November–December 2010

The China Business Review

USCBC THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

Cover More Markets:
Reach Consumers outside First-Tier Cities

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PRC government incentives and rising income levels make China's lower-tier cities attractive markets for foreign companies.

The China Business Review

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Focus: Off the Beaten Path

Features

Departments

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Letter from the Editor

While living in second-tier cities in China, I sometimes envied friends who lived in Beijing or Shanghai. After all, they had easier access to pizza, fine chocolate, and the latest movies—common items in the United States that were luxuries in China a few years ago. Though the presence of such products may not be a sound marker of a city's development, it is refreshing to see more options available throughout China now.

This *CBR* issue explores China's emerging markets—inland cities as well as second- and third-tier cities throughout the country. The PRC government has worked to raise wealth and living standards in inland cites for years. In their article, Nancy Huang, Joie Ma, and Kyle Sullivan examine the PRC government's plans to develop central and western China further, including by providing incentives to foreign investors.

As their wealth rises, consumers in lower-tier cites are able to purchase more goods. James Sinclair discusses how foreign consumer goods companies should adapt their sales, marketing, and distribution plans to reach the increasing number of potential consumers outside of first-tier cities and stay competitive. Francis Bassolino and Matthew Smith explore new markets for luxury and other branded good companies, stressing that companies should seek first-tier consumers in all markets. With an eye to US exporters, Richard Craig and Jacqueline Qiang look at the strengths of, and opportunities in, various second-tier cities. We hope you enjoy these and other articles in the issue.

Meanwhile, stay tuned for the January–February 2011 *CBR*, which will feature articles on China's advertising, marketing, social media, and public relations trends.

Paula M Miller

Paula M. Miller

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Internet and Digital Media

China's e-commerce industry created 1.3 million domestic jobs in 2009, and the country's e-commerce retail sales doubled from a year earlier to ¥212 billion ($31 billion) in the first half of 2010, according to the *China Daily*. A recent Alibaba.com Ltd. report indicated that about 65 million individuals and 12 million enterprises had opened online stores as of June 2010. Roughly one-third of the country's total online population now shops online.

China's digital publication industry revenue jumped 50.6 percent year on year to reach nearly ¥80 billion ($12 billion) in 2009, according to Xinhua News Agency. The PRC General Administration of Press and Publication recently released a blueprint of strategies to further boost the digital publishing industry. The blueprint sets several goals, including that digital publications account for at least 25 percent of the publishing industry's total revenue by the end of 2015 and that all publishers begin offering digital publications by 2020. China also plans to construct 8 to 10 digital publication industrial parks with a target revenue of more than ¥10 billion ($1.48 billion) each. To promote indigenous innovation, the PRC government will give preference in granting Internet copyrights to competitive publication enterprises and upgrade the research and development capacities of online game producers, according to the blueprint.

China is one of the world's biggest producers of online and mobile games, according to the *Wall Street Journal*, but Chinese software developers face difficulties selling to their home market. While foreign companies such as Apple Inc. and Facebook, Inc. typically give 70 percent of sales and advertising revenue derived from applications to their creators, Chinese platforms often give less than 50 percent, making the domestic market less attractive to developers. Weak intellectual property protection and fragmented distribution systems also make the Chinese market particularly challenging.

The PRC government is increasing its use of online communication platforms. According to the *Financial Times*, the Chinese Communist Party recently launched an online bulletin board that allows Chinese netizens to leave messages for top PRC leaders. The message board, called "Direct Line to Zhongnanhai," is hosted on the *People's Daily* website and is part of the PRC leadership's efforts to use the Internet proactively.

Rail

The PRC government plans to increase investment in rail as part of its 12th Five-Year Plan (FYP, 2011–15). According to state media reports, the PRC Ministry of Housing and Urban-Rural Development estimates that investment in urban railways will reach more than ¥700 billion ($105 billion) in the next five years. PRC Vice Minister of Railways Lu Dongfu said in August that the Ministry of Railways (MOR) plans to build several new rail lines in the 12th FYP period, including high-speed rail lines that connect the Pan-Pearl River Delta region to large-capacity freight transportation networks. According to Xinhua News Agency, China plans to build 5,000 km of high-speed railways in the Pan-Pearl River Delta region by 2012 and an additional 5,000 km by 2015—further integrating the region with Hong Kong and Macao.

China is advancing transportation networks in the country's western region. Construction began in late September on an extension to the Qinghai-Tibet Railway that will connect Xigaze, Tibet's second-largest city, with Lhasa. The line is expected to stretch 150 miles, cost nearly $2 billion, and take four years to complete, according to *China Daily*. The PRC government is also planning two additional extensions, including a line that will reach the Nepal border.

To encourage private investment, MOR and the PRC National Development and Reform Commission plan to establish a rail industrial investment fund soon. According to the *Legal Daily*, the fund will be the main tool for attracting private investment to the industry.

China is also looking to invest in rail overseas. MOR in September signed a memorandum of understanding for California's Bay Area Council to provide consulting and advisory services on high-speed rail construction to MOR and its companies. The agreement was signed as China seeks to win a bid to construct a new high-speed rail between Los Angeles and San Francisco, California. According to Bloomberg LP, China is competing with other Asian and European bidders for the $40 billion project, which will likely begin construction in 2012. Bloomberg also reported that the China Railway Construction Corp. and China Northern Locomotive & Rolling Stock Industry Group Corp. are the leading contenders for a $19.2 billion rail project in Brazil.

Investment

The United Nations Conference on Trade and Development's (UNCTAD) World Investment Prospects Survey 2010–12, which surveys more than 300 leading multinational corporations and investment promotion agencies on the global investment climate, ranked China the top destination for foreign direct investment (FDI) for the second year in a row. India, Brazil, the United States, and Russia rounded out the top five. *China Daily* recently reported that China's FDI reached $58 billion in the first seven months of 2010, up 20 percent year on year.

China's investment overseas is also rising. The PRC Ministry of Commerce (MOFCOM) announced in September that China was the fifth largest global investor in 2009. A newly released MOFCOM report showed that the country's outbound direct investment (ODI) grew 1.1 percent year on year to reach more than $56 billion in 2009, the majority of which was invested in Asia. China's investment in Europe and North America grew at triple-digit rates, while its investment in Africa dropped significantly. China's investment in the United States nearly doubled from $462 million in 2008 to $908 million in 2009. A significant portion of Chinese ODI in 2009 was directed to the leasing and business services and mining sectors.

Top PRC leaders stressed China's commitment to invest overseas at the September UNCTAD World Investment Forum in Xiamen, Fujian. PRC Vice President Xi Jinping encouraged Chinese domestic companies to participate more in developing infrastructure overseas. Vice Minister of Commerce Wang Chao also noted that overseas mergers and acquisitions will be an important part of China's outbound investment.

Population and Human Resources

A white paper recently released by the PRC Ministry of Human Resources and Social Security reported that only 780 million people—73 percent of China's total labor force—were employed at the end of 2009, leaving one quarter of the work force without jobs. The registered urban unemployment rate at the end of 2009 was 4.3 percent. The white paper noted that the number of employees in primary industries fell significantly, but the number of jobs in the services sector rose in 2009.

China's urbanization rate reached nearly 47 percent last year and is predicted to rise in the next few years, according to Xinhua News Agency. To improve urban infrastructure, the PRC government plans to invest up to ¥7 trillion ($1 trillion) to construct public facilities in urban areas as part of the 12th FYP.

China's deputy family planning director expects the country's population to peak at 1.5 billion by 2033 and the labor pool to peak at 1 billion by 2016. State media have reported that the PRC government will continue its family planning policy to stabilize birth rates, but faces challenges in managing an aging population. *Shanghai Daily* noted that 12.5 percent (roughly 160 million) of China's current population is over the age of 60. The PRC government estimates that the elderly population will increase to 200 million by 2015 and 400 million by 2040. The government is considering increasing the country's retirement age for men from 60 to 65 but has encountered significant resistance. In a recent *People's Daily* online poll, 62 percent of the more than 126,000 respondents opposed extending the retirement age.

China wants to attract more foreign students to bolster its higher education system and enhance the domestic talent pool. According to PRC Vice Minister of Education Hao Ping, China hosted 240,000 foreign students in 2009. Various PRC leaders, including Premier Wen Jiabao, have recently said that the government plans to offer more scholarships and develop new policies to attract foreign talent. In late September, the Ministry of Education released China's Study Abroad Plan for 2010–20, which aims for the country to become the largest Asian destination for foreign students by 2020. Qinghua University, one of China's most prestigious institutions, has already pledged to increase its proportion of foreign graduate students from 7 percent to nearly 10 percent by 2020.

China's Secondar

The number of durable goods per region still shows a significant urban-rural divide.

Durable Goods per 100 Households, 2009

Item	Eastern Region		Northeastern Region		Central Region		Western Region	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Air conditioner	152.9	34.3	17.2	0.6	100.8	11.4	70.0	2.8
Auto	17.3	NA	5.6	NA	5.1	NA	7.5	NA
Bicycle	NA	145.6	NA	79.9	NA	91.4	NA	57.0
Camera	54.6	9.2	34.8	4.1	29.6	2.8	33.4	2.3
Color TV set	149.0	126.7	116.9	109.5	129.2	102.8	126.5	96.7
Computer	82.2	15.7	52.5	6.3	53.0	4.2	54.5	2.5
Mobile telephone	195.2	147.3	171.2	127.5	162.3	117.7	179.3	110.4
Motorcycle	29.3	69.5	7.9	55.8	21.2	53.0	17.9	47.4
Refrigerator	99.3	57.8	91.3	47.0	93.1	37.0	92.1	27.5
Washing machine	97.1	71.4	92.8	77.4	96.1	51.2	95.4	48.5

Notes: Eastern region includes Beijing, Fujian, Guangdong, Hainan, Hebei, Jiangsu, Shandong, Shanghai, Tianjin, and Zhejiang; northeastern region includes Heilongjiang, Jilin, and Liaoning; central region includes Anhui, Henan, Hubei, Hunan, Jiangxi, and Shanxi; western region includes Chongqing, Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang, and Yunnan.
NA = not available.

In all regions, urban households consume much more than rural households.

Rural and Urban Consumption, 2009 (¥)

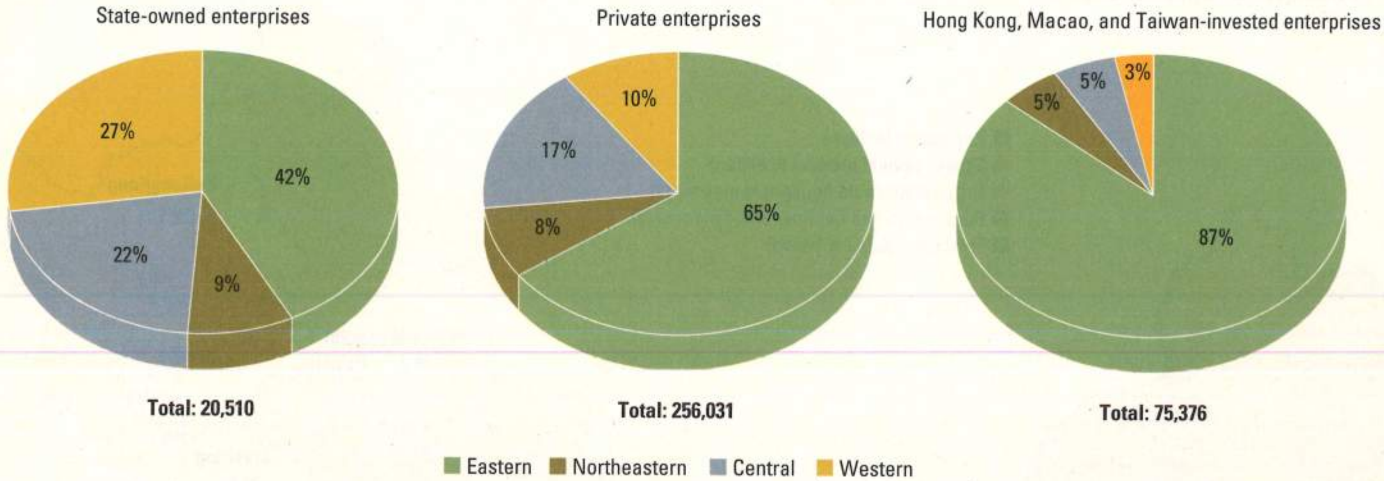
Item	Eastern Region		Northeastern Region		Central Region		Western Region	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Clothing	1,349	289	1,378	326	1,170	206	1,236	184
Cultural, educational, and recreational services	1,903	498	1,119	444	1,140	289	1,164	222
Food	5,173	2,048	4,025	1,415	3,774	1,540	4,111	1,396
Healthcare and medical services	930	340	1,029	449	753	240	740	246
Household facilities, articles, and services	939	260	574	171	699	204	689	163
Miscellaneous goods and services	576	116	507	102	348	81	396	54
Residence	1,434	993	1,231	839	1,078	748	989	677
Transport and communications	2,315	605	1,266	404	1,069	314	1,318	296

Markets Expand

Provincial Snapshot, 2009

Most enterprises are concentrated in eastern China, and the percentage of state-owned enterprises—compared to other enterprises—is high in western China.

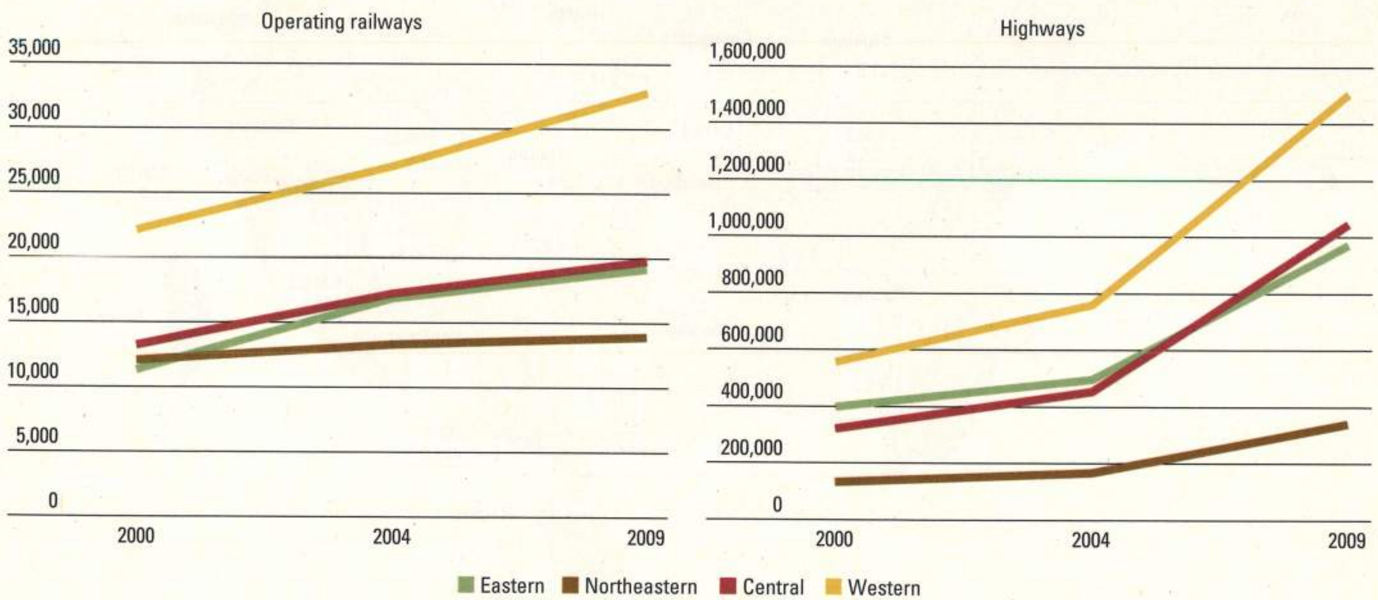
Established Enterprises, 2009



Note: Percentages may not equal 100 because of rounding.

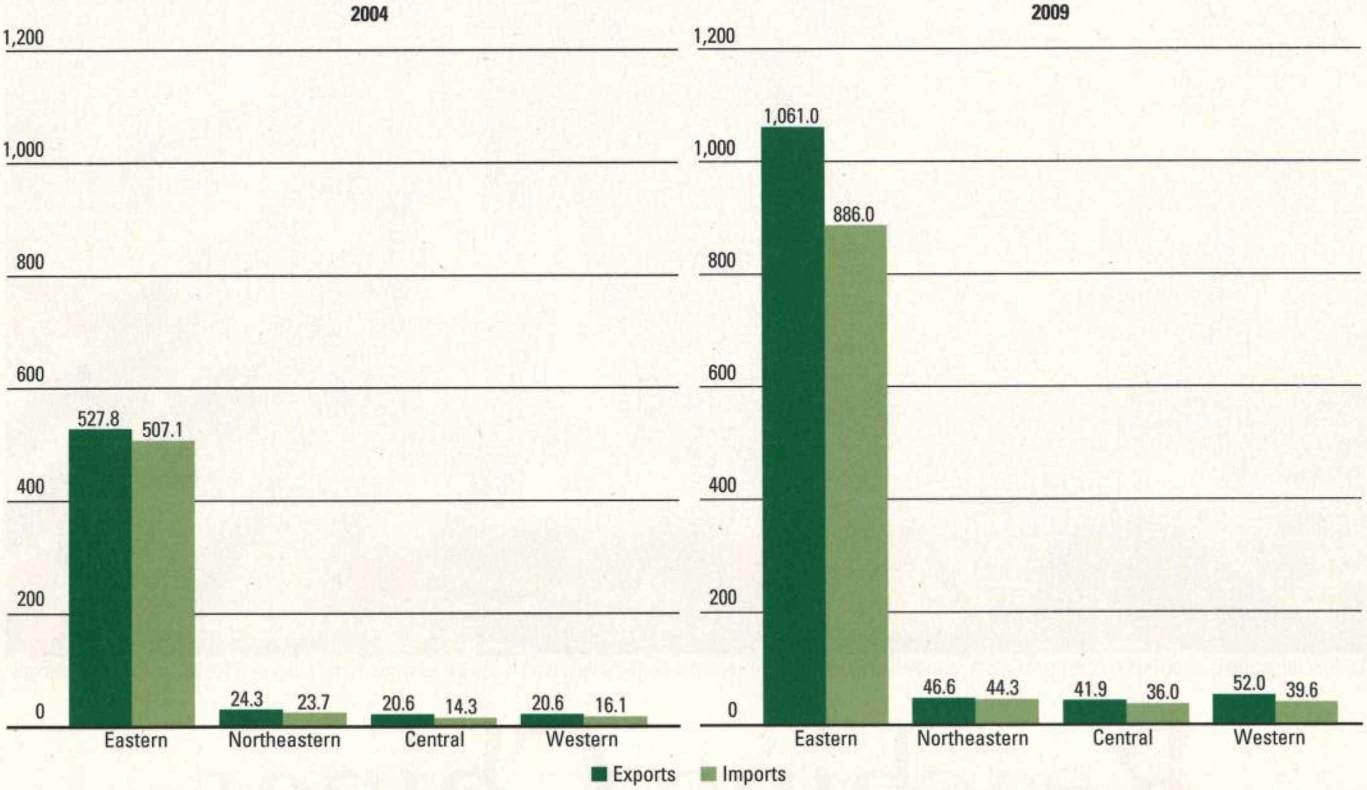
The length of operating railways has increased modestly since 2000, while the length of highways has roughly tripled in all regions.

Length of Transport Routes, 2009 (km)



Most import and export trade remains concentrated in the eastern region, but trade in all other regions has roughly doubled in the past five years.

Imports and Exports by Region, 2004 and 2009 ($ billion)



Top Industrial Producers by Region, 2009

Coal
1. Inner Mongolia
2. Shanxi
3. Shaanxi

Beer
1. Shandong
2. Henan
3. Guangdong

Motor vehicles
1. Beijing
2. Shanghai
3. Chongqing

Crude oil
1. Heilongjiang
2. Shandong
3. Shaanxi

Chemical fertilizer
1. Shandong
2. Hubei
3. Henan

Mobile telephones
1. Beijing
2. Guangdong
3. Tianjin

Electricity
1. Jiangsu
2. Shandong
3. Guangdong

Source: PRC National Bureau of Statistics, *China Statistical Yearbook*, 2001–10

Top Provincial Capitals and Cities, 2009

Most populous
1. Chongqing
2. Shanghai
3. Beijing
4. Chengdu, Sichuan
5. Harbin, Heilongjiang

Most freight traffic
1. Shanghai
2. Chongqing
3. Guangzhou, Guangdong
4. Tianjin
5. Chengdu

Most operating public vehicles
1. Shenzhen, Guangdong
2. Beijing
3. Shanghai
4. Guangzhou
5. Hangzhou, Zhejiang

Most theaters, music halls, and cinemas
1. Beijing
2. Shanghai
3. Harbin
4. Wuhan, Hubei
5. Shenzhen

Most students enrolled in higher-education institutions
1. Wuhan
2. Guangzhou
3. Nanjing, Jiangsu
4. Jinan, Shandong
5. Xi'an, Shaanxi

Most hospitals and healthcare centers
1. Chongqing
2. Shanghai
3. Beijing
4. Chengdu
5. Harbin

China Foto Press

As they target various markets, consumer goods companies must consider regional preferences, which can be determined by culture, dialect, cuisine, and climate.

Reaching China's Next 600 Cities

Consumer goods companies must adapt their sales, marketing, and distribution plans to reach rapidly expanding markets in smaller cities.

James A. C. Sinclair

Demand for consumer goods in hundreds of cities across China is increasing. While Chinese companies in smaller cities look to expand into larger cities, their international counterparts are trying to do just the opposite. The China market is no longer limited to Beijing and Shanghai, or even provincial cities such as Changsha, Hunan; or Harbin, Heilongjiang. International companies that do not ramp up their sales, marketing, and distribution efforts risk losing touch with consumers, losing market share to domestic and foreign competitors, and becoming marginal players.

Consumer goods companies should reevaluate what being a national player now means. Firms should examine their current approach to market research, assess which city segments have potential, check that they have a suitable product mix, determine whether to expand by region or by tier, and learn how to better work with traditional trade channels and large sales forces. To compete in an unfamiliar, diverse, and complex environment, companies must experiment, learn, and adapt over time.

Just as companies must understand the differences between Beijing and Shanghai to be successful in both cities, companies should understand that regional variations also matter for smaller cities. Tier 2 cities have become much less homogenous as they have developed, and smaller cities from different tiers in the same region will likely have much more in common than same-tier cities in different regions. (For a description of Chinese city tiers, see p.14.) Culture, dialect, cuisine, and climate all have implications for consumer goods companies because they influence consumers' responsiveness to advertising, product preference and acceptance, price and quality sensitivity, and shopping behavior. For example, consumers in eastern China prefer entertaining and aspirational advertisements, whereas those in southern China prefer concise ads that explain product benefits. Not all regions have the same media and retail infrastructure, level and nature of competition, and exposure to a company's brand. These are important factors to consider before entering a new regional market.

Quick Glance

- China's smaller cities are unfamiliar territory for many international consumer goods companies.
- Consumer goods companies that seek to be national players must learn how to work with modern and traditional trade channels.
- These companies must also build large sales forces to remain competitive.

Competition from Chinese brands

China's smaller cities are unfamiliar territory for many international consumer goods companies, which often face competition from Chinese counterparts that already know these markets well. Small cities have been serving as incubators for Chinese companies before they expand into larger markets. Such companies are skilled at identifying spaces in the market, experimenting, and learning and adapting as they go. Strong Chinese brands are emerging in packaged foods, quick-service restaurants, infant products, personal care products, and footwear and fashion retail.

For example, Xiang Piaopiao Food Co. Ltd. (XPP), a successful Chinese brand in the powder beverage sector, entered the market in 2005 with an innovative milk tea product. At the time, the China market had two established milk tea drinks: takeaway milk tea sold at roadside counters and three-in-one (tea, creamer, and sugar) instant milk tea packets sold in multi-packs for home and office consumption. XPP's Chair and General Manager Jiang Jianqi saw an opportunity to capitalize on China's established milk tea culture, combining the concepts of milk tea packets and three-in-one coffee cups to create milk tea cups. The milk tea cups would be more readily available, offered in single servings, convenient for impulse consumption, and sold at a lower price per unit. XPP was followed by one other successful early mover, Uloveit (ULI), a brand owned by Guangdong Strong Group Co., Ltd.

Though the existing market for milk tea packets had been in Tier 1 and Tier 2 markets, XPP saw potential for their product in roughly 600 smaller cities, which did not have the prohibitively high entry fees of bigger cities. To rapidly build its distribution and retail network, the company's sales team trudged across fields with sample cases to find and persuade distributors and retailers to carry its milk tea cups. After the initial sales, the team transferred retailers to its distributors and nearby wholesale markets. Eventually, 400 distributors, each with a strong local presence, agreed to distribute the product. This gave XPP a flat distribution structure with nearly national coverage in breadth and depth. The company, however, continued to use its own sales force to conduct merchandising with retailers to ensure visibility, run promotions, and control retail prices.

Though milk tea packets had largely been sold through modern trade channels, such as hypermarkets, supermarkets, and convenience stores, few modern trade channels exist in smaller cities. To reach smaller markets, XPP prioritized traditional channels, including small independent supermarkets, mom-and-pop shops, and small retailers in schools and universities. Traditional trade channels eventually contributed 50–60 percent of the company's sales.

XPP's sales per city from provincial capitals (Tier 2) were by far the largest, but the aggregate sales from smaller cities and towns (Tier 3 to Tier 6) typically accounted for 75–80 percent of total sales in a province. XPP and its competitor ULI have both grown at a compound annual growth rate of more than 100 percent for the past three to five years and have been the major drivers behind the domestic milk tea industry's growth. XPP has since moved down to Tier 5 and Tier 6 towns and up to Tier 1 cities, where it is competing head-to-head with international counterparts.

When it comes to expanding to smaller cities, international consumer goods companies have much to learn from companies such as XPP, including the importance of new product development. Successful expansion should not be about replicating models and capabilities, but rather developing insights that allow a company to play to its strengths. At minimum, foreign companies must keep an eye on the horizon to spot new companies emerging from smaller cities that could be competitive threats and acquisition targets.

Expansion of geographic coverage

Some international consumer goods firms, such as the Procter & Gamble Co. (P&G), entered smaller Chinese cities 10 years ago. P&G's personal care products are now in 1,300 counties (Tier 5) across the country. Few other international players have entered China's smaller cities, however, and foreign companies still face many challenges.

Foreign companies often ask which cities they should tackle first. The answer is often related to the product's market potential and the company's distribution capabilities. Most companies should use a larger city to launch into smaller cities nearby. For example, the provinces around Shanghai are relatively developed and likely have attractive markets. Clusters of small cities may share regional similarities, allowing for greater transferability of propositions and models, especially if out-of-town visits to bigger cities have already exposed consumers to the company's brand. Proximity to a big city hub makes it easier and more feasible to expand the sales force, extend existing distributors or identify new ones, and handle warehousing and logistics.

KFC Corp. used the hub approach to expand in China from 1995 to 2000. KFC entered new provinces by selecting the provincial capital, usually the largest population center, as the hub. Because food service uses short shelf-life items, such as bread and vegetables, the supply chain had to be fully functional before operations began. Identifying suppliers and setting up logistics and a distribution center took significant time and effort, but once in place, the investment could be tapped for other cities and towns within a reasonable driving range. Though it took a relatively long time to establish the first restaurant in a province, the other restaurants could follow much more quickly. KFC reached 3,000 restaurants in China by June 2010, and it continues to add one new restaurant in China almost every day.

Evolution of retail channels

Expansion into new cities and towns is heavily dependent on available retail channels. Many global retailers in China—including Home Depot, Inc. and B&Q plc in home improvement, Isetan Mitsukoshi Holdings Ltd. and Parkson Retail Development Co. Ltd. in department stores, and Wal-Mart Stores, Inc. and Carrefour SA in hypermarkets and supermarkets—still account for only a small proportion of China's total retail sales and an even smaller proportion of total retail outlets. Though modern trade channels will continue to expand rapidly, traditional channels will remain relevant for the next 5 to 10 years, especially in smaller cities. International consumer goods companies that seek to be national players must learn how to work with both types of trade channels.

Leading international hypermarkets and supermarkets are expanding their city coverage. Wal-Mart has 189 supercenters in 101 Chinese cities, covering all Tier 2 cities except those in remote western China, and in most cases has opened stores in surrounding Tier 3 cities. In Northeast, East, and South China in particular, Wal-Mart is building a higher density of stores, including in a handful of Tier 4 cities and Tier 5 towns. Carrefour, with 159 stores in 47 cities across China, and Tesco plc, with 78 stores in 35 cities largely concentrated in eastern China, are one step behind. The trend is clear: International retailers will expand rapidly far into the future. Tesco will likely open more floor space in China in the next five years than it has done in eight decades in the United Kingdom.

China's Tier Variations

The hundreds of cities that are part of China's consumer boom are far from homogenous. Companies must categorize these cities and determine which segments to tackle and in which order. Though many analysts use their own classification system, it is useful to understand China's administrative tiers, which are loosely based on demographic and economic criteria and reflect a hierarchy of economic links. Tier classification can help companies under stand urbanization patterns, transportation links, distribution structures, flow of goods, and the mobility of the population. Though this classification system should not be used as a segmentation framework alone, it can serve as a basis for some more nuanced thinking.

Tier 1 cities are at the top of the administrative structure and usually include China's municipalities: Beijing, Chongqing, Shanghai, and Tianjin. Guangzhou and Shenzhen, Guangdong, are sometimes included on this list—or substituted for Chongqing and Tianjin—because of their developed economies and sophisticated consumer markets. Provincial capitals largely make up Tier 2 cities. Provinces are further divided into prefecture-level cities (Tier 3), which are divided into county-level cities (Tier 4) and counties (Tier 5). At the bottom of the structure are townships (Tier 6) and villages (Tier 7). Though many analysts use gross domestic product and population size to classify large cities in China, some also use government tiers to classify smaller cities, towns, and villages.

Classifying China's cities can be confusing. The term "city" in China refers to an administrative division, typically comprising an urban core and the surrounding rural area. The surrounding area often includes lower-tier cities, towns, and villages. For example, in Jiangsu province, Suzhou city (Tier 2) has jurisdiction over Kunshan, Taicang , and Zhangjiagang cities (Tier 4), among others. China thus has many cities within cities, which can complicate retail coverage and sales volume statistics and risk double counting and exaggeration.

—James A. C. Sinclair

Chinese hypermarkets and supermarkets are also developing to rival their international peers. Lianhua Supermarket, owned by China's largest retailer, Shanghai Bailian Group, already has more than 3,000 supermarkets and 5,000 retail outlets. During the first half of 2010, Lianhua opened 258 new outlets, focusing on the Yangzi River Delta.

In addition, convenience store chains will expand. Lawson, Inc., Japan's second-largest convenience store chain, announced that it may spend up to $200 million annually on its China expansion in the next four years and will have as many as 10,000 stores in the country by 2020. Growth in the number of convenience stores will likely occur in eastern and southern China, where purchasing power is higher and the pace of life is faster. The number of Chinese regional convenience store chains will also rise, although in many cases their outlets will continue to resemble traditional mom-and-pop shops in the way they function.

Role of the sales force

A strong case can be made for a large sales force in China, especially in the fast-moving consumer goods (FMCG) sector. Because of the rapidly developing nature of the sector, distributors and retailers still lack the ability or resources to properly merchandise products. The problem exists in modern trade channels, but it is much worse in traditional trade. If merchandising is weak, products suffer from poor visibility, become neglected, and stop moving.

FMCG players in China have realized that merchandising is a key success factor for traditional channels. Some players that have tried to push merchandising to their distributors are now bringing it back in-house to allow stronger control. Companies should give sales personnel key performance indicators that incentivize them appropriately—combining total sales with sales per store or quality of display—and use supervisors to monitor performance against these indicators. The sales force should also generate and handle new orders and run in-store programs that increase influence at the point of purchase. In most cases, sales reps that work in traditional channels should be dedicated to traditional channels alone. This makes it more likely that sales reps will devote time and effort to develop the channel and consolidate and build on lessons learned along the way.

FMCG companies therefore must build and manage large sales forces. For example, Master Kong runs an organized and disciplined sales force of 7,000 employees. Owned by the Taiwan group Tingyi (Cayman Islands) Holding Corp., Master Kong earned ¥34 billion ($5.08 billion) in 2009 and is the market leader in instant noodles in China with a 55 percent market share. Master Kong has more than 1 million sales points across China, of which only about 60,000 are modern trade, the remainder being traditional trade.

Master Kong handles the vast majority of merchandising in-house. The company divides cities and towns into patches of roughly 300 stores each, with one sales rep responsible for each patch. Sales reps use an electric bike to cover about 30 stores on a daily fixed route, visiting most stores on a two-week rotation. During each visit they conduct inventory checks, merchandise the products, generate new orders, and gather competitor intelligence. In addition to the frequency and professionalism of the visits, the sales reps are also trained to build strong relationships with the store owners. Importantly, Master Kong is one of the few FMCG players that strictly implements a key performance indicator system that covers both sales and merchandising. Because of this sales system, most of Master Kong's distribution partners are limited to warehousing, delivery, and payment collection.

One of the concerns companies have with running a large sales force is China's relatively employee-friendly regulatory environment. Though Master Kong directly employs most of its sales reps, there are alternative employment models. For example, dispatching—employing and dispatching sales reps by a third-party human resources organization—is becoming more common. Another model involves sales reps that are employed by distributors but managed by the principal.

Look to the lower tiers

In the years to come, many relatively unknown Chinese consumer brands from smaller cities will achieve scale and compete with existing market leaders in various consumer product categories. Foreign consumer goods players may not even see them coming because existing retail audit data misses market activity that occurs beyond bigger cities and modern distribution channels.

Foreign companies that want to remain competitive should first ensure that the current approach to market research covers more than just bigger cities and modern distribution channels. Once nuances between city segments are properly understood, a go-to-market plan must be developed. For many companies, this will include contracting with distribution partners that are strong in traditional channels, and recruiting, training, and organizing a large sales force. Plans may have to vary across the country, and part of the challenge will be achieving a balance between a robust national model and customized local variations.

Though discussions now focus on reaching China's next 600 cities, companies may soon focus on China's thousands of towns. For some consumer goods companies that is already the case. The companies that get this right today will be the market leaders of tomorrow. Many Chinese companies have the ambition and are building the ability to replace international counterparts that fall behind. 完

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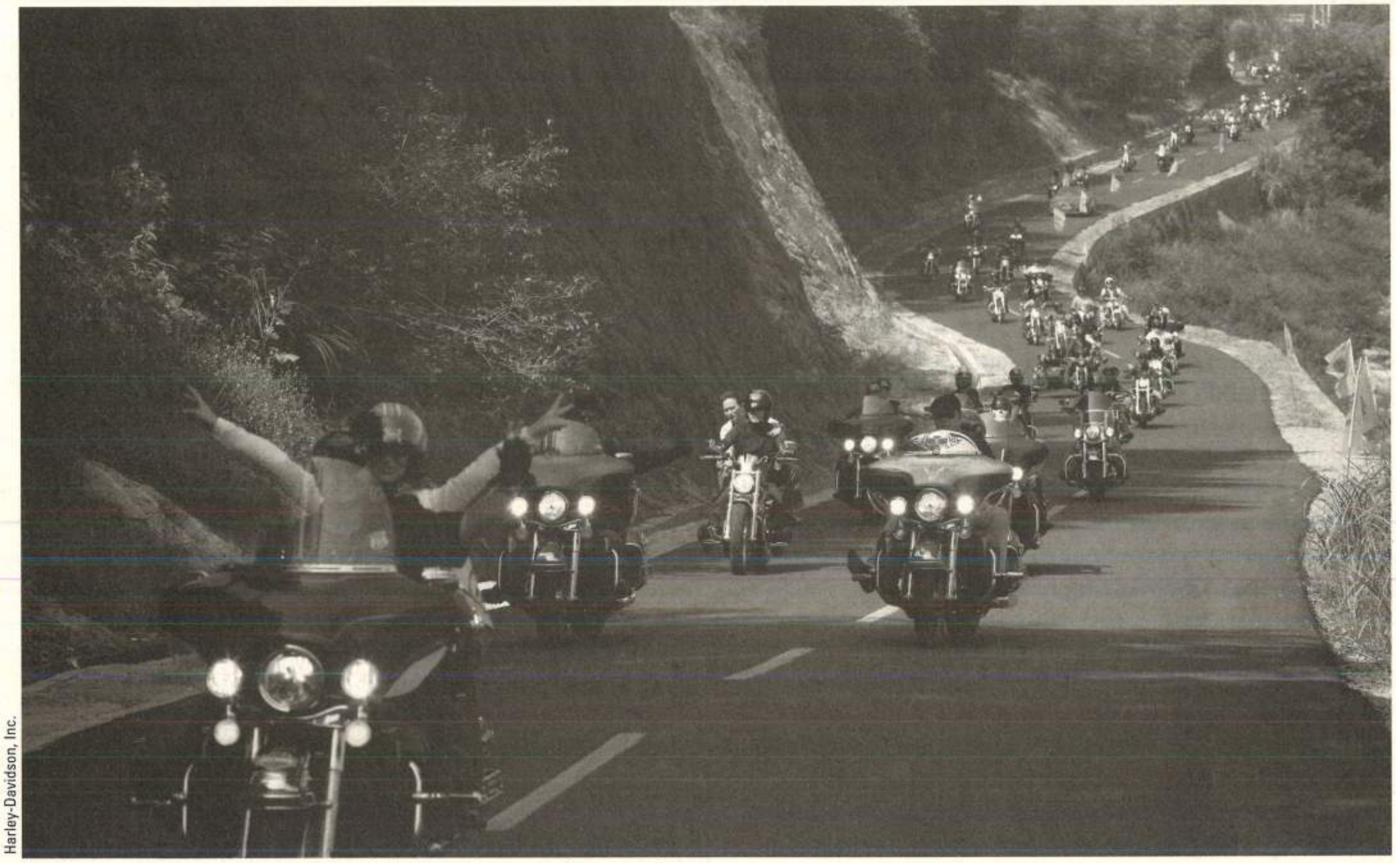

Harley-Davidson, Inc.

Many successful Western brands adapt their strategies to reach new markets.

Find First-Tier Consumers —in Hundreds of Cities

Rising disposable income levels across China's second- and third-tier cities mean more opportunities for purveyors of branded goods.

Francis Bassolino and Matthew Smith

First-tier or second-tier city? Many foreign analysts and strategists fall into the standard practice of categorizing cities in China to determine which markets to enter or how to expand beyond the traditional entry points, such as Beijing or Shanghai. A far more effective approach is to target the "first-tier consumer"—a consumer defined more by spending behavior, income, and lifestyle than by home geography. (Though the qualifications that define a first-tier consumer lack standard guidelines, analytical frameworks for this research often include savings, car ownership, ownership of luxury goods, and disposable income.) This approach is particularly effective for marketing and selling luxury products and branded goods in general.

Given the rapid pace of development throughout China, many companies find that negotiating a successful brand launch in a first-tier city is no longer a sufficient market-entry or expansion move. Cities such as Beijing; Guangzhou, Guangdong; and Shanghai have a large share of first-tier consumers—but they no longer have them all. More than 50 percent of the richest Chinese live outside traditional centers of wealth. Given current macroeconomic trends that support broad-based growth across the country, growth in China's middle class and wealthy consumers over the next five to seven years will occur primarily outside the traditional first-tier cities.

The question that remains is how to tap the first-tier customers that live outside Beijing, Guangzhou, and Shanghai. These customers have the desire and ability to consume branded products. They are also able to allocate a larger share of their income to these products because the cost of living in second- and third-tier cities is generally lower.

Look deeper

First-tier consumers in China's second-tier cities offer some of the most attractive growth opportunities. For example, at the end of 2009, Suzhou, Jiangsu, (population 2.4 million) had nearly 16,000 residents worth at least ¥10 million ($1.5 million) and more than 900 residents worth at least ¥100 million ($14.9 million) (see Table 1). With rapid growth predicted over the next decade, the number of millionaires in Suzhou should continue to rise. This increase in wealth will not be limited to the top quartile of consumers, as defined by disposable income and net personal wealth. Alaris Inc. projects that given the trajectory of current growth patterns, Suzhou's overall 2010 gross domestic product (GDP) may reach ¥740 billion ($110.3 billion), up 11 percent over 2009. (The city's GDP grew at an annual rate of 15 percent over the past 25 years, 5 percent higher than China's national annual growth rate.)

Alaris research shows that in Suzhou urban residents' per capita disposable income may reach ¥26,350 ($3,928) in 2010, up more than 10 percent over 2009. This growth rate is not unique to Suzhou—it is a common trend in rapidly growing second- and third-tier cities across the country. Disposable incomes in these areas are rising and will foster higher demand for branded goods as consumers and companies move beyond basic needs to more emotional purchases (as they make direct connections to a brand personality) and functional demands (as they seek higher relative performance) from the products they consume. Many brands—both foreign and domestic—have prominent representation in Beijing and Shanghai but are under-represented in second-tier cities with wealthy households and companies.

Quick Glance

- Instead of targeting Tier 1 cities, companies that sell luxury goods and other branded goods should focus on reaching top-tier customers in all cities.
- Though companies may need to adjust their marketing, distribution, and human resources plans, they must tap consumers in second and third-tier cities to expand sales and remain competitive.

Follow the money

Some companies that sell branded goods have already begun rapid expansion into second-tier cities to take advantage of burgeoning demand. For example, Harley-Davidson, Inc. has expanded outside of Beijing and Shanghai to open new motorcycle dealerships in cities such as Chengdu, Sichuan; Dalian, Liaoning; Qingdao, Shandong; Wenzhou, Zhejiang; and Xiamen, Fujian. Steve Wasser, managing director of Harley-Davidson China, says that the company will double the number of Mainland cities with dealerships to 15 cities by 2012.

With so many up-and-coming second-tier cities, which areas stand out in the search for the top-tier consumer? Somewhat surprisingly, such consumers are everywhere. Northeastern cities such as Dalian and Shenyang, Liaoning; and Harbin, Heilongjiang; as well as Yangzi River Valley cities such as Changsha, Hunan; Nanjing, Jiangsu; and Wuhan, Hubei, represent the strongest retail growth markets. But hundreds of cities will be rich targets for many levels of consumer products, and regional statistics suggest that many of China's top-growth areas will be outside of traditional markets (see Table 2).

The average compound annual growth rate (CAGR) for these second-tier markets from 2000–09 (adjusting for the outlier Qingdao, where annual growth rates reached 42 percent) was nearly 15 percent, according to PRC National Bureau of Statistics figures. Interestingly, the CAGR for regional GDP trails behind the retail sales growth numbers. This gap likely reflects the lack of accounting for the gray economy and pent-up consumer demand in these previously underserviced markets.

A national poll conducted by Alaris in summer 2010 showed a frequent mismatch in supply and demand: Chinese have the money and desire to consume but the products they want are unavailable (see p.19). Notably missing from a top 10 list of cities with selected luxury brand presence are several cities with high GDP per capita or high levels of disposable income, including Fuzhou and Xiamen, Fujian; Hohhot, Inner Mongolia; Jinan, Shandong; Wenzhou; and Zhuhai, Guangdong (see Table 3). This ranking of cities by various indicators of consumption and savings suggests that most companies should consider a wide range of factors when moving beyond the first tier.

Other areas that companies tend to overlook as strong potential markets are "smaller" cities near big first-tier cities along the coast. For example, Tianjin ranked as China's third fastest-growing city in GDP terms. It has a population of more than 8 million, total GDP reaching at least ¥750 billion ($112.7 billion), and GDP per capita of more than ¥62,400 ($9,390). But for market-entry purposes, analysts often try to cover Tianjin from Beijing. Alaris research shows that such an approach yields below-average results as not all Tianjin consumers will travel to Beijing to make purchases. Generally, Tianjin is a first-tier consumer city; it has the disposable income levels, population density, and the general state of development that demand direct coverage and care. Therefore, if economic constraints force a company to choose Beijing over Tianjin, an effective alternative strategy may be to focus on a region—say capturing all of the first-tier consumers of the Bohai region instead of starting a strategy that has less returns to scale in Beijing, Guangzhou, and Shanghai.

A wide open road

Rapid economic growth in Tianjin, Suzhou, and many other second-tier cities may have some analysts worried about the long-term stability of these local economies. But such fears may be unwarranted, as growth is driven by several factors—government spending, improved infrastructure, regulatory changes, and relative competitiveness—that will support development for the foreseeable future.

Government spending

In 2008, the PRC government launched a ¥4 trillion ($601 billion) stimulus plan to help the country weather the economic crisis that began in China almost a full year before financial chaos struck the Western world in late 2008. Among the key components of this plan are funds allocated to infrastructure, earthquake reconstruction, technology advancements, rural development, and environmental engineering projects. With 52 percent of the stimulus aimed at supporting development in second- and third-tier cities, this spending will continue to fuel the development of these areas and underpin sustainable growth.

Improved infrastructure

The stimulus plan adds to infrastructure spending already in the pipeline, with a total of about 3,500 km (1,900 miles) of new transit routes scheduled to be added in China by 2015. New high-speed rail lines, such as the one between Shanghai and Nanjing, will improve the logistics and general speed of commerce of many second- and third-tier cities, linking high-tech, modern services, manufacturing, and other industries. China does not appear to be building bridges to nowhere; many of the transportation lines are already operational and adding value.

Internet access is another infrastructure priority. Internet usage across China has skyrocketed in recent years, with 40 percent of new users residing in rural areas. By June 2010, China's Internet users reached 420 million—double the number of users in the United States—according to a recent *McKinsey Quarterly* report. In 2009, more than 87 million Chinese bought products online, up nearly 40 percent over the previous year. Online shopping allows companies to sell

Table 1: Distribution of China's Millionaires

Region	No. of RMB millionaires	Individuals with more than ¥100 million
Beijing	151,000	9,400
Guangdong	145,000	8,200
Guangzhou	49,200	3,810
Shenzhen	45,600	3,160
Shanghai	122,000	7,300
Zhejiang	116,500	6,760
Hangzhou	47,300	2,590
Wenzhou	20,400	2,130
Ningbo	13,500	860
Jiangsu	62,600	4,300
Nanjing	22,100	1,680
Suzhou	15,600	930
Fujian	33,500	2,100
Xiamen	11,500	640
Fuzhou	10,200	540
Shandong	30,500	1,720
Qingdao	11,100	570
Liaoning	26,800	1,710
Dalian	11,000	690
Shenyang	7,660	510
Sichuan	22,100	1,520
Chengdu	13,500	730
Henan	15,200	1,040

Source: Hurun Research Institute, *2010 Hurun Wealth Report*

Table 2: Select Second-Tier Cities with Up-and-Coming Consumers

City	Population, 2009 (million)	Retail growth, 2008–09 (%)	GDP, 2009 (¥ billion)	GDP growth, 2000–09 (%) CAGR
National average	**1,319.2**	**16.0**	**33,535.3**	**13.2**
Chengdu, Sichuan	11.0	20.5	450.3	13.1
Dalian, Liaoning	6.2	17.4	441.8	14.8
Nanjing, Jiangsu	7.7	16.9	423.0	15.3
Ningbo, Zhejiang	5.7	13.2	421.5	12.4
Qingdao, Shandong	8.5	18.0	489.0	41.7
Suzhou, Jiangsu	6.3	24.2	774.0	19.0
Tianjin	12.3	20.7	750.1	16.7
Wenzhou, Zhejiang	7.5	15.0	252.8	11.8
Xiamen, Fujian	2.5	NA	162.3	12.5

Notes: GDP = gross domestic product; CAGR = compound annual growth rate; NA = not available
Source: PRC National Bureau of Statistics (NBS)

to otherwise difficult-to-reach second- and third-tier cities. Given relatively poor distribution channels, inadequate retail formats, and a mismatch between supply and demand throughout many regions in China, the Internet is becoming an excellent channel to identify and service first-tier consumers nationwide. Alaris's recent work building an Internet-based business-to-consumer strategy for high-end home textiles firm Shanghai Cottonest Information Technology Co. Ltd. showed that more than 60 percent of Cottonest's customers were located in second-tier and smaller cities. Moreover, the average total purchase value per visit for the second-tier buyer is about 20 percent higher than for the first tier. The Internet is an effective way to reach consumers that are "hidden" in China's vast market.

A regulatory window

A number of recent factors suggest that reaching more markets is becoming increasingly easy. From a structural standpoint, China's regulatory environment finally allows international investors to wade into most retail and wholesale markets without restriction (see the *CBR*, May–June 2010, p.16). Firms now also have more flexibility to choose the investment structure that best suits their needs. Though not all foreign firms can pursue solo ventures in China, they have far more business options than they did a decade ago (see the *CBR*, September–October 2010, p.14). And though these changes affect foreign investment throughout China, increased regulatory transparency and access to a broader range of retail and wholesale opportunities should reassure foreign companies considering a move into a second- or third-tier city. The challenges are now less about legal limitations and more about finding the right human resources to manage a company in second-tier cities.

Customers and cost advantages

Realizing that the income gap between urban and rural residents was increasing, the PRC government in 2006 abolished certain agricultural taxes to sharpen the competitive edge and relative prospects of rural residents. In addition, central and local governments allocated a total of ¥218.9 billion ($27.4 billion) to subsidize compulsory education in rural areas for five consecutive years beginning in 2006. This legislation provided an incentive for people to stay in second-tier cities and suggests that local economics will stabilize or improve.

All of these factors complement the one overriding driver of growth: The coastal first-tier cities have a cost base—including labor, rent, and general operating costs—that is 20–40 percent higher than the second-tier competitors. Thus, firms looking for cost advantages are moving out of the traditional manufacturing locations to more cost-competitive areas. As jobs move, wealth expands to other areas.

Challenges of second- and third-tier markets

When setting up shop to capture first-tier consumers in second- and third-tier cities, foreign companies should consider many challenges. Regardless of the type of business operation, the company's human resources requirements—including

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Tapping into Consumer Desires

One hallmark of a successful brand is that it connects with consumers on an emotional level, appealing to an individual's dreams and aspirations. This connection strengthens the bond between the brand and the consumer and makes the brand difficult for others to copy. A recent Alaris Inc. study divided 2,000 consumers throughout China based on various functional and aspirational attributes and factors. Though the study projected that there would be more brand-conscious consumers in first-tier markets, the survey results found little difference between markets. Aspirational consumers were found everywhere, from the richest environs of Shanghai to the remote towns and cities in fourth- and fifth-tier cities. China's emergence as the fastest-growing consumer society in the world is not just happening on the eastern seaboard but throughout the entire country.

The table on the left shows several attributes that typically define an aspirational consumer mindset. As the results suggest, this mindset is not bound by geography. In fact, consumers in second-tier cities are more likely to buy their favorite brands, even if the products cost a bit more.

—*Alaris Inc.*

Percentage of Consumers Who "Strongly Agree" with the Following Statements

Survey question: Thinking about shopping in general, indicate how much you agree or disagree with each of the following statements:

	Market tiers		
	Tier 1	Tier 2	Tier 3+
All respondents	**1,384 100%**	**412 100%**	**1,041 100%**
I buy my favorite brands, even if they cost a little more.	36%	42%	33%
I buy international brands whenever I can.	36%	36%	32%
Sometimes I splurge and buy myself something expensive.	24%	25%	19%
I often go shopping just because it's fun.	21%	17%	20%
I mainly buy products that are on sale or a special offer.	13%	12%	12%

Note: Results were based on a six-point scale with "strongly agree" being the highest point.

China Foto Press

As the world's largest manufacturer of consumer electronics, China offers an increasingly attractive market to US producers of high-tech manufacturing equipment.

China's Emerging Tier 2 Cities: Opportunities for US Companies

As living standards and the business environment improve, US companies may be able to export more goods and services to China's second-tier markets.

Richard Craig and Jacqueline Qiang

China's expanding economy is rich with business opportunities for US firms, many of which are small and medium-sized enterprises. In 2008 and 2009, the United States exported more than $69 billion worth of goods annually to China. As China's wages rise nationwide and interior regions receive greater investment and government support, US exporters may find more opportunities to sell to China's second-tier markets.

China's diverse urban and rural markets present challenges for foreign companies, however. To understand domestic market trends and opportunities, companies should study the strengths of various regions—and do their homework.

The importance of Tier 2 cities

Though analysts often categorize China's Tier 2 cities in different ways because the PRC government does not officially define tiers, this article focuses on 15 key Tier 2 cities, many of which are provincial capitals: Chengdu, Sichuan; Chongqing; Dalian, Liaoning; Hangzhou and Ningbo, Zhejiang; Kunming, Yunnan; Nanjing and Suzhou, Jiangsu; Qingdao, Shandong; Tianjin; Shenzhen and Zhuhai, Guangdong; Wuhan, Hubei; Xiamen, Fujian; and Xi'an, Shaanxi. Though the total population of the 15 cities accounts for only 8 percent of China's overall population, these markets receive more than 59 percent of total US imports, according to the US Commercial Service. Global Trade Atlas statistics show that the cities with the highest year-on-year growth in US imports as of June 2010 were Hefei, Anhui (164 percent), Ningbo (90 percent), Chengdu (75 percent), and Hangzhou (63 percent)—far outpacing the 19 percent and 21 percent growth rates in Beijing and Guangzhou, Guangdong, respectively.

Recent social and economic reforms have transformed and reshaped the indus trial, commercial, and regulatory landscapes of China's developing Tier 2 cities. As living standards and the business environment improve, these cities have enormous market potential. For example, Suzhou's population was roughly 6.3 million and its gross domestic product (GDP) was $774 billion in 2009. (In comparison, New York, the largest US city, had a population of about 8.4 million and GDP of nearly $1.5 trillion in 2009.)

Consumer spending is an important factor in Tier 2 cities' growth. Purchasing power is increasing, as evidenced by major retailers' expansion into these cities. Wal-Mart Stores, Inc. opened its first supercenter in Shenzhen in 1996 and expanded to 189 stores in 101 cities throughout China by August 2010. Home Depot Inc. operates 12 stores in six Chinese cities, including Qingdao, Tianjin, and Xi'an.

China's 12th Five-Year Plan (FYP, 2011–15), which lays out national policies in major social and economic areas for the next five years, is currently being drafted and is expected to continue funneling major investments into Tier 2 cities. The plan will likely focus on seven strategic emerging industries: biotechnology, high-end equipment manufacturing, new energy, new-energy vehicles, new materials, and next-generation information technology. According to PRC state media reports, the government is considering a $738 billion 10-year energy plan that will develop clean energy by investing in nuclear, solar, wind, and other non-fossil fuel energy sources. These sectors could provide opportunities for US companies that export components or key technologies to manufacturers.

Quick Glance

- Though China's Tier 2 cities may be less populated than their Tier 1 counterparts, they receive more than half of total US exports to China.
- Each second-tier city is strong in certain industries, such as high-tech manufacturing, food and agricultural processing, and clean technology.
- US exporters that research and understand China's diverse business environment may find more markets for their products.

Based on data available for different sectors, this article primarily focuses on second-tier market opportunities in China's high-tech, food processing, and clean-tech sectors.

High-tech manufacturing

China's high-tech manufacturing industry has seen unprecedented growth in the past decade. From 1995 to 2007, the industry grew from $19 billion to $167 billion, ranking third worldwide after the United States ($374 billion) and the European Union ($306 billion). The 12th FYP will continue to provide subsidies, deferred interest and lower tax rates, and other support policies to advance the development of high-tech enterprises. The industry's rapid growth has created opportunities for US companies that export precision machinery used in high-tech manufacturing.

China is the world's largest manufacturer of consumer electronics—including electric office appliances, electronic communication equipment, home appliances, and plasma and digital TVs—and accounts for more than 35 percent of the global electronic industry's total revenue. Suppliers and manufacturers of high-tech portable consumer electronics, market-leading innovative technologies, and smartphones may find opportunities in this sector. For example, as of second quarter 2010, Apple Inc. was China's fifth-largest smartphone vendor, accounting for more than 7 percent of the country's smartphone shipments.

Qingdao ranks high as a potential export market because of its numerous industries, including alcohol, auto manufacturing, building materials, cargo handling, chemical fertilizers, consumer electronics, food processing equipment, petrochemicals, shipbuilding, steel, and textiles and apparel. The local government has placed special emphasis on the development of consumer electronics. Qingdao is home to more than 30 research, higher-education, and managerial institutions and has roughly 800,000 scientifically and technically skilled personnel. In 2009, Shandong's GDP grew 12 percent to nearly $495 billion, ranking third among China's provinces.

Other key cities with strengths in the consumer electronics industry are Lu'an, Anhui; Luoyang, Henan; and Shenzhen.

Food and agricultural processing

Despite the global economic downturn, China's food processing industry output reached a record high of $662 billion in 2009. The industry grew nearly 30 percent annually from 2003 to 2008, as more consumers replaced traditional fresh foods purchased at morning and wet markets with packaged foods found in Western-style hypermarkets.

The food processing industry is one of the six pillar industries of Chengdu. Chengdu has companies in 22 divisions in the industry and competitive advantages in beverages, dairy products, feedstock, meat, and tobacco. The city's total food processing industry output is expected to reach $11.5 billion by the end of 2010. This growth has created opportunities for US exporters, especially those that export high-tech equipment used in food and agricultural processing.

Other cities that have strengths in food and agricultural processing include Nanchang, Jiangxi; Tianjin; and Zhangzhou, Fujian.

Clean tech

In 2009, investment in China's clean-tech industries reached about $34 billion, overshadowing the $18 billion total investment made in the same industries in the United States. The PRC Ministry of Environmental Protection stated that the total output of enterprises in the environmental protection industry is expected to exceed ¥1 trillion ($149 billion) by the end of 2010. Some PRC sources have predicted that the 12th FYP's budget for environmental protection, which includes wastewater and solid-waste treatment, will reach roughly $454 billion—more than double the amount allocated in the current FYP. Further investment and development plans are underway as China attempts to derive at least 15 percent of all energy from renewable sources by 2020. Companies that provide innovative solutions and advanced equipment and technologies may find opportunities in China's clean-tech sector.

Wastewater treatment

China generated 57.2 billion tons of wastewater, composed of 58 percent municipal wastewater and 42 percent industrial wastewater, in 2008. Analysts expect that the country's total wastewater output will reach 79 billion tons by 2015 because of rapid urbanization and industrialization. China's current wastewater treatment infrastructure is still inadequate. The PRC government plans to build new facilities and upgrade existing ones, resulting in a large demand for technology and components. Competition for these projects is fierce, however, and ranges from foreign companies that provide advanced technology and management to domestic players that typically offer more competitive prices and in some cases comparable technology.

Wuhan, Hubei, is a key emerging market for wastewater treatment facilities. The city is particularly rich in fresh-water resources and the local government strongly supports the development of wastewater and urban sewage treatment facilities. The city's industrial zones, which will each have wastewater treatment facilities, may present additional export opportunities for US suppliers.

Other key cities with strengths in the wastewater treatment industry include Tianjin; Wuxi, Jiangsu; and Xiamen.

Solid-waste treatment

China is the world's largest producer of municipal solid waste (MSW). In 2008, the country produced more than 223 million tons of MSW. With a forecasted annual growth rate of 8–10 percent, production is expected to top 250 million tons in 2010. To reduce the amount of MSW, the PRC government is making investments to improve its solid-waste treatment capabilities.

For example, the primary methods of disposing of solid waste in Ningbo in the past 100 years included uncontrolled burning, terrestrial dumping, and dumping into waters—all of which have polluted the environment and affected citizens' daily lives. To minimize the negative effects of MSW, Ningbo has made significant improvements to its waste treatment facilities in the past few years. The local government has invested roughly $88 million to develop a comprehensive infrastructure system for MSW.

Case One: A Wholly Foreign-Owned Wastewater Treatment Company

A medium-sized North American wastewater treatment company engaged in the design and manufacture of key components for wastewater treatment plants has been active in China for more than five years. The company has been working through agents to sell its design and technology in China and is now in the process of establishing a wholly foreign-owned enterprise (WFOE) in Wuhan, Hubei, to better engage in sales and business development while directly importing key components from North America.

By establishing a sales office capable of importing components directly from its North American factory, the company is able to take advantage of the tremendous opportunities in central China by establishing ties with key project planners. Importing key components also allows the company to cut out middlemen and further increase margins.

Firms considering establishing a WFOE must be aware that it requires a two-month process that can be complicated because of the potential number of government entities involved. In addition, capital requirements vary by industry. (For more information on the pros and cons of WFOEs, see the *CBR*, September–October 2010, p.14.)

—Richard Craig and Jacqueline Qiang

More than 90 percent of China's landfills do not meet international standards because of capacity constraints and unsanitary conditions. Alternative MSW treatment methods such as incineration will likely become more widely accepted by local governments and industry players in China. These methods require more advanced technologies and instruments than Chinese companies currently have the capability to produce—including sanitary landfill and incineration equipment, treatment equipment, waste-to-energy technologies, and sampling instruments—and thus open greater export opportunities for US firms.

Other cities with strengths in the solid waste treatment industry include Chongqing, Hangzhou, and Harbin, Heilongjiang.

Other industry opportunities

In addition to the main sectors discussed above, exports of other products to key Tier 2 cities are also growing rapidly. Xi'an's imports of electrical machinery rose 118 percent in 2009, while Tianjin's imports of railway equipment jumped 634 percent during the same period. Wuhan's chemical imports increased 100 percent, and Xiamen recorded 544 percent growth in imports of pharmaceuticals.

Considerations for US companies

Tier 2 cities may present opportunities for US companies that take the time to research and understand China's domestic market trends and complex business environment. Companies must recognize that the China market is highly fragmented with significant differences between cities and regions. They must also choose an appropriate location with a market environment most suitable to their industry and objectives.

Companies may also face other challenges when entering the China market, such as China's selective enforcement of World Trade Organization rules, vulnerable intellectual property rights, government restrictions on foreign ownership, local content requirements, and competition from established domestic enterprises. In some cases, markets are either premature (especially in the case of expensive or advanced technologies) or highly saturated with intense competition. US companies must therefore understand the China market and assess all opportunities and challenges when determining their entry strategy.

To help US companies better understand the China market, the US Commercial Service offices in China, together with the China Council for the Promotion of International Trade, provide business counseling and matchmaking services for US exporters in 14 markets. To learn more about the services of the US Commercial Service in China and opportunities in emerging Tier 2 markets, visit www.buyusa.gov/china/en, contact a trade specialist at a US Export Assistance Center in any state, or visit www.export.gov or www.trade.gov to find the nearest office. These websites, and the US Comercial Service, are under the US Department of Commerce International Trade Administration. 完

> The PRC government is considering a $738 billion 10-year energy plan that could provide opportunities for US companies that export components or key technologies to manufacturers.

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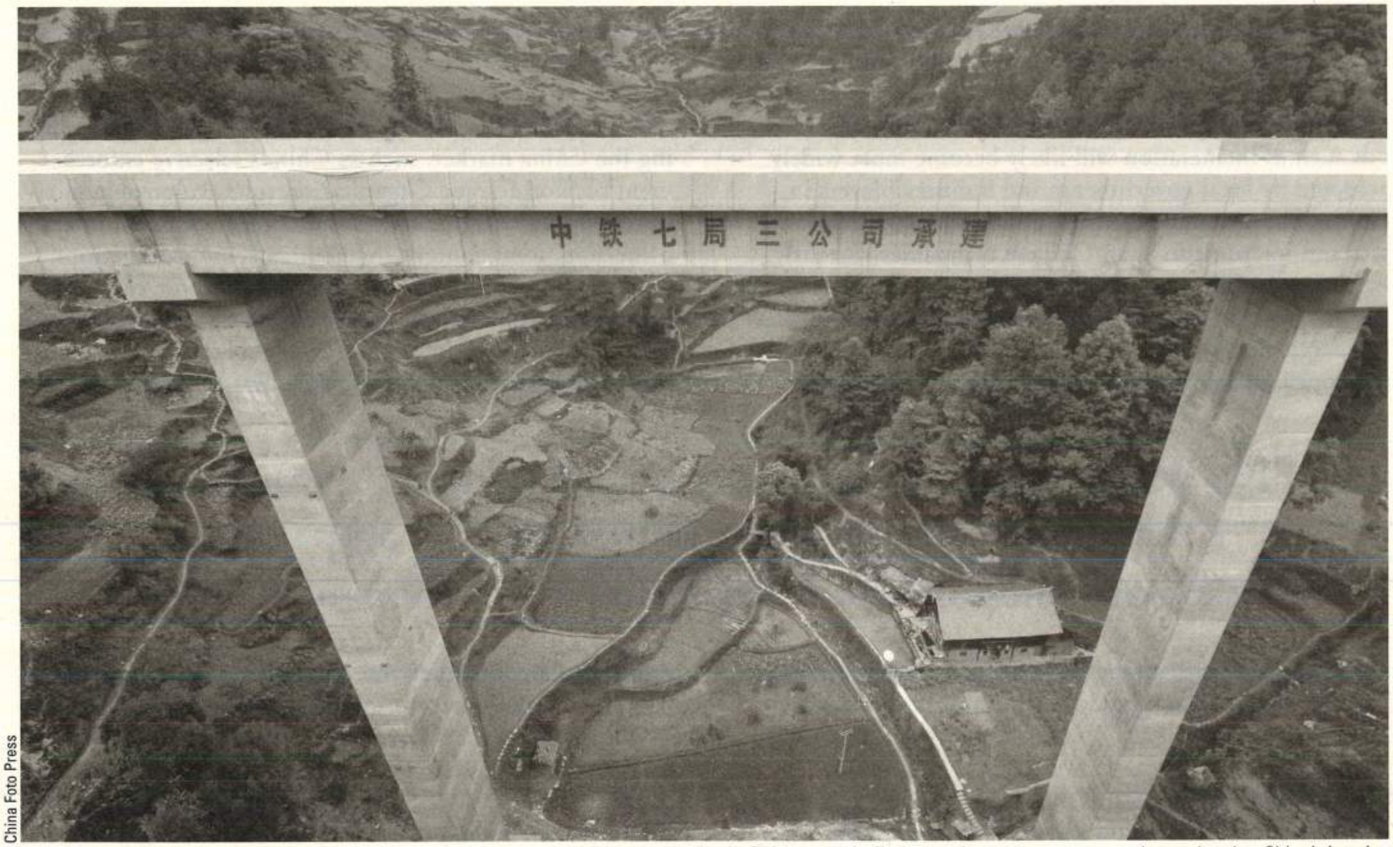
The US Commercial Service and the JLJ Group jointly conduct market research and webinars to inform US exporters of emerging opportunities in different sectors throughout China.

Case Two: A Fruit Juice Company's Representative Office

A small New England producer of premium fruits and juices is expanding its sales in the China market. The company has had some marginal success in China by using established local distributors and is now looking to improve its distribution and sales channels without making a significant investment. The company is setting up a representative office (RO) to assist its distributors and advertise in cities throughout China.

By establishing an RO, which is easier to set up than a wholly foreign-owned enterprise, the firm can monitor distributors and assist with promotional and consumer education activities as needed without worrying about registering capital. In addition, it can more quickly react to changes in local market conditions with people on the ground in China. The RO structure has limitations, however, such as restrictions on hiring, generating contracts, and receiving revenue (see the *CBR*, September–October 2010, p.18).

—Richard Craig and Jacqueline Qiang



China Foto Press

The PRC government is investing in infrastructure projects, such as this expressway in Guizhou, and offering tax incentives to companies to develop China's interior.

Economic Development Policies for Central and Western China

The PRC government has ramped up incentives to develop central and western China—will foreign companies bite?

Nancy Huang, Joie Ma, and Kyle Sullivan

China launched two strategies to develop its central and western regions in the last decade. The PRC State Council launched the Western Development Strategy, China's first comprehensive regional development plan to boost the economies of western provinces, in 2000. Premier Wen Jiabao announced the Rise of Central China Plan, a development strategy to coordinate regional growth in six central provinces, in 2004. To achieve the broad goals outlined in the plans, the PRC government has implemented strategic programs, developed industry-specific plans, created industry-specific catalogues of preferred technologies, and announced new incentives to attract investment to the central and western regions. Though both plans have limitations, they provide important guidance—and specific incentives—for foreign companies looking to expand in China and gain access to potential customers in untapped regions.

Push for regional development plans

Economic development in China's central and western provinces has lagged far behind progress on the booming coast. PRC data show that China's gross domestic product (GDP) increased nearly 17 times, and GDP per capita rose 12-fold between 1978 and 2008. Most of this growth was generated by a handful of eastern and southern provinces, however. The average income in central and western China was roughly 77 percent of the national average in 1999, and increased only slightly to 80 percent of the national average by 2008.

The push to develop China's hinterland has gained more traction within the PRC government in recent years. The composition of China's industrial structure is undergoing a major transformation in which traditional industries, such as low-end or energy-intensive manufacturing, are losing policy support from the coastal provinces. As a result, central government officials have adopted a different development model that seeks to direct foreign investment to meet specific needs. The PRC government is thus now more focused on promoting the central and western regions. For example, the National Development and Reform Commission (NDRC) in 2008 revised the Catalogue of Encouraged Industries for Foreign Investment in Central and Western China to guide foreign investors to sectors that the government intends to develop: high value-added, environment-friendly, energy-efficient industries that take advantage of local resources, as well as areas in which China lacks the capabilities necessary for development (see Table). The revised catalogue opened to foreign investment sectors that had been previously restricted or prohibited, or that had been restricted in the more developed coastal regions. Examples include auto components manufacturing, value-added telecom services, and natural resource exploration.

Quick Glance

- Economic development in China's central and western provinces has lagged far behind progress on the booming coast.
- Foreign companies that invest in priority industries in central and western China can enjoy tax incentives, such as a 10 percent reduction in enterprise income tax payments.
- Companies will find greater investment options as previously restricted industries in the interior open up to foreign investment.

Western Development Strategy

Passed in March 1999, the Western Development Strategy was the first central government-directed development program for China's western region. The strategy calls for the central government to invest in infrastructure development and natural resource exploitation, and set market liberalization policies to create regional economic development centers.

With the first 10-year phase of the Western Development Strategy coming to a close—along with concerns about the damaging effects of the global recession—the central government began to call for a new round of regional development in 2008. The purpose was not only to support ongoing efforts to build basic infrastructure, but also to call attention to the broad industries the central government wanted to prioritize for development. The government added new energy, equipment manufacturing, new materials, biotechnology, pharmaceuticals, aerospace and defense, and information technology (IT) to the list of encouraged industries. These additions joined traditional sectors that had previously dominated economic activity in the western region, such as petrochemicals, energy, mining, and minerals processing.

In addition to revising the catalogue, the PRC government has also designated three economic clusters in western China to spur regional development: the Chengdu-Chongqing Economic Zone, Guangxi-Beibu Gulf Economic Zone, and Guanzhong-Tianshui Economic Zone. Regional plans have been released for two zones—Guangxi-Beibu (2008) and Guanzhong-Tianshui (2009)—and media reports indicate the plan for the Chengdu-Chongqing Economic Zone will be released in late 2010, though no official confirmation has been made. The clusters will encourage economic development in surrounding areas and, over time, will connect to create widespread growth across the western region.

Policymakers intend to allocate certain industries to core areas to match industries with local capabilities and resources. For example, under the Guanzhong-Tianshui plan, Xi'an, Shaanxi, aims to become a national center for science and technology research and development (R&D), as well as a base for high- and new-tech industries and advanced manufacturing. Baoji, Shaanxi, is slated for development as a base for new-materials R&D and production, and as a center for machine-tool manufacturing, heavy-auto manufacturing, non-ferrous metal processing, and retail industries. Shaanxi's resource-rich cities of Tongchuan and Weinan encourage investment in the energy, coal-to-chemical, and agricultural processing industries. For the province's remaining areas that are largely rural, government efforts will still focus on basic infrastructure construction to foster urbanization.

From 2000 to 2008, the western region's GDP grew by an average of 11.7 percent annually. But these robust numbers mask the shortcomings of the Western Development Strategy. From 1999 to 2009, high-volume growth in western China was limited to just three major cities: Chengdu, Sichuan; Chongqing; and Xi'an. Average annual incomes in the western region remain below the national average.

The Rise of Central China Plan

In 2009, the State Council released the Rise of Central China Plan with the clear goal of transforming central China into a production base for four major industrial areas: grain production, energy and raw materials, equipment manufacturing, and high technology. The plan also aims to develop the region into a major transport hub.

To support the 2009 plan, the PRC Ministry of Commerce (MOFCOM) in May 2010 issued the Central China Foreign Investment Promotion Plan (2009–14) and six related provincial sub-plans that cover Anhui, Henan, Hubei, Hunan, Jiangxi, and Shanxi. Each provincial plan contains a foreign-investment promotion strategy that focuses on specific industries. For example, the Henan Promotion Plan encourages foreign investment in chemicals, electronic equipment, equipment manufacturing, high technology—especially IT—and mining.

More policies on the horizon

Signs indicate that the PRC government is pushing for further development in the country's central and western regions. China's 12th Five-Year Plan (2011–15), which is currently being drafted and is scheduled to be finalized in March 2011, will devote significant attention to developing central and western China. Though details of specific policy initiatives are not yet public, the policies will likely emphasize balanced regional economic growth instead of focusing on generating rapid economic development.

As an indication of a renewed commitment to development in central and western China, the State Council approved in June 2010 a plan to establish the Liangjiang New District in Chongqing. The district was modeled after Shanghai's Pudong New District and Tianjin's Binhai Development Zone, offering all the same incentives, including a reduced enterprise income tax (EIT) rate of 15 percent through 2020 to companies that operate in encouraged industries. NDRC Vice Minister Du Ying announced in July that regulators are currently developing the Catalogue of Encouraged Industries in Western China.

> Impressive economic growth in the central region appears to be generating domestic demand and driving policymaking toward the region.

Industries encouraged in the Central China Foreign Investment Promotion Plan include a mix of traditional and emerging industries, including

- Agricultural products and food production;
- Clothing, food, light industry, electronics, and other labor-intensive industries;
- Electronic information, biotechnology, new energy, new materials, and other high-tech industries;
- Energy and raw materials;
- Farm machinery, vehicles, and shipbuilding;
- Logistics, transportation, and other modern services; and
- Mining, metallurgical, and petrochemical equipment.

The Rise of Central China Plan has a few characteristics that set it apart from the Western Development Strategy. Notably, central China development policies seek to exploit the region's agricultural advantages and develop industries such as agriculture machinery, food processing, logistics, and petrochemicals.

The Rise of Central China Plan has already shown some positive results. In 2009, the average GDP growth rate of the six central provinces reached 11.6 percent, exceeding the 11.1 percent growth rate of coastal provinces. Industrial value-added and fixed-asset investment in the region also demonstrated robust growth in 2009. Indeed, impressive economic growth in the central region appears to be generating domestic demand and driving policymaking toward the region.

Yet companies have expressed doubts about the business operating environment in central China. Many complain about the region's poor infrastructure and fragmented logistics networks relative to the coast. Higher transport costs and relative isolation from supply chains may outweigh the benefits of tax breaks and other financial incentives available to foreign-invested enterprises (FIEs) that relocate to central China.

Regional development incentives

By offering incentives to foreign companies, the PRC government has emphasized that foreign investment is key to developing the central and western regions. Under current investment schemes, foreign companies that invest in priority industries in these regions can enjoy the same preferences that are offered to industries in the encouraged list of the Catalogue Guiding Foreign Investment in Industry. Incentives are mainly tax related, such as a 10 percent reduction in EIT payments. Current policy allows exemptions until the end of 2010, but the exemption may be extended for emerging industries such as bio-sciences, IT, pharmaceuticals, and renewable energy. The State Council is urging localities to streamline or liberalize investment processes and technology funding to encourage FIEs in eastern China to relocate to the central and western regions.

Incentives in central China

Many tax incentives are available to investors in central China, with the bulk of them offered at the county and city levels. County and city tax incentives include exemptions or reductions in payments of value-added tax (VAT), EIT, import tax, urban land tax, and other tax liabilities. Local governments also offer preferential land-use policies, such as discounted rental fees, rebates, and accelerated approvals for land use. Eligibility for preferential policies depends on the location, industry, and nature of the applying company's operational activities.

According to a 2007 State Council General Office notice, companies in 26 central China cities are eligible for incentives that were once applied to companies under the Plan for Revitalizing the Old Industrial Base in the Northeast Region. More than 200 counties offer incentives to companies under the Western China Development Strategy. Incentives are primarily related to tax and land use in the following 26 cities:

- **Anhui Province** Bengbu, Hefei, Huainan, Ma'anshan, and Wuhu;
- **Henan Province** Jiaozuo, Kaifeng, Luoyang, Pingdingshan, and Zhengzhou;
- **Hubei Province** Huangshi, Shiyan, Wuhan, and Xiangfan;
- **Hunan Province** Changsha, Hengyang, Xiangtan, and Zhuzhou;
- **Jiangxi Province** Jingdezhen, Jiujiang, Nanchang, and Pingxiang; and
- **Shanxi Province** Changzhi, Datong, Taiyuan, and Yangquan.

Companies operating in the agricultural products and processing, auto, defense, equipment manufacturing, high- and new-technology, metallurgy, petrochemical, and shipping industries may be eligible for rebates on their VAT payments for fixed assets. The rules also apply to organizations that have head offices (*zong ji gou*) in central China and have purchased fixed assets through their head office. Industrial enterprises can write off 40 percent of the purchase value of fixed assets or intangible assets from their income taxes.

The rules also provide incentives for land use. Any land that is deemed by the land utilization plan as a "transformational project" and that is used for urban construction can be regarded as priority. Transformational projects are those that use land for a different purpose than what it had been used for in the past. Land applications for key infrastructure projects will be given additional priority status.

Incentives in western China

Despite reforms to China's enterprise tax regime in 2008, preferential tax policies listed in the Circular on Issues Regarding Tax-Related Preferential Policies for Western Development (1999) remain effective, and most of them are likely to be extended past 2010. Tax benefits listed in the circular include:

- Reduced EIT rate of 15 percent for investment that falls under the encouraged category in the Catalogue Guiding Foreign Investment in Industry or the 2008 Catalogue of Priority Industries for Foreign Investment in Central and Western China.
- Local tax deductions or exemptions approved by the provincial government.
- 2+3 tax holidays for new enterprises in the transportation, grid power operation, irrigation works, postal services, and broadcasting industries. Eligible companies receive a two-year exemption on their EIT payments beginning from their first profitable year, and pay a 12.5 percent EIT rate from the third to fifth year. To qualify, companies must derive 70 percent of their annual revenue from services related to their core business and must have been operational for 10 years or more.
- Duty-free imports and exemptions on VAT payments on imported products that are used directly by the importing company, according to the product types listed in the Import Commodities Not Exempt from Duty and Tax for Foreign Investment Projects Catalogue.

Media reports indicate that the State Administration of Taxation has already begun internal discussions on updating the circular, and may include a 3+3 tax holiday for companies that invest in key public infrastructure projects. (A 3+3 tax holiday would be similar to a 2+3 holiday, but would allow an additional year of exemptions on EIT payments.) Statements from the PRC leadership also suggest it will extend the 10-percent reduction in EIT rates.

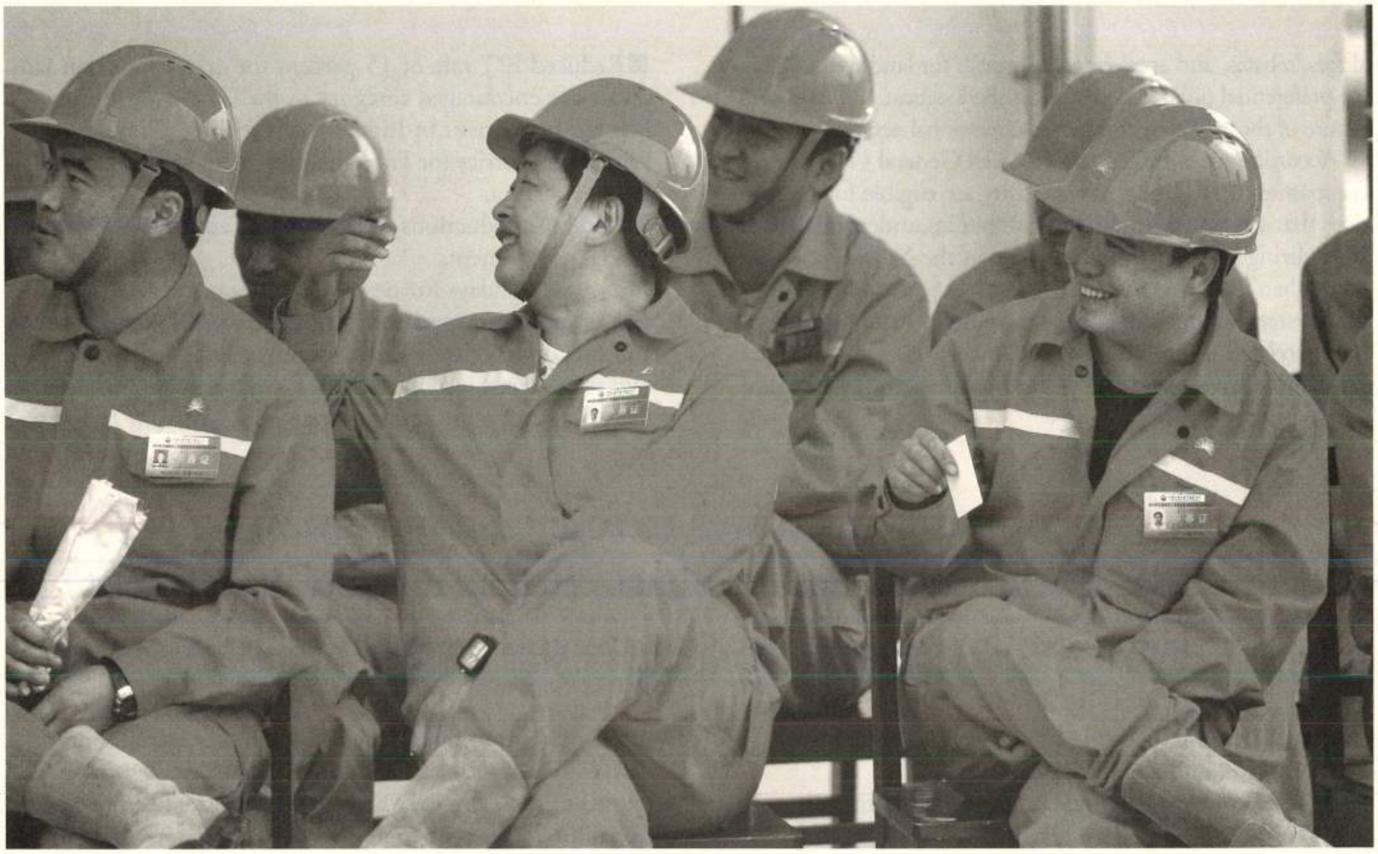
> By offering incentives to foreign companies, the PRC government has emphasized that foreign investment is key to developing the central and western regions.

More options for foreign investors

The push to develop China's central and western regions will open market segments to foreign investment for years to come. Companies will find greater investment options as previously restricted industries in the interior open to foreign investment and favorable policy incentives become available.

Despite the growing attractiveness of China's interior as a destination for investment, establishing operations in central and western China brings distinct challenges that companies must account for in their planning. Local officials' relative lack of experience in facilitating foreign investment may require companies to educate government officials about how their operation supports government policy objectives. Companies

Continued on page 43



China Foto Press

Companies can maximize their input in the unionization process by designating the union chair and committee members.

Unionization and Collective Bargaining: New Tools for Social Harmony

As the PRC government renews its unionization campaign, companies must prepare to respond to greater labor pressures.

K. Lesli Ligorner and Todd Shengqiang Liao

All is no longer quiet on the unionization front. After putting its unionization drive on hold in 2008 because of the financial crisis, the All-China Federation of Trade Unions (ACFTU), China's only government-recognized union, has reenergized its efforts to unionize foreign-invested enterprises (FIEs). Starting in May 2010, ACFTU began issuing a series of notices that requested its local branches to increase pressure on private domestic companies and FIEs to establish unions and sign collective contracts with their employees. The notices indicate that the PRC government is resuming its unionization campaign and highlight the focus on implementing collective bargaining agreements. FIEs would do well to consider the legal and practical implications of the new notices on their operations and prepare to respond to greater unionization and collective bargaining pressures.

A look back

The current unionization campaign builds on a foundation that solidified in 2006 when ACFTU set up branches in all Wal-Mart Stores, Inc.'s outlets in China. After failing to make considerable progress in unionizing several other multinational corporations (MNCs), ACFTU in June 2008 launched an aggressive campaign that focused on unionizing the Chinese subsidiaries of Fortune 500 companies. Though many MNCs initially resisted the campaign, some companies believed that unionization was inevitable and chose to work with ACFTU officials, including by designating the union chair and committee members. According to ACFTU reports, the unionization rate among Fortune 500 companies in China rose from less than 50 percent to 83 percent in 2008 as a result of the campaign.

PRC government efforts to encourage collective bargaining also expanded during that time. ACFTU, the PRC Ministry of Human Resources and Social Security (MOHRSS), and the China Enterprise Confederation in April 2008 jointly introduced the Rainbow Plan—which originally aimed to establish collective contracts in large companies in eastern China by 2009, in central China by 2010, and in the remainder of China by 2012. (The final plan was not officially issued and implemented until May 2010 [see below]). By September 2008, 108 Wal-Mart outlets in China had entered into collective contracts, and ACFTU reports that by the end of 2009 more than 1.2 million collective contracts were signed involving more than 2 million enterprises and nearly 162 million workers nationwide.

During the global financial crisis, which started later in 2008, ACFTU temporarily halted unionization and collective bargaining efforts and shifted its focus to mitigating the risks of unemployment as enterprises closed their doors and reduced production capacity. Though sporadic unionization activity took place in 2009, ACFTU's activity did not become more concerted and directed until spring 2010, with the release of a wave of new notices and regulations.

- **The Notice on Pushing Forward Collective Bargaining and the Implementation of the Rainbow Plan**, jointly published by ACFTU and MOHRSS on May 5, requires trade unions to focus on collective wage negotiations in private and labor-intensive enterprises. The notice further encourages companies and employees to establish collective contracts regarding wage-related topics, such as salary levels and work quotas.
- **A revised Rainbow Plan**, issued on May 25, aims to increase collective bargaining coverage to more than 60 percent in 2010 and to more than 80 percent by 2011. The plan focuses on collective bargaining for fair wages to ensure that companies increase wages in proportion to their revenue growth. It also targets companies that have not engaged in collective bargaining, have expired labor contracts, or have consistently given low to no salary increases.
- **The Urgent Notice on Further Advancing the Establishment and Use of Enterprise Labor Unions**, issued by ACFTU on June 4, directs all ACFTU branches to advance the establishment of trade unions in private enterprises, including FIEs and entities with investors from Hong Kong, Macao, and Taiwan. The notice also calls for expanding union representation for migrant workers.

On July 3, ACFTU requested that its local branches offer to engage in collective bargaining with all enterprises that have not established a collective bargaining mechanism, have refused to establish such a mechanism, or have expired collective bargaining contracts. According to PRC media, local ACFTU branches have the jurisdiction and authority to issue a "notice of rectification recommendations" to enterprises that reject or fail to respond to the offer in a timely manner. If a company refuses to take action in response to the recommendations, the local ACFTU branch may raise the request with local labor authorities and work with such authorities to investigate and pursue legal liabilities against the company.

Quick Glance

- The PRC government's labor campaign, which stalled in 2008 because of the economic downturn, is regaining speed.
- The renewed campaign is increasing pressure on foreign companies in China to unionize and conduct collective bargaining on wages.
- Companies should be proactive and prepare to respond to unionization and collective bargaining requests.

Labor unrest emerges—and the government responds

Many observers believe that the renewed unionization and collective contract campaign was in part prompted by recent labor unrest and worker demands for wage increases throughout China. Most notably, roughly 1,900 workers (including many low-paid interns) at Honda Motor Co., Ltd.'s auto parts company in Foshan, Guangdong, went on strike in May to demand a monthly salary increase of ¥800 ($118). The employees bypassed the official trade union to organize the strike and resisted confrontations with ACFTU representatives who requested that the employees return to work. The strike lasted two weeks before Honda agreed to increase monthly wages by roughly ¥500 ($74) through negotiations with employee-elected representatives (as opposed to union representatives). After the Honda incident, other similar strikes largely planned and executed outside the authority of official ACFTU-controlled trade unions occurred throughout China—most of them settled with the employers agreeing to a wage increase.

The recent spread of labor unrest in part reflects the deepening class conflict in China. Since the reform and opening policy began in 1978, China's rapid economic development has been relying on low-wage, labor-intensive industries. Rather than benefiting from economic growth, however, many workers in these industries are struggling against inflation and possess little tangible wealth. Aware of the potential threats posed by unequal income distribution, the PRC government has been encouraging wage increases. At the same time, the government is concerned that the independent grassroots labor movement could undermine social stability. To address these issues, PRC leaders have formed a top-down strategy to increase workers' income gradually. An essential aspect of this strategy is unionization and collective bargaining guided by ACFTU-controlled trade unions.

operate without trade unions in China are considering whether to change their "anti-union" strategy based on the risk of delaying what appears to be inevitable. Companies that have agreed to unionize have focused on maximizing the management's input in the establishment process and minimizing the disruption to business operations.

Unlike the previous unionization campaign that focused on Fortune 500 companies, the current campaign also targets small and medium-sized FIEs.

What to expect from the renewed campaign

Greater unionization pressures

As implementation of the Rainbow Plan becomes national policy, the PRC government sees a growing urgency for enterprises to establish trade unions, despite the lack of a clear statutory requirement for this to occur. Unlike the previous unionization campaign that focused on Fortune 500 companies, the current campaign also targets small and medium-sized FIEs. ACFTU branches will likely contact companies without unions to set up union preparation teams through in-person meetings with employees. Based on past experience, ACFTU may also take countermeasures against "non-cooperative" companies, such as bringing negative media attention to the companies, lobbying local authorities to impose sanctions on the companies, withholding government approvals, or initiating regulatory-related audits. Many MNCs that

The PRC government is also using the collection of trade union dues to increase unionization pressures. Under the PRC Trade Union Law, the employer, not employees, must contribute the dues if the company is not unionized. In many second- and third-tier cities, the local tax authorities collect and hold the dues in escrow until the company establishes a trade union. Some districts in first-tier cities such as Beijing and Guangzhou, Guangdong, are also threatening to withhold these funds unless a company agrees to establish a trade union. The pressure to unionize through the collection of union dues by tax authorities is likely to continue and broaden across more locations in China as ACFTU aims to meet its previously mentioned directives.

Once a company forms a trade union, the employer must fund the trade union with 2 percent of its gross

Regional Snapshot: Shenzhen's Draft Collective Bargaining Rules

The Shenzhen People's Congress on August 13 released for comment the Draft Rules on Collective Bargaining in the Shenzhen Special Economic Zone. If implemented, the rules would place greater legal responsibility on employers to respond to collective bargaining offers and to protect employee representatives in the negotiations.

According to the draft rules, a company must conduct collective bargaining regarding wage adjustments with employees at least once a year. If at least 20 percent of employees request collective bargaining on wages, the company's union must submit a request to the company. If a company does not have a labor union, the local "sub-district trade union" would submit a collective bargaining request to the company on the employees' behalf. Either the employer or employees may make an offer for collective bargaining, and the other party must respond within 10 business days of receiving the offer. If the employer refuses the offer to negotiate without justification and fails to come to the bargaining table within a specified time limit set by the labor authority, the employer would face a fine ranging from ¥5,000 ($734) to ¥50,000 ($7,340).

The draft rules would provide job protection to bargaining employees by forbidding the company from terminating the labor contracts or reducing the wages of participating representatives during the collective bargaining process. If the employer violates these rules by disturbing or halting the negotiations, and the employee proposes terminating his or her employment contract, the employer must pay statutory severance. If the employer's violation of the rules leads to a shutdown or work stoppage, the employer would not have the right to terminate the employee's employment contract.

Another aspect of the draft legislation would provide for a binding resolution if an impasse occurs in the collective bargaining process. If the impasse cannot be resolved by the parties, the parties may apply to the local labor relations coordination committee for mediation. The local labor relations coordination committee must then set up a panel within five days of receiving the application to decide on the issue.

—K. Lesli Ligorner and Todd Shengqiang Liao

payroll. According to ACFTU regulations, the dues must be paid to the upper-level ACFTU branch, which will then refund at least 40 percent of the dues to the company's trade union; the remainder of the dues is shared among ACFTU and its branches.

ACFTU branches are drafting the regulations themselves. As of June, 23 provinces and municipalities have issued local collective bargaining regulations, and 13 provinces and cities have issued formal government guidance promoting collective bargaining initiatives. Many other localities are reviewing similar draft legislation.

Companies that have agreed to unionize have focused on maximizing the management's input in the establishment process and minimizing the disruption to business operations.

More collective bargaining demands

Companies with or without unions will likely see higher demands for collective bargaining focused on wage increases. In determining how to respond to this pressure, many employers are considering the influence of the trade union in the collective bargaining process and the fact that the lack of a trade union will place such authority in the hands of employee-elected representatives and local ACFTU branches. Accordingly, some companies believe that it is more beneficial to guide their own trade unions through the collective bargaining process rather than involve the local ACFTU branch.

In the past, wages negotiated through collective bargaining usually reflected the minimum wages required by local regulations. ACFTU and some local governments plan to replace this practice with regular pay raises that are higher than the annual local minimum wage increases. The amount of the increase would generally depend on local regulations, local ACFTU branch requirements, salaries of other companies in the same industry or region, the previous year's average local salary, inflation indexes, and the employer's corresponding profit increase. The implementation of collective bargaining will also likely restrict the employer's ability to implement company rules. Because collective contract provisions must cover company rules that affect employee interests, rules issued unilaterally by the employer without consulting employees would likely be deemed ineffective and nonbinding.

Building on the Rainbow Plan, provincial and municipal governments are implementing local collective bargaining regulations, which frequently impose stricter standards on employers than the national rules do. Drawing on the experience of successfully influencing the 2008 PRC Labor Contract Law, many local ACFTU branches are actively involved in drafting local collective bargaining regulations (see p.30). In some provinces such as Guangdong, the local

Be prepared

The PRC government's goals for unionization and collective contracts are clear and unwavering: All MNCs in China will have trade unions and collective bargaining agreements that apply new minimum standards for their employees. Companies of all industries and sizes should be proactive and formulate a response to this renewed government push. As initial steps, companies should think about employees that might be beneficial on the union preparation committee and about what the union structure would be if the company has multiple branches or entities across China. Companies could also consider drafting collective contract templates to prepare for potential negotiation requests from an employee or new local rules.

The speed at which industry-wide and national and local regulatory developments are taking place requires advance preparation. Companies cannot afford to be caught unprepared by a request to unionize or engage in collective bargaining. Companies should also test the efficacy of their work rules before an employee challenges his or her termination of employment based on work rule violations, which would require a labor arbitration committee to review the rules. The preparation for increasing labor pressures requires vigilance and careful thought as to how to proceed in this ever-changing environment, which is just as new for the PRC government as it is for MNCs and their Chinese employees. 完

WEB EXCLUSIVE:
National Snapshot: Draft Regulations on Democratic Management of Enterprises

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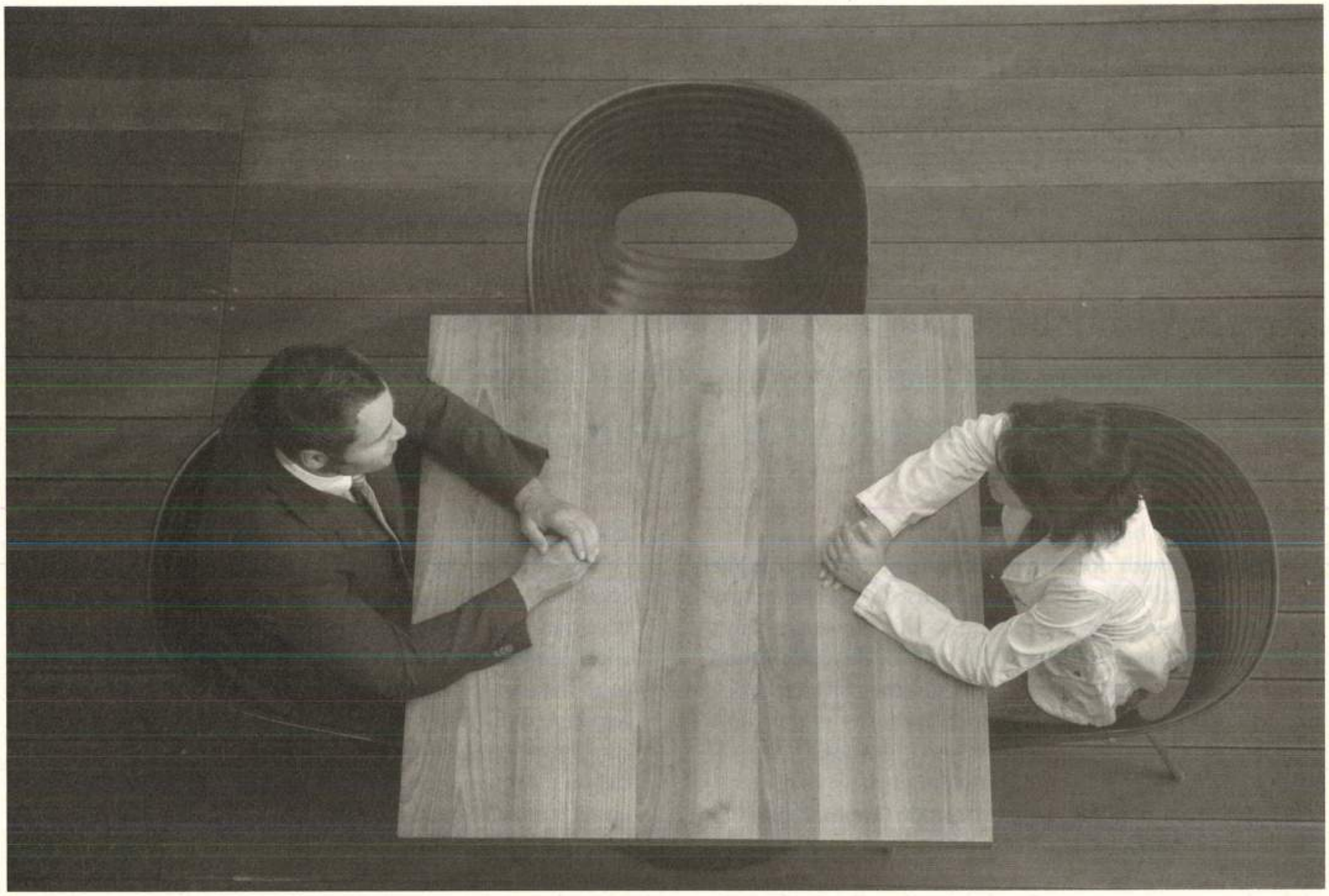

Thorough preparation will help companies decide the best way to approach the negotiation table.

Negotiations, Chinese Style

Strategic preparation and cultural awareness can sharpen the competitive edge for companies negotiating in China.

Betsy Neidel

The global economic slowdown and debt crises in the Western hemisphere have spurred many corporations to look east for new business opportunities. For newcomers to the China market, as well as for those with established business relationships, China's expanding economy and ballooning consumer demand can exert an irresistible pull. Such conditions also create operational obstacles and competitive challenges for foreign players.

Today, effective strategies for leaping into China's operating environment or for taking existing ventures to the next level include stepping off the beaten path. To become or remain competitive in China, corporations may have to enter second- or third-tier cities, build relationships with regional and niche players, or cultivate deals in China's interior provinces (see p.12). These strategic paths will take companies beyond the cosmopolitan comforts of Beijing and Shanghai to regions and cities where business dealings frequently exude more traditional Chinese characteristics and follow local rhythms.

When working outside first-tier cities, where officials and local companies tend to be more attuned to Western deal-making styles, corporations can benefit from honing their Chinese-style negotiation skills, regardless of their level of experience in China. Negotiation is a constant for multinational corporations working in China, whether for acquiring new business, managing ongoing ventures, or coping with the rapidly changing business environment. The ability to negotiate well, Chinese-style, constitutes a strong competitive advantage.

The Chinese view of negotiations

The Chinese word for negotiation—*tan pan*—combines the characters meaning "to discuss" and "to judge." From a Chinese perspective, negotiation exists primarily as a mechanism for building trust so that two parties can work together for the benefit of both. Trust is built through dialogue that lets each party judge or evaluate the partner and the partner's capabilities and assess each other's relative status. The negotiation process also enables parties to reach an understanding on a specific issue, condition, or transaction, in a way that lets each side feel that "a good deal" was brokered. But the concept of negotiation hinges on creating a framework for long-term cooperation and problem-solving much more than on drafting a one-time agreement.

As such, negotiation in China is viewed as an ongoing, dynamic process that takes into account practical matters and context. Many Chinese prefer this approach over creating contract-based absolutes, which many Chinese perceive as the primary purpose of Western-style negotiations. Significant differences in negotiation style and culture can be accompanied by mutually unfavorable perceptions. Americans may see Chinese negotiators as inefficient, vague, and perhaps even dishonest, while Chinese perceive American negotiators as impersonal, impulsive, and overly focused on immediate gains.

When adapting to Chinese-style negotiations, task-based, time-conscious foreign partners must balance the need for quick settlement on specific issues and contract terms with the slower-paced and seemingly abstract building of interpersonal relationships. Competing effectively within a Chinese negotiation framework means understanding and accommodating the Chinese-style approach in order to craft a strategic plan that works on a local level.

Quick Glance

- When working outside first-tier cities, where Western deal-making styles are more familiar, foreign companies can benefit from honing their Chinese-style negotiation skills.
- To prepare for negotiations, the company should understand the circumstances of the deal, itself, and its potential partner; evaluate relative strengths and weaknesses of each side; and create a cohesive team.

Take the time to prepare

The objective of strategic preparation for negotiations is to gain insight into the negotiating partner's situation, intent, and capabilities, and to identify areas of focus for discussions. This takes time and effort, but thorough preparation will help a company decide the best way to approach the table, increasing the likelihood of a successful negotiation and sustainable business arrangement. There are five main success factors to consider:

Know the context of the deal

Understanding the circumstances and environment in which business takes place is critical. Because the business context in China can differ from what Western executives are used to or expect, investing resources in broad-ranging due diligence is often money well spent.

Chinese partners generally expect foreign parties to know and work within the local context, making ready access to local information and insights an important precursor to sitting down at the negotiation table. Local staff, local contacts, and external advisors can provide pre-negotiation guidance by knowing what questions to ask prior to and during the negotiation. They may also interpret and evaluate the answers received, in the context of the local business environment. A foreign partner that is knowledgeable about the local situation and circumstances is more credible in the eyes of the Chinese partner and will build trust.

As an example of the importance of context, Western corporations often underestimate the degree to which government and business are linked in China. Lack of clarity on Chinese industrial policy, government regulations, and relevant government and business stakeholders at the national, provincial, and local levels can lead to the wrong strategic approach to discussions. If, for example, foreign corporate objectives conflict with local directives, efforts to find agreement with the Chinese partner may slow or stall without the foreign company understanding why. With adequate knowledge of the business context, companies can position themselves to achieve the best possible outcome.

Know your partner

Foreign companies must become familiar with prospective Chinese partners on the interpersonal and organizational levels, verifying credibility by looking at past track records and understanding the Chinese partners' objectives for entering into a business relationship. Too often partners are chosen based on English-language capability alone or at a random meeting, rather than through a strategic screening process. Having a reputable local partner and being closely aligned on mutual goals are two prerequisites for successful negotiations and a lasting business partnership.

Lack of organizational transparency in China makes it critical for companies to spend time upfront understanding their counterparts—especially in areas such as ownership structure, revenue sources, and funding of capital assets and operations. Companies should take time to confirm whether there is a basis for sustainable business before investing in discussions.

In one case, partners concluded an agreement for the purchase of a product that required export licenses. The foreign partner entered into a purchase agreement only to discover later that the Chinese entity did not have—and was not authorized to obtain—the necessary export licenses. Deeper investigation into a partner's capabilities can reduce the risk of concluding a deal that must be completely re-negotiated and restructured later.

Know yourself

Parallel to knowing one's partner is knowing oneself. On an individual level, self-awareness allows one to know how to best prepare for negotiating in China (see below). On a corporate level, clarity about high-level objectives, resource commitment, and managerial support for business in China drives internal pre-negotiation positioning. This, in turn, helps the company prepare opening statements about its background, commitment, track record, and value to Chinese partners—the "big picture" story that is standard in the opening phase of Chinese-style negotiations. The effectiveness of this approach requires knowing how to position the foreign company's pitch in the local Chinese business context.

As an example of what not to do, a foreign executive new to negotiation in China was discussing a business venture with his company's long-time China partners. When asked how a recent US court ruling had affected corporate relations with a domestic regulatory agency, the foreign executive brushed it off as being unimportant to the business at hand. But by appearing either not to know about "big picture" issues that affected his own organization, or being unwilling to share knowledge with trusted partners, the new executive lost credibility. This resulted in less openness and trust from the Chinese side, and business volume was much lower than the Western company originally expected.

Negotiation in China is viewed as an ongoing, dynamic process that takes into account practical matters and context.

Put relative strengths and weaknesses in context

After a company gets to knows itself and its Chinese counterpart, it must evaluate the relative strengths and weaknesses of each side within the business context to prepare the negotiation strategy. The company also must understand its strengths and weaknesses compared to potential competitors—in terms of both price and nonmonetary value.

For example, the Chinese partner is likely to rank potential partners against others and is often quite open about this during negotiations. It is not uncommon for a Chinese partner to say that it has received much more favorable pricing from the foreign company's direct competitor. To minimize the focus and discussion on price, be prepared to highlight product values and company comparison in areas like brand recognition, quality, service, and overall perception in China.

Companies that take the time to thoroughly analyze external and internal strengths and challenges in the local context are better equipped to participate in Chinese-style negotiations. Being unaware of how the company ranks in the eyes of a Chinese partner yields a distinct disadvantage during negotiations and possible loss of competitive positioning.

Strive for operational readiness

Operational readiness means aligning internal organizational resources to work most effectively in Chinese-style negotiations. Most important is the creation of a highly

Up Close and Personal

When negotiating in China, what types of qualities are most likely to resonate? Though it is by no means exhaustive, this list provides some perspective on the types of strengths and abilities that would benefit members of the foreign negotiating team. The foreign team should

- Be able to see the "big picture";
- Convey clarity about the company's purpose and objectives in China;
- Listen;
- Be patient and persistent;
- Control emotions, expectations, and ego;
- Have a thorough knowledge of Chinese culture;
- Make a commitment to understand and observe protocol;
- Have a good memory and pay attention to detail; and
- Be respectful, trustworthy, and sincere.

—Betsy Neidel

disciplined, cohesive negotiation team that follows a unified communication plan. This differs from typical, unscripted Western-style negotiations, where each team member has an individual voice in the process and is encouraged to use it.

In the unified team approach there is generally one designated speaker. If other team members speak, it should be from the plan or script, showing corporate consensus. Even in side talks, team members should never openly disagree, question each other, or air unresolved internal issues in front of the Chinese partners. In Chinese-style negotiations, saying less is always better than saying too much.

A unified team also designates individual duties for each team member; these often include that of notetaker, translator, cultural interpreter, and intermediary. Functions may overlap but all are typical and expected in Chinese-style negotiations. For example, the notetaker serves an important role because the Chinese partner may refer back to statements or concessions made in the past. Without accurate documentation, it will be difficult to contest specific statements such as, "During his visit last March, your New York vice president assured us that you would provide...."

Similarly, foreign companies should use their own Chinese translator even if an official interpreter has been provided. Much can be lost in translation without access to the full breadth of discussions in both languages, and many insights can be gleaned from the other side's internal discussions. Showing a willingness to use both languages is also viewed as a sign of goodwill.

Separate from verbal interpretation (though sometimes done by the same person), a cultural interpreter provides insight into nonverbal developments, cultural factors, and outside influences that the foreign party may not be aware of. The "big picture" and highly contextual nature of Chinese-style negotiations mean that Western negotiators are usually at a disadvantage if they lack this capability during operational readiness planning. For example, a cultural interpreter can tell a foreign negotiator whether the Chinese partner is constrained from giving concessions by his environment or by management and what is possible to "push for" in the negotiations.

Finally, companies should not neglect the role of intermediary within the team. The Chinese proclivity for avoiding direct confrontation and personal embarrassment necessitates having someone who can speak informally to the Chinese team: to ask for clarification, exchange ideas, influence attitudes, and otherwise work behind the scenes. Often the most pivotal information for advancing negotiations is conveyed over dinner or in "small talk" in the hallway. Building the role of trusted intermediary as part of the team provides a conduit for the all-important informal discussion and is part of Chinese-style operational readiness.

Companies that take the time to thoroughly analyze external and internal strengths and challenges in the local context are better equipped to participate in Chinese-style negotiations.

Negotiations are never "over"

All situations involving two or more entities in China require some form of negotiation, ranging from informal, friendly discussions with a long-term partner to formal bilateral talks. Chinese-style negotiation is the process of building and tending relationships to produce benefits for both sides. It is a process that does not end unless the relationship is severed. This approach to negotiation is rooted in Chinese cultural, historical, and practical considerations and exists throughout modern China. It also differs greatly from the view that the negotiation ends when the contract is signed. From the Chinese perspective, the contract signing indicates the formal beginning of the partnership and with it, the commitment to the ongoing negotiation. In this context, successful foreign companies commit adequate time and resources to understanding and tending local China relationships for the long run. 完

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China Foto Press
China's top leadership bodies will replace two-thirds of their members in fall 2012.

New Challenges in Predicting China's Upcoming Political Succession

Though it is difficult to predict PRC leadership changes, accurate assessments are necessary to create effective US policies toward China.

Cheng Li

China is set to undergo a major turnover in leadership at the 18th Chinese Communist Party (CCP) National Congress in fall 2012. The country's three most important leadership bodies—the Politburo Standing Committee, State Council, and Central Military Commission—will replace about two-thirds of their members because of age or other factors. The principal figures responsible for the country's political and ideological affairs, economic and financial administration, foreign policy, and military operations will consist largely of newcomers after 2012.

For the next two years, the leadership transition will be the main focus of power contenders in China. The China-watching community will also pay more attention to the next generation of rising stars, especially the successors to PRC President Hu Jintao and Premier Wen Jiabao.

For US government leaders and business executives, accurate assessments of China's upcoming political succession are essential to creating effective policies toward China. Though access to information about China's leaders has never been better, Western analysts often miss the mark when they make predictions about politics and policy in China.

Better access, improved analysis?

For the first few decades of the People's Republic of China, Western China watchers had minimal access to information and sources. Chinese military affairs scholar Ellis Joffe once jokingly referred to his research on the People's Liberation Army (PLA) as an exercise in "seeking truth from unavailable facts." Today, many sources of information are available online, even for the relatively sensitive subject of Chinese military affairs. Several dozen unofficial Chinese websites focus on military affairs and provide extensive information about PLA officers' backgrounds, PRC military strategies, China's naval development objectives, and China's newly obtained weapons.

The availability of new open sources of information and unprecedentedly dynamic US-China scholarly exchanges have altered the way Americans perceive political and economic developments in China. In particular, the sudden arrival and meteoric growth of the Internet has allowed the public to quickly and conveniently access more comprehensive official and unofficial Chinese sources. In some ways, the rapid growth of Internet sources has created an "oversupply" of information—a new challenge for those who study China. As John Naisbitt, author of the *Megatrends* series has noted in a general context, Western researchers of Chinese politics often find themselves "drowning in information but starved for knowledge."

In trying to understand Chinese politics, many foreign analysts tend to hold one of two extreme views. Some analysts hold stale perceptions, are vulnerable to rumors, and overly focus on investigating information obtained from unverified "secret documents" in China. Other analysts have become so impressed by the achievements of the PRC leadership that they have lost their critical lens and sometimes overlook the fundamental deficiencies and flaws of the present-day Chinese political system.

Quick Glance

- Though difficult to make, accurate assessments of China's upcoming political succession are necessary to create effective policies toward China.
- China watchers should look beyond overly positive or negative assessments of the PRC leadership transition and the country's political trajectory.
- Uncertainty surrounding the upcoming leadership turnover and its potential impact on the Chinese Communist Party's factional dynamics may make 2012 an especially interesting year in Chinese elite politics.

False predictions and wrong lessons

Even with more information available each day, China watchers' predictions about PRC elite politics still often overlook some important trends. As the new century began, for example, many China analysts and experts expected major events—China's accession to the World Trade Organization in 2001, the leadership succession in the 16th CCP National Congress in 2002, and the severe acute respiratory syndrome epidemic in 2003—to trigger the decline of the CCP leadership or even the collapse of the regime. Gordon Chang's 2001 book, *The Coming Collapse of China*, was one of the most frequently cited monographs on China in the first half of the decade.

But toward the end of the decade, many analysts began to perceive the Chinese political system as "resilient." According to this view, CCP leaders have found a sustainable way to maintain their authoritarian rule over this emerging economic powerhouse. A large number of these China watchers focus on the PRC government's growing "confidence" and overlook the vulnerability of the communist one-party system, the serious difficulties it faces, and the possibility of a failure to broker deals between competing factions in the next leadership transition. (The two most powerful factions—the leaders who come from high-ranking official families, known as "princelings," and the officials who advanced their careers through the Chinese Communist Youth League, known as "*tuanpai*"—are vigorously competing against each other for power, influence, and the policy agenda. The two leading power contenders in the fifth generation, Xi Jinping and Li Keqiang, each represent one of these two factions [see the *CBR*, March-April 2008, p.20].)

One of the central arguments of the "authoritarian resilience" thesis is that the CCP has relied on economic development and material incentives for the Chinese people to prevent sociopolitical challenges. New socioeconomic forces, especially entrepreneurs and the emerging middle class, are seen as political allies of the CCP regime. But this perception should be subject to greater debate. Just as yesterday's political target could become today's political ally, today's political ally could become tomorrow's political rabble-rouser. For example, recent studies cited in *Chinese Social Sciences* have found that the Chinese middle class tends to be more cynical about policy promises, more demanding about policy implementation, and more sensitive to corruption among officials than other social groups. If middle-class Chinese begin to think that their voices are being suppressed, that their access to information is being unjustly blocked, or that their space for social action is unduly confined, a political unrest of sorts may take place.

The grievances of China's middle class over government policy have become more evident in recent years. The rising unemployment rate among recent college graduates (who usually come from middle-class families and are presumed to be members of China's future middle class) should send an alarming signal to the PRC government, as well as those who analyze Chinese elite politics. In a recent forum on China's response to the global financial crisis held by the Academy of Chinese Reform and Development in Beijing, Chinese scholars argued that the government should pay much greater attention to the needs and concerns of the middle class—otherwise the "sensitive" Chinese middle class will become the "angry" middle class.

Upcoming PRC leadership turnover

In fall 2012, the 18th CCP National Congress will appoint new leaders to replace President Hu, Premier Wen, and other senior leaders. Some prominent Western China watchers may be overly optimistic about the likelihood of a peaceful, orderly, and institutionalized transition. For example, in his new book, *How China's Leaders Think*, Robert Lawrence Kuhn, a businessman-turned-biographer of PRC senior leaders, praises the rising stars of the fifth-generation leadership for their talents, wisdom, and vision. The book presents Xi Jinping's and Li Keqiang's succession to the positions currently held by Hu and Wen as certain and predicts that, as a team, the fifth generation of leaders will take over power smoothly from the fourth generation in 2012.

But this upcoming succession may not be as smooth as the last power transition in 2002. It has been widely perceived in China that Xi and Li are weaker and less impressive than Hu and Wen. Several factors make these two potential successors even more vulnerable. For example, a few other fifth-generation leaders are notoriously ambitious and probably more capable than Xi and Li. Also, Hu Jintao is not the only soon-to-be retired top leader who would like to run the country from behind the scenes—Hu's predecessor Jiang Zemin also wants a say. Meanwhile, several of the regime's military leaders have become increasingly out of party and civilian control.

Though the fifth-generation leaders boast remarkable life experiences, the top contenders for succession must overcome many daunting obstacles to consolidate their power in the years ahead. Xi and Li's formative experiences during the Cultural Revolution (1966–76) as sent-down youth working at rural farms (along with many of their fifth-generation peers) led these future leaders to develop valuable traits such as endurance, adaptability, and humility. Exposure to Western ideas and values in their college years in the late 1970s and early 1980s, one of the most liberal periods of university education in contemporary China, helped them form worldviews that diverge from previous generations of PRC leaders. In addition, their shared leadership experiences in running provinces and cities in the course of the country's rapid economic development in the 1990s appears to have prepared them well, as they are now reaching the pinnacle of power. But Xi and Li are less experienced in a variety of ways than Hu and Wen were when they were in line to succeed former PRC President Jiang Zemin and Premier Zhu Rongji in 2002.

A look at Xi Jinping

When Hu was being considered for China's top leadership post, he was the only contender in his generation who had served as a provincial party secretary in two provinces. He had also been on the Politburo Standing Committee for 10 years. Hu was well known for his political savvy, strong network within the Chinese Communist Youth League, and uncontroversial rhetorical ability.

Xi does not stand out in the same way among his competitors. Among the 344 full and alternate members of the 15th Central Committee in 1997, Xi received the fewest votes from the more than 2,000 delegates of the Party Congress. The fact that he served only eight months as CCP Secretary of Shanghai before being promoted to the Politburo Standing Committee made his rise unusual in terms of the new norms in elite promotion. Until now, Xi has failed to form his own political network of peers and members of lower echelons of the PRC leadership. Most important, as with other prominent figures in the fifth generation, Xi's capacity and leadership skills have yet to be tested.

Some of Xi's public remarks have been highly controversial. During his visit to Mexico in 2009, Xi accused American politicians of "interfering in China's domestic affairs," saying: "It seems there are some foreigners who've stuffed their bellies and don't have anything else to do but point fingers. First, China does not export revolution. Second, we're not exporting hunger or poverty. And third, we aren't making trouble for you. What else is there to say?" These remarks were characterized even by many Chinese bloggers as "undiplomatic" and "non-statesmanlike."

Xi, of course, has his advantages. He is well positioned as the frontrunner in the fifth-generation leadership. His recent appointment as vice chair of the powerful Central Military Commission was another major step on the path to becoming Hu's successor, and the PRC political establishment will likely soon launch a public campaign to praise his credentials. Xi has long been known for his market-friendly approach to economic development, and business communities—both state-owned and private firms—may support Xi despite his lack of a solid political power base. Xi's experience in the military—serving as a personal assistant to the minister of Defense early in his career—also makes him stand out among his peers.

Eye on Li Keqiang

Many observers think that Li Keqiang, who is expected to succeed Wen Jiabao as premier, lacks Zhu Rongji's political courage and Wen's charisma. Zhu and Wen were already known for their leadership talents and administrative achievements by the time they were vice premiers and even earlier in their careers. Wen worked as a chief of staff for three CCP secretary generals, two of whom were purged, and yet he managed not only to survive, but to rise rapidly. In addition, Wen had gained broad administrative experience before becoming premier—coordinating power transitions, commanding the anti-flood campaign in 1998, supervising the country's agricultural affairs, and overseeing financial and banking reform. Wen's talent as an administrator and his role as a coalition-builder explain his legendary survival and success. In particular, Wen has been known, both at home and abroad, for his remarkably quick response during natural disasters and other crises.

In contrast to Wen, Li has not reacted as quickly to national emergencies, including the Sichuan earthquake in 2008 and the Yushu earthquake early this year. During Li's tenure as Henan's governor and party secretary, the province was notorious for its "AIDS villages," coal mine explosions, and widespread counterfeiting of goods. Only after then-Vice Premier Wu Yi visited some of the AIDS villages in Henan did Li acknowledge the problem. Some AIDS activists and nongovernmental organizations have criticized Li's lack of action as a provincial chief.

Li also has his advantages. His humble family background, low-profile personality, legal education, reputation for loyalty, strong political network, and provincial leadership experience may prepare him well for the role as a top national leader, but it will be difficult for him to claim any major achievements as a provincial chief or vice premier. In sharp contrast with Zhu's restructuring of the Chinese bureaucracy, which resulted in substantial personnel changes and increased the efficiency of the central government, many observers believe that Li's reform of major ministries and commissions has been largely ineffective.

Further hampering his chances, the Chinese public may view Li as too "soft," even compared to Wen. Analysts in China and abroad believe that the State Council's economic policies have become less effective in controlling China's provinces, major cities, and key state-owned enterprises. Having a premier with such a soft image may not fit well with the need for a more efficient and effective central government to coordinate its various policy initiatives.

Other rising stars

A factor that makes the upcoming PRC leadership succession more uncertain is that other rising stars in the fifth generation, most noticeably Chongqing CCP Secretary Bo Xilai (a princeling) and Guangdong CCP Secretary Wang Yang (a *tuanpai* leader), have launched self-promotion campaigns that have garnered great publicity in the country. Their unconventional and bold efforts to tap public opinion for political advancement may change the dynamic in which future leaders jockey for power. Vice Premier Wang Qishan and CCP Organization Department Director Li Yuanchao, also a princeling and a *tuanpai* leader respectively, have developed their own hot-button issues. Wang has consolidated his reputation as one of the few Chinese leaders who understands the global financial system, while Li has recently initiated an ambitious national plan to cultivate and recruit global talent. The daunting socioeconomic and political challenges that face the fifth-generation leaders will likely spur other leaders to reach out to the public for support. The country may soon witness a more dynamic and perhaps even more factionalized phase in its potentially difficult—but still hopefully peaceful—political transformation.

A careful, balanced, and non-ideological analysis of the upcoming leadership transition is essential for Washington to implement effective China policies.

Imperative for a well-grounded analysis

The general sense of uncertainty surrounding the upcoming leadership turnover and the profound effect it might have on the CCP's factional dynamics will likely make 2012 an especially interesting year in Chinese elite politics. China watchers should be aware of many possible policy deadlocks within the Chinese collective leadership. At the same time, observers may also feel a sense of urgency on the part of the Chinese political elites to search for new sources of legitimacy.

Foreign observers who study Chinese politics should look beyond overly positive or negative assessments of the PRC leadership transition and the country's political trajectory. Rather, China watchers should be aware of inter-party factional dynamics, new institutional norms, and rapidly changing rules of elite politics in China. Analysts should not be led astray by superficial phenomena or official propaganda. A careful, balanced, and non-ideological analysis of the upcoming leadership transition is essential for Washington to implement effective China policies, especially when China has more influence on the world economy and regional security than perhaps ever before. 完

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The opinions stated in this article are the opinions of the author and not necessarily the views of CBR *or the US-China Business Council.*

US Companies Report Views of China Business Environment

USCBC's 2010 membership survey results show companies experience continued growth—and rising protectionism concerns.

US-China Business Council staff

The results of the US-China Business Council's (USCBC) 2010 annual member survey show similar business and investment trends as in the past three surveys. The results are also consistent with recent surveys conducted by other business organizations, including the American Chamber of Commerce in Beijing and Shanghai and the European Union Chamber of Commerce in China:

- Companies report strong growth and profitability in their China operations despite the global economic downturn;
- Companies remain committed to the China market overall, with resource commitments returning to pre-recession growth patterns; and
- Companies remain optimistic about business prospects in China over the next five years, but believe the China business environment is less welcoming now than it was three years ago.

This year's survey results reveal that increasing concerns about protectionism and continued market access barriers threaten the commitment for some, but not all, companies and sectors. Many firms are less concerned about the immediate impact of protectionism on operations today and more about policy trends that could disfavor foreign companies and discourage future investments—if the trends continue and these policies are fully implemented.

The survey results suggest two contrasting views of the current business and investment landscape in China. The optimistic view is that companies still have an opportunity to influence these trends and prevent implementation of protectionist policies. The pessimistic view is that these trends are entrenched within the PRC government and the outlook for foreign companies will deteriorate. Only time will tell which one is accurate, but the difficult task of engaging China to influence policy and achieve outcomes favorable to US companies remains as important now as any time in the past three decades of commercial relations.

Top 10 Business Issues in China

1. (Three-way tie) Human resources: Talent recruitment and retention
1. Administrative licensing
1. Competition with PRC state-owned enterprises or national champions
4. Intellectual property rights enforcement
5. Cost increases
6. Market access in services
7. Transparency
8. Protectionism risks in China
9. Government procurement
10. Standards and conformity assessment

China's current business climate

Sales and profitability

Despite PRC policy and regulatory challenges, licensing barriers, and rising costs, 87 percent of this year's respondents stated that their China operations are profitable, consistent with responses in previous years. In each of the past five years' surveys, more than 80 percent of companies have reported profitability in China. This year's survey results are only slightly below past surveys' highest results on this topic—in 2008, prior to the global economic downturn, 88 percent of companies were in the black.

These numbers were robust even in a tough economic climate recovering from the global economic recession. Nearly 65 percent of respondents saw at least a 10 percent increase in revenue in the last year, including 21 percent who stated that their company's revenue in China rose by more than 20 percent. Most companies report that their China operations turned these revenue gains into increased profits in 2009, although almost 30 percent report that profitability was flat compared to the prior year (see Figure 1).

These results also continue to outpace companies' global profitability rates. This year, 88 percent of respondents reported that their China operations' profit margins were the same or better than their other global operations, a situation that has been reflected in USCBC surveys for the last five years. Most firms expect to increase revenues further in 2010. This is significant at a time when the rest of the global economy is weak and sales in more mature markets, especially in the United States, have yet to fully rebound. Companies increasingly rely on their business outcomes in China to help maintain their existing operations—and employment—back in the United States.

As in previous years, nearly all of this year's respondents (96 percent) report that they invest in China primarily to access or serve China's domestic market (see

Figure 2). Transportation lead times and costs, plus the need for many businesses to be closer to their customers, mean that many US companies cannot reach the China market simply by exporting from US operations. But 40 percent of respondents indicate they are also using China as an export platform to sell goods to other non-US markets.

Perhaps unsurprising given the above results, 74 percent of survey respondents rank China among their top five priorities for their company's global strategic investment planning and nearly 20 percent of respondents make China their top global investment priority. Two-thirds plan to accelerate their investment plans in China in the next year.

Clouds gathering: Tempered optimism about China's business climate

Data from the previous five annual surveys show a strong and steady view that China will be a place where companies can find growth. This year, almost 60 percent of survey respondents indicated they are optimistic about their five-year outlook for business in China and another 37 percent indicated they are somewhat optimistic. This result is virtually identical to data from USCBC's 2009, 2008, and 2007 surveys.

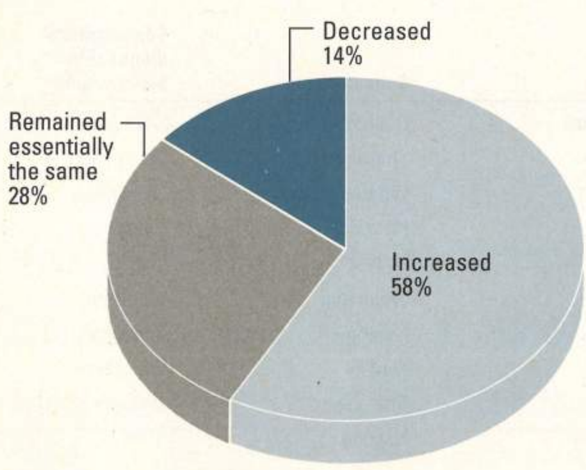
These numbers are tempered by increasing concerns about the longer-term outlook in China. This year's survey asked how respondents currently view the business climate compared with three years ago. Though most companies were optimistic or reported no change in their views, almost 40 percent of respondents indicated they were less optimistic about the business climate now than they had been in the past.

The concerns about China's business climate center around various policies, including China's domestic indigenous innovation policies, government procurement policies, and continuing restrictions on foreign investment and market access. Each of these policies has important near- and long-term ramifications for many companies; each also plays into issues that appear in USCBC's top 10 list, including protectionism risks in China, transparency, and competition with Chinese state-owned enterprises (see Box).

USCBC believes the PRC government needs to take this shift in opinion about the business climate seriously as it develops and implements policies that affect foreign companies and their ability to compete on a level playing field with Chinese enterprises, particularly China's state-owned enterprises. This concern about recent trends is significant enough that some companies may be carefully considering what their future China investment plans and strategies will look like. USCBC conversations with some companies indicate these internal company discussions are already occurring at senior levels. 完

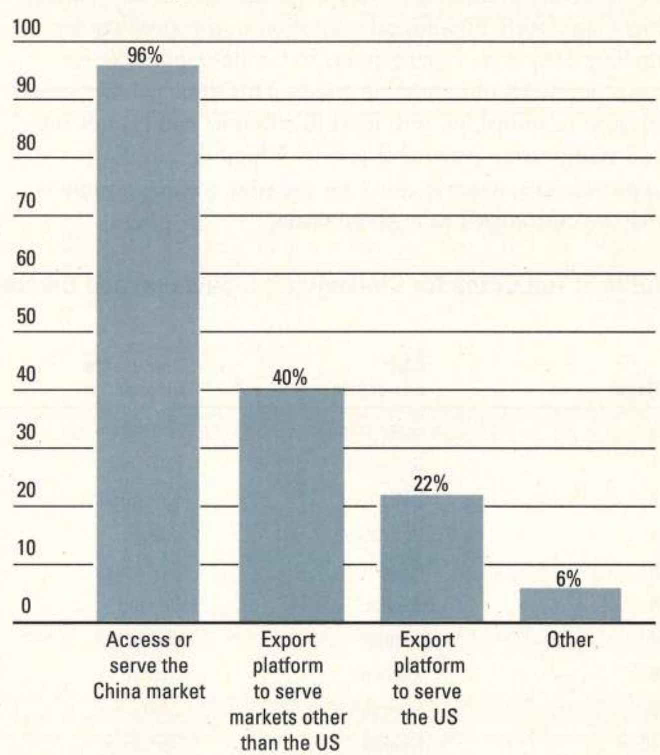
The US-China Business Council (USCBC), publisher of the China Business Review, *is the leading organization of US companies engaged in business with the People's Republic of China. Founded in 1973, USCBC provides extensive China-focused information, advisory and advocacy services, and events to more than 200 US corporations operating in the United States and throughout Asia. This article is adapted from* USCBC 2010 Member Priorities Survey Results. *For the full report, including analysis of the top-ten issues, see www.uschina.org.*

Figure 1: Profitability of Companies' China Operations in 2009 vs. 2008



Source: The US-China Business Council (USCBC)

Figure 2: Company Objectives in China*



*Multiple responses allowed
Source: USCBC

Find First-Tier Consumers—in Hundreds of Cities

Continued from page 19

the need to hire competent managers who will exhibit long-term loyalty to the international brand—will likely be at the forefront. Currently, after receiving training from international brand leaders, local managers often leave for new opportunities at other local companies. Beginning about five years ago, the turnover rates of managers at foreign-invested firms began to decrease in the first tier and rose slightly in the second tier. Finding good management in the second-tier cities is difficult and retaining trained managers often proves even harder.

Fine-tuning marketing and communication campaigns also can be tricky in lower-tier markets. For example, a recent Alaris market study found that consumers in some markets such as Chengdu considered a cosmopolitan image as a reason to believe a brand story, while consumers in Shanghai thought the same message was crass and boastful. Foreign companies should not underestimate the importance of regional cultural differences when forming their marketing strategy. Just as marketing to a New Yorker is different than marketing to a San Franciscan, Chinese cities also have different cultures.

There is no single approach to take when it comes to distribution decisions, either. From a functional perspective, infrastructure and distribution problems plague some locales, despite China's rapid growth in transportation infrastructure. Transporting perishable goods, in particular, can be challenging. Carrefour China found a solution to this problem by making each of its supermarkets in China responsible for open purchases of perishable goods. This strategy has resulted in good relationships with local distributors and greater success transporting perishable goods. A local distribution approach also makes it easier for the store to carry products that are customized to regional tastes.

Companies should also consider regional variations in how consumers transport their goods. Many consumers in first-tier cities use autos to transport their purchases, but many consumers in second- and third-tier cities rely on buses, bicycles, or their own two feet. Only 40 per 1,000 people in urban China owned cars in 2009, and far fewer owned cars in the countryside. This means that products must be packaged in a manner that allows consumers to transport them from the store to their homes, using their most common mode of transport. The distribution problem is complex and evolves rapidly. For example, in Shanghai restaurants with no parking have seen decreasing sales per table as more people drive on weekends and evenings. Just a few years ago, restaurants that were primarily frequented by customers who drove to the restaurant had lower average sales.

Focus on regional markets

Entering China today offers more opportunities and challenges than it did just a few years ago. The prize is much larger and the competition much stronger. Yet experience shows that successful firms focus their resources—building brand recognition in one regional market first and then expanding to more markets as the business model and product offering is sculpted to local tastes. Companies that do their homework and make realistic projections of what brands will sell in which markets are off to a good start in the race to tap China's first-tier consumers, wherever they may be. 完

***Francis Bassolino** (francis_bassolino@alaris.com.cn) is president of Alaris Inc. **Matthew Smith** (matthews@ljs.com) is president of Leo J. Shapiro & Associates LLC. The two firms work together to help companies build brands. **Mariusz Trzaskowski** and **Grace Lewin**, Alaris senior associate and research assistant, respectively, also contributed to the preparation of this article.*

Table 3: Top Cities for Consumption, Savings, and Income, 2008*

Rank	GDP per capita	Disposable income	Savings	Consumption	Consumption/ disposable income ratio
1	Guangzhou	Shenzhen	Guangzhou	Guangzhou	Shenyang
2	Shenzhen	Wenzhou	Shenzhen	Shenzhen	Changchun
3	Dalian	Hangzhou	Hangzhou	Wenzhou	Guangzhou
4	Hangzhou	Ningbo	Zhuhai	Hangzhou	Dalian
5	Tianjin	Guangzhou	Dalian	Zhuhai	Zhuhai
6	Zhuhai	Nanjing	Xiamen	Wulumuqi	Wenzhou
7	Hohhot	Xiamen	Nanjing	Ningbo	Chengdu
8	Xiamen	Zhuhai	Ningbo	Xiamen	Shenzhen
9	Shenyang	Jinan	Tianjin	Shenyang	Tianjin
10	Ningbo	Fuzhou	Shenyang	Nanjing	Xi'an

*Shanghai and Beijing are not included in these rankings
Sources: Alaris Inc., NBS

Economic Development Policies for Central and Western China

Continued from page 27

should also be aware of the risk of local protectionism, particularly favoritism toward state-owned enterprises.

Policy is just one component of the decision to embark on a major investment. Companies must consider other factors—such as the operating environment, access to a talented labor pool, ease of transportation and logistics, and access to the supply chain—before entering a new market. For now, most cities in central and western China are underdeveloped. But given the speed with which the PRC government aims to grow the economies of interior China, conditions for investment may improve quickly. 完

*Nancy Huang (nancyhuang@uschina.org.cn) is manager, Business and Policy Research; **Joie Ma** (jma@uschina.org.cn) is manager, Programs; and **Kyle Sullivan** (ksullivan@uschina.org.cn) is manager, Business Advisory Services, at the US-China Business Council (USCBC) in Shanghai. USCBC is the publisher of* CBR.

Highlights from the PRC Catalogue of Encouraged Industries for Foreign Investment in the Central and Western Regions (2008)

Industry	Encouraged product, project, or technology	Province
Agriculture	Development and application of water-saving irrigation technologies	Chongqing, Gansu, Guizhou, Henan, Inner Mongolia, Ningxia, Shanxi, Sichuan, Tibet, Xinjiang, Yunan
Auto	Production of spare auto parts (clutches, connecting rods, cylinder bodies, cylinder covers, engine crankshafts, engine electronic spraying systems, engine timing chains, gear boxes, instruments, lamps, and shock absorbers)	Anhui, Chongqing, Guangxi, Guizhou, Hubei, Jiangxi, Sichuan
Education	Medical institutions (limited to equity and cooperative joint ventures)	Anhui, Jiangxi, Qinghai, Shaanxi
	Vocational educational institutions (limited to cooperative joint ventures)	Anhui, Jiangxi, Hubei, Hunan, Qinghai
Environmental protection	Restoration of farmland to forests and grasslands and restoration of pastures to grasslands; protection of natural forests; and development of other national key ecological projects	Chongqing, Guangxi, Guizhou, Henan, Inner Mongolia, Qinghai, Shaanxi, Shanxi, Sichuan, Tibet, Xinjiang, Yunnan
Industrial	Technical development and deep processing of special varieties of superior float glass (super white, super thin, and online Low-E)	Anhui, Chongqing, Guangxi, Guizhou, Henan, Hubei, Jiangxi, Qinghai, Shaanxi, Shanxi, Sichuan, Xinjiang, Yunnan
	Production of new dry-processing cement by using cement clinker with a daily production of 4,000 tons or more	Anhui, Chongqing, Guangxi, Guizhou, Henan, Hubei, Hunan, Inner Mongolia, Jiangxi, Ningxia, Qinghai, Shaanxi, Shanxi, Sichuan, Xinjiang, Yunnan
Light industry	Deep processing of silk products	Guangxi, Guizhou, Henan, Hubei, Shaanxi, Shanxi, Sichuan, Xinjiang, Yunnan
Natural resources	Development of applied technologies for coal processing and production of coal-to-chemical products (requires Chinese majority control)	Guizhou, Henan, Inner Mongolia, Shaanxi, Shanxi, Xinjiang
	Deep processing of rare earths and production of applied products	Gansu, Jiangxi, Sichuan
	Production and development of downstream chemical products of natural gas (excluding products under restricted and prohibited categories of the Policies on Utilization of Natural Gas)	Chongqing, Gansu, Inner Mongolia, Qinghai, Shaanxi, Sichuan,
New energy	Production of power-generation equipment by using solar, wind, and other new energy resources, and parts and components (limited to equity and cooperative joint ventures)	Chongqing, Gansu, Ningxia, Xinjiang
Pharmacy	Deep processing of natural, raw material, and Chinese patent medicines, and production of their derivatives (excluding those restricted or prohibited by the Catalogue Guiding Foreign Investment in Industry)	Henan, Jiangxi
	Processing and production of Chinese medicinal plants, extracts of Chinese traditional medicine, and Chinese patent medicine (excluding those restricted or prohibited by the Catalogue Guiding Foreign Investment in Industry)	Anhui, Chongqing, Tibet
	Development and production of animal and plant medicine resources (excluding those restricted or prohibited by the Catalogue Guiding Foreign Investment in Industry)	Guangxi, Guizhou, Hubei, Shaanxi, Sichuan, Yunnan
Printing	Package and decoration printing	Anhui, Henan, Hubei, Hunan, Jiangxi, Shanxi, Yunnan
Public services	Passenger road transportation (requires Chinese majority control)	All provinces
	Construction and operation of urban gas, heat, and water supply and drainage systems (requires Chinese majority control in large cities)	All provinces
Telecom	Value-added telecom services (according to China's World Trade Organization commitments)	All provinces
Tourism	Protection, development, and operation of tourist areas and supporting facilities	All provinces

Source: PRC National Development and Reform Commission

China Expands International Use of the Renminbi

Nina Palmer

The PRC government has expanded the use of the renminbi (RMB) for cross-border trade settlement, presenting new opportunities for financing trade in China and cost savings for those who buy from or sell to participating Chinese enterprises. The State Council and the People's Bank of China (PBOC) recently issued regulations to expand the 2009 RMB cross-border trade settlement pilot program to allow more geographic areas and enterprises to participate, furthering international use of the RMB. The PRC government has long expressed interest in making the RMB an international currency to benefit Chinese exporters and develop China's major cities—particularly Shanghai and Hong Kong—into global finance centers.

PRC government expands RMB cross-border trade settlement

The State Council's July 2009 Administrative Measures on Pilot Projects for RMB Cross-Border Trade Settlement marked the beginning of the program to make the RMB convertible outside of China by allowing eligible companies in seven provinces to settle trade debt in RMB with Hong Kong, Macao, and the 10 countries of the Association of Southeast Asian Nations. The pilot program helped companies better manage risk associated with exchange rate fluctuations and decrease settlement costs.

PBOC, the Ministry of Finance, and the Ministry of Commerce in June 2010 released a notice to expand the original pilot program. The Notice on Issues of Expanding Pilot Programs for RMB Cross-Border Trade Settlement:

- Extends RMB cross-border trade settlement privileges to include transactions with all of China's trading partners;
- Allows eligible enterprises in 20 provinces and cities, including Beijing, Tianjin, Jiangsu, Sichuan, and Zhejiang, to pay for their merchandise imports, services trade, and other current account transactions in RMB; and
- Allows eligible enterprises in 16 of the 20 provinces and cities to accept payments in RMB for their exported goods.

To participate in the program, enterprises must be nominated by one of the 20 participating provincial governments. Foreign companies are eligible and should contact their provincial government to apply. Enterprises in eight border provinces—Guangxi, Heilongjiang, Inner Mongolia, Jilin, Liaoning, Tibet, Xinjiang, and Yunnan—that have import or export rights can accept RMB payments for trade with neighboring countries without nomination from the relevant provincial government.

In a separate agreement, PBOC and the Bank of China-Hong Kong removed all restrictions on banks in Hong Kong (including foreign banks) that wish to create RMB accounts for customers. The agreement also allowed individuals and corporations to send international RMB payments and transfers through those banks.

RMB bond market investments

Regulations passed in recent months allow foreign financial institutions to offer new settlement services and reduce transaction costs for importers and exporters. In August, PBOC began allowing approved foreign financial institutions to invest RMB holdings in the Chinese interbank bond market. Further, foreign banks may apply to conduct trading in the interbank bond market using RMB funds gained from the handling of international RMB trade settlement. The notice allows banks to easily invest the RMB assets they hold as a result of the new trading rules.

The expanded RMB cross-border trade settlement program allows banks and financial institutions operating in China to expand their services into RMB trade settlement. Companies such as Allied Wallet Ltd.; Bank of East Asia, Ltd.; HSBC Holdings plc; JPMorgan Chase & Co.; and Standard Chartered Bank have already expressed their intent to offer RMB trade settlement services and participate in the interbank bond market. In addition, companies in the expanded pilot areas that import to or export from China will see reduced transaction costs as the need to hedge against foreign currency risks diminishes. 完

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

Inside the Beltway: High Frustrations, Low Rhetoric, and a Bad Bill

John Frisbie

A columnist at the *Washington Post* in late September called the US-China Business Council (USCBC), an organization of roughly 220 US companies that employ more than 7 million Americans, "un-American" for opposing, in USCBC's opinion, counterproductive tariff legislation aimed at addressing China's undervalued currency. During a September 29 House of Representatives debate, several members of Congress characterized the bill as being one that supported "real" Americans.

Frustrations are high on Capitol Hill and Election Day is close at hand, but that's pretty strong rhetoric, even for Washington. There isn't much disagreement about the desired result; it's all about how we get there.

The House of Representatives passed the currency legislation in late September by a wide margin. The Senate did not act before it left for recess in October, but it could take up the issue during a "lame duck" session following the elections.

Like others, USCBC believes that China's exchange rate should better reflect market influences from trade flows. But USCBC also believes that tariff legislation will be counterproductive to reaching that goal and will harm American manufacturers and farmers.

Why? Proposed legislative solutions require an estimate of the "true" value of the renminbi (RMB) and then assess tariff penalties to offset the undervaluation. The problem is that 10 different economists will give you 10 different exchange rate estimates; at best, only nine of them will be wrong. The approach is not only highly subjective, but also impractical. Exchange rates change daily; inflation rates, interest rates, and all the other factors that affect an exchange rate estimate also change frequently. How can a fixed-tariff penalty accommodate this fluctuating reality?

In addition, despite changes made to the bill in the House Ways and Means Committee, significant questions remain about whether addressing the exchange rate with countervailing duties would violate World Trade Organization (WTO) rules. Losing a WTO case would not strengthen our ability to sway China to make changes to its exchange rate policy.

USCBC further opposes the legislation because it will not achieve the purported goals of significantly reducing the trade deficit and creating jobs here at home. Much of the products we import from China are items that we imported from Japan, South Korea, Taiwan, Hong Kong, and Malaysia before. If the RMB exchange rate appreciates to the point that we no longer import something from China, in many—if not most—cases we will import it from somewhere else, not make it in the United States. The big winners from this legislation may turn out to be countries such as Thailand and Mexico.

The Congressional Budget Office (CBO) backs up this point in its assessment of the bill: "CBO estimates that a small share of imports from [China] would be found to cause injury to domestic [US] firms," because of limited overlap with US production.

US companies large and small have a host of other critical trade issues with China, such as intellectual property rights piracy, Buy China policies, and other market access barriers, that would likely get sidelined in a currency fight. The annual US-China Joint Commission on Commerce and Trade bilateral trade talks, an important channel to address these issues, are tentatively scheduled for mid-December. This tariff legislation could impede negotiations on other key commercial issues.

We should also assume that China will retaliate against US exports of manufactured goods and farm products if Congress takes unilateral action. Weathering retaliation might be worth it, if it achieves anything. Legislation that won't get us to the goal, yet will harm American exports and jobs, just doesn't seem like a win, however.

Rather than punishing China by punishing ourselves—or Congress picking winners and losers—we need to focus on less divisive ways to get results. The Obama administration is on the right course. Sustained bilateral and stepped up multilateral engagement with China on this issue, as well as dealing with other global imbalances, is critical to addressing the fundamentals driving the US trade balance.

Dissatisfaction with China is high, but tariff legislation will not help China's exchange rate better reflect market influences from trade flows. Let's hope wiser minds prevail in the Senate. Engagement might not be politically expedient or feel like the right solution on the campaign trail, but counterproductive legislation will not help us reach the intended goals of the supporters of the House currency vote.

Name calling won't get us there either. Since when did it become "un-American" to point out the fallacies of bad policy? 完

John Frisbie *is president of the US-China Business Council.*

Do You Know the Deputy Chief Engineer of Bengbu's Economic and Industry Commission?

Julie Walton

Most US companies that invest in China do so to serve the country's diverse customers, rather than to manufacture and export back to the United States, the US-China Business Council's (USCBC) 2010 membership survey results show (see p.40). The survey results also suggest that, from a business operating and profitability standpoint, these companies' China operations are doing as well as or better than their global operations. US companies in China continue to play to their strengths in China: design, production, management, and delivery of quality goods and services.

Over the past year, however, I have seen one area in which US companies are not doing as well as they could be: communicating with local government officials. Though many US companies are better managed, provide higher wages, and offer safer working conditions than their Chinese counterparts, even US companies that have been in China a long time have yet to fully internalize the government's substantial influence on daily operations, according to survey results.

To be sure, more companies have dedicated government affairs staff now than in the past. More companies are also taking steps to ensure that their voices are heard when the central government develops broad policies that will affect their sector. Given that industrial policy is a tool the central government uses to drive economic development, US companies should take these steps to make their voices heard.

But what happens when a foreign company leaves Beijing? What happens when a factory or office is located in, say, Bengbu, a small city in rural Anhui, one of China's less-developed provinces? Two recent phenomena suggest that US companies have invested less effort in equipping their local staff to cultivate and maintain proper relationships with local officials than they have in building dedicated teams that can track and influence central government policy. The two phenomena—factory closures to meet energy-efficiency targets set in the 11th Five-Year Plan (FYP, 2006–10) and the development of the 12th FYP (2011–15)—highlight the connection between national policy and local implementation. They also reveal that US companies must know what is going on in their little corner of China *before* daily operations are interrupted.

Energy efficiency targets

According to targets established in China's 11th FYP, energy consumption per unit of gross domestic product must be reduced by 20 percent from 2005 levels. At the end of 2009, central government officials began to signal through the press that the country would miss these targets. This was a clear warning that the government had identified a problem and would likely adopt administrative measures to address it. What those measures entailed became clear in July, when the central government announced that provinces would have to cut their energy consumption. As is common in China, provinces and municipalities were largely left to their own devices to determine how to implement the required energy cuts. As a result, local governments across China took myriad actions—shifting work days, assigning energy quotas, and shutting down factories.

US companies were caught off guard. By early August, phone calls and e-mails were rolling into USCBC's Shanghai office from companies asking what was happening and what they could do about the local official standing on their factory floor telling them they had to reduce energy consumption by 20 percent immediately. What surprised me was that US companies were so unprepared, even after seven months of verbal warnings from the central government, and after many companies faced similar experiences in 2005 when factory and office shutdowns occurred nationwide because of coal shortages and high temperatures.

What would have helped US companies? Companies should have ensured that staff in their local facilities had developed and maintained appropriate relationships with relevant local government officials to understand the government's thinking before disruptions reached crisis levels. In this situation, knowing how the local government was interpreting messages from Beijing, collecting and analyzing energy-usage data, developing methodologies to assign quotas, and targeting specific companies or industries would have afforded the companies extra time to prepare. More important, such knowledge may have enabled the companies to share ideas and best practices with local officials to reach energy-efficiency goals in a mutually beneficial manner, thus potentially minimizing disruption to work schedules and supply chains.

Local 12th FYPs

By overlooking the importance of government affairs, US companies may also be missing out on identifying and planning for future business opportunities or challenges under local FYPs. The central government drafts these massive economic and social guidance documents every five years, and it will release the 12th FYP next March. Each province and city will also develop its own 12th FYP. These plans will target all aspects of urban and rural planning, including priority sectors, investment incentives, social policy changes that may affect compensation and benefits packages, and, unsurprisingly, energy-efficiency goals. As local governments across China debate what to include in their 12th FYPs, some local governments will quietly seek industry input, predominantly from Chinese companies. US companies that have been in China for a while may have seen this process happen several times before, though they may not have participated in the past. Right now, US companies have a rare opportunity to know "the plan" for the next five years and may also be able to influence it. This privilege, however, is only given to companies that have deep connections to multiple local government entities.

At the end of the day, relationships with local government officials enable companies to respond to the challenges that arise in China's ever-changing business environment. Local governments will play a decisive role in determining the ease with which companies can meet efficiency targets, protect intellectual property, pay taxes, or manage human resources. Chinese companies have an advantage because they inherently know the system and have personnel in place to interact with local officials. But Americans can, and must, learn how to do this too. So, encourage the plant and office managers to spend time with local officials and brainstorm solutions to company challenges. Train the finance and human resources professionals to ask the right questions and communicate information back to headquarters. When US companies start acting a little more like their Chinese competitors in recognizing the importance of maintaining professional, cooperative relationships with local officials, they will be adding another piece to the toolbelt of a successful company in China. 完

Julie Walton (jwalton@uschina.org.cn) is the US-China Business Council's chief representative in Shanghai.

Event Wrap Up

BEIJING

September

Reception with US-China Business Council (USCBC) President on US-China Trade Politics

USCBC President John Frisbie briefed members on China trade politics, the Obama administration's trade policy, and prospects for congressional trade legislation. Frisbie also discussed USCBC's advocacy work on market access issues and other company concerns.

Luncheon on Trade Progress and Trade Prospects: China's Challenges as a Member of the World Trade Organization (WTO)

James Bacchus, chair of the Global Practice Group of Greenberg Traurig and former chair of the WTO Appellate Body, shared views on China's WTO development. Lisa Wang, senior import administration officer and first secretary for the US Commercial Service in Beijing, provided an update on WTO cases and general trade remedy issues.

October

Luncheon with Senator Max Baucus

Cosponsored by USCBC and the American Chamber of Commerce (AmCham) in China, Senator Baucus (D-MT) briefed members about Washington perspectives on currency, intellectual property, and indigenous innovation issues.

DETROIT, MICHIGAN

October

Breakfast Program with USCBC President on Current Issues in US-China Trade

Cosponsored by USCBC and Dykema Gossett PLLC, Frisbie discussed the current operating environment for US companies in China and the latest developments in US-China trade politics.

HONG KONG

September

Roundtable with USCBC President on the US-China Commercial Relationship

Hosted by AmCham Hong Kong, Frisbie discussed Washington viewpoints on US-China trade relations.

NANCHANG, JIANGXI

September

USCBC Delegation to Central China Expo

Led by USCBC Vice President of Operations Bob Poole, a delegation of member companies visited the three-day expo and met privately with Hunan and Jiangxi vice governors and PRC Vice Minister of Commerce Wang Chao. The delegation discussed the companies' current presence and interest in expanding in China's central provinces.

NEW YORK

September

Dinner Honoring PRC Premier Wen Jiabao

See p.49.

ONLINE

September

Webinar on Acquisitions in China: Getting the Deal Done

Organized by USCBC and *CBR*, Barry Chen, corporate practice director at InterChina Consulting, and John Leary, partner at White & Case LLP in Shanghai, discussed how to successfully close mergers and acquisition deals in China. The webinar can be viewed at www.chinabusinessreview.com/cbr/webinars.html.

SHANGHAI

September

Reception with Shaanxi Governor Zhao Zhenyong

Governor Zhao, Vice Governor Jing Junhai, and several provincial commission heads celebrated Shaanxi Province's week at the Shanghai Expo. The reception provided an opportunity for the US business community to interact with the governor's delegation.

Luncheon with USCBC President on US-China Trade Politics

Frisbie briefed members in Shanghai on China trade politics, the Obama administration's trade policy, and prospects for congressional trade legislation, as well as USCBC's advocacy work in preparation for several upcoming bilateral meetings.

October

Briefing with Shanghai Commerce Commissioner Sha Hailin: New Directions for Foreign Investment

The Chinese-language luncheon program featured a presentation by Sha on how Shanghai will improve its use of foreign investment and encourage multinational corporations to establish headquarters and other centers in the city.

WASHINGTON

September

Briefing on US Procurement of Certain Products from China

Brandie Sasser and Marcia Eugenio of the Department of Labor's Bureau of International Labor Affairs and Ernest Woodson of the General Services Administration briefed members on the revised list of products that the United States believes may have been produced by forced or indentured child labor.

Briefing on China's State Secrets Law

Mitchell Silk, partner at Allen & Overy LLP, and Patrick Norton, partner at Steptoe & Johnson LLP, informed members about the new law and its impact on US companies.

Issues Briefing on Evolving Labor Issues in China

Companies discussed recent regulations, trends, and developments regarding unionization and collective bargaining in China with Andreas Lauffs, principal and head of Baker & McKenzie LLP's China Employment Law Group.

Meeting with Top White House Officials on Innovation

Cosponsored by USCBC and the US Chamber of Commerce, the meeting allowed Joan Rolf and Eugene Huang of the White House Office of Science and Technology Policy to hear companies' views on China's business and regulatory environment and indigenous innovation issues.

Upcoming Events

SHANGHAI

China Operations Conference
November 18, 2010

WASHINGTON

Gala 2010
December 1, 2010
(see p.47)

Forecast 2011 Evening Reception
February 9, 2011

Forecast 2011 Conference
February 10, 2011

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

USCBC Co-Hosts Dinner for PRC Premier Wen Jiabao

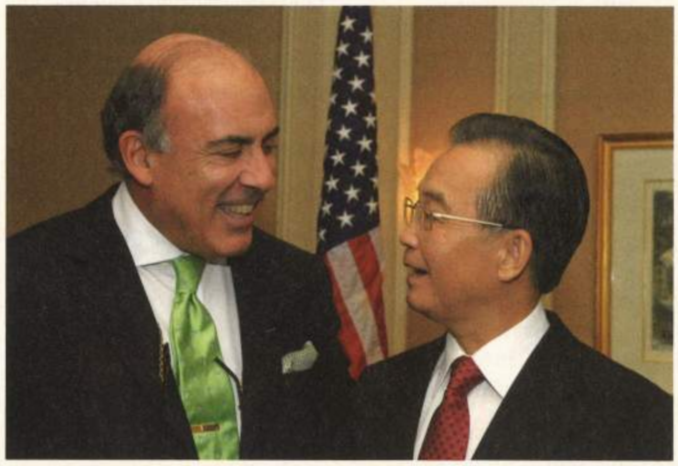
The US-China Business Council (USCBC) and the National Committee on US-China Relations (NCUSCR) hosted a reception and dinner at the Waldorf=Astoria Hotel in New York City in honor of PRC Premier Wen Jiabao on September 22. More than 400 government and business leaders attended the event. USCBC Chair and Coca-Cola Co. Chairman and CEO Muhtar Kent offered welcome remarks and a toast at the start of the dinner. Attendees heard remarks from US Secretary of Commerce Gary Locke and former US Secretary of State Henry Kissinger, who spoke about China's impressive economic growth in the past three decades and how vital the commercial relationship is for both countries.

Wen's remarks at the dinner—the only speech he delivered on US-China relations during his New York visit—expressed confidence that trade frictions and issues between the two countries will be resolved. He noted that "the future of the Sino-US relationship is bright."

Responding to claims in the United States that Beijing is keeping its currency low, Wen said that there was no basis for a drastic appreciation of the renminbi, which would cause many Chinese companies to go bankrupt.

The Honorable Carla Hills, chair and CEO of Hills & Co. and chair of NCUSCR, conducted a brief question-and-answer session following Wen's speech. In response to a question about the greatest risk for China's continued economic and social development, Wen stressed the lack of balance and coordination and the need for China to pursue a more sustainable development model.

The Honorable Henry A. Kissinger, chair of the America-China Forum and former secretary of State; David Paterson, governor of New York; the Honorable Barbara Franklin, president and CEO of Barbara Franklin Enterprises; and others mingle at the pre-dinner reception.



Muhtar Kent, chair of USCBC and chairman and CEO of the Coca-Cola Co., and PRC Premier Wen Jiabao share a laugh.

Elsa Ruiz and Michael Ian

Stephen A. Orlins, president of NCUSCR; Kent; Premier Wen; the Honorable Carla A. Hills, chair and CEO of Hills & Co. and chair of NCUSCR; and John Frisbie, president of USCBC.

US Secretary of Commerce Gary Locke speaks at the dinner.

Premier Wen gives an animated speech on the future of US-China relations.

China Conference Calendar

China-related events near you

November 2010–April 2011

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* website at www.chinabusinessreview.com/conference-calendar.php.

China International Advanced Materials Industry Exhibition

NOVEMBER 8–10

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Adsale Exhibition Services Ltd.
Contact: Eric Shew
Tel: 86-21-6469-6751
ciami@adsale.com.hk
www.ciamichina.com/JasperWe/Shows/sid-278/lang-eng/Details.aspx

Luxury Brands

NOVEMBER 8–10

Location: Ritz-Carlton Shanghai
Organizer: Marcus Evans
Contact: Esther Wong
Tel: 603-2723-6736
estherw@marcusevanskl.com
www.marcusevans.com/marcusevans-conferences-event-details.asp?EventID=16778&SectorID=1

World Scrap Metal Singapore

NOVEMBER 9–11

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

China International Industry Fair

NOVEMBER 9–13

Location: Shanghai New International Expo Center
Organizers: China Council for the Promotion of International Trade (CCPIT); Chinese Academy of Engineering; Chinese Academy of Science; PRC Ministry of Commerce; Ministry of Education; Ministry of Industry and Information Technology; Ministry of Science and Technology; National Development and Reform Commission; Shanghai Municipal People's Government
Tel: 86-21-6289-2666
www.ciif-expo.com/article/list.php?catid=41

FHC China

NOVEMBER 10–12

Location: Shanghai New International Expo Center
Organizer: China International Exhibitions Ltd.
Contacts: Lily Zhu; Ken Cui
Tel: 86-21-6209-5209
fhc@chinaallworld.com
www.fhcchina.com/en

Interphex China

NOVEMBER 10–12

Location: Jiangsu: Suzhou International Expo Center
Organizer: Reed Sinopharm Exhibitions
Contact: Tan Zhen
Tel: 86-10-8455-6693
zhen.tan@reedsinopharm.com
www.interphexchina.com

Retail China Summit

NOVEMBER 16–18

Location: Shanghai: The Westin Bund Center
Organizer: Beacon Events Ltd.
Contact: Winnie Louie
Tel: 852-2531-6121
wlouie@beaconevents.com
www.retailchinasummit.com

Airshow China

NOVEMBER 16–21

Location: Zhuhai, Guangdong: China International Aviation and Aerospace Exhibition Center
Organizer: China International Aviation and Aerospace Exhibition
Tel: 86-75-6336-9235
zhuhai@airshow.com.cn
www.airshow.com.cn/en

China Hi-Tech Fair

NOVEMBER 16–21

Location: Guangdong: Shenzhen Convention and Exhibition Center
Organizer: Shenzhen Convention and Exhibition Center Management Co. Ltd.
Tel: 86-755-8284-8900
chtf@chtf.com
www.chtf.com

Water Expo China

NOVEMBER 17–19

Location: Beijing: National Convention Center
Organizers: Chinese Hydraulic Engineering Society; Messe Frankfurt (Shanghai) Co. Ltd.
Contact: Zhu Haiyan
Tel: 86-10-6320-3094
expo@mwr.gov.cn
www.waterexpo.cn

China International Rail Transit Technology Exhibition

NOVEMBER 18–20

Location: Beijing Exhibition Center
Organizers: HNZ Media Group; PRC Ministry of Housing and Urban-Rural Development
Contact: Laurence Ni
Tel: 86-21-5101-6290
laurence.ni@hnzmedia.com
www.hnzcrts.com

China Solar PV Conference and Exhibition

NOVEMBER 18–20

Location: Jiangsu: Nanjing International Expo Center
Organizers: China Renewable Energy Society Solar PV Committee; Jiangsu Photovoltaic Industry Association; Nanjing People's Government; Southeast University
Contact: Janet
Tel: 86-21-3428-0006
nuogaisi2004@126.com
www.ch-solar.com

Money Fair International Exposition

NOVEMBER 19–21

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

China (Guangzhou) International Automobile Exhibition

NOVEMBER 21–27

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

Bauma China

NOVEMBER 23–26

Location: Shanghai New International Expo Center
Organizers: China Construction Machinery Association; China Construction Machinery Co., Ltd.; CCPIT Machinery Sub-Council; Messe Muenchen International; MMI (Shanghai) Co., Ltd.
Tel: 49-89-949-20251
info@bauma-china.com
www.bauma-china.com

Ningbo International Auto Parts & Accessories Trading Fair

NOVEMBER 24–26

Location: Zhejiang: Ningbo International Auto Mall
Organizers: Ningbo International Auto Mall Co., Ltd.; Ningbo

Shengdong International Trade Fairs Ltd.
capa@capafair.org
www.capafair.org

Human Resources Conference

NOVEMBER 25

Location: Sheraton Shanghai Hongqiao
Organizer: European Union Chamber of Commerce in China
Contact: Noelia Arizaga
Tel: 86-21-6385-2023 x116
marizaga@euccc.com.cn
www.europeanchamber.com.cn/view/events/fullview?eid=3084#content

China Hotel Expansion Summit

NOVEMBER 25–26

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

Shanghai International Oil and Gas Transportation & Storage Technology Equipment Exhibition

NOVEMBER 25–27

Location: Shanghai New International Exhibition Center
Organizer: Shanghai AiExpo Exhibition Service Co., Ltd.
Tel: 86-21-6592-9965
info@aiexpo.com.cn
www.sippe.org.cn

Anticorruption China

NOVEMBER 30–DECEMBER 2

Location: Grand Millenium Beijing
Organizer: Beacon Events Ltd.
Contact: Annie Ng
Tel: 852-2219-0111
ang@beaconevents.com
www.beaconevents.com/2010/AntiCorruptionChinaBJ/en/Home/index.jsp

China Gold & Precious Metals Summit

DECEMBER 1–3

Location: Shanghai: Majesty Plaza
Organizer: IGVision International Corp. Shanghai
Contact: Tina Tian
Tel: 86-21-5161-5300
gold@igvision.com
www.chinagoldsummit.com

China Municipal Solid Waste Forum

DECEMBER 2–3

Location: Shanghai Metropark Jiayou Hotel
Organizer: Genesis Resourcing Consulting China Co., Ltd.
Contact: Fox Shen
Tel: 86-21-5180-7933
fox@genesis-resourcing.com

US-China Wind 2010

DECEMBER 7–9

Location: San Francisco, California: Holiday Inn Golden Gateway Hotel
Organizer: Information Cast Inc.
Contact: Erin Dolleris
erind@infocastevents.com
www.infocastinc.com/index.php/conference/uschinawind

Innovation in Drug Discovery: Science & Technology

DECEMBER 7–10

Location: Shanghai: Pudong Shangri-La Hotel
Organizer: Society for Biomolecular Sciences
Contact: Trish Sexauer
Tel: 1-703-964-1240
tsexauer@sbsonline.org
www.sbsonline.org/china

IMMEX China

DECEMBER 8–10

Location: Guangzhou, Guangdong: China Import and Export Fair Pazhou Complex
Organizers: Guangzhou Auch Exhibition Services Co., Ltd.; IIR Exhibitions Pte Ltd.
violet.yong@iirx.com.sg
www.maritimeshows.com/china/2010

Automechanika

DECEMBER 8–11

Location: Shanghai New International Expo Center
Organizers: Automechanika; China National Automotive Industry International Corp.
Contact: Perry Tang
Tel: 852-2238-9926
perry.tang@hongkong.messefrankfurt.com
www.automechanika-shanghai.com

PharmChina

DECEMBER 9–11

Location: Jiangxi: Nanchang International Exhibition Center
Organizer: Reed Sinopharm Exhibitions
Contact: Liu Yongxiang
Tel: 86-10-8455-6506
yongxiang.liu@reedsinopharm.com
http://en.pharmchina.com.cn

Shanghai International Fisheries & Seafood Expo

DECEMBER 10–13

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai Gehua Exhibition Service Co., Ltd.
Tel: 86-21-3414-0187
info@gehuaexpo.com
www.sifse.com/en

China (Shanghai) International Optics Fair

FEBRUARY 18–20

Location: Shanghai Everbright Convention & Exhibition Center
Organizers: China Light Industrial Corporation for Foreign Economy & Technical Cooperation; China Optometric & Optical Association; Orient International Exhibition Co., Ltd.
Tel: 852-2789-3220
orientex@netvigator.com
www.siof.cn

International Integrated Circuit China

FEBRUARY 24–26

Location: Guangdong: Shenzhen Convention and Exhibition Center
Organizers: Global Sources; UBM Sinoexpo; United Business Media Ltd.
Contact: Athena Gong
Tel: 86-21-2327-0199
www.english.iic-china.com

China International Expo for Auto Electronics, Accessories, Tuning & Care Products

FEBRUARY 25–27

Location: Beijing: New China International Exhibition Center
Organizers: China Chamber of International Commerce; YASN International Exhibition Co., Ltd.
Contact: Ruby Yang
Tel: 86-10-5797-0888
info@yasn.com.cn
www.ciaacexpo.com

International Integrated Circuit China

MARCH 2–4

Location: Theme Pavilion, Shanghai Expo
Organizers: Global Sources; UBM Sinoexpo; United Business Media Ltd.
Contact: Athena Gong
Tel: 86-21-2327-0199
www.english.iic-china.com

China International Industry Fair

APRIL 20–22

Location: Chongqing Exhibition Center
Organizer: Broadfairs Co., Ltd.
Tel: 86-23-6292-5058
cnfair@163.com
www.cnfair.org/cif

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

Sales and Investment

September 2010

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor (publications@uschina.org). *CBR* subscribers with online access and members of the US-China Business Council can access complete China Deal Database listings from 2000 to present at www.chinabusinessreview.com.

Compiled by Jeffrey Genota and Joseph Luk

Agriculture

OTHER

Aftab Bahumukhi Farms Ltd. (Bangladesh)/Yuan Long Ping High-Tech Agriculture Co., Ltd. (Hunan)
Signed MOU for technical cooperation on hybrid rice seeds.

Government of the PRC
Will loan Bangladesh $559 million to set up fertilizer factory in Shahjalal, Bangladesh.

Government of Vietnam/ Government of the PRC
Signed MOU to strengthen agricultural and forestry cooperation.

Automotive

CHINA'S INVESTMENTS ABROAD

Chery Automobile Co., Ltd. (Anhui)/St. Paul State Government (Brazil)
Signed MOU for Chery to build an auto industrial park in Jacarei, Brazil. $400 million.

GAZ Group (Russia)/China FAW Group Corp. (Jilin)
Will form JV in Miass, Russia, to manufacture and sell trucks in Russia and abroad.

INVESTMENTS IN CHINA

Chang'an Ford Mazda Automobile Corp., Ltd. (Chongqing), a JV between Chang'an Automobile (Group) Co., Ltd., Ford Motor Co. (US), and Mazda Motor Corp. (Japan)/ Chongqing Municipal Government
Signed MOU to build an engine plant in Chongqing. $500 million.

OTHER

RWE Effizenz GmbH (Germany)/ BYD Europe BV, a subsidiary of BYD Co., Ltd. (Guangdong)
Will jointly sell BYD's electric vehicles and RWE's fast-charging posts and eco-electricity in Europe; will also cooperate on international standards.

Aviation/Aerospace

INVESTMENTS IN CHINA

Airbus SAS (France)/China Commercial Aircraft Co. (Shanghai)
Signed deal to manufacture 5% of Airbus's A350 XWB airframe in China.

OTHER

Air France-KLM (France), a JV between Air France and KLM Royal Dutch Airlines/China Southern Airlines (Guangdong)
Signed agreement to form JV. (PRC:50%-France and the Netherlands:50%).

Banking & Finance

OTHER

Equity Bank Ltd. (Kenya)/China UnionPay Co., Ltd. (Shanghai)
Will allow Equity Bank customers to access their accounts globally from China UnionPay ATMs.

MasterCard International Inc. (US)/China UnionPay Co., Ltd. (Shanghai)
Signed MOU to explore future business development.

PetroVietnam Finance Co. (Vietnam)/CDB (Beijing)
Signed agreement on customer and business exchange.

SinoPac Financial Holdings Co., Ltd. (Taiwan)/China Huarong Asset Management Corp. (Beijing)
Signed agreement to cooperate on business information and talent exchange and jointly develop new products and business models.

Taishin International Bank, a subsidiary of Taishin Financial Holding Co., Ltd. (Taiwan)/Bank of Nanjing Co., Ltd. (Jiangsu)
Signed MOU on business expansion and employee exchanges.

Chemicals, Petrochemicals & Related Equipment

INVESTMENTS IN CHINA

BASF SE (Germany)/Tianjin Municipal Government
Signed MOU for BASF to establish a polyurethane systems house in Tianjin.

LanzaTech Ltd. (New Zealand)/ Henan Coal and Chemical Industrial Corp.
Signed MOU to jointly build a plant in Henan to produce ethanol fuel and chemicals using LanzaTech's gas fermentation technology.

OTHER

LanzaTech Ltd. (New Zealand)/ Chinese Academy of Sciences (Beijing), Henan Coal and Chemical Industrial Corp.
Signed LOI to establish a bio-energy research center to develop, produce, and commercialize technology that changes coal-derived synthesis gas to ethanol fuels and chemicals.

Abbreviations used throughout text: 3G: third generation; ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LCD: liquid crystal display; LNG: liquefied natural gas; LOI: Letter of intent; MIIT: Ministry of Industry and Information Technology; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PV: photovoltaic; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise.

Electronics, Hardware & Software

CHINA'S IMPORTS

Fairchild Semiconductor Inc. (US)/Sichuan Changhong Electric Co., Ltd.
Signed MOU for Changhong to purchase Fairchild's power and mobile components through 2015.

INVESTMENTS IN CHINA

NEC China Co. Ltd. (Beijing), a subidiary of NEC Corp. (Japan)/ Neusoft IT Service Co., Ltd., a subsidiary of Neusoft Corp. (Liaoning)
Will establish JV, NEC Neusoft Information Technologies Co., Ltd., in Dalian, Liaoning, to expand cloud computing services in China. (Japan:70%-PRC:30%). $7.5 million.

OTHER

Epic Data International Inc. (Canada)/Qiming Information Technology Co., Ltd. (Jilin)
Signed MOU to collaboratively develop and market manufacturing execution systems in China and abroad.

Energy & Electric Power

CHINA'S INVESTMENTS ABROAD

HRL Ltd. (Australia)/China National Electric Equipment Corp. (Beijing)
Signed contract for China National Electric Equipment to build coal power plant in Australia.

State Grid Corp. of China (Beijing)
Will purchase seven power transmission companies from Brazil-based Plena Transmissoras. $1.8 billion.

INVESTMENTS IN CHINA

Atomstroy export JSC, a subsidiary of Rosatom State Nuclear Energy Corp. (Russia)/ Jiangsu Nuclear Power Corp.
Will jointly design the second stage of the Tianwan Nuclear Power Plant in Jiangsu.

Environmental Equipment & Technology

CHINA'S EXPORTS

Yingli Green Energy Holding Co., Ltd. (Hebei)
Will supply France-based Cegelec, a wholly owned subsidiary of VINCI Group, with 7.9 MW of PV modules.

INVESTMENTS IN CHINA

General Electric Co. (US)/ Harbin Electric Machinery Co., Ltd., a subsidiary of Harbin Power Equipment Co., Ltd. (Heilongjiang)
Will form JV to manufacture and sell wind turbines in China. (US:51%-PRC:49%).

Harbin Electric Corp.
Will buy 49% stake in US-based General Electric Co.'s wind factory in Shenyang, Liaoning.

OTHER

Los Angeles Department of Water and Power (US)/BYD Co., Ltd. (Guangdong)
Signed MOU to develop a grid-scale battery project for renewable energy storage.

US Department of Energy National Renewable Energy Laboratory/LDK Solar Co., Ltd. (Jiangxi)
Signed MOU to jointly research and develop silicon materials and PV devices.

Healthcare Services & Investment

INVESTMENTS IN CHINA

Excelsior Medical (HK) Co., Ltd. (Hong Kong), a wholly owned subsidiary of Excelsior Medical Co., Ltd. (Taiwan)/Sinopharm Group Co., Ltd. (Shanghai)
Signed agreement to form Shanghai-based JV, Sinopharm Excelsior, to acquire medical institutions, manage hospitals, provide medical advisory services, and trade medical devices. (PRC:51%-Taiwan:49%). $150 million.

Metals, Minerals & Mining

CHINA'S IMPORTS

Siberian Coal Energy Co. (Russia)
Will supply Beijing-based China Datang Corp. with 1 million tons of thermal coal.

CHINA'S INVESTMENTS ABROAD

China Guangshou Group Co., Ltd. (Zhejiang)
Will acquire 65% stake in Australia-based Victory West Moly Ltd.'s Malala Molybdenum Project.

China-Africa Development Fund, China Uranium Corp., a subsidiary of China National Nuclear Corp. (Beijing)
Signed agreement to set up JV to invest and explore uranium in Africa.

Ghana Bauxite Co. Ltd./Bosai Minerals Group Co., Ltd. (Chongqing)
Signed MOU for Bosai to establish a modern alumina refinery plant in Ghana. $1.2 billion.

Government of Russia/ Government of the PRC
Signed agreement to establish JV to develop coal resources in Russia.

Government of Ukraine/ CDB (Beijing)
Signed agreement for CDB to invest in various coal projects in Ukraine.

Steel Development Co., LLC (US)/ Anshan Iron and Steel Group Corp. (Liaoning)
Formed JV to build steel mill in Amory, Mississippi. (PRC:14%-US and international partners:86%).

INVESTMENTS IN CHINA

Yinfu Gold Corp. (US)
Will acquire gold mines in Liaoning and Gansu.

OTHER

Government of Russia/ Government of the PRC
China will loan Russia $6 billion in exchange for a 25-year supply of coal.

Miscellaneous

INVESTMENTS IN CHINA

POSCO China, POSCO E&C (China) Co., Ltd., subsidiaries of POSCO (South Korea)/Tonghua Iron & Steel Group Co., Ltd. (Jilin), Jilin Municipal Government
Signed agreement to cooperatively develop the Changchun-Jilin-Tumen River zone.

OTHER

Government of Wisconsin (US)/ Shaanxi Provincial Government
Signed MOU to collaborate on agriculture, clean energy, cultural exchange, education, environment, and sustainable manufacturing.

Ministry of Trade and Industry (Egypt)/PRC Ministry of Industry and Information Technology (Beijing)
Signed MOU to further bilateral economic cooperation.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

OAO Gazprom (Russia)
Will supply Beijing-based CNPC with 30 billion cubic meters of gas annually from 2015–45.

INVESTMENTS IN CHINA

BP plc (UK), Chevron Corp. (US)
Acquired deepwater exploration block 42-05 in the South China Sea from Guangdong-based Devon Energy China Ltd. (UK:40.82%-US:59.18%).

Chevron Corp. (US)
Acquired 100% stake in deepwater exploration blocks 53-30 and 64-18 in the South China Sea from Guangdong-based Devon Energy China Ltd.

China Deals

OTHER

Chevron Corp. (US)/CNPC (Beijing)
Signed MOU to jointly develop Chevron's proposed Wheatstone project in Australia and on gas exploration in China.

Empresa Publica de Hidrocarburos del Ecuador
Will sell Beijing-based PetroChina 36,000 barrels of oil a day for four years in exchange for $1 billion loan from Beijing-based CDB.

OAO Inter RAO UES (Russia)/Shenhua Group Corp. Ltd. (Beijing)
Signed MOU to jointly build a coal-to-liquid plant.

OAO Lukoil (Russia)/CNPC (Beijing)
Signed agreement to further cooperate on oil and gas projects.

Pharmaceuticals

INVESTMENTS IN CHINA

Carbosynth Ltd. (UK)/Healtang Biotech Co. Ltd. (Shandong)
Will set up pharmaceutical JV in Jinan, Shandong.

Ports & Shipping

CHINA'S INVESTMENTS ABROAD

Sundance Resources Ltd. (Australia)/China Harbour Engineering Co. Ltd., a subsidiary of China Communications Construction Co. Ltd. (Beijing)
Signed MOU to jointly establish the scope, cost, and delivery program for the proposed Lolabe Port Project in Cameroon.

Rail

CHINA'S EXPORTS

China Railway Materials Import & Export Co., Ltd. (Beijing)
Will provide Pakistan Railways with 25,000 metric tons of rail material.

CHINA'S INVESTMENTS ABROAD

Government of Iran /Government of the PRC
Will construct a railway network to connect Tehran with cities in western Iran. $20 billion.

Sundance Resources Ltd. (Australia)/CRCC China-Africa Construction Ltd., a subsidiary of China Railway Construction Corp. Ltd. (Beijing)
Signed MOU to jointly establish the scope, cost, and delivery program for the railway and rolling stock for Sundance's Mbalam iron ore project in Cameroon and Congo.

OTHER

Alstom (France)/China CNR Corp., Ltd. (Beijing), Shanghai Electric Group Co. Ltd.
Signed MOU to expand their JVs, Shanghai Alstom Transport Co., Ltd. and Shanghai Alstom Transport Electrical Equipment Co., Ltd., and jointly develop new markets for mass transit products.

Research & Development

OTHER

Oslo Cancer Cluster (Norway)/Shanghai Institute of Materia Medica, a branch of the Chinese Academy of Sciences (Beijing)
Signed MOU on mutual student and researcher exchange to accelerate the development of new cancer therapies.

Tourism & Hotels

OTHER

Government of Nepal/Government of the Tibet Autonomous Region
Signed MOU to attract Chinese and other tourists to Nepal.

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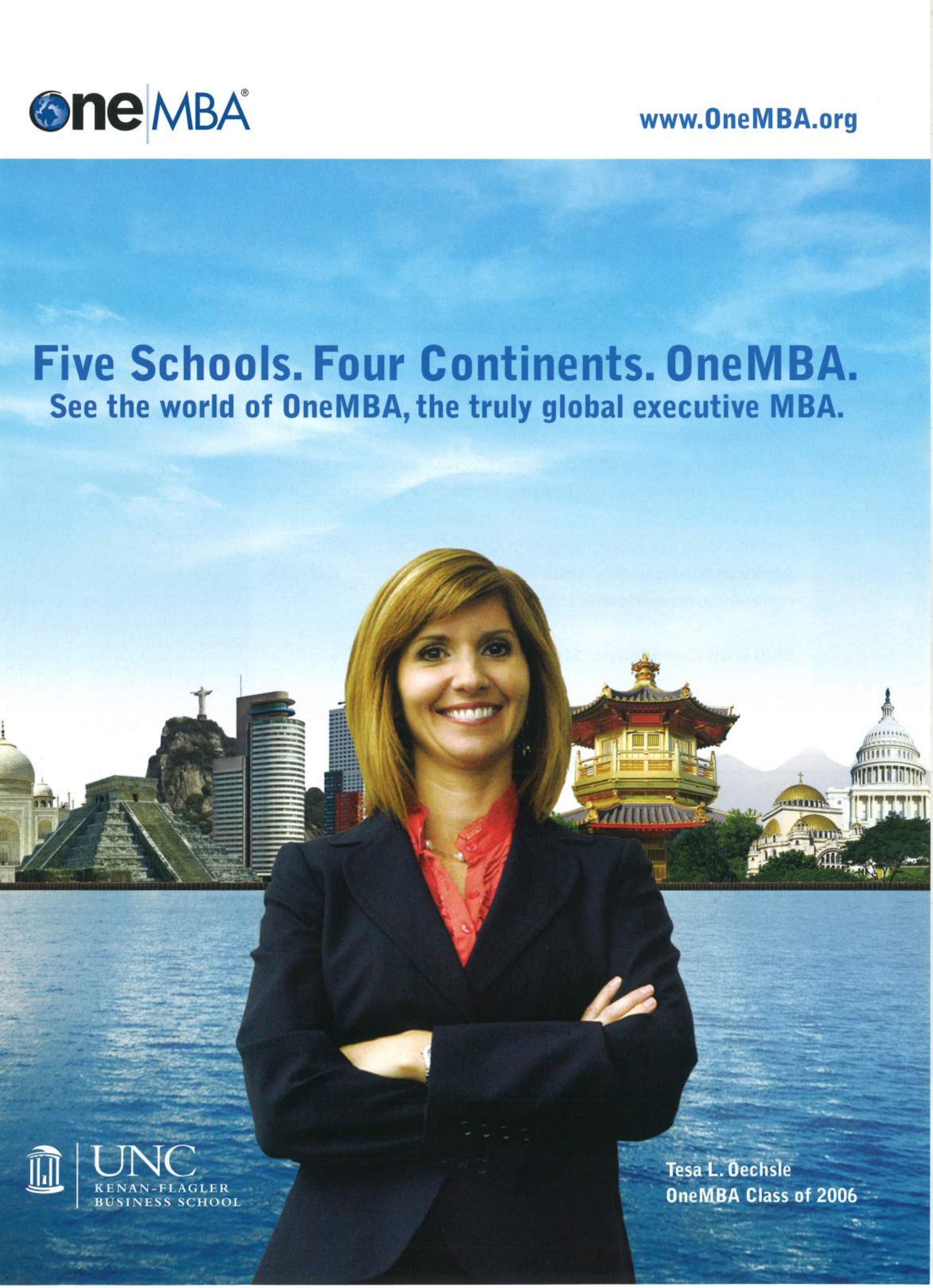

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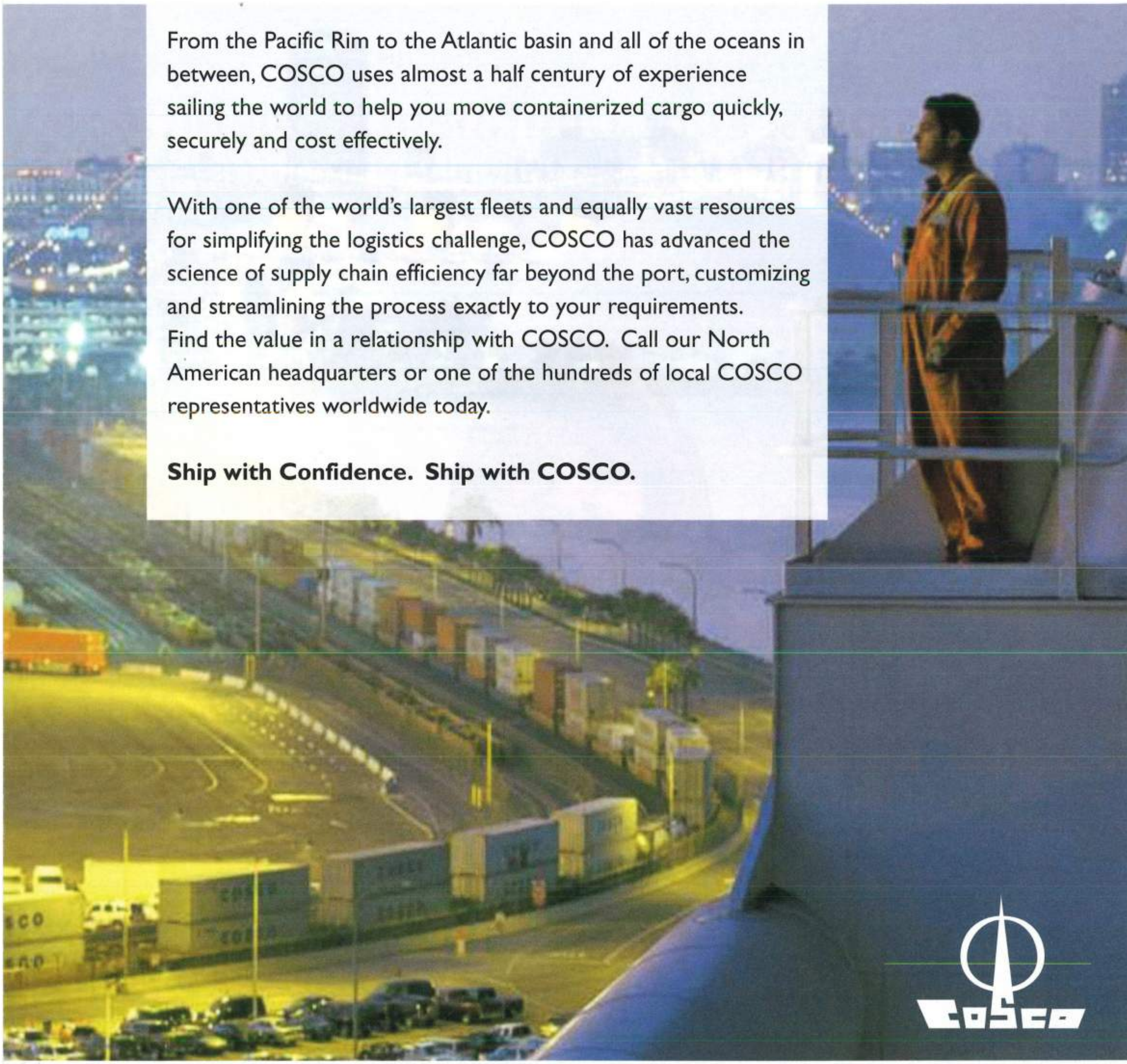

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