2009 Member Priorities Survey Results. *For the full report, see www.uschina.org/public/documents/2009/10/uscbc_member_survey.pdf.*

Supply Chain Actions to Improve

Collecting products from multiple suppliers and shipping them together makes for a more efficient supply chain.

China Sourcing

Companies should revamp their supply chains in China to reduce operating costs and increase efficiency.

Steven H. Ganster

Companies sourcing from China have been hit by a one-two punch over the last few years that has sent many of them reeling. In 2006, the renminbi (RMB) appreciated significantly, and China began to dismantle many of its tax benefits for China-based exporters. In response, US companies importing goods from China raised consumer prices, squeezed supplier pricing, and adjusted supplier portfolios. In some cases, companies have moved sourcing from China to other countries, such as Vietnam, and some even considered moving production or supply sources back to Mexico and the United States.

Most US importers and Chinese suppliers adjusted their operations to meet these challenges only to be hammered by the global economic recession. The downturn is driving companies all along the supply chain to cut costs. Lower demand for goods and intense competition are forcing companies to reevaluate their operations, with some leaving China altogether. Companies that aim to secure long-term profits by remaining invested in China should review their supply chain for ways to realign sourcing, improve transparency, and integrate high-tech solutions that enhance distribution efficiency.

Realign supply sources

The RMB's appreciation, as well as the declining health and occasional exit of key suppliers, sparked an aggressive rethinking of supply sources that continues today. With rising China-based costs, many companies scrambled to Vietnam, India, and other markets, only to find that those markets lacked the infrastructure and capabilities to support logistics needs, as well as a host of other business challenges. But in most cases, companies sourcing large volumes from China found that they were invested too heavily there to exit.

Logistics (moving and storing goods) is the key to supply chain and business effectiveness. Developing more advanced logistics solutions in China is a strategic imperative if the benefits of longer supply chains are to outweigh the costs. In most cases, this means investing in people, processes, and technology. The total cost of logistics from origin to destination matters, as does the total time.

An American Chamber of Commerce in Shanghai China Manufacturing Competitiveness survey in 2008–09 notes that fewer companies—10 percent in 2008, down from 17 percent a year earlier—had concrete plans to relocate manufacturing sources outside of China, reflecting that China remains a competitive source for a wide range of products. Rather than leave China, foreign companies are exploring the benefits of working more closely with key suppliers and service providers there. In some cases, they are even investing in equity partnerships with domestic companies. A recent Tompkins Associates survey found that two-thirds of respondents are seeking new suppliers or rethinking their existing supplier portfolios. As the strategic importance of their China sourcing escalates, companies tend to invest more in sourcing and supply chain operations, moving from opportunistic to direct to strategic approaches, to gain more visibility of and control over the process, while streamlining costs and optimizing performance. This process sometimes leads to establishing a partnership with local suppliers or logistics service providers. For example, Rich Products Corp. formed a joint venture with Kangxin Logistics (Tianjin) Ltd. Co. in 2003 to gain access to local cold-chain supply chain facilities, skilled drivers, and on-the-ground expertise (see the *CBR*, September–October 2008, p.24). In 2007, Fellowes, Inc. formed a joint venture with its main Chinese supplier, Jiangsu-based Jinsen Office Supplies Co., Ltd. The structures of such partnerships can be diverse, ranging from close contractual supply agreements to shared equity. The common goal is to improve cost and performance through closer and more strategic relationships. But establishing these partnerships is not easy and requires a shift in buyer think-

> Companies must work—and share information—with suppliers, service providers, and transport carriers so that the ultimate customer has end-to-end visibility.

ing away from the prevalent vendor-management attitude held by many companies. To be successful, such partnerships also require financial and management investment.

China hubbing

Evidence of companies increasingly adopting advanced logistics solutions can be seen in their growing use of "China hubbing"—the process of bringing together products from multiple suppliers or origins to a central hub in China that can then reroute larger shipments to the final destination. Hubbing can be combined with bypassing the distribution center and direct-to-store transportation solutions to make logistics more efficient. Though such solutions reduce costs, they are often complex and require good processes and technology. The Tompkins survey found that more than half of the respondents have their products flow through a Chinese consolidation center before entering US deconsolidation or distribution centers. This is especially common for companies that import finished goods from China but less common for companies that import components, subassemblies, and raw materials.

The consumer retail market in the West, which has been hardest hit by the downturn, reveals some interesting hubbing approaches. An increasing number of retailers are using cross docking—a process that eliminates long-term storage—to enhance the flow of their supply chains, and retailers and suppli-

Five Ways to Improve Your Supply Chain

1. Explore the benefits of getting closer to sources and consider creative ways to work more closely with key suppliers and service providers, even to the point of taking an equity share.

2. Consider ways to move distribution activities and assets from high-cost markets, such as the United States, to a lower-cost region or source country.

3. Work with suppliers, service providers, and transport carriers to improve visibility of products and materials that flow from China to the final destination. Then act on this knowledge to reduce costs and times to market.

4. Use information technology to manage supply chain operations.

5. Explore options for optimizing the supply chain and work with partners to achieve the best results.

—Steven H. Ganster

ers are stocking less inventory. Some retailers are also reducing the number of shipments per week to each store to save logistics costs.

Competing with the sourcing scale and sophistication of Wal-Mart Stores, Inc. is a concern for nearly every other retailer in the market. One third-party, start-up logistics provider, Hong-Kong based Swan Logistics (China) Ltd., is promoting the concept of store-ready delivery, which seeks to level the playing field for retailers. Swan's idea, which is a good example of hubbing taken to an extreme, aims to take time and cost out of the supply chain for Asian-sourced products by using web-based management tools that provide end-to-end visibility and by delivering store-ready shipments to destination-country distribution centers. Firms that take an integrated view of the supply chain—measuring all costs in both cost of goods sold and selling, general, and administrative expenses—will be most successful in using these types of process changes to achieve lowest total delivered cost.

Look for ways to improve supply chain transparency

Supply chain visibility is a top priority for all companies, especially those that operate in China. For most products, many entities are involved in the transport and storage of goods from origin to destination, making transparency throughout the supply chain difficult to achieve. Companies need timely, accurate information at multiple points in their supply chain to respond quickly to market trends and distribution problems, yet many are not getting this information. Most companies want a higher level of visibility at an earlier point in the cycle than they have today.

To achieve a high level of transparency, companies need on-the-ground intelligence, rigorous information requirements, and close cooperation with everyone involved in a product's supply chain. As logistics capabilities have improved, large US-based companies have changed—or are in the process of changing—the terms of sale to take control of their goods at the supplier's dock as a way to gain visibility and reduce logistics costs. Companies that serve China's domestic market want more supply chain visibility too. Technology now makes it possible for computers and databases to talk to each other. Companies must work with—and share information with—suppliers, service providers, and transport carriers so that the ultimate customer has end-to-end visibility.

Closely related to supply chain transparency is the question of total delivered cost. Most companies underestimae the total costs of moving goods and products in global supply chains, and it is often difficult to estimate distribution costs in China, where transport infrastructure varies considerably from region to region. Guidelines used by the Institute of Management

Accountants provide companies with information on what the true costs will be, including the time and expense of logistics, management time, quality control, capital efficiency, and technology support. Once the true costs are estimated and budgeted, companies can use knowledge gained through supply chain visibility to reduce them.

Use global trade management systems...

Industry players generally agree that the level of sophistication of supply chain skills, processes, and technologies for managing global supply chains has remained low relative to equivalents for supply chains within the industrialized economies. This is especially true in China, where many companies have rushed to market their products in the past 5 to 10 years. Realizing the significant gains to be had by addressing low efficiency, organizations have begun to improve their global trade operations in a systematic manner.

Global trade management (GTM), a term used to describe the processes to support cross-border transactions, uses information technology (IT) software applications that automate international documentation and customs compliance. GTM systems have evolved to enable supply chain processes that support decisions about the routing of goods, total costs, and trade financing, and they offer information about customs in up to 150 countries and related taxes. Leading applications include TradeBeam, Inc.; GT Nexus, Inc.; and Management Dynamics, Inc., as well as larger enterprise resource-planning companies such as SAP AG and Oracle Corp.

Intelligent uses of GTM have saved many companies millions of dollars in international logistics costs by reducing the amount of time that staff need to research logistics issues and the inherent costs in how goods are routed and financed. A recent, year-long study managed by Stanford University and TradeBeam found that companies could benefit significantly from the application of readily available IT and the corresponding skills and process enhancements, which would help them improve their global trade processes and look at global trade in a strategic manner (see below).

...and logistics service providers

As supply chains have gone more global, so have the capabilities of logistics service providers (LSPs). Larger

Optimize Your Supply Chain with Information Technology

Stanford University, together with TradeBeam, a global trade management software provider with operations in China and the United States, recently completed a year-long study of how enterprises and their trading partners can benefit by applying information technology (IT) to their global supply chains. The study focused on China-to-US trade and was based on interviews from supply chain experts in both countries who helped define a new global trade process model, the Stanford Global Trade Process Model.

The study found that companies can benefit significantly from the application of readily available IT, along with corresponding skills and process enhancements. Under reasonably conservative scenarios, IT-enabled global trade management is estimated to

- Cut costs by 1.7 percent of annual sales for exporters;
- Cut costs by 1.4 percent of annual sales for importers;
- Increase profits by 28 percent for exporters; and
- Increase profits by 23 percent for importers.

In addition, benefits are estimated to equal 3 percent of annual revenue from a representative client for export supply chain intermediaries, such as forwarders, brokers, and carriers, and more than 5 percent from a representative client for similar import intermediaries. Companies that want to take full advantage of these gains can use the Stanford Global Trade Process Model as a framework, following traditional process improvement methodologies.

—*Alex Thompson*

Summary of Information Technology-Enablement Benefits

Benefit category	Exporter	Importer
Manufacture to invoice	4 days faster	NA
Cycle reduction	9%	NA
Days sales outstanding	11–12 days faster	NA
Reduction	28–29%	NA
Order to receipt cycle	NA	36 days faster
Reduction	NA	35%
Benefit as a percentage of sales	1.7–2.4%	1.4–4.3%
Profit increase	28–40%	23–72%

Note: NA = not applicable or not available; profit is assumed to equal 6% of sales.
Source: *How Enterprises and Trading Partners Gain from Global Trade Management: A New Process Model for the China-to-US Trade Lane*, Stanford University and TradeBeam.

Alex Thompson *is chief architect and vice president of Market Strategy at TradeBeam, a global trade management software provider. He is coauthor of the joint Stanford University-TradeBeam report,* How Enterprises and Trading Partners Gain from Global Trade Management: A New Process Model for the China-to-US Trade Lane.

firms such as APL Ltd., Deutsche Post AG (DHL), and UPS have the capabilities to move goods faster and more cheaply than ever before. Any company that sources, distributes, produces, or sells globally without engaging an LSP risks spending more on logistics than it should. In addition, the larger LSPs can bring best practices, technology, and even innovation to their customers' supply chains.

Regardless of company size, the Tompkins' survey showed that about half of the companies use a combination of direct sourcing and sourcing through a trade partner. Also, most companies surveyed use an LSP for at least some of their logistics activity. LSPs almost always build full container loads, which typically head to a US distribution or deconsolidation center. These LSPs provide other services as well, such as labeling, shrink-wrapping, and kitting.

Merger-and-acquisition activity in China has risen over the past few years as many LSPs followed their clients and entered the market by partnering with a local company or acquiring the capabilities to provide the end-to-end solutions they advertise. Ryder System, Inc.; Menlo Ventures; Schneider Electric SA; Werner Enterprises, Inc.; and YRC Worldwide, Inc. have all increased their presence in China. A.P. Møller-Mærsk A/S, APL, and NYK Logistics have expanded their China consolidation capabilities and partnered with US trucking companies, sharpening their focus on promoting end-to-end solutions. This is good news for companies that import goods from China and for those that look to China's domestic market to spur future growth for their products.

Logistics capabilities in China are evolving. Companies should explore all available options to enhance their logistics operations and coordinate their efforts with partners all along the supply chain. They should out-think and out-maneuver opponents by looking for performance improvements in their global supply chains. These actions work, and companies should carefully consider how to apply them to their supply chain. 完

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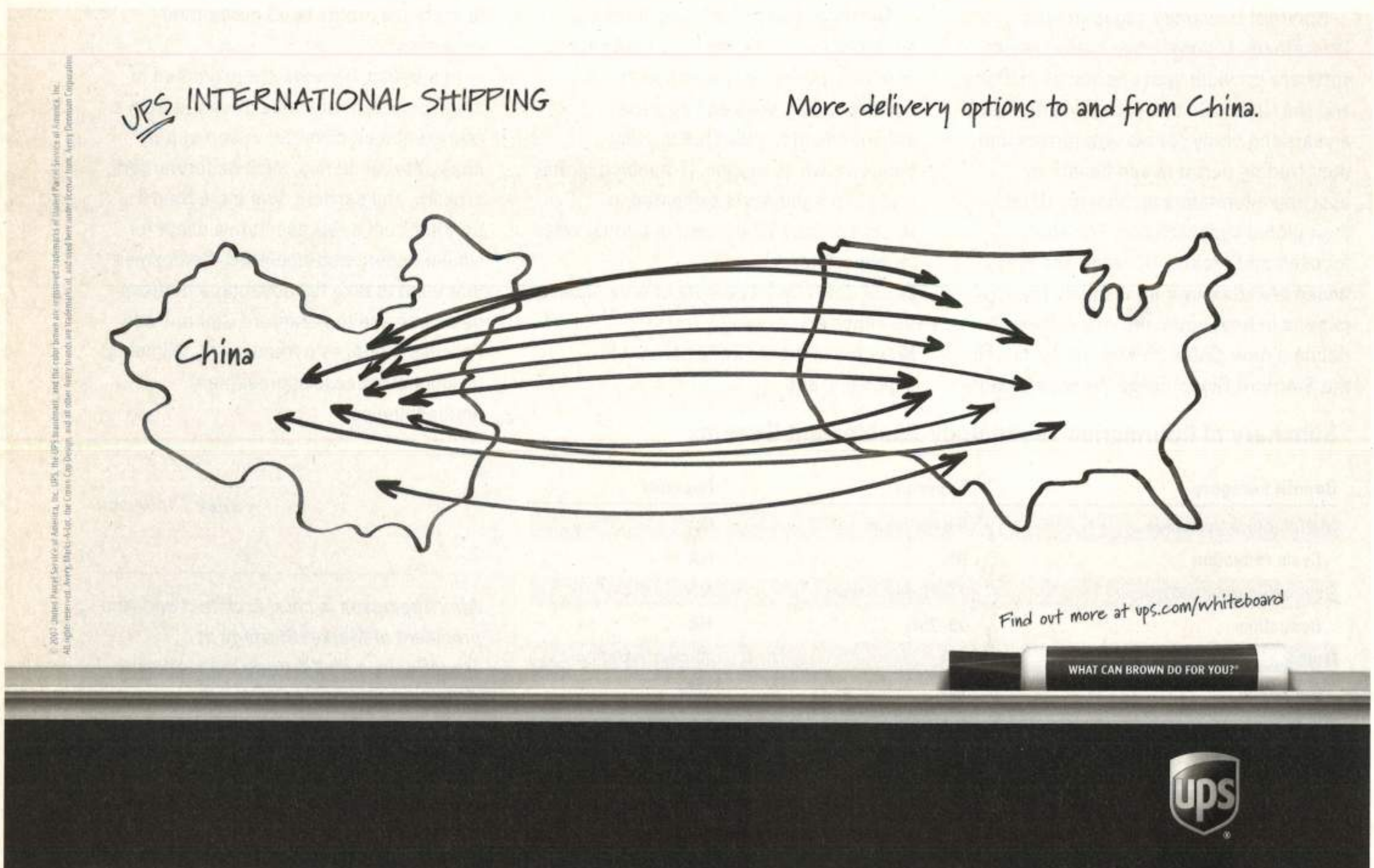

China Deals

Sales and Investment

September 2009

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor (publications@uschina.org). The full list of deals will no longer be printed in each issue; *CBR* subscribers with online access and members of the US-China Business Council can now access complete China Deal Database listings from 2000 to present at www.chinabusinessreview.com.

Diane Hsiung and Daniel Strouhal

Accounting

CHINA'S IMPORTS

Jingwei International Ltd. (Guangdong)
Hired US-based Bernstein & Pinchuk LLP as its public accounting firm for 2009.

Agriculture

OTHER

Government of the United States/ Government of the PRC
Renewed MOU to continue cooperation through the Joint Committee on Cooperation in Agriculture, which meets every two years and focuses on scientific and agricultural trade.

Automotive

CHINA'S EXPORTS

Grupo Berge (Spain)/ BYD Co. Ltd. (Guangdong)
Signed agreement for Berge to import BYD's electric vehicles.

CHINA'S INVESTMENTS ABROAD

Koenigsegg Automotive AB (Sweden)/Beijing Automotive Industry Holdings Co. Ltd.
Signed preliminary partnership agreement for Beijing Automotive to buy minority stake in Koenigsegg.

INVESTMENTS IN CHINA

Friendly Auto Dealers, Inc. (US), Excellent Auto Consulting, Inc. (British West Indies)
Signed MOU for Friendly Auto Dealers to acquire Excellent Auto Consulting, which sells autos in Guangzhou, Guangdong.

Pan Asia Environmental Protection Group Ltd. (Hong Kong)/Jiangsu Dazhong Electric Motor Co., Ltd.
Signed MOU for Pan Asia to buy 20% stake in Jiangsu E Motors. $8.8 million.

Pirelli & C. SpA (Italy)/Hixih Group (Shandong)
Signed MOU to build a tire manufacturing plant in Yanzhou, Shandong.

OTHER

Transense Technologies plc (UK)/Qingdao Mesnac Co. Ltd. (Shandong)
Signed MOU to develop pressure monitoring systems that can be embedded in tires.

Aviation/Aerospace

CHINA'S EXPORTS

Economic Affairs Division (Pakistan)/Government of the PRC
Signed framework agreement for China to fund a communications satellite project in Pakistan, to be jointly implemented by Pakistan Space and Upper Atmosphere Research Commission and China Great Wall Industry Corp. $200 million.

OTHER

Changi Airport Group (Singapore)/Beijing Capital International Airport
Signed MOU to share information and collaborate on projects, seminars, and staff training.

Banking & Finance

INVESTMENTS IN CHINA

Silicon Valley Bank, a subsidiary of SVB Financial Group (US)
Opened a representative office in Shanghai.

OTHER

Australia and New Zealand Banking Group Ltd. (Australia)/ CDB (Beijing)
Signed MOU for Australia and New Zealand Banking Group to act as an agent for CDB in Australia and other parts of Asia.

Chemicals, Petrochemicals & Related Equipment

INVESTMENTS IN CHINA

Air Products & Chemicals, Inc. (US)
Signed contract to purchase and operate four air separation units and build a new air separation unit for Hebei-based Xingtai Iron and Steel Corp., Ltd.

OTHER

Enel SpA (Italy)/ Government of the PRC
Signed agreement to conduct a feasibility study for using carbon capture and storage technology at a Chinese coal-fired plant.

Consulting

CHINA'S INVESTMENTS ABROAD

DVS Korea Co., Ltd. (South Korea)/Beijing Blue I.T. Technologies Co., Ltd.
Jointly opened an office, ChinaCache Korea, in South Korea to serve the local market.

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: Civil Aviation Administration of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LNG: liquefied natural gas; LOI: Letter of intent; MIIT: Ministry of Industry and Information Technology; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise.

Education

OTHER

Government of Nepal/ Government of the PRC
Signed MOU for Tianjin Municipal Government to provide full scholarships for 20 Nepalese students to study in Tianjin.

Electronics, Hardware & Software

INVESTMENTS IN CHINA

Compal Electronics Inc. (Taiwan)
Will construct its fifth manufacturing plant, which will have a monthly output of 6 million notebook computers, in China.

Hon Hai Precision Industry Co., Ltd. (Taiwan)
Will invest $2 million in Guangzhou OED Technologies Co., Ltd., which conducts R&D, manufacturing, and sales of electrophoretic displays, and will set up a trading company in Shanghai. $12 million.

Light Engineering Corp. (US)/ Advanced Technology & Materials Co., Ltd. (Beijing)
Signed MOU to establish a partnership to market, distribute, and manufacture amorphous iron-based electric motors and other products.

Sharp Corp. (Japan)/Nanjing Municipal Government (Jiangsu), China Electronics Corp. (Beijing)
Signed memorandum of intent to establish JV to produce LCD panels using eighth-generation glass substrates.

OTHER

Technopark.org (India)/Dalian Hi-Tech Industrial Zone (Liaoning)
Signed MOU on IT technical cooperation.

Energy & Electric Power

CHINA'S IMPORTS

Exousia Advanced Materials Inc. (US)
Will provide Exousia's power-shield coatings for use in electrical transformers produced by Henan Pinggao Electric Co., Ltd.

First Solar Inc. (US)
Will construct 2,000 MW solar powerplant in Ordos, Inner Mongolia.

INVESTMENTS IN CHINA

GDF SUEZ (France)/Chongqing Energy Investment Group
Will form a 25-year JV to build and operate district cooling and heating schemes in Chongqing. (PRC:60%-France:40%).

OTHER

Viaspace Inc. (US)/DP CleanTech Co., Ltd. (Beijing)
Signed MOU to conduct efficiency tests of CleanTech's biomass power generation in burning Viaspace's Giant King Grass crop.

Environmental Equipment & Technology

CHINA'S EXPORTS

Baoding TianWei SolarFilms Co., Ltd. (Hebei)
Will provide Thailand Green Energy Co. with 70 MW thin-film silicon solar photovoltaic solar panels.

CHINA'S IMPORTS

SiC Processing (Baoding), a subsidiary of SiC Processing AG (Germany)
Will recycle exhausted cutting slurries for Yingli Green Energy Holding Co. Ltd.

INVESTMENTS IN CHINA

Carrier Asia Ltd., a subsidiary of Carrier Corp. (US)/Bank of Beijing
Signed MOU for Carrier to offer energy auditing and implementation solutions, while Bank of Beijing will provide financing services to building owners, in China.

Ecotality Inc. (US)/Shenzhen Goch Investment, Ltd. (Guangdong)
Formed JV to market and sell electric vehicle charging equipment systems in China. $5 million.

Ecotality Inc. (US)/Shenzhen Goch Investment, Ltd. (Guangdong)
Formed JV to manufacture and assemble electric vehicle charging equipment in China. $10 million.

OTHER

Chicago Climate Exchange (US)/ CNPC, PBOC (Beijing)
Signed agreement to establish China-US Low Carbon Finance and Development Research Center to research financing low-carbon initiatives.

Future Fuels LLC (US)/Thermal Power Research, a subsidiary of Huaneng Power International, Inc. (Beijing)
Signed MOU to exchange information between Future Fuel's integrated gasification combined cycle (IGCC) facility in Good Spring, Pennsylvania, and Thermal Power's GreenGen IGCC facility in Tianjin.

Food & Food Processing

INVESTMENTS IN CHINA

Danone SA (France)
Will sell its 51 percent stake in JVs it has with Zhejiang-based Hangzhou Wahaha Group Co., Ltd.

OTHER

Ecolab Ltd. (US)/ Government of the PRC
Signed MOU to establish a China holding company and regional headquarters in Shanghai. $30 million.

Healthcare Services & Investment

INVESTMENTS IN CHINA

Qualcomm Inc. (US)/ China Children and Teenagers' Foundation (Beijing), Xi'an Kingtone Information Technology Co., Ltd. (Shaanxi)
Will set up a rural healthcare delivery system in select clinics in Hebei using third-generation (3G) handsets and 3G-ready personal computers.

OTHER

National Cancer Institute of Sri Lanka/Tianjin Medical University
Signed MOU for Tianjin Medical University to host medical staff from a Maharagama cancer hospital for two months of intensive training.

Light Industry/Manufacturing

INVESTMENTS IN CHINA

NKT Cables A/S (Denmark)/ Xinhua Cables Group (Hebei)
Signed a final purchase agreement for NKT to acquire Xinhua's high-voltage cable factory in Hejian, Hebei.

Media, Publishing & Entertainment

CHINA'S IMPORTS

Linktone Ltd. (Shanghai)
Signed agreement with US-based Major League Baseball (MLB) Advanced Media, LP to become the exclusive licensee of MLB related interactive media rights in China (including Hong Kong and Macao).

INVESTMENTS IN CHINA

IMPACT Entertainment (International) Ltd., Qin Jia Yuan Media Services Co. Ltd. (Hong Kong)
Formed JV, QJY IMPACT, to jointly develop the concert and entertainment markets in China.

OTHER

Dubai Media Inc. (UAE)/Qingdao Television Station (Shandong)
Signed MOU to exchange media experience and provide logistical assistance to visiting crews from each other's organizations.

Metals, Minerals & Mining

CHINA'S IMPORTS

Exousia Advanced Materials Inc. (US)
Will sell coating formulations to Hubei-based Wuhan Iron and Steel Group.

Kawasaki Kisen Kaisha Ltd. (Japan)
Will ship 1.5 million metric tons of iron ore over 10 years from Australia to China for Liaoning-based Anshan Iron and Steel Group Corp.

CHINA'S INVESTMENTS ABROAD

Jinchuan Group Ltd. (Gansu)
Acquired 70% stake in Tiomin Kenya Ltd., a subsidiary of Canada-based Tiomin Resources Inc.

INVESTMENTS IN CHINA

Grand T G Gold Holdings Ltd. (Hong Kong)/Henan Hongnan Mining Co. Ltd.
Signed MOU for Grand T G Gold to acquire Hongnan Mining in two stages, with the first-stage purchase of a 60% stake. $2.4 million.

Miscellaneous

OTHER

Karnataka Small Scale Industries Association, India-China Chamber of Commerce and Industry (India)
Signed MOU to promote India-China trade ties.

Scottish Development International (UK)/Shandong Provincial Department of Science and Technology
Signed MOU to strengthen scientific and technological exchanges.

Petroleum, Natural Gas & Related Equipment

CHINA'S INVESTMENTS ABROAD

Korea National Oil Corp. (South Korea)/Sinopec (Beijing)
Signed MOU to cooperate in crude oil storage, trade, and marketing.

PetroChina (Beijing)
Will buy 60% stake in Canada-based Athabasca Oil Sands Corp.'s Mackay River and Dover oil-sands projects. $1.7 billion.

Qatar Petroleum/CNOOC Middle East, a unit of CNOOC (Beijing)
Signed gas exploration and production-sharing agreement. $100 million.

OTHER

Shell (China) Ltd., a subsidiary of Royal Dutch Shell plc (the Netherlands)/Shenhua Coal to Liquid and Chemical Co. Ltd., a subsidiary of Shenhua Group Corp. Ltd. (Beijing)
Signed MOU to explore opportunities to jointly develop advanced coal gasification technology and discuss application for carbon-capture technology.

Pharmaceuticals

OTHER

BioCryst Pharmaceuticals, Inc. (US)/NT Pharma (Group) Co., Ltd. (Beijing)
Signed binding LOI for NT Pharma to represent BioCryst and its partners exclusively in stockpiling influenza anti-viral peramivir, as well as marketing and distributing peramivir in China.

Boryung Pharmaceutical Co. Ltd. (South Korea)/Sinovac Biotech Ltd. (Beijing)
Signed agreement to collaborate on marketing and supplying the H1N1 vaccine to the South Korean government.

HUYA Bioscience International LLC (US)/Guangzhou Institutes of Biomedicine and Health, Chinese Academy of Sciences (GIBH) (Guangdong)
Formed strategic partnership to give HUYA exclusive rights to first review and negotiation of licensing and development of certain compounds developed by GIBH .

Rail

CHINA'S EXPORTS

China Civil Engineering Construction Corp. (Beijing)
Won contract as part of a consortium from Saudi Railway Co. to construct a rail line linking Riyadh to Al-Qassim in Saudi Arabia. $720 million.

CHINA'S IMPORTS

Bombardier Sifang Power (Qingdao) Transportation Ltd., a JV of Bombardier Transportation (Germany), Power Corp. of Canada, and China South Locomotive and Rolling Stock Industry (Group) Corp. (Beijing)
Won contract from the PRC Ministry of Railways to supply China with 80 next-generation high-speed trains and 1,120 rail cars. $4 billion.

Research & Development

OTHER

BT Group plc (UK)/Qinghua University, School of Economic Management (Beijing)
Signed MOU to cooperate on researching new technologies in emerging markets, industrialization mechanisms in China, and innovation ecosystem evolution.

Government of Cuba/ Government of the PRC
Renewed five-year MOU to cooperate on biotechnology.

Telecommunications

CHINA'S IMPORTS

China Unicom Ltd. (Beijing)
Will sell Apple Inc.'s iPhone in China.

MindTree Consulting Ltd. (US)
Won contract to conduct independent testing for Guangdong-based Huawei Technologies Co., Ltd.

Servo Software, Inc. (US)
Will supply Beijing-based China Mobile with search-bar software for the OPhone operating system.

Tata Communications Ltd. (India)/China Enterprise Communications Ltd. (Beijing)
Will collaborate to supply ethernet service in China.

CHINA'S INVESTMENTS ABROAD

China Unicom Ltd. (Beijing)
Will take a 0.88% stake in Spain-based Telefonica SA.

INVESTMENTS IN CHINA

Telefonica SA (Spain)
Will increase stake in Beijing-based China Unicom Ltd. to above 8%.

OTHER

Cisco Systems Inc. (US)/ Chongqing Municipal Government
Signed MOU to advance Chonging's IT manufacturing industry, innovation and R&D in green technologies, and development of Cisco's Smart+Connected Communities solutions.

Tourism & Hotels

CHINA'S INVESTMENTS ABROAD

Baha Mar Resorts Ltd. (the Bahamas)/China State Construction Engineering Corp. Ltd., Export-Import Bank of China (Beijing)
Signed framework agreement to establish commercial terms for participation in the Baha Mar Resort project.

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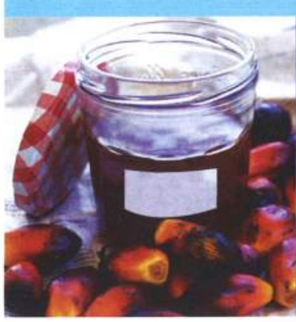
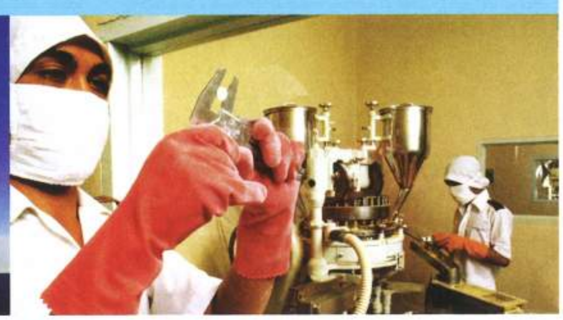
MALAYSIA

THE PREMIER INVESTMENT DESTINATION





Malaysia is internationally recognised for being a nation that thrives on high technology, capital-intensive, high value-added and skill-intensive operations. These facts are further enhanced with the incorporation of Design & Development and Research & Development in the manufacturing sector. With its vibrant business environment, Malaysia places a special emphasis on the services sector, which is considered to be one of the country's engines for greater growth.

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or e-mail investmalaysia@mida.gov.my

MIDA
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