THE CHINA BUSINESS REVIEW

SEPTEMBER-OCTOBER 1995 VOLUME 22, NUMBER 5

TO MARKET, TO MARKET

SPECIAL REPORT: China's Real Estate Sector

How to meet with success in Beijing.

Have your next business conference at the Shangri-La Hotel,
the first hotel in China to receive the international "Pinnacle" Award for excellence in hosting meetings. Our special meeting package starts at just US$95 per person, twin sharing, includes lunch, two coffee breaks, use of the meeting room you require and all essential meeting facilities.

Shangri-La hotel

BEIJING

29 Zizhuyuan Road, Beijing 100081, China. Tel: (86-10) 841 2211 Fax: (86-10) 841 8002/3
For reservations and information, call Hong Kong 2599 3838, Singapore 535 3578,
Tokyo 3667 7744. Toll-Free : USA & Canada (1-800) 942 5050.

CONTENTS

美中商贸评论

September-October 1995

FOCUS: Distribution and Marketing

12 ■ Cracking the System An overburdened infrastructure struggles under the weight of goods destined for the China market.
Steven R. Frewen

19 ■ In Search of the Chinese Consumer Just what does a nation of 1.2 billion people buy?
Dong Li and Alec M. Gallup

23 ■ Tapping the Retail Market in China New regulations bode well for foreign retail chain stores.
Alexa C. Lam

30 ■ The Right Price Many companies entering China's retail sector think long and hard about pricing strategies
Jane Greaves

34 ■ China Puts on a New Face From shampoo to nail polish, companies cash in on the foreign cachet.
Mitzi Swanson

SPECIAL REPORT: THE REAL ESTATE SECTOR

38 ■ Hanging Out Your Shingle in China Modern buildings mean more leasing choices.
Andrew Ness

43 ■ Shifting the Center Shanghai seeks to regain its former status as the country's commercial capital.
Andrew Ness

46 ■ A Toehold in the South Foreign investment drives up property values in Guangzhou.
Andrew Ness

50 ■ Sprucing Up China's Cities Foreign architects help light up China's skyline.
Timothy Geisler

DEPARTMENTS

4 ■ Trends & Issues
VAT refund reduction; change at the PBOC helm; China's brewing industry faces the prospect of consolidation; new personnel agencies receive approval to represent Chinese nationals.

6 ■ Letter from the President
Sizing up this summer's Congressional actions toward China.
Robert A. Kapp

8 ■ Commentary
A GATT agreement could open China's procurement sector to more foreign bidding.
Robert F. Dodds, Jr.

55 ■ China Business

61 ■ Classified Ads

63 ■ Last Page
A Council staff member takes note of some symbolic changes in China.
Rick Peterman

Cover Photo by Joe Sohm, Unicorn Stock Photos

More Bad News on the VAT

New changes to the Value Added Tax (VAT) refund rate have further aggravated foreign-invested enterprises (FIEs) that engage in exporting (*see The CBR*, March-April 1994, p.40). The VAT refund on all exports—excluding agricultural products and coal—was reduced in May by order of the State Council. Exporters are still responsible for paying the 17 percent VAT rate on their inputs, but will only receive a 14 percent VAT refund on exports. The input VAT on processed agricultural exports remains 13 percent, but the refund rate has dropped to 10 percent. The new VAT refund rate on unprocessed agricultural goods and coal is 3 percent. VAT refunds on all goods shipped after July 1, 1995, are subject to the lower refund rate. Some exporters will likely pass the increased cost on to their customers, but this is not a viable option for all exporters.

Chinese officials justify the policy change as a necessary step to halt corrupt import and export practices. Authorities discovered that some exporters circumvent the input VAT on raw materials through false invoicing, creating bogus VAT receipts, or falsely claiming that the materials are inputs for VAT-exempt joint ventures. These enterprises then demand VAT refunds from local tax bureaus. Central government coffers were coming up short in meeting the demand for VAT rebates. According to press reports, Beijing owes roughly $4.2 billion in unpaid VAT rebates.

Many economists argue that rather than reducing VAT rebates, Beijing should have focused instead on preventing exporters from overvaluing commercial invoices. Lowering the VAT refund rate acts as a disincentive to exporting and will not stop corrupt exporters from trying to cheat the central government by inflating invoices. In addition to harming FIEs engaged in exporting, the new rules exacerbate FIE efforts to balance their foreign exchange. Unfortunately, Beijing shows no signs of changing its current policy and may actually cut the refund rate further in the future.

—*Daniel Martin*

Daniel Martin is manager of the Council's Investment Program.

FESCO Alternatives

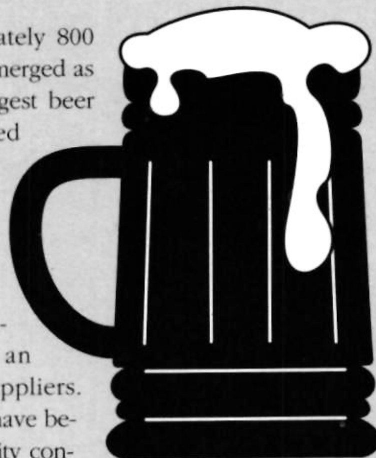
The Beijing municipal government formally appointed three companies—China International Enterprise Cooperative Corp., China International Intelletech Corp., and China International Talent Development Center—to staff foreign representative offices in Beijing, in addition to the Foreign Enterprise Service Company (FESCO). Previously, the Public Security Bureau recognized FESCO as the only legitimate source for foreign representative offices' Chinese personnel and refused to register Chinese personnel hired through other management-service companies.

The four entities offer personnel and consulting services to foreign companies with offices in Beijing. Each management-service company acts as the legal employer of the Chinese staff it hires out to foreign companies and provides a basic benefits package for most full-time permanent employees. China International Enterprise Cooperative Corp. and China International Intelletech Corp. also maintain offices in other cities.

—*MCV*

Brewing Up a Storm

Home to approximately 800 breweries, China has emerged as the world's second-largest beer market after the United States. Yet, despite prospects of 20 percent annual growth in total sales volume over the next five years, China's beer industry is faced with an overabundance of suppliers. Chinese beer drinkers have become increasingly quality conscious and many breweries—especially those established several years ago by city and county governments attempting to capitalize on the Chinese beer craze of the late 1980s—are now going out of business due to consumers' preference for a better-tasting brew.



Central authorities are also planning to modernize the industry with $30 million in subsidies and loans. By importing state-of-the-art equipment, Chinese officials hope to attract foreign investors to form beer joint ventures that will produce high-end products for export. Two German brewing conglomerates have already formed joint ventures with Chinese entities to produce export-quality beer to compete with Tsingtao, China's best-known liquid export.

—*TLK*

New Central Bank Leader

Dai Xianglong has replaced Executive Vice Premier Zhu Rongji as governor of the People's Bank of China (PBOC), the country's central bank. The June 30 announcement will likely mean that macroeconomic and monetary policies will be pursued separately, with Zhu retaining his responsibilities for State economic planning and Dai presiding over monetary policy.

Dai, a 50-year old native of Jiangsu Province, had served as PBOC vice-governor since 1993. Previous to joining the PBOC, Dai was general manager and vice chairman of the Bank of Communications in Shanghai and vice president of the Agricultural Bank of China. As PBOC governor, Dai inherits a two-year-old austerity campaign aimed at reducing speculative investment, excessive money supply growth, and inflation. Dai will face the challenge of relying more heavily on indirect monetary tools, such as interest rates, to manage economic growth.

Zhu assumed the top position at the PBOC two years ago in the midst of an overheated economy. During his tenure, Zhu attempted to change the bank from a politically driven institution into a more efficient central bank by eliminating the special currency for foreigners, introducing currency markets, and liberalizing the banking sector. Zhu's resistance to pleas from regional officials to ease credit restrictions that were part of the austerity campaign, however, gained him enemies along the way.

—KAS

SHORT TAKES

Hole in One

Shenzhen is set to host the forty-first World Cup of Golf in November at the Mission Hills Golf Club in Guangdong Province. Golf is fast gaining popularity in China. An estimated 50 golf courses—30 in Guangdong alone—are slated to be built by the year 2000.

Reaching Out

Since China had only 2.17 main telephone lines per 100 people in 1994, frequent callers in China are finding other ways to keep in touch. Reports suggest that the number of mobile phone subscribers in China will nearly double from 1.57 million in 1994 to more than 3 million in 1995. To accommodate the increase in mobile phone use, China's Ministry of Posts and Telecommunications has established an official operating protocol for mobile phone communication and is further testing transmissions and receiving equipment.

Bad News for Smokers

Increasing health care costs due to smoking-related medical problems have prompted Chinese medical associations to encourage the government to tax cigarette production. According to a report by the Chinese Academy of Preventative Medicine, roughly ¥27 billion is spent annually to cover medical expenses for smoking-related diseases and decreased worker productivity. The medical associations have suggested that the revenue from the cigarette tax be used to fund education campaigns and anti-smoking activities. China's smokers currently number approximately 350 million.

THE CHINA BUSINESS REVIEW

The magazine of the US-China Business Council

美中商贸评论

EDITOR
Vanessa Lide Whitcomb

ASSISTANT EDITORS
Tali Levine Kamis
Kirsten A. Sylvester
Maria Christina Valdecañas

BUSINESS MANAGER
Caitlin Stewart Harris

PRODUCTION MANAGER
Jon Howard

RESEARCH ASSISTANT
Alan R. Kahn

1818 N St., NW Suite 500
Washington, DC 20036-5559
Tel: 202/429-0340
Fax: 202/833-9027, 775-2476

PRINTED IN THE USA

The China Business Review welcomes articles from outside contributors. Manuscripts submitted for consideration should be sent to the editor at the address above. The China Business Forum retains all rights to articles and artwork published in *The China Business Review*. Articles or artwork published in *The China Business Review* may be reprinted or reproduced only with the written permission of the China Business Forum. Articles in *The CBR* do not reflect Forum policy, unless indicated.

The China Business Review, ISSN No. 0163-7169, is published bimonthly by the China Business Forum, 1818 N St., NW, Washington, DC, 20036-5559, USA (Tel: 202/429-0340), a nonprofit organization incorporated under the laws of Delaware. Second class postage paid at Washington, DC, and additional mailing offices. Postmaster, please send address changes to *The China Business Review*, 1818 N Street, NW, Suite 500, Washington, DC 20036-5559, USA.

© The China Business Forum, Inc., the educational and research arm of the US-China Business Council, 1995. All rights reserved.

ISSN No. 0163-7169; USPS No. 320-050

Annual subscription rates: $99 US/Canada; $150 international. Single copy issues: $20, airmail $25; issues over 1 yr: $10, airmail $12.50. DC residents add 5.75% sales tax.

All commercial inquiries and renewal/purchase orders should be sent to the above USA address.

ADVERTISING OFFICES

ASIA:
Godfrey Wu
1305, 13 Fl, CC Wu Building
302-308 Hennessy Rd.
Wanchai, Hong Kong
Tel: 852/2591-1077 Fax: 852/2572-5158

NORTH AMERICA:
Caitlin Stewart Harris
1818 N St., NW Suite 500
Washington, DC 20036-5559
Tel: 202/429-0340 Fax: 202/833-9027

Robert A. Kapp

Relationship Rebuilding

Tensions in US-China relations await cool-headed resolution in the fall

Greetings from Dog Days, DC. Washington lies becalmed under the tropical sun. Neighborhoods drowse. As an approaching hurricane slightly stirs the soggy air, sophisticated Washingtonians make their move—out of town. Congress has gone home. The President is on his way to the Rockies. Only sad-eyed newcomers like me and my family stay on, our summer vacation already concluded, reflecting on the old-timers' wisdom: leave town in August, not July.

China is off the front pages and gone from the nightly news. Only preparations for the upcoming UN Women's Conference in Beijing ripple the surface.

The mercury rises

It's been a summer of contrasts. In mid-July, the US-China Business Council was in high gear to defend China's Most Favored Nation (MFN) status from Congressional efforts to undo it. The string of incidents that brought severe tensions to US-China relations between May and July—the Lee Teng-hui visit, recall of China's ambassador, more rumors of Chinese proliferation of missiles and technologies for weapons of mass destruction, cancellation of important US-China negotiations, and the arrest of US citizen Harry Wu—put angry China issues on the desktops of US legislators just as they prepared to vote on the resolution of disapproval of President Clinton's renewal of MFN status for China. By the third week of July, key Council staff members were 100 percent engaged, mobilizing member companies, strategizing with allies in the business community, meeting with legislators and their staffs, writing updates and position papers, and making the case for restraint and sobriety to the media, in order to avert a major setback in US-China commercial and diplomatic relations.

The campaign ended with a curious anticlimax: the House of Representatives preserved MFN on July 20 with no vote at all. Instead, proponents of the resolution of disapproval agreed to take the legislation off the floor in return for the inclusion of a series of complaints against China's behavior in another piece of legislation, the China Policy Act of 1995. A wide-ranging statement of House dissatisfaction with China's demeanor authored by International Relations Asia-Pacific Subcommittee Chairman Doug Bereuter (R-NE), the China Policy Act passed the House almost unanimously. The bill lists the House's objections to China's behavior and calls on the President to use "intensified diplomatic initiatives" to persuade the Chinese government to mend its ways. The bill certainly won't endear Congress to the Chinese leadership, but the language could have been far worse—it could have called for much more interventionist measures, as in the

approval of conditional MFN status in 1993.

The Senate has yet to take action on the China front, and it isn't clear, during the August recess, whether it will do so in the fall. A companion bill to Bereuter's China Policy Act could emerge and take on some of the noxious provisions already in the hopper that are looking for a legislative home. In July, the Senate decided not to take up—for now—the State Department Authorization bill, which until now has been the vehicle for a series of inflammatory provisions aimed at China. We'll see in the autumn where the Senate goes on China legislation.

Meanwhile, the first signs of movement out of the US-China deep freeze are detectable. The meeting of the US secretary of state and the Chinese foreign minister in Brunei at least seems to have caused no additional damage. Meetings at the under secretary of state level, canceled by China after the United States announced its decision on Lee Teng-hui's visit, have been rescheduled. A couple of sizeable Sino-American business deals have apparently jelled in the midst of the diplomatic crisis.

The ties that bind

Are we out of the woods? I suspect the answer is "not yet." Harry Wu remains in jail—a lightning rod for US concerns, both principled and opportunistic. The PRC continues to flex its military muscle at Taiwan, testing missiles and conducting naval exercises close to the island. The possibility of untoward, media-driven misfortunes during the upcoming Women's Conference, complete with spillover into the political arena, is very real.

Ahead lies, I hope, a period of careful building down from the brink of serious confrontation. The glare of the world's media, when focused on US-China relations, not only illuminates; it also contributes to a kind of media fever—good for TV ratings but terrible for reasoned discourse between the two countries. What is needed now from both sides are incremental efforts to build and strengthen practical links. Business contacts are the key to this building process, but other forms of engagement—academic gatherings, cultural and arts programs, scientific and intellectual exchanges, and tourism—must again play their constructive roles, as they have since normalization of US-China relations in 1979.

> We operate in the context of a history that we ignore at the expense of our national and commercial interests.

A sudden, bold gesture will not restore the tattered fabric of US-China relations, and it is foolish to hope for such miraculous salvation. Both sides must avoid pushing each other's "hot buttons," and instead rebuild trust and cooperation through patient, multi-faceted efforts.

This won't be easy. The consistency of reports these days that many in China—leaders, intellectuals, and people in general—believe the United States is carrying out a campaign to contain and oppose China suggests that this conspiracy theory may have attained the status of a political "line" in Beijing. If it has achieved such status, then some influential Chinese figures probably now have a vested interest in propagating such a Devil Theory. The United States will not twist itself into knots to disabuse those who read US behavior toward China so darkly, no matter how misdirected that reading might be.

Moreover, neither efforts to soothe US policymakers nor campaigns of bluster can obscure the reality that the core issue in the recent US-China imbroglio—the PRC-Taiwan relationship—is beyond US control. Washington can make the triangular relationship dramatically worse, but Washington cannot dramatically improve it. For all its textual flimsiness, the One China policy espoused in 1972 and 1979 offered one key virtue: it bought time for the United States and the PRC during which the Communists and the Nationalists might resolve remaining issues of the Chinese civil war.

The existence of a US One China policy itself does not fix the PRC-Taiwan mess, but intentional or casual abandonment of the One China formulation seems certain to make things worse all around. What matters most is how the PRC and Taiwan deal with each other. Political changes in both Taiwan, where the first direct presidential election is set for March 1996, and the PRC, which is already passing through leadership changes of its own, could stimulate the two sides either to more realistic and peaceful resolution of their disputes, or to greater hostility. Either way, the United States should avoid becoming a card in somebody else's hand.

Bridging communication gaps

So we labor on, through the quiet August, awaiting September with hope and trepidation. The US business community has learned a number of important lessons in the past couple of months: namely, that we operate in the context of a history that we ignore at the expense of our national and commercial interests; that the realities of doing business with China need to be conveyed much more clearly to lawmakers; and that within corporations, close linkages between China-based operations and US-based policy personnel are vital.

The business community's concern that it will feel most painfully the effects of US-China political conflict is legitimate. A more positive way to view the difficulties of recent months, however, is that business may turn out to be the key avenue of recovery for the relationship. If, as I hope, the inflammatory rhetoric and gratuitously offensive gestures can be brought under control in both countries (admittedly a tall order), and the brick-by-brick reconstruction and enlargement of US-China relations can quietly proceed, I see a real chance that both countries will be eager for business relations to blossom and lead the way forward. This is hardly guaranteed, but neither is it a pipe dream. If and when the political environment permits business to break the trail, US companies should be ready to move decisively forward. 完

Countering China's Procurement Offsets

■ Robert F. Dodds, Jr.

The GATT provisions on procurement could help US companies—if China agrees to comply

■ Robert F. Dodds, Jr., a graduate of the Georgetown University Law Center and School of Foreign Service Master's Program, has lived and worked in China, most recently as a commercial assistant for the US consulate general in Chengdu. He is the author of several law review articles on Chinese government procurement practices and State enterprise reform.

The Chinese government is expected to spend over $1 trillion by the year 2000 on infrastructure improvements, including power plants, highways, and telecommunications projects. US firms hoping to participate in these projects may find it difficult to do so unless the US government puts more pressure on China to sign the Agreement on Government Procurement (the Agreement). But even if US officials succeed in convincing Beijing to sign, the Agreement's coverage limitations, special provisions for developing countries, and potential compliance difficulties will make it less than a full panacea.

While it has not attracted as much attention as other opportunities in China's rapidly growing economy, government procurement is clearly a lucrative sector. Foreign companies have been allowed to bid on some major projects, including the ongoing construction of the Three Gorges Dam and projects sponsored by the World Bank, Asian Development Bank, and other lending agencies that require international competitive bidding. However, a large percentage of government procurement is not accessible to foreign vendors. Moreover, when foreign companies do bid on government procurement contracts, they are often required to commit to "offset" the value of the contract through the purchase of Chinese goods, the use of local content, or other means. For example, informal studies by US embassy officials in Beijing have found offsets to be pervasive in hydropower and aircraft procurement.

Taking on offsets

Although the PRC could accede to the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO) without signing the Agreement, the United States has asked China to sign as part of its accession. The Agreement would force China to open more government contracts to foreign bidders and commit itself to the removal of offsets. While the GATT allows favoritism of local industry in government procurement by explicitly exempting government procurement contracts from the core GATT obligation of nondiscrimination against imported goods, the Agreement aims to fill this gap by requiring nondiscrimination in procurement. However, unlike most other GATT codes which will become mandatory for all WTO members, the Agreement will remain voluntary even after the WTO becomes fully operational in January 1997 (*see The CBR*, March-April 1995, p.16). Consequently, only countries that choose to sign the Agreement must comply with it.

The Agreement forbids offsets, defining them as "measures used to encourage local development or improve the balance-of-payments accounts by means

of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements." Offsets are defined broadly to prevent governments from converting an explicit offset program such as a local subcontracting requirement into hidden offsets such as project-specific agreements to develop local technology in return for procurement contracts.

The language of the Agreement prohibiting offsets is also broad. It states that government entities shall not "impose, seek, or consider offsets." By prohibiting governments from seeking or considering offsets, the Agreement forbids them from pressuring foreign companies into making concessions that are not required in the bidding documents and from favoring those companies that offer such concessions. Foreign companies may voluntarily structure their business plans to help the procuring country's balance of payments or local industry. Nonetheless, a government that rewards such voluntary acts in the bidding process is most likely violating the Agreement's prohibition against considering offsets.

The Agreement also requires that goods, services, and contractors of other parties to the Agreement be entitled to treatment "no less favorable than" that given to domestic or any other goods, services, and contractors. It mandates open and transparent procurement, including prompt publication of all procurement rules and regulations. It also obligates members to provide mechanisms for obtaining bid rejection explanations and for the hearing and review of complaints.

The Agreement currently has 12 signatories (including 23 countries, since the European Union has signed as one member) and 34 observers, including China, that have not signed the Agreement but may attend and participate in Agreement meetings even though they are not allowed to vote. The Agreement was expanded during the Uruguay Round, resulting in the opening to international bidding of an estimated $350 billion per year of government contracts.

The new Agreement replaces the current Agreement and is scheduled to go into effect early next year with 11 contracting parties. The new Agreement covers more procurement areas, including services and subcentral government procurement. Aruba, Australia, Liechtenstein, New Zealand, and Taiwan are all considering or have expressed interest in signing on to the new Agreement. The new Agreement allows only GATT/WTO members or acceding parties to sign the Agreement. Taiwan is expected to sign when it accedes to the GATT/WTO. Hong Kong, a member of the current Agreement, is scheduled to become a member of the new Agreement in 1997. If China were to become an Agreement member, it would join as a signatory to the new Agreement.

The Agreement was expanded during the Uruguay Round, resulting in the opening to international bidding of an estimated $350 billion per year of government contracts.

Some limitations

Although the Agreement strictly forbids offsets, it does not apply to all government contracts by parties. Only those government entities listed in a member's annex that the member has agreed to make subject to the Agreement are covered. During the negotiations over the new Agreement, parties attempted to expand the coverage of the Agreement as far as possible. Some significant areas of government procurement, however, remain uncovered. For example, because of the inability of the United States and the European Union to reach an agreement on the procurement of telecommunications equipment, this area is not covered by the Agreement and members have omitted the relevant procuring entities from their annexes.

In other areas such as services and subcentral government procurement, the parties were able to negotiate coverage, but only on the basis of strict reciprocity. Departing from Most Favored Nation (MFN) treatment, parties did not extend equally favorable treatment to all other members. When they found that the offers of other parties were not as complete as their own, they reduced their offers accordingly, on a one-to-one basis.

Another limit to the Agreement's coverage is that only those contracts above a minimum monetary value or threshold are subject to the Agreement. Thresholds vary slightly from country to country and range from approximately $85,000, or 130,000 Special Drawing Rights (SDRs—a basket of currencies used as an international unit of account) for central government supplies to roughly $3,263,000 (5,000,000 SDRs) for construction services.

The Agreement also provides some additional leeway for developing countries. Article V of the Agreement permits developing countries to negotiate "mutually acceptable exclusions from the rules on national treatment." Article XVI includes a narrow exception for offset use, allowing developing countries at the time of accession to the Agreement to negotiate conditions for the limited use of offsets. Offset requirements allowed under this exception may only be used for qualification to participate in the procurement process and not as criteria for awarding contracts. If China accedes to the GATT/WTO as a developing country and, upon signing the Agreement, successfully negotiates conditions for the use of offsets, foreign suppliers could see only partial relief from offsets.

China's use of offsets

While offsets adversely affect foreign firms, they enable China to pursue two of its most important policy goals: economic development and self-reliance. Local content and co-production requirements, for example, allow China to conserve foreign exchange, making it easier to pay for its many infrastructure and modernization needs. Offset requirements in sensitive industries such as telecommunications enable China to develop its own technical capabilities to

avoid dependence on foreign equipment and technology.

Offsets fall into two categories: direct and indirect. China seeks direct offsets—those related to the procurement order—in the form of local content, technology transfer, and co-production requirements. In 1993, Department of Commerce officials at the US embassy in Beijing reported a proliferation of direct offset requirements in hydropower procurement contracts.

Chinese officials also frequently insist on various indirect offsets—those not related to the procurement order—when granting procurement contracts to foreign firms. For example, to win aircraft sales contracts, foreign manufacturers are often required to buy certain amounts of unrelated Chinese goods. Likewise, in the procurement of digital switching equipment, China has insisted that AT&T and other foreign providers establish semiconductor joint ventures and research institutions in China.

A tough sell

In ongoing trade negotiations with China, the United States and other parties to the Agreement continue to request that China sign the Agreement as part of its accession to the GATT/WTO. However, China thus far has resisted signing the Agreement and other optional agreements formulated under GATT.

China's socialist market economy and huge decentralized procurement system pose a number of difficulties for its accession to the Agreement. The basic issue of what constitutes government procurement must be resolved for China to sign the Agreement. It is conceivable, though unrealistic, to expect that all Chinese State-owned enterprises should be subject to GATT government procurement standards. Only government entities are covered by the Agreement, while all other entities are covered by the different rules of the GATT general agreement. Agreement signatories will have to decide whether they want Chinese State-owned enterprises to be subject to the Agreement or to other GATT provisions on tariff and non-tariff barriers. China must decide how much coverage it is willing to offer—which government entities, which service contracts, and what minimum SDR thresholds. Existing signatories will then have to determine whether the Chinese offer is adequate enough to allow China to sign the Agreement.

China's socialist market economy and huge decentralized procurement system pose a number of difficulties for its accession to the Agreement.

Another issue to be resolved before China can sign the Agreement is its lack of a national procurement law. While some Chinese tendering companies, subsidiaries of State-owned trading companies that organize bidding for procurement contracts, have issued procurement regulations, China has yet to promulgate a national procurement law. It is unlikely that China would be able to accede to the Agreement without a comprehensive procurement law that would serve as a vehicle to implement its obligations under the Agreement. Even with a national procurement law, provincial and local authorities may be able to flaunt central directives on procurement as they have done in other areas. The decentralization of authority in China and the weakness of the Chinese legal system, therefore, raise concerns over China's potential compliance to the Agreement.

As the negotiations over China's membership in the Agreement are in their incipient stage, much progress remains to be made, particularly on the part of the hesitant Chinese, if China is to join. If China were indeed to comply with the US desire to see it sign the Agreement, the PRC would be required to open more government contracts to foreign bidders and to end offset practices. In such a scenario, China would probably want to negotiate conditions for the use of offsets, as permitted under the Article XVI developing country exception.

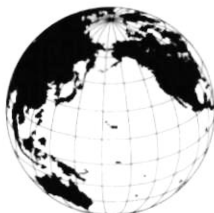
Excluding Israel, no current Agreement signatory has successfully negoti-

Helping Companies Succeed in China Since 1978

"We put years of experience and insight to work in planning, negotiation and implementation of specific projects and missions."

~ George P. Koo, Sc.D, MBA, Managing Director

Former: Vice President, Chase Pacific Trade Advisors
Managing Director, Bear Stearns China Trade Advisors



International Strategic Alliances, Inc.
1265 Montecito Avenue
Suite 109
Mountain View, CA 94043

Tel: 415-969-1671
Fax: 415-969-1673

ated offset-use provisions. Israel has an offset program that requires foreign vendors to subcontract to domestic firms a set percentage of their procurement contracts. Upon accession to the Agreement, Israel negotiated a timetable for the gradual reduction of those subcontracting requirements. Though lacking a formal offset program, China could probably negotiate similar offset provisions. Although it remains unclear whether the United States will support developing country status for China's GATT/WTO bid, the United States would probably be willing to negotiate special terms for the gradual reduction of China's offsets because, without special terms, the PRC would not likely be willing to join the Agreement.

If China signed the Agreement, US firms could gain access to tens of billions of dollars' worth of Chinese procurement contracts per year—the full amount would depend on the final terms of China's accession.

A win-win situation

Despite these unresolved issues, the Agreement is flexible enough to allow special consideration for China's transitional economy, and offers significant benefits to China, including increased access to foreign government procurement for Chinese exporters and the fulfillment of one US demand for the PRC's entry into the GATT/WTO.

In addition, a more open and competitive procurement system would enable the Chinese government to buy better quality goods and services at a lower price. A more effective and better managed procurement system would help reduce corruption, curb the formation of monopolies, and would generally force the government to be more accountable.

For the American business community, Chinese membership in the Agreement would increase access to one of China's most lucrative markets. While some US business leaders have lobbied the United States Trade Representative (USTR) and other US trade officials to pressure the Chinese to join the Agreement, these efforts have yet to produce tangible results. If China signed the Agreement, US firms could gain access to tens of billions of dollars' worth of Chinese procurement contracts per year—the full amount would depend on the final terms of China's accession. USTR sources, however, have noted that it is premature even to begin formulating such projections since present Agreement negotiations have not made significant progress and there are no indications that China will sign the Agreement in the near future. It may take some time for American companies faced with burdensome offset requirements to be able to breathe a long-awaited sigh of relief. 完

No matter what business you're in, D&B's new **Directory of Key Manufacturing Companies in P.R. China** can help you pinpoint your best prospects in China. You get the most authoritative information, in Chinese and English. Published by Dun & Bradstreet Information Services and China Statistics Consultants Ltd., this directory contains 17,000 manufacturing companies indexed by region, industry, company name and size, with 18 data elements including • Contact information • Line of business • Employee size • Sales, assets and profit ...and more, all for just $495. To order, or find out more, just call: **1-800-526-0651**.

Looking to expand your business into China?

Need new prospects or trading partners?

Special introductory offer. Order now and we'll send you free *D&B's Export Guide to China.* You'll learn how to trade efficiently with business in China using objective information compiled by D&B. This special offer expires December 31, 1995, so call and order your D&B directory now.

Dun & Bradstreet Information Services

D&B a company of The Dun & Bradstreet Corporation

Copyright 1995 Dun & Bradstreet, Inc.

FOCUS

Cracking the System

The ins and outs of China's distribution networks have been slow to improve

Stephen R. Frewen

With more than one fifth of the world's population and vast stretches of inhospitable terrain, China poses a complex distribution challenge for today's business managers. Estimates recently reported in the *South China Morning Post* suggest that poor transportation links in 1994 contributed to the loss of nearly ¥43.8 billion—approximately one percent of China's gross domestic product (GDP).

Beijing's unwillingness to allow substantial foreign involvement in wholesaling and distribution and the lack of an adequate transportation infrastructure means that foreign investors often find it difficult to move their goods from the factory to the consumer. Until more foreign involvement is allowed and until rail, road, and water transportation networks improve, distribution headaches will likely continue to plague China-based operations. In the meantime, however, greater cooperation among foreign manufacturers could lessen the obstacles to efficient distribution.

From here to there

Until the mid-1980s, when Beijing liberalized the country's State-controlled distribution companies, manufacturers—both Chinese and foreign—were assigned State-owned distributors and had little control over their products once the goods left the factory. Various options have since emerged, giving manufacturers more control over how their goods are transported and marketed (*see* p.14). Nevertheless, because modernization of China's infrastructure system lags behind other economic priorities, distribution throughout China is still difficult, and to a great degree limited to the country's eastern and coastal provinces. Although Beijing has pledged to improve the country's road and rail infrastructure, the growth of China's transportation network is not expected to catch up to actual needs for another 10-20 years.

In all three modes of available transportation—roads, railroads, and waterways—China's current infrastructure lags well behind international standards. Major problems face each mode:

■ **Roads** Present road networks, measured in km/person, rank China behind such developing countries as Argentina, Brazil, India, Mexico, and even the former Soviet Union. The country has only barely increased the number of roadways since 1950, although the volume of freight traffic accessing the roads has grown 250 fold over the same period. Although a number of north-south and east-west highways are slated for completion by the end of this century, financing and the government's commitment to follow through with these plans appears to be lacking.

Given China's shortage of financial resources and abundance of other development needs, some estimates suggest that China's roadways will increase only 2.5 percent annually during this decade. While an improvement, this compares to an estimated real GDP growth of more than 10 percent a year for the decade and is certain to result in even greater strains on the country's roadways.

■ **Railroads** Projected to grow only 3.5 percent a year for the rest of this decade, China's railway system suffers from similar

■ Stephen R. Frewen is managing director of Modecc Developments Limited, a Hong Kong-based firm. He has been involved in the distribution industry for more than 18 years.

problems. Although both countries have roughly the same land mass, China has only one fifth of the railways currently in place in the United States—roughly equivalent to the US railway infrastructure in 1860. Even India, with only one third the land area of China, has a larger rail network. Railroad bottlenecks cost an estimated $3.5 billion in direct sales and production losses per year, and China's current system does not extend into the areas where dependable transportation networks are needed most.

■ **Waterways** What it lacks in rail and road structures, China makes up for in a comprehensive array of inland and coastal water routes. But, because Beijing is reluctant to allow foreign involvement in waterway development or grant foreign companies shipping rights, China's waterways are also in need of development. Large amounts of foreign investment are required to upgrade the boats and harbors presently servicing the waterways. A few large Chinese consortia from Hong Kong are making some headway, however, and have been granted rights to manage inland ports and related transportation centers. Beijing will probably announce several other joint ventures in inland river transportation and port management within the next year.

Despite logistical and political problems, the distribution outlook in China is not entirely hopeless.

The right mix

Despite these types of logistical and political problems, the distribution outlook in China is not entirely hopeless. Though the optimal distribution method for any manufacturer in China depends on the goods to be distributed and the consumer market the manufacturer hopes to reach, Modecc's research suggests that a combined approach of coastal shipping and waterway development—using inland ports and flat-bottomed barge transportation services—presents the most efficient solution. The combination method would allow foreign manufacturers to transport consumer goods in bulk to major provincial capitals, employing ex-

Distribution through Cooperation

At a series of seminars hosted by Modecc in 1993, more than 35 foreign manufacturers expressed an interest in establishing a nationwide distribution network within China. Rather than establishing individual contracts with Chinese transportation companies, six of the manufacturers—including the American companies Colgate, Kraft General Foods, and Johnson & Johnson—decided to create the China Logistics Council to contract international distribution companies such as APL, Exel Logistics, and Federal Express Corp. to transport the group's goods to each company's respective market.

During its first five years, the council plans to explore options for physical transportation. The council's network will initially cover 20 major cities with plans to extend operations to 80 minor cities within its first two years. The network will extend from Shenyang in the north to Hainan Island in the south and Wuhan in the west. It will focus on distributing—but not marketing—the products of the six manufacturers to first- and second-level wholesalers. In the subsequent three years, the network will be extended further west to Chengdu, eventually involving a total of five regional distribution centers and numerous depots to cover the geographical spread. Later, the council may independently experiment with retail distribution in Beijing, Guangzhou, and Shanghai, with the goal of reaching 5,000-10,000 retail outlets per city. Whether the council is able to follow through on these plans will depend on developments in China's wholesaling laws over the next several years.

The council's main long-term goal will be to encourage the establishment of a number of joint-venture distribution networks involving the country's rail, road, and waterway systems. The group hopes to assist in standardizing such measures as pallet and container sizes, bridge heights, and railway gauge. It will use its resources to encourage all levels of government in China to invest in modernizing the country's infrastructure and related transport services and to support the distribution demands identified by council members. The council also seeks to be a starting point for foreign banks and capital and infrastructure investors to take on a larger role in developing the country's transportation infrastructure.

In addition, the council will lobby the central government on the distribution needs of leading foreign consumer manufacturers operating in China. These efforts will include discussions on wholesaling and transportation licenses, geographical coverage, and the need for China to upgrade all aspects of distribution. *—Stephen R. Frewen*

CONTACTS

For more information, interested parties should contact:

Stephen R. Frewen
Modecc Developments Limited
2003A-2004 Car Po
Commercial Building
18-20 Lyndhurst Terrace
Central
Hong Kong
Tel: 852/2851-4868
Fax: 852/2544-3223

From Factory to Consumer

After 17 years of economic reforms in China, almost all foreign-invested enterprises (FIEs) still confront obstacles to the seamless distribution of goods. Although Beijing has loosened control over distribution, regionalism and fragmentation caused by differences in the speed of development among regions continue to hinder nationwide distribution efforts. FIEs cope with these difficulties by developing various ways to get their goods into Chinese consumers' hands. Some rely completely on outside companies to handle all aspects of product distribution; others handle distribution concerns in-house. Since different goods and geographic locations demand different distribution approaches, the best method for a particular company depends upon the volume and type of goods sold and the enterprise's size, resources, and level of local involvement.

For China-based FIEs, there are a number of ways to get goods from factories to wholesalers, retailers, and Chinese consumers. Starting with the traditional approaches and progressing to more innovative systems, these include:

■ **State distribution companies** Historically, all goods, from rolled steel to baby food, were distributed through a national system tightly controlled by the central government. Two or three layers of distribution companies (national, regional, and local) often operated between manufacturers and consumers, in addition to a government-run import-export company if the goods were purchased from abroad. The distribution companies were organized by industry, each with its own State-controlled distributors; the manufacturer had no say in choosing a distributor for its products.

To encourage profitability and efficiency among State-owned distribution companies, Beijing relaxed control over the distribution firms during the mid-1980s. Private Chinese distributors emerged to compete with State-owned distribution companies. For most industries, manufacturers are no longer assigned a distributor, and if a particular distribution firm does not meet a manufacturer's expectations, the manufacturer is now usually free to choose other distribution channels. In many cases, manufacturers choose to stay with a State-owned distribution company if the State distributor is particularly effective in that industry.

In the past, when manufacturers relied solely on State-owned distribution companies, the manufacturer had little contact with the endusers of its product. The situation has improved somewhat as the manufacturer now has a much closer relationship with and obtains much more information from the State distributor. The manufacturer now contributes to downstream marketing, sales, and distribution decisions, and also advises the State-owned distribution company on installation and maintenance procedures. Although the increased contact is promising, the manufacturers' involvement in State-controlled marketing and distribution is minimal compared to some of the other distribution options available.

■ **Private Chinese distributors** Private distributors have filled the gap created by the liberalization of the country's distribution system and the growing number of foreign manufacturers servicing the China market. Frequently created from the remnants of disbanded State-controlled distribution networks, private distributors often draw on extensive existing networks of local contacts to obtain shelf space for the manufacturer's consumer products and to facilitate sales for industrial goods. Most private distributors have not had sufficient time to establish new contacts outside their regional or provincial areas, however, and foreign companies hoping to expand far from their factories must find distributors for each new region or province they enter. This means not only identifying potential Chinese distribution firms in the new area, but also vetting and training them.

Despite the limited servicing area, some foreign manufacturers prefer working with private distributors because of the greater level of control over the marketing of their goods. Product marketing and distribution have a great impact on a product's image—and thus, their potential for sale. Foreign manufacturers are therefore careful to discuss with private distributors how merchandise should be handled, what marketing materials and sales techniques should be used, and how the goods should be transported. Foreign manufacturers report that private Chinese distributors generally lack knowledge of product distribution in other countries, but are eager to learn.

■ **Distribution through a joint-venture partner** A popular option for joint-venture manufacturers is to distribute goods through the Chinese partner's existing distribution network. The joint venture agrees to set aside a specific amount of the joint-venture product to be bought by the Chinese partner for domestic sales. In theory, the joint venture is then no longer responsible for distribution and the goods belong solely to the Chinese partner. Foreign manufacturers often try to negotiate some control over the distribution of the joint-venture product to ensure that the product's image is being maintained. This tactic works particularly well for manufacturers of foodstuffs, where the Chinese partner frequently controls its own retail food outlets. The joint-venture product frequently complements the local partner's existing line, but because the joint-venture product is usually more expensive than the Chinese partner's product, the two goods are not in direct competition.

■ **Joint-venture distribution department** Rather than distribute through its Chinese partner, some joint ventures have created a separate distribution department within the venture itself. This allows the foreign partner greater control over the joint-venture product's marketing, distribution, installation, and, ultimately, image. Foreign companies are not legally allowed to act as direct distributors in China. While a joint venture can distribute its own products, it cannot distribute goods manufactured by the foreign partner outside of China.

The main disadvantage to distribution through a joint venture is the large amount of time needed to train the Chinese staff in marketing, sales, distribution, and servicing. FIEs that produce goods such as equipment and machin-

ery that have demanding installation and maintenance requirements frequently manage distribution through their joint ventures. The greater control over the correct usage of the equipment that this method affords helps protect the product's reputation.

Because industrial goods manufacturers have a more limited client base, they are better able to manage distribution in-house. Given the nature of their product, they generally have fewer customers and are able to devote more time to individual customer needs. Nevertheless, some rely on local distributors in different parts of the country to service clients. High-technology firms such as China-Schindler Elevator Co. and Hewlett-Packard Co. also use their joint-venture marketing and distribution personnel for a portion of their mainland sales.

Consumer goods manufacturers also frequently manage some of their distribution through the joint venture to maintain client contact and feedback. Because distributing all of their products through an in-house distribution department would be costly, however, most consumer goods manufacturers continue to rely on outside companies for distribution of the majority of their goods.

■ **International distribution companies** Foreign manufacturers with little China experience can turn to international distributors for complete distribution and after-sales service within the country. The manufacturer sells its goods to the international distributor who, in turn, provides marketing, sales, and distribution services. The international distributor also oversees the product's installation and monitors retail product displays. International distributors usually negotiate directly with Chinese companies to provide physical distribution.

In overseeing the process, however, these international companies are subject to certain regulations. Because the Chinese government considers distribution vital to the national economy, it has been reluctant to allow foreign participation in direct distribution services. International distributing companies can only fulfill contracts signed outside China by their parent companies or contracts signed on behalf of the parent in China through their representative offices.

International distributors' fees tend to be high given the third party involved and the product training they must provide to their employees for technical goods. Many companies find the cost of employing international distributing companies prohibitive and use this method only as an initial entry strategy.

■ **Direct marketing and distribution** One of the most recently developed means of selling products in China is direct marketing—a process by which the manufacturer contacts individual consumers directly. This method has tremendous implications for distribution, as it permits a company to distribute widely without the cost of employing a third party. The labor costs to the company are low because of the lower wages paid in China. Products requiring consumer education are well suited to direct marketing because of the one-on-one nature of the contact.

Avon Products Inc. runs the best-known direct marketing operation in China, and many copycat companies are emerging. Avon first focused on Guangdong, investing considerable time and effort in training its sales force, and recently expanded to the greater Shanghai market. Unlike direct marketing operations in other countries in which the company delivers its products through the mail, Avon must arrange physical distribution of its products within China via a fleet of company-owned trucks.

■ **Special marketing efforts** Although not yet widely used by American FIEs, retailers from other countries have attempted to develop a presence in China by renting space in department stores. For example, the Hong Kong Trade Development Council encourages sales of consumer goods manufactured by Hong Kong-invested companies in China through "Hong Kong Showcases"—rotating displays in major department stores throughout the country. Each stop on the circuit can last from two months to two years. The council leases special counter space within the participating department stores, but the manufacturer is responsible for getting the goods to the display site.

Other consumer products manufacturers have adapted similar strategies by taking advantage of specialized boutiques within China's largest private and State-run department stores. The manufacturer provides display cases, and the boutiques offer sales assistance if the manufacturer desires. The manufacturer compensates the host store on a commission basis and is directly involved in managing its product's presentation. Many consumer product manufacturers, particularly clothes, shoes, and cosmetics companies, are experimenting with this strategy, but the number of department stores offering this option remains small.

Although neither method is a permanent solution to shelf access, each can greatly increase product exposure—especially for firms with limited resources. Both methods work well as a point of entry for smaller companies wanting to test market response to their products in several different regions.

■ **Creating one's own system** A final option open to FIEs with substantial manufacturing investments in China is creating an individual distribution system to reach customers by opening sales offices in all test markets to handle marketing, sales, and physical distribution issues. This approach is much more comprehensive than merely establishing a distribution department within a joint venture and entails more logistical problems and expenses. FIEs must be willing to devote a large amount of energy to cultivate the human resources needed to open a network of this scale. Finding Chinese individuals to staff new offices who speak the right dialect, are willing to relocate, and have some connections in a specific location is especially difficult in China. Multinational personal care product companies and foreign brewing companies often spend thousands of hours recruiting staff for each new regional sales office. One senior foreign manager of a pharmaceutical joint venture reported spending over 1,000 hours interviewing prospective Chinese staff for marketing and distribution responsibilities in 1994 alone.

—Jane Greaves

Jane Greaves is director, Asian trade, for Intercedent Limited, a Toronto-based international marketing andconsulting firm.

isting and planned roads and railroads to transport the products the rest of the way. This method would reach more than 90 percent of China's population—and more than 77 percent of China's current GDP. With sailing transit times of approximately three and one-half days from Hong Kong to Shanghai or six and one-half days from Hong Kong to Dalian, the combination method would also provide foreign exporters with a realistic alternative to total reliance on China's rail and road system.

Before such a system can be put in place, however, the PRC must remove licensing restrictions on wholesaling and retailing activities by foreign entities. The Chinese retail laws still prohibit foreigners from entering wholesaling activities, although recent press reports suggest that the Ministry of Internal Trade will gradually loosen the restrictions. Traditionally, Beijing has tended to grant approvals to foreign investment projects that bring large amounts of capital into the country. Wholesaling ventures which bring little or no capital into the country will likely remain the responsibility of local Chinese companies until such attitudes change.

Foreign assistance in infrastructure planning and developing logistics companies will no doubt be welcomed by manufacturers based in China.

In practice, large firms such as The Procter & Gamble Co., Philips Electronics NV, and Unilever PLC have tried to circumvent the retail law by "shadow managing" the more efficient Chinese wholesalers across the country. The foreign companies work closely with the wholesalers, providing training, marketing, sales, and management support in exchange for physical distribution services. However, by merely propping up China's outmoded wholesale structures, the foreign manufacturers do nothing to rectify the system's shortcomings, and the inherent weaknesses of China's physical distribution system remain.

Opportunities for foreigners

Historically, the major distribution companies in China—and throughout Asia—have consisted of relatively old-fashioned trading companies known for providing all-inclusive marketing, sales, and distribution functions, but few companies specializing only in physical distribution. With the exception of Inchcape and, more recently, the East Asiatic Co., trading groups have generally also neglected to invest in capital improvements, management expertise, or resources to build professional physical distribution chains. Foreign assistance in infrastructure planning and developing logistics companies that can oversee nationwide physical distribution networks will no doubt be welcomed and should help emerging Chinese transport companies. Such ventures are currently allowed under Chinese laws, in contrast to wholesale ventures.

During the early stages of operation, indigenous Chinese transport companies will rely mainly on trucking capacity, but should be able to provide warehouse facilities and limited computerization of their operations within three years of start-up. Nevertheless, because many existing Chinese transport companies are inexperienced, undercapitalized, or over-staffed, transferring physical distribution operations to actual distribution chains will likely require forming joint ventures with international firms. Only international transport logistics companies have the necessary skills in network modeling, information technology resources, and experience in coordinating the activities of different transport companies to form distribution logistics chains. Only the largest and most efficient international transport logistics companies have the experience in supply chain management necessary to service the vast China market and tackle its inadequate transportation infrastructure.

Until such distribution chains are established, some foreign companies are

IN THE LAIR OF THE DRAGON:
Mastering the Chinese Negotiation Maze

An Interactive Negotiation Simulation Program
with Certificate of Completion from Fletcher School of Law & Diplomacy

November 7 ~ 9, 1995
Boston, MA

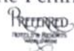
Sponsored by:
Fletcher School of Law & Diplomacy, Tufts University
Price Waterhouse LLP • Goodwin, Procter & Hoar
Intercultural Training Resources, Inc. • Greater China Business Network

To receive a free brochure, please call the Greater China Business Network at
(800) 42-CHINA or (617) 570-8178

THE
DETAILS
MAKE
A
PENINSULA.

王府飯店
THE PALACE HOTEL
Beijing
Managed by THE PENINSULA GROUP

8 Goldfish Lane, Wangfujing, Beijing 100006, P.R.C. Tel: (86-10) 512 8899 Fax: (86-10) 512 9050
The Peninsula: Hong Kong • Manila • New York • Beverly Hills • The Palace Hotel Beijing • The Kowloon Hotel Hong Kong


Tollfree: (800) 323 7500 one of The Leading Hotels of the World Tollfree: (800) 223 6800 UTELL Tollfree: (800) 44 UTELL

attempting to formulate short-term solutions. For example, given the present lack of experienced logistics groups, six major manufacturing firms based in China recently agreed to pool their combined product volumes and contract international distribution companies to handle their transport needs (*see* p.13).

Staking a claim

Once a foundation for the distribution networks is in place, and some of the major problems involving the country's transportation infrastructure are solved, individual distributors will inevitably move to stake their claims in the country's distribution business. Due to the geographical challenges of distribution within China, distribution logistics companies will have to specialize in certain areas or product lines to make the system more manageable. Distribution contracts between foreign manufacturers and international logistics groups will probably be awarded on a mainly regional or provincial basis, with most focusing on developing strong resources in management and tracking software.

> If Beijing allows greater foreign involvement in both wholesaling and shipping, problems of accessing the country's railroads, roads, and waterways will likely be alleviated.

Competition among local transport companies for contracts with China-based FIEs is likely to prove healthy for the upcoming generation of joint-venture logistics groups. Few foreign-invested logistics groups would be willing to tackle a distribution network of up to 350 cities, but with competent and competitively priced transport services, many may be willing to establish logistics networks within a single region. The result of such specialization would be three or four foreign-invested logistics companies providing nationwide networking capabilities, while most Chinese distributors and wholesalers continue to focus their transport and marketing efforts around larger cities such as Beijing, Guangzhou, and Shanghai.

A brighter future

In the final analysis, the range of options for distribution within China and the competition arising from regional fragmentation of the distribution market will result in practical short-term solutions. If Beijing takes decisive action to allow greater foreign involvement in both wholesaling and shipping, problems of accessing the country's railroads, roads, and waterways will likely be alleviated. The first ventures open to foreign involvement will likely be concentrated in management organizations controlling a vast range of trucking and warehouse subcontractors. But as Beijing begins to perceive the benefits of encouraging joint ventures in physical distribution, initiatives involving different types of transportation and integrated supply chain packages will start to emerge.

In planning a distribution strategy for China, logistics managers and international transport companies must be careful to tailor their programs to the China market and the country's terrain. Until China's transportation infrastructure is modernized to meet current demand, distribution—with or without competent distribution chains and logistics companies to manage them—will be a difficult endeavor. Moreover, sophisticated solutions transplanted from Europe or the United States which do not tackle the special demands of an antiquated transportation infrastructure, deteriorating urban traffic conditions, or the sensitivity of PRC officials to allowing foreign cooperation in this sector will likely fail to produce the intended results. Only by working with Chinese officials in developing both a physical and managerial framework for extensive distribution, cooperating with local transportation and distribution companies, and pooling resources with other FIEs can foreign managers be assured of faster and more efficient distribution of their goods. 完

China Market Access Tool
on CD-ROM

China Market Access Tool (CMAT) provides comprehensive information assistance to your business with China:

- multimedia profiles on 30,000+ accredited companies in 40 major industries in China, including industrial outlooks, full-color pictures and analytical charts;
- information on all special development zones and open cities;
- major associations, research and education institutions, electronic and paper media for advertising, recreational and cultural spots;
- opportunities for joint ventures, foreign investment;
- laws and regulations on foreign trade, investment
- and taxation; and more ...

For detailed information, contact:
Pacific Business Technology Corp.

37053 Cherry Street, Suite 115, Newark, CA 94560
Tel: (510) 796-2584 Fax: (510) 796-2574
or visit our Web Site: *http://www.pbtco.com/*

In Search of the Chinese Consumer

■ Dong Li and Alec M. Gallup

A national survey sizes up Chinese buying patterns

In an attempt to discover who the average Chinese consumer is—or if such a being even exists—interviewers for Gallup China Ltd. set out in mid-1994 on bicycles, trains, and even camels to conduct the first national consumer survey by a foreign research company in China. Based on a sample of 3,400 people representing the entire adult population in China between the ages of 18-60, excluding the Tibet Autonomous Region, the survey asked 60 questions in personal interviews conducted in people's homes. What Gallup uncovered is a consumer who is generally pragmatic, price and quality conscious, a careful planner, and patriotic.

To take greater account of the significant economic development in China's urban areas, statistical weighting methods were used to facilitate analysis along national, urban, and rural lines. Responses were validated through follow-up measures to confirm that the people selected for the survey were representative of the population at large. The survey provided insights into national norms as well as urban, rural, and generational consumption patterns and preferences.

Likes and dislikes

Though commonalities exist among China's vast stretches of consumers, the survey reveals significant differences in attitudes between people in rural and urban areas. The vast majority of respondents stated that purchases of "big ticket items" (*da jian*) are planned rather than impulsive, and almost half stated that they browsed advertisements before making such purchases. The urban consumer, however, is more likely than the rural consumer to study advertisements before purchasing a big ticket item. Among a "selected cities" cohort consisting of respondents in Beijing, Chengdu, Guangzhou, Nanjing, Shanghai, Shenyang, Tianjin, Wuhan, and Xian, more than 60 percent said they first study advertisements before purchasing consumer durables such as refrigerators, air conditioners, and rice cookers. Respondents were evenly divided between those who decide on product purchases before visiting stores and those who visit two or three stores and then select a product to purchase.

Most Chinese consumers, especially those in urban areas (78 percent), prefer to pay more for high-quality, durable products than make repeated purchases of cheaper, less durable products. Thirty-eight percent of all respondents (52 percent of urban respondents) state that they would pay higher prices for high-quality products rather than buy inexpensive products, regardless of quality. Interestingly, the survey reveals that over half of those questioned buy big ticket items according to current trends rather than go against convention.

■ Dong Li received his Ph.D. in Political Science from Columbia University and is the executive assistant to the president and the international project director of Gallup China Ltd. Alec M. Gallup is co-chairman of The Gallup Organization and a board member of Gallup China Ltd.

The survey reveals sharp differences between rural and urban attitudes about foreign products. Overall, Chinese consumers prefer to buy domestically manufactured products rather than comparable foreign-made goods. Respondents in the selected cities group, however, are less likely to favor domestic products than are consumers nationally. Only in Guangzhou did more consumers prefer foreign products to domestically made goods.

Brand names seem to play only a minor role in the purchasing decisions of the average Chinese consumer—only 30 percent of respondents state that they would buy leading brands regardless of price, though among urban respondents the statistic rises to 41 percent. In general, Chinese consumers do not look for products with numerous added features—the average Chinese consumer prefers to buy inexpensive products with limited features (44 percent) over top-rated products with many features (29 percent). Finally, based on the survey results, most of China's consumers prefer to shop at stores they trust as opposed to stores with the lowest prices.

The typical Chinese home

In addition to querying consumer likes and dislikes, the survey sought to size up present living standards in China. It found

With the exception of VCRs and video cameras, respondents expressed a preference for domestically made products.

that the average Chinese household consists of four people. Nationwide, 81 percent of households surveyed own at least one bicycle, roughly 60 percent have electric fans and radios, 54 percent own black and white televisions, and 40 percent have color televisions. Over one third of the households have electric rice cookers but only 9 percent own telephones.

Rates of consumer durable ownership are considerably higher in the country's three largest cities—Beijing, Guangzhou, and Shanghai. Ninety-four percent of the households in these three cities own color televisions, 90 percent have refrigerators and bicycles, 88 percent possess clothes washing machines, 65 percent have electric hair dryers, and 58 percent have rice cookers. Roughly half of all households in these three cities have electric steam irons and video cassette recorders (VCRs), and one third have telephones, stereo systems, or gas water heaters. Less than a fifth of respondents in Beijing, Guangzhou, and Shanghai own air conditioners and only 2 percent own automobiles.

In addition to quizzing respondents on the items they presently own, interviewers also inquired about short-term purchasing intentions. Nationally, the big ticket items on Chinese consumers' wish lists for the coming two years include color televisions (32 percent), washing machines (22 percent), refrigerators (21 percent), tape recorders (19 percent), VCRs (16 percent), electric fans (15 percent), and stereo systems (15 percent). Big ticket purchase plans also include air conditioners (12 percent), telephones (11 percent), video cameras (6 percent), automobiles (4 percent), and computers (4 percent).

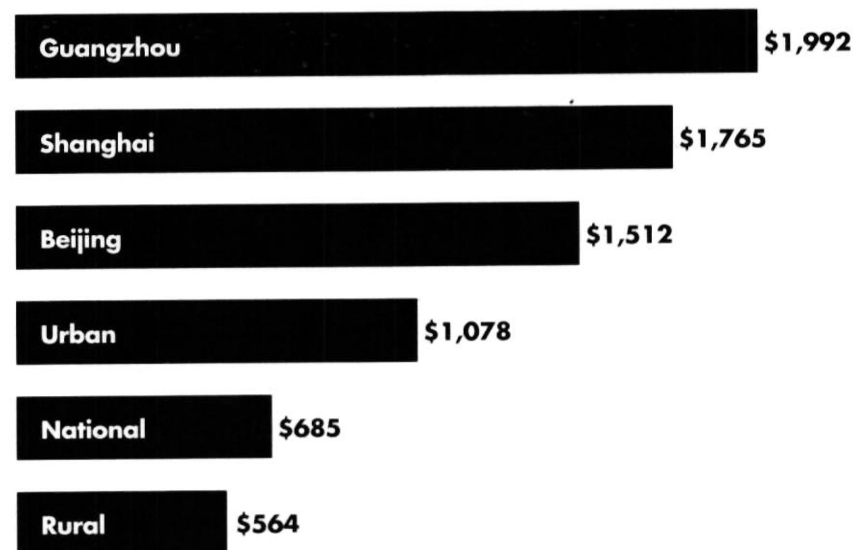
With the exception of VCRs and video cameras, respondents expressed a preference for domestically made products. As more Chinese-made consumer durables are manufactured using advanced production techniques, the Chinese population seems to perceive the quality of domestic goods to be comparable to, and the price lower than, that of imported goods.

Household names

For much of modern Chinese history, a strict isolationist policy kept foreign goods and trends out of reach of the average Chinese person. With the door now swung open to international trade, the survey sought to assess the extent of foreign commercial penetration in the PRC. Names of 98 companies and brands of consumer goods (44 American, 25 Japanese, 22 European, and 7 from other countries) were presented to interviewees. The results indicate that the "Hitachi" moniker is most widely recognized by those surveyed, with a recognition rate of 65 percent. "Coca Cola" and "Panasonic" follow closely, with 62 percent and 60 percent recognition respectively. Six of the 10 most widely recognized names are Japanese and only three ("Coca Cola," "Mickey Mouse," and "Marlboro") are American. "Nestle," the most widely recognized European name, ranked 16 out of 98 (40 percent recognition), and "Mercedes Benz" ranked 18 (39 percent).

Recognition of foreign brand names appears to be highest in China's urban

Figure 1
Mean Annual Household Income by Area, 1994



NOTE: ¥8.7 = $1
SOURCE: The Gallup Organization

areas, especially in the selected cities cohort. "Coca Cola," for example, registers 62 percent national recognition but 83 percent in urban areas and 94 percent in the selected cities. "Pepsi Cola" rises from 42 percent nationally to 69 percent in urban areas and 85 percent in the selected cities. Brand recognition also correlates with education and affluence. Recognition of "Coca Cola" is 43 percent among consumers who have an elementary education, 66 percent among those with a junior high school education and 81 percent among college graduates. With respect to income, recognition of the "Pepsi Cola" name is 23 percent among consumers whose annual household income is less than $350, 45 percent among consumers whose annual household income is $350-$799, and 71 percent among the consumers surveyed whose annual household income is greater than $799.

Wide name recognition may be related to several cultural subtleties, such as how the product name is translated into Chinese. "Coca Cola," with high name recognition, is rendered in Chinese to mean "taste good and taste happy" (*kekou kele*). Advertising also may factor into a product's recognition—wide recognition of "Nestle" may be related to the television advertisement slogan coined in the early 1980s for Nestle coffee—"*Weidao haojile!*" or "The taste is excellent!"—that gained widespread popularity.

Six of the 10 product and company names most widely recognized by respondents are Japanese and only 3 are American.

The emerging elite

The survey reveals that Chinese consumers may not be wealthy as individuals but, in the aggregate, China possesses enormous buying power. The national annual consumer income based on our data is about $206 billion. The aggregate household savings based on our data, including bank and non-bank savings, is about $240 billion. The difference between the combined total of household income and household savings—$446 billion—and the value of retail consumer products sold in 1993—$141 billion—leaves much room for growth in consumer spending.

The survey also reveals, however, growing income disparities between a small group of *nouveau riche* and the majority of the population. The mean annual pre-tax household income is ¥5,963 ($685), but half of Chinese households have annual incomes lower than ¥4,500 ($517). Not surprisingly, urban families are more affluent than rural families in terms of annual household income (*see* Figure 1).

While the emergence of a wealthy elite would have been unthinkable just 20 years ago, 4 out of 1,000 Chinese households (about 4.8 million people) now have annual household incomes exceeding ¥50,000 ($5,747). At the other end of the spectrum, our data show that 14 percent of Chinese families fall below ¥1,800 ($207) annual income, which is roughly the level below which individuals can file for government assistance in Shanghai, Fuzhou, and Dalian.

China's income levels also divide along occupational lines (*see* Figure 2). Businesspeople and owners of private enterprises have the highest average annual personal income among all occupations (¥5,053), followed by cadres (leading members at all levels in government departments, State enterprises, institutions, and Party organizations) (¥4,406), professionals (including clerks and employees in the service industries) (¥3,763), factory workers (¥3,652), and agricultural workers (including those in agriculture, forestry, animal husbandry, and the fishing industry) (¥1,852).

Within the categories of private businesspeople and farmers, wide income variations exist, in contrast to the incomes of cadres and workers. The standard deviation of personal income of businesspeople surveyed is ¥4,661, compared to ¥3,109 for cadres and ¥2,675 for factory workers. As the reforms cut deeper into China's State enterprises, however, increasing income differences undoubtedly will emerge among State cadres and factory workers as well.

The family budget

The make-up of a typical Chinese family's budget looks quite different than the average American family's outlays. Over a third of a Chinese family's budget is spent on food (*see* Figure 3). People in urban areas budget the most of any pop-

Figure 2
Mean Annual Personal Income by Occupation, 1994

NOTE: ¥8.7 = $1
SOURCE: The Gallup Organization

ulation group to food expenses. Urbanites allocate 37 percent to food purchases, compared to the national norm of 33 percent and the rural rate of 30 percent. In Beijing, Guangzhou, and Shanghai, the proportion spent on food is even higher—40 percent, 42 percent, and 41 percent respectively.

Savings are second to food in the Chinese family's budget. The typical family puts away 29 percent of total household income for a rainy day. To many Chinese, however, saving means simply spending at a later date. In order of decreasing priority, Chinese households mark savings for children's education, family sickness or injury, purchase of a new home or remodeling an existing home, purchases of home electronic items and other durable consumer goods, children's wedding expenses, living expenses for retirement, financing for a business, and travel and entertainment.

To measure Chinese spending propensity in another fashion, interviewers asked about ways in which a person would spend a large windfall. Of the 16 categories for allocation of funds presented to interviewees, the top 6 were housing, family savings, purchase of home electronic items or consumer durables, purchase of everyday household products, and purchase of interior decorations. Overseas travel ranked fourteenth, while stock investments ranked last.

> Nationwide, 92 percent of those surveyed said they had watched television at least once before and 80 percent had watched television the previous day.

Media aficionados

Marketing specialists may be glad to learn that mass media (newspapers, magazines, television, and radio) has a wide audience in China. Overall, the survey reveals that those most likely to be reached through mass media tend to be educated, male, aged 18-29, and with incomes higher than the national average.

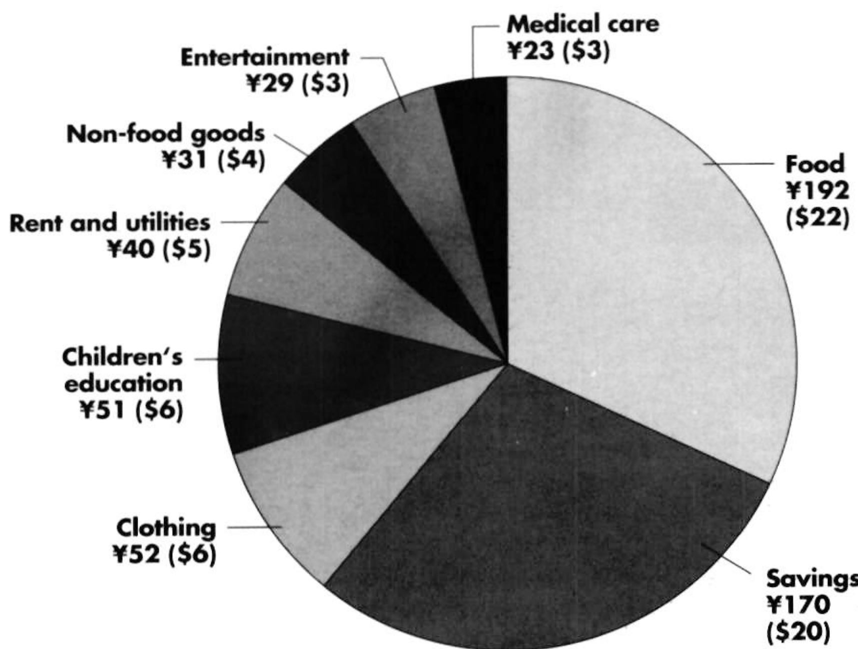
Television viewing in China is surprisingly high. Nationwide, 92 percent said they had watched television at least once before and 80 percent had watched television the previous day. Even more of the urban population surveyed (86 percent) reported they had watched television the previous day. Roughly half of both rural and urban residents reported having listened to the radio on the previous day.

With regard to print media, Chinese men are more likely than women to read newspapers—43 percent of men said that they had read newspapers "yesterday," compared to 34 percent of the women surveyed. Young people are more likely to read magazines than are older Chinese. Roughly half of those aged 18-29 had read a magazine on the day prior to being questioned, compared to roughly a third of respondents in the 30-39 and 40-60 age groups. There were no substantial differences among age groups in the incidence of reading newspapers, although urban residents are much more likely than rural residents to have read a newspaper the previous day—74 percent compared to 37 percent. For prior-day magazine reading, urban and rural response rates were 54 percent and 34 percent respectively.

Knowing your market

While every foreign company wants to learn what will sell in China and what won't, finding this type of information has never been easy. Until the mid-1980s, market research did not even exist in China. Economic information gathered by the State Statistical Bureau and other State agencies is generally reserved for government decisionmakers. Gallup's survey provides a methodologically sound glimpse of China's national consumption patterns in a format familiar to international firms. The importance of a good translation of a product's name into Chinese and the high rate of television viewing are just two morsels of information provided by the survey that foreign companies can consider as they plan their China marketing strategies. Though the study reveals that the average Zhou is not rushing out to buy expensive name brands, the typical Chinese consumer is perhaps only waiting until his or her cash flow picks up speed—nationwide, 68 percent of those surveyed identified with a personal philosophy of "work hard and get rich." 完

Figure 3
Average Monthly Household Budget, 1994



NOTE: ¥8.7 = $1
SOURCE: The Gallup Organization

Tapping the Retail Market in China

■ Alexa C. Lam

Retail chain stores may provide foreign retailers the link to China's consumers, but beginning operations is no easy task

■ **Alexa C. Lam is a partner in the Hong Kong law firm of Kao, Lee & Yip, specializing in China's retail, corporate, commercial, banking, and infrastructure sectors.**

Despite the publicity surrounding the new-found spending power of China's 1.2 billion people, foreign retailers have discovered that the immense mainland population does not translate easily into a heady stream of customers. The euphoria of 1992 brought on by Deng Xiaoping's call for accelerated economic reforms grudgingly subsided after the central leadership began an austerity drive in the second half of 1993. The tightening had a direct impact on retail sales, resulting in a negative real growth rate for China's retail market during the first half of 1994.

Although sales rebounded somewhat in 1995, many foreign-invested retail businesses suffer from sluggish sales, escalating overhead costs, an inefficient local workforce, and the omnipotent Chinese bureaucracy. After the first rush of curious visitors, most foreign-invested retail enterprises quickly settle down to the routine of watching people come and go, sometimes logging only a few sales a week. If properly structured and blessed with the necessary government assistance, however, a foreign retail operation can probably find—or create—its own niche. By structuring operations to minimize costs and training sales personnel to provide friendly service, foreign retailers should be able to attract more customers and slowly build profit margins.

A cool retail climate

Most foreign investors confront numerous obstacles on the long road to the China market, but for foreign retailers the problems are multiplied. Since Beijing does not value retail ventures as highly as construction or other industrial ventures deemed necessary to fulfill China's development needs, the PRC has been reluctant to grant approvals for individual retail activities and has limited the scope of foreign retail activities in China.

Under the Retail Rules promulgated by the State Council in 1993, the State Council and the Ministry of Internal Trade (MIT, the organization that oversees all retail operations in China) strictly control the procedure for establishing a retail foreign-invested enterprise (FIE) in China. The rules merely set forth policy statements listing conditions to be satisfied before PRC authorities will consider an application for a retail license, but do not set guidelines for gaining approval (*see The CBR*, January-February 1994, p.22). Because retail joint ventures are likely to be difficult to set up, many foreign companies rely on other means to get their goods to the Chinese consumer (*see* p.22).

To obtain approval, a prospective foreign retail investor must submit a project proposal and feasibility study to the State Council. The State Council will then discuss the application with MIT

Other Inroads

Because of the many restrictions placed on retail operations in China, approval from the State Council is a valuable asset for foreign-invested enterprises (FIEs) wanting to sell their goods in China. Few approvals have been granted since the promulgation of the State Council Retail Rules in 1993, however, and some foreign retail firms have sought alternative means to reach the Chinese consumer. Though these methods do not afford the foreign retailer the luxury of directly importing foreign goods, they do allow the foreign investor a point of entry into the China market. Non-State Council-approved options include:

■ **Locally approved retail ventures** These enterprises are often joint ventures, approved by local government authorities in the same manner as other FIEs with a total investment of less than $30 million. Foreign-invested department stores such as Shanghai's Wing On, Shui Hing, Sincere, Maison Mode, and Isetan, and Pacific Concord in Beijing operate on a local approval basis.

Because they do not have State Council approval, they are not restricted to the 11 areas prescribed by the Retail Rules, but such ventures usually lack direct import or export rights and are only allowed to operate at a given site. Many locally approved retail joint ventures also do not have retail licenses from the Ministry of Internal Trade (MIT) and must rely on the Chinese partner's license. The Chinese partner to the venture often contributes land use rights as its in-kind contribution to the joint venture. In some cases, the Chinese partner merely acts as a rental agent, receiving a guaranteed payment in exchange for land and license use.

■ **Renting "counters"** Using this option, the foreign retailer enters a distribution or consignment agreement with a State-owned or Sino-foreign joint-venture department store. Effectively, the foreign retailer supplies goods to the department store, which displays and sells the goods at designated counters or booths within the store. The salespeople manning the counters are employees of the department store, but may be asked to wear uniforms designed by the foreign retailer. The department store receives a commission on each sale, but the retailer has no lessee or tenant rights.

While this option allows foreign retailers to participate in the Chinese retail market without incurring substantial initial outlays, it does not grant the foreign retailer much control over the presentation or sale of its goods. In addition, the renter has very little security or comfort in the event the department store goes bankrupt or fails to hand over the sales proceeds.

■ **Management subcontracting** Private and State-owned Chinese retail businesses with weak sales are permitted to subcontract the management and operations of their retail business to other retailers, including foreign companies, who have established a reputation in the China retail field. If the Chinese business contracts management of its operations to a secondary retailer, the store typically takes on the name of the secondary retailer. The subcontractor controls management decisions and generally receives a substantial share of the profits. This is usually only a short-term option; the second party has nothing more than contracting rights and can be relieved of its duties in accordance with the contract terms.

■ **Joint-venture retail arms** FIEs that are already manufacturing goods in the PRC can avoid the hassle of getting approval for retail projects by instead setting up retail outlets geared specifically at selling the FIE's products. Permission for such ventures is usually easily obtained from the venture's original approval authorities. A few well-known clothiers, including Crocodile and Giordano, have set up retail branches in this manner. Because these outlets source directly from their own factories, they reduce their operating costs and avoid importing finished goods.

■ **Establishing a local retail business** An existing FIE whose business scope does not necessarily have to include retailing can enter into a joint venture with a local Chinese retail company. The new joint venture, regarded as a domestic enterprise, will not require Ministry of Foreign Trade and Economic Cooperation approval. The venture must, however, obtain the proper retailing license from MIT.

Because the joint venture has the status of a domestic enterprise, its scope of business activities can be wider than that of standard FIEs. The foreign partner's contractual duties usually involve taking care of the store's merchandise, managing and training personnel, and planning product displays and shelf layouts. The Chinese partner's responsibilities include procuring store space and developing the store's customer base.

■ **Franchising** Franchising, still a relatively new concept in China, lacks a recognized legal framework (*see The CBR*, November-December 1992, p.20). The relationship between the proprietor of the brand names and the store owner who sells products under these names often involves variations on the traditional franchiser-franchisee arrangement. Companies such as Theme, Benetton, and Crocodile are widely assumed to be franchising their store names to local Chinese entrepreneurs.

Foreign retailers who want to tap the true potential of the China market but who also want to avoid the logistical troubles of operating each and every store themselves should consider franchising their brand names and operational systems to local entrepreneurs. However, since no legal framework governing franchising activities exists, foreign retailers must take extra precautions to ensure that their tradename, trademarks, and proprietorial systems are adequately protected. To bolster protection of the foreign investor's intellectual property rights, employees and franchisees should also be required to sign binding confidentiality and non-competition agreements.

In the current campaigns by multinationals to protect their intellectual property rights in China, foreign investors have launched lawsuits against infringing manufacturers and sellers, turning to the Chinese courts for protection. Some Chinese enterprises have also fallen victim to copycat manufacturers and counterfeiters and have initiated their own legal battles.

—*Alexa C. Lam*

and solicit its opinion. If approval to consider the application is granted, the investors can proceed to execute the relevant joint-venture contract, articles of association, and other ancillary documents and submit them to the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Retail FIEs should seek approval from both the State Council and MOFTEC. Those which operate with only local and MOFTEC approval are not guaranteed import and export licenses. With the exception of restaurants, all retail FIEs must form either equity or cooperative retail joint ventures.

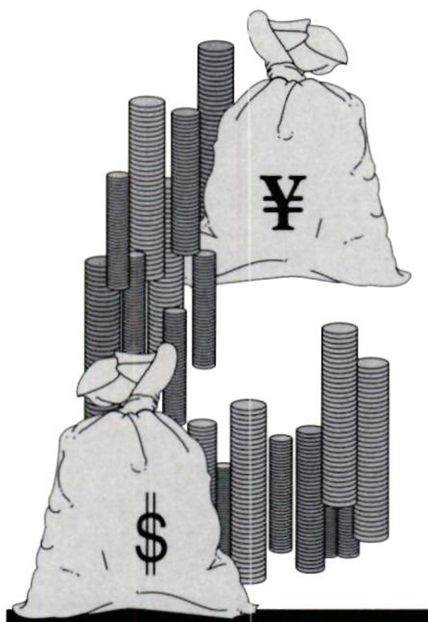
Foreign retail firms—both those approved under the State Council Retail Rules and those with only local-level approval—constitute a minute fraction of China's mammoth retail industry, which is dominated by State-owned conglomerates such as the Jin Jiang Group of Shanghai. The State Council Retail Rules allow foreign retail joint ventures in six cities and five special economic zones. As of March 1995, only 14 such enterprises had received approval.

Currently, companies from Hong Kong, Taiwan, Southeast Asia, and Japan partner the bulk of State Council-approved retail FIEs in China. Some major US and Canadian retailers are actively trying to establish their presence in the country. Small-scale Chinese private enterprises are also beginning to emerge, and some State-owned retailers have restructured themselves into shareholding enterprises to compete more effectively with other retail entities.

Approval has its privileges

If a retail FIE is lucky enough to obtain State Council approval, it may import goods worth up to 30 percent of its total retail sales per year without having to work through a foreign trading company (FTC) licensed by MOFTEC. The imports must consist of general retail merchandise to be sold within the foreign-invested store. Any goods imported by the retail FIE are still subject to Customs duties of the import's value, which can exceed 100 percent, depending on the type of merchandise.

State Council-approved firms need not work through FTCs to sell China-produced goods abroad.



Any imports of State Council-approved retail ventures above the 30 percent value limit or imports by retail firms with only local approval must be brought into China through an FTC. Typically, FTCs charge a handling fee equal to 30 percent of the value of the imported good. Feeling the pinch of China's economic tightening, however, many FTCs are hungry for business and may be prepared to cut deals with foreign retailers, often covering or underwriting Customs duties and insurance payments to entice foreign business. MIT is reportedly reviewing the 30 percent import restriction under the State Council Retail Rules. An MIT official has hinted that while the restriction will not be lifted altogether, it will likely be relaxed.

Another advantage for retail firms with State Council approval is unlimited export privileges. Unlike key infrastructure projects, foreign retail joint-venture operations are not guaranteed foreign exchange earnings. Without export privileges, retail ventures that lack State Council approval must depend on the openness of China's swap markets to balance their foreign exchange. Because approved firms need not work through FTCs to sell China-produced goods abroad, they can export goods purchased locally from third parties, sell those goods overseas, and earn foreign exchange to aid their currency balancing efforts. State Council-approved retail FIEs are banned, however, from exporting commodities such as corn, soybeans, tea leaves, silk, cotton, crude oil, coal, and aluminum.

Drawing in customers

Despite the many difficulties in entering the Chinese retail market, foreign in-

vestors continue to be lured by its potential. The best strategy for those FIEs wishing to jump into this sector is to examine carefully the consumption needs and patterns of the typical Chinese family, and take the lead in creating a desire for their products.

The most common mistake among foreign retailers in China is targeting the wrong market segment. Contrary to the hype about the dramatic rise in income and spending power of modern China's city dwellers, most are still struggling to make ends meet. Given the small pool of affluent consumers and expatriates in Chinese cities, a retail business should anchor itself firmly to the average consumer, rather than selling only high-priced goods in a market where available demand is already soaked up by other competitors. Although sales growth in this segment will take time to develop, the average Chinese consumer holds the most buying potential over the long term.

The most common mistake among foreign retailers in China is targeting the wrong market segment.

To date, however, foreign manufacturers have had trouble conducting market research in China. Several international research and accounting firms conduct market research for foreign investors in China, but the research firms are wary that the data they collect from official sources may not be reliable. Moreover, information and statistics which are available publicly in Western countries are often treated as confidential and classified information within the PRC (*see* p.19).

Because of this, surveys in Chinese consumer practices may need careful analysis. The Japanese, for example, do not rely on survey data alone, but also conduct field studies in which they hire a team of locals to pick up discarded supermarket receipts to monitor consumer preferences and habits.

In the absence of market information, the foreign retail investor should focus on bringing average Chinese consumers into their stores by offering ordinary daily necessities or products that could improve the overall quality of life—even in the smallest ways. Whether the products are home decorations and improvements, photography supplies, hobbies, toys, greeting cards, or confectioneries, they

Truthful Touting

Foreign and domestic advertisers spent an estimated $3.8 billion in 1994 to promote products in the China market, a 72 percent jump over the previous year, and advertising expenditures are expected to continue rising. In the absence of comprehensive national legislation, however, the 30,000 China-based advertising agencies have gone largely unregulated. This situation is quickly changing, though not necessarily to foreign companies' advantage.

In an attempt to standardize advertising practices and combat abuses which have plagued the ad industry in recent years, China recently passed a new law governing advertisements. The Advertising Law of the People's Republic of China, which went into effect in February 1995, imposes a uniform set of regulations on television, radio, and written advertisements. The new law, which is intended to supplant the State Council's 1986 Rules Regarding Advertisement, is being implemented and enforced by the State Administration of Industry and Commerce (SAIC).

Designed to address the increasingly widespread problem of false advertising, the Advertising Law lists fairness, accuracy, and truth-in-advertising as its underlying principles, and prohibits false statements or any attempts to defraud or mislead consumers. The law further stipulates that the content of advertisements must "be conducive to the physical and mental health of the people" and protect the interests of consumers. Due to the vague language used in some of the Advertising Law's provisions, it may be necessary for advertisers to adopt a wait-and-see attitude regarding their enforcement. However, more detailed implementing regulations are expected to be issued in coming months.

The Advertising Law specifically prohibits advertisers from using the Chinese national flag or anthem as well as names of government figures. Superlatives such as "nation's best" or "top level" may not be used, and advertisements may not contain anything deemed "obscene, superstitious, terrifying, violent, or disgusting." Content suggesting racial, ethnic, or religious discrimination is also prohibited, and ads may not "disrupt peace and order or damage collective interests" or endanger persons or property. In addition, the Advertising Law prohibits ads containing material that is deemed harmful to the physical or mental health of minors or disabled persons.

The Advertising Law also stipulates criteria for truth-in-advertising. Any advertising claims concerning the nature, capabilities, place of manufacture, durability, quality, or price of goods must be stated clearly. Moreover, the Advertising Law requires that advertisers provide evidence to prove that any statistics and investigative results used to promote a product are true, and express such claims in a clear and unambiguous manner. It also specifies that advertisements mentioning patented products or processes include the relevant registered patent number, and requires advertisers to display business licenses where applicable.

No snake oil

Several of the Advertising Law's provisions are designed to crack down on the exaggerated claims often seen in medical and pharmaceutical product ads. Ads for these products are specifically prohibited from including "unscientific" claims, or descriptions of the

need not be big ticket items, but must merely act to introduce the Chinese buyer to Western luxuries. Advertising a foreign novelty, however, can get companies into hot water if their ads fail to measure up to new rules (*see* box).

Foreign retail stores in China, including Hong Kong's Watson's Personal Store and the Wellcome and Park'N Shop supermarkets, have already attempted to provide such an introduction to residents in China's larger cities. But because these stores charge relatively higher prices than their local Chinese counterparts, their customers are primarily expatriates.

Minimizing costs

To attract a greater domestic clientele, a retail operation must be able to keep costs low while offering customers a wide selection of products. One way to accomplish this task is to take advantage of economies of scale and establish retail chains with a large network of stores spread over the country or at least in the more affluent coastal regions.

Foreign retail investors should focus on bringing average Chinese consumers into their stores.

Not all foreign investors can or wish to organize chain stores, but those who do often find that their expanded network allows them to identify a niche, create a market, control costs, and increase sales volume by reaching out to every potential customer. In addition, retail chain stores are able to reap efficiency benefits in management, training, warehousing, and distribution operations, and use their clout to obtain supplies from local Chinese distributors. The availability of inventory from the chain's other stores within China will also lessen the pressure on the retail FIE to import, driving operation costs even lower.

Although in theory each new store needs only obtain local approval, a foreign retailer interested in establishing a retail chain in China should aim for State Council approval to qualify for import and export privileges. Even if the original approval is specific to a given store, future stores can be established as branches, divisions, or subsidiaries of

---

Ads are prohibited from including "unscientific" claims, or descriptions of the product's effectiveness.

product's effectiveness or cure rate. Advertisers are also prohibited from associating their products with the name or image of any hospital, research institute, or similar organization, or from comparing their product with that of their competitors. Cosmetics, beverage, and food advertisements cannot include medical terms, while ads for pharmaceuticals must warn prospective users that the products should be taken only when accompanied by a doctor's prescription. Narcotic, anaesthetic, psychoactive, or radioactive drugs may not be advertised in any form.

All pharmaceutical advertisements must be submitted for approval to the relevant provincial or central public health, pharmaceutical, or agricultural authorities. Drug advertisers planning to advertise nationally must obtain approval directly from the Ministry of Public Health, the State Pharmaceuticals Administration, or the Ministry of Agriculture, depending on the product's classification.

Tobacco advertisements also face severe restrictions under the new law, which prohibits such ads on television, film, radio, and in the press, as well as in theaters, meeting halls, waiting rooms, and sports arenas. Consistent with the emphasis on truth-in-advertising, tobacco ads must include the warning that "Smoking is harmful to one's health."

The Advertising Law places liability for violations on the company whose product is being advertised, the ad agency, and the entity responsible for publishing or broadcasting the ad. The SAIC is empowered to enforce the Advertising Law, and may subject violators to the following penalties: an injunction to cease dissemination of the offending advertisement; an injunction to use a portion of the advertising fees to publish or broadcast retractions; the imposition of a fine of between one and five times the amount of the advertising fees; an injunction to cease all advertising business in "grave" cases; civil or tort liabilities if the ads violate the rights of consumers; and criminal liabilities if the violation constitutes a crime such as slander or denigration of the national flag or emblems.

The Advertising Law has already adversely affected some foreign advertisers. For example, the SAIC recently prevented the airing of a number of foreign agency-produced ads, and requested that these agencies tone down the ad language and feature business licenses more prominently on food, cosmetics, and pharmaceutical products. Some foreign firms, feeling the new law's pinch, have claimed that while the Advertising Law generally complies with international standards, it has been applied and implemented unevenly. Given the scope of the advertising industry and its relatively undeveloped state, both foreign and domestic advertisers fear that inconsistent interpretation of the law may complicate advertising plans in the China market for some time to come.

—*Randy Peerenboom*

Randy Peerenboom is an attorney in Freshfields' China Practice Group.

the original venture, requiring only a retail license from MIT and business registration with the local bureau of industry and commerce. The import and export needs of subsequent stores can be handled by the original venture provided the scope of business in the original venture's business license is wide enough to accommodate such responsibilities.

Currently, the foreign retail chain store concept appears to have a nod of approval from senior Chinese officials. In a speech given earlier this year, China's Vice Premier Li Lanqing suggested that retail chain store operations will help modernize China's distribution system and bring more goods to an even greater number of the country's consumers at lower costs. To tap foreign investment in this area, the PRC has hinted it will promulgate regulations permitting foreign joint-venture investments in retail chain stores, although such guidelines are currently only in the trial stages. MIT plans to encourage the establishment of retail chain stores—either by well-endowed domestic enterprises or Sino-foreign joint ventures. About 40 enterprises have been targeted in 15 cities, including Beijing, Dalian, Guangzhou, Hangzhou, Shanghai, Shenzhen, Tianjin, Wuxi, Xian, and Yantai.

Not all foreign investors can or wish to organize chain stores, but those who do often find that their expanded network allows them to reach more customers.

Under the proposed chain store rules, stores will be able to engage in a variety of businesses, including supermarkets, convenience stores, restaurants, fast food chains, pharmacies, bookstores, and jewelry shops. The Chinese government hopes that by reversing its previous practice of conferring preferential tax and other treatments only to operations bringing "hard" technology (like that involved in building cars and planes), foreign retailers will be encouraged to form joint ventures in China and introduce their chain store management and operations as "soft" technology in-kind capital contributions.

Municipal governments are also encouraging foreign retail chains in their jurisdictions. For example, the municipal government of Shanghai has announced that approved chain store joint ventures will be permitted to set up as many other stores within the Shanghai municipality as the owners desire. The subsequent stores will not require separate approval from the city, provided that each store has a business license from the municipal bureau of industry and commerce.

Expansion efforts

Regardless of the current popularity of the retail chain store concept in China—both within the PRC government and the foreign investment community—the PRC must address certain issues before foreign retail chains or other foreign retail establishments can truly flourish. The government needs to restructure the approval process for retail FIEs and re-evaluate the chains of authority granted to each area to avoid problems of local protectionism.

As their China operations grow, foreign investors will probably want PRC assurances that they will be able to expand their operations nationally to rationalize their investments and marketing efforts. MIT is reportedly considering opening another 10 Chinese cities—including Chongqing, Harbin, Nanjing, Shenyang, and Wuhan—to State Council-approved foreign-invested retail ventures, but no plans have been made to centralize approval authority for multiple operations by a single retail FIE in these locations. Until such a system is implemented, retail FIEs wanting to conduct operations in different provinces or municipalities will continue to be at the mercy of individual local authorities who have power to grant approvals. Local governments have been known to refuse licenses to foreign-invested retail operations as a way to protect existing stores from competition.

Until local protectionism problems are resolved—hardly an easy task—foreign retail firms with established ventures may run into resistance when attempting to expand their operations into different cities or provinces. Though the easiest way out of this predicament would be to create separate joint ventures with different partners in each locale, managing a number of different ventures would be an administrative nightmare.

Given China's size, local protectionism, and regional variations in living standards and consumption power, any plan to establish any nationwide chain of stores under one umbrella may be too ambitious at this point. Yet with patience and perseverance, a firm intent on establishing a wide presence in China can begin its operations solidly on a smaller scale—identifying the right market, establishing a niche, and, over time, building a lucrative retail network. 完

100% SUCCESS!

In just the last year our China team has helped 15 U.S. companies to:

- **Analyze their China markets**
- **Profile candidate partners**
- **Negotiate and close transactions**
- **Source high quality components**

...and all 15 give us top ratings.

With over 50 professionals on the ground in China in the **chemical, medical, electronics and industrial fields,** we can help you, too.

运筹帷幄　决胜千里

Science Center International Ltd.
3600 Market St., Suite 100
Philadelphia, PA 19104-2642
Phone: 215-823-5008
Fax: 215-823-5005

Tim Weckesser, Ph.D., Vice President
Shiqiang Gu, Director, China Business

Increase your accessibility to the world's most dynamic market

CHINA DISTRIBUTION & MARKETING

Your choice of 2 venues:

29 & 30 January 1996 ▪ The Meridian, Singapore

31 January & 1 February 1996 ▪ Excelsior Hotel, Hong Kong

Essential issues covered will give you up-to-the-minute information on....

- Economic, trade, & infrastructural policy
- Financial management of the supply chain
- Global distribution standards in China
- Legal framework impacting product distribution
- Managing and controlling sales teams
- Selecting distribution channels and distributors
- Optimizing the marketing/distribution mix
- Monitoring distribution from customer responses

Hear how the latest policy directives are shaping logistics and distribution from 3 PRC government authorities....

- Ministry of Foreign Trade and Economic Cooperation
- Ministry of Internal Trade
- Ministry of Communications

Plus, one-day workshop:

"Developing a fully integrated supply chain in China"
Workshop Leader: **Stephen Frewen,** Managing Director
Modecc Developments Ltd.

31 January 1996 at The Meridian, Singapore
2 February 1996 at Excelsior Hotel, Hong Kong

Yours speaker panel includes:

- **Li Dongsheng**, Director General, Department of Foreign Trade Administration, Ministry of Foreign Trade and Economic Cooperation, PRC
- **Huang Hai**, Director General, Department of Policy, System, Laws & Regulations,Ministry of Internal Trade, PRC
- **Sun Rongxing**, Deputy Director General, Department of Restructuring Economic System & Legislation, Ministry of Communications, PRC
- **Matthew Estes**, General Manager, Wella China's Distribution Company
- **Heiko Schaefer**, Market Research Manager Group Product Manager for Color and Perm Products, Wella China's Distribution Company
- **Owen D. Nee Jr.**, Managing Partner Coudert Brothers
- **Danny Wong**, General Manager Confederated Wholesalers Limited
- **Dickson D.S. Lo**, Project Director Lifung Districenters Management Ltd.
- **Stephen R. Frewen**, Managing Director Modecc Developments Limited
- **Richard L. Miskewicz**, Principal A.T. Kearney
- **Albert Yeung**, Marketing Director Yeung & Lee Trading Development Inc.
- **Lai Ying Meng**, Regional General Manager, for Greater China & Korea Gillette Far East Trading Limited
- **Au-Yeung Hon**, Senior Consultant MacNeil Pacific Limited
- **Chris Strachan**, Managing Director United Biscuits China
- **Jackson Hong**, Executive Officer North China Rank Xerox (Hong Kong) Ltd.
- **Robert Roethenmund**, Partner, Trammell Crow International
- **Bruce Norris**, Executive Director Retail Research, SRG China

Organised by:

PLEASE RETURN THIS FORM TO BRUCE MCDONALD, IIR LIMITED, 20TH FLOOR, SIU ON CENTRE, 188 LOCKHART ROAD, WANCHAI, HONG KONG. FAX: +852 2586 1999

❑ **PLEASE SEND ME A FULL CHINA DISTRIBUTION & MARKETING SUMMIT BROCHURE**
❑ **PLEASE SEND ME SPONSORSHIP & EXHIBITION INFORMATION**
❑ **PLEASE ADD MY NAME TO YOUR MAILING LIST**

Family Name First Name Mr/Ms/Dr

Job Title Company

Address

City Postcode Country

Telephone( ) Fax( )

FOR FURTHER DETAILS, PLEASE CALL OUR CUSTOMER SERVICE DEPARTMENT ON +852 2586 1777 CodeCBR

The Right Price

■ Jane Greaves

Pricing strategies allow foreign manufacturers some control over distribution patterns

■ Jane Greaves is director, Asian trade, for Intercedent Limited, a Toronto-based international marketing and consulting firm which assists clients with the formulation and implementation of international business development strategies. She is the author of *Distribution in China*, published by the Economist Intelligence Unit in November 1994.

One of the main factors contributing to successful distribution and sale of goods in China is pricing. In the past, manufacturers and retailers had little freedom to manipulate prices because the State controlled the entire distribution process, including the manufacturer's ex-factory price, the wholesale mark-up, and the retailer's end price to consumers. Since fixed pricing has been abandoned for all but 30 percent of goods—primarily industrial products and commodities that the State still considers crucial to the national economy, including coal, agricultural fertilizers, and steel—manufacturers now have much more latitude to use pricing to affect distribution patterns.

As the State pricing monopoly has dissolved, a more liberalized, market-oriented economy has taken shape in China. Foreign products now fill store shelves, reflecting the magnitude of foreign investment in China. As foreign products have become more commonplace, standardization of labelling and packaging is being enforced in some localities (*see* p.32).

Pricing, however, has remained largely unregulated, leaving foreign manufacturers of most goods free to price according to market trends. Some foreign manufacturers are tempted to price retail goods low to reach the maximum number of potential consumers. Despite increasing numbers of people able to afford Rolex watches and Mercedes-Benz automobiles, price continues to be a major determinant in most purchasing decisions for the vast majority of the population, which has a per capita annual income of $373.

A fine line

Although suppliers who price high risk pricing themselves out of the market, many foreign-invested enterprises (FIEs) in China and overseas manufacturers usually believe that they have no option but to price their goods at a premium to make a profit. These manufacturers have managed to capture a significant market share by providing better packaging, marketing, supply, and after-sales service support, justifying Chinese consumers' belief that foreign products are superior to local products.

Both FIEs and overseas producers that opt to price low position themselves as direct competitors to State firms, which have lower overheads and perhaps receive State subsidies. The State firms are likely to enjoy higher profit margins than foreign firms at a given price point and will likely be able to lower their prices to gain more market share. Pricing low can also damage the cachet of exclusivity that foreign and joint-venture products hold in the minds of Chinese consumers. To walk the tightrope between exclusivity and sales volume, foreign suppliers should research their target markets thoroughly and then determine

an appropriate price range to maintain market share.

Swiss watch manufacturer SMH Ltd., for example, entered the China market in the early 1980s, selling its least expensive line of Rado brand watches, at a retail price of approximately $420. As Chinese income levels increased and Rado gained a stronger market position, the company introduced more expensive lines and removed the lower-priced watches to maintain its stylish image. The bulk of Rado watches sold in China today range in price from ¥8,000-¥20,000 ($964-$2,410). This strategy appears to be working as SMH sold approximately 20,000 Rado watches in 1993, and a 1994 survey of Chinese consumer preferences revealed that Rado watches were the most popular among imported and domestic brands alike.

Working backwards

Some foreign companies are able to determine target enduser prices first, and then negotiate profit margins and costs with distributors and wholesalers. To the pleasant surprise of foreign investors, many Chinese distributors and retailers are unusually obedient in following pricing decisions and leads set by other participants in the distribution chain, testifying to the legacy of a State-imposed distribution system. Industries such as foodstuffs, watches, and photographic products tend to be well organized and efficient, and are generally the most compliant when it comes to pricing directives.

Another trend that can work both to the advantage or disadvantage of foreign investors is that a single wholesaler can act as a control point in the distribution of a given product in China. If distributors do not respect agreed-upon wholesale markups and prices, the wholesaler can easily curtail supply to a specific company or individual. Having too much power vested in the hands of one point in the chain, however, can backfire on occasion. Many companies that contract with one wholesale agent for the China market often discover that their chosen agent cannot adequately service the entire market.

Twists and turns

In addition to manipulating enduser prices, foreign companies can use pricing decisions to minimize conflicts between potentially competing dealers. For example, Seiko Epson, a Japanese computer and peripherals manufacturer, allows all of its China distributors to sell the company's low-end and low-margin goods. However, to segment the distributors into separate groups, Epson Hong Kong, the branch sales office responsible for Seiko Epson's China operations, offers different distributors different prices for its expensive, high-margin products.

To the pleasant surprise of foreign investors, many Chinese distributors and retailers are unusually obedient in following pricing decisions and leads set by other participants in the distribution chain, testifying to the legacy of a State-imposed distribution system.

Epson Hong Kong first transfers ownership of products to its China distributors at the gates of its warehouses in Hong Kong. Its mainland distributors are then responsible for all costs related to the product, including Customs duties and transportation expenses. If Epson Hong Kong does not want a certain distributor selling a particular high-end product, it raises the price to that distributor while simultaneously selling the exact product at a lower price to a second distributor. The second distributor can then take over the first distributor's targeted market by selling at a lower price. To compete successfully in the second distributor's market, the first distributor must accept a much smaller, often inadequate margin.

Differing transportation costs must also be considered when setting pricing strategies. Simply selling goods at a fixed price throughout China may entice distributors, who often must cover transportation costs, to sell to markets they can reach most cheaply, ignoring more inaccessible areas that are nevertheless important to the manufacturer. As a result, the manufacturing company must review its sales structure with regard to transportation costs for existing and new distributors. If, for example, a Shanghai manufacturer starts to sell to a new distributor approximately 1,850 km away in Chengdu, transportation costs will be significant. The transportation expenses will cut either the manufacturer's profit or the Chengdu distributor's profit margin, or result in a loss for both parties.

Overseas and local suppliers can, however, manipulate prices along geographic lines by negotiating the relative amount of transportation costs paid by the manufacturer and the distributor for the transportation of goods. Both parties should first attempt to estimate the transportation fees involved and then try to reach a compromise ex-factory price. Frequently, the manufacturer can lower his ex-factory price in exchange for the dealer assuming responsibility for transportation costs. This works to both parties' advantage—the manufacturer does not have to worry about transportation difficulties, and the dealer can improve his profit margin by identifying less costly means of transportation. Many companies manufacturing outside of China use this method when their China distribution point is Hong Kong because they are inexperienced in exporting to the China market and do not want to be responsible for their products' physical distribution when based overseas.

Taxes and tariffs

Besides contending with pricing conflicts, perhaps the most serious concern that FIEs and firms manufacturing outside of China face is the challenge created by differential tariff rates and duties. Many unaccounted-for goods often find their way into China because PRC Customs treats goods differently depending on their components' country of origin, the manufacturing site, and the destination market.

These goods are often considered parallel imports, products destined for other markets that end up in China because the manipulation of tariffs can result in higher profits. Import tariffs on the foreign components of goods manufactured in China, for example, can be waived if the final product is targeted for export, but not if

the good is sold on the domestic market. Consequently, products sold as exports often re-enter China to be sold on the domestic market. Even with additional transportation costs and import duties, the re-imported goods may sell for a lower price than the same goods sold legitimately through domestic channels. Chinese distributors who re-import these goods may make a profit regardless of the additional transportation costs. Quasi-legal channels through which personal connections can be used to reduce high import duties makes parallel importing even more attractive for some distributors.

FIEs and wholly foreign-owned enterprises, in particular, suffer competition from parallel imports of their own goods. The Singer Co., for example, cannot sell its joint-venture manufactured sewing machines to the domestic market in Shanghai because its own machines destined for export to other countries end up for sale in Shanghai—at a price against which Singer cannot compete. Offshore manufacturers also find their distribution in China disrupted by parallel imports. To achieve larger profits, a given company's overseas distributors, who may have connections in Hong Kong or China that facilitate cost-effective transportation into China, might sell their products to the China market rather than their company's intended export market. For all manufacturers, the problem of parallel goods disrupting distribution is much more severe in south China where transportation costs from Hong Kong—the exit and entry point for many of the parallel imports—are lower.

> To discourage distributors from parallel exporting, some foreign firms now require Chinese distributors to pay a deposit on the products to be delivered.

The amount by which parallel imports undercut their domestic competition is difficult to estimate as both import tariffs and transportation costs differ among products. Distributors are reluctant to divulge too much information on the cost-effective import channels they have found. The profits are substantial enough, however, to create a flourishing industry and headaches for manufacturers who often lose control of their products en route, sometimes finding them marketed in a manner they had not intended.

...And the Right Label

China's supermarket and department store shelves teem with products labelled in a confusing babble of languages. Chinese authorities, in an effort to standardize product labelling, are now beginning to pay closer attention to what goes on the outside of goods sold in China. As of May 1, all commodities and manufactured goods marketed or sold in Beijing have been required to sport product labels in Chinese characters. This announcement, one of a series of notices issued with great fanfare by the Beijing Technology Supervision Bureau (BTSB), is directed toward enhancing implementation of the Product Quality Law passed by the National People's Congress in March 1993.

The notices stipulate that product names used on package labels in the Beijing area must conform to national or industry standards. Product names likely to mislead consumers or be confused with other common, generic words are prohibited, while any product labelled with an "innovative" or "unusual" name, or with a brand number or trademark name, must also include a common national or industry standard name in its label.

If the BTSB actions are indicative of the beginning of a nationwide crackdown on product labelling, foreign companies should pay careful attention to how goods intended for sale in China are labelled. The Product Quality Law requires that all products—including those imported from abroad or manufactured in China by foreign companies—bear labels printed in simplified characters as standardized in the 1986 State Council General Guide to Simplified Characters. While companies may also label their products using *pinyin* (the Chinese romanization system) or a foreign language, such labels may not exceed the size of the corresponding Chinese labels.

Although the Product Quality Law enumerates several guidelines for labelling, its provisions, especially the Chinese-language requirement, have often been flouted in practice. While many products which fail to use Chinese labels are genuine foreign imports, angry consumers have reported numerous cases in which domestic enterprises have intentionally labelled products in foreign languages in an attempt to capitalize on consumers' preference for imported goods.

Under the Product Quality Law, all commodities marketed in China, including imports, are required to display the product name and the manufacturer's name and address in Chinese on either the product itself or its packaging. The specifications, grade, and, if applicable, the name and content of the product's major components must be clearly stated as well. Labels for perishable products must also include the manufacture and expiration dates. Products, presumably such as explosives and toxic chemicals, which pose a potential danger to the user's health, safety, or property must carry an additional warning label or brochure.

Whether BTSB will carry through on its threats to strictly enforce the labelling requirements in Beijing remains to be seen. To some extent, BTSB's hands are tied by the lack of enforcement mechanisms in the Product Quality Law. Under the Product Quality Law, failure to label goods that are either perishable, dangerous, or both results only in an injunction to correct the practice, and fines ranging from 15-20 percent of the income from the sale of illegally labelled goods can be assessed only in cases where "circumstances are serious." Likewise, the

Like parallel imports, parallel exports—goods that are destined for the China market but end up being exported to other markets—most often occur when the price in China is less than the price these same goods command in other countries. Chinese distributors have been quick to take some goods intended for the Chinese market and sell them overseas to reap greater profits. As a result, some foreign companies have raised the prices of their China-bound products to be on a par with prices elsewhere, in an attempt to decrease the practice of parallel exports. These companies risk losing market share, however, if all other companies in the market do not follow suit. Other foreign firms resort to packaging their China-market goods distinctly so they can be identified easily if found outside of China. Once the goods are identified, the manufacturer must then follow the trail of the goods backward to the source of the problem. To discourage distributors from parallel exporting, some foreign firms now require Chinese distributors to pay a deposit on the products to be delivered. The deposit is refunded upon the arrival of the entire shipment when the manufacturer can verify that no goods were sold in transit or re-exported.

Testing the waters

While pricing strategies may help firms avoid being undercut by parallel imports and exports, pricing is not a cure-all for slow sales. For example, after conducting extensive market research, one company introduced an improved model of a successful existing product, but despite apparent demand for the new product, sales were flat. Fearing that its higher price had scared consumers away, the company priced the new product at an even lower level than the original model, but was disappointed to see no corresponding jump in sales. Only later did the company learn that the weak sales were attributed to the conservative buying habits of Chinese consumers, not its pricing decisions (*see* p.19).

Nevertheless, while a well-planned pricing strategy does not guarantee that foreign companies' goods will arrive at the checkout counter, adopting a comprehensive pricing strategy to orchestrate distribution patterns can facilitate the transfer of goods from the factory to the store shelf and grant China-based manufacturers some control over the distribution of their goods. Given the vagaries of China's marketplace, companies that price strategically may achieve faster delivery times between the factory and store shelf, and maximize sales and market share. In a sales environment where there are few hard and fast rules, companies with well-researched pricing strategies are already one step ahead of the competition. 完

only penalty for failure to label all other products is an injunction to correct the practice. As a result, the legal basis for BTSB's threat to impose fines on violators remains unclear.

Order in the kitchen

In a related development, the National Technology Supervision Bureau (NTSB) has approved and is in the process of implementing the 1994 Standards for Uniform Labelling of Foodstuffs (the Standards), which set out detailed labelling requirements for packaged foodstuffs nationwide. The drafting and implementation of these standards was conducted under Chapter 5 of the PRC Public Health Law Concerning Foodstuffs (the Food Law), which gives relevant public health bureaus the authority to implement the Food Law. After October 1, improperly labelled food products, both imported and domestic, will be barred from sale on the Chinese market.

The NTSB Standards are designed to elaborate on the more general provisions outlined in the Food Law. The Food Law's general provisions stipulate that packaged foodstuffs must display labels or brochures containing the following: the product's name, the producer's name and location, production date, expiration date, product specifications, batch or lot number, ingredients, and method of preparation or use. The Food Law also stipulates that labelling may not include exaggerated or false claims.

The Standards cover finer details such as the wording of expiration date labels and the proper method of listing ingredients. One minor inconsistency between the Standards and the Food Law appears in the "method of use" labelling requirements. Section 7.2 of the Standards indicates that "in order to ensure the correct use of foodstuffs," labels *may* include information on method of use or recommended daily intake whereas the Food Law *requires* that such information be provided.

Failure to comply with the Food Law may result in administrative penalties, although these are generally aimed at Chinese distributors. The penalties, as specified in the Food Law, include: warnings requiring compliance within a specified period of time, recall of products already on the shelves, confiscation of products, an injunction to cease distribution and sale of products, fines ranging from ¥20-¥30,000, and, for distributors, revocation of their public health licenses. If noncompliance results in illness, disability, or death, the law stipulates that the "production operators" of a business may be ordered to pay compensation—including medical expenses, lost wages, funeral fees, and financial support for survivors—and may face criminal sanctions in extreme cases.

In a related enforcement measure covering imported packaged foodstuffs sold in Beijing, the Beijing Public Health Bureau recently announced its intention to implement the Notice to Strengthen Management of Labelling of Pre-packaged Imported Foodstuffs (the Notice), which was jointly issued by the National Public Health Bureau and the NTSB. As of August 1995, the Notice requires that all imported foodstuffs have printed Chinese-language labels. After September 1996, shipments of imported foodstuffs lacking the appropriate packaging labels will not be permitted to enter China. In the interim, distributors will be permitted to submit sample Chinese labels and, upon approval by the National Committee on Technology for Standardization of the Food Industry, attach the temporary labels to the imported foodstuffs when submitting shipments for inspection.

—*Randy Peerenboom and Adam Kearney*

Randy Peerenboom is an attorney and Adam Kearney is a legal assistant in Freshfields' China Practice Group.

China Puts on a New Face

■ Mitzi Swanson

More cash in hand means higher cosmetics sales

Amid the grime, smoke, and fumes rising from cars and factories in China's largest cities, some sweeter smells are wafting through the air. It may be the perfume worn by young women on the way to the disco, or the scent of freshly scrubbed schoolchildren, but to multinational cosmetics manufacturers, it is the sweet smell of success. Rapid increases in consumer incomes and changing spending patterns have helped sales of cosmetics—including skin, hair, facial, and nail care products—to increase 210 percent between 1990-93, according to a March 1995 *Euromonitor International* report. Sales of cosmetics in China reached almost ¥9 billion last year, a 30 percent jump from 1993 levels, and similar sales growth is expected over the next few years.

Money to spend

As real disposable income has increased, Chinese spending on consumer goods such as cosmetics and clothing appears to have outpaced outlays for durable goods. Many consumers, hoping to show off new-found wealth, have also developed a penchant for buying and wearing cosmetics, which have status symbol appeal.

According to ASL research, a typical urban resident now spends an average of 20 percent of his monthly income on cosmetics and personal care products—a significantly higher proportion than his US or European counterpart spends. With housing and welfare expenses generally covered by the government, low transportation costs, and limited availability of leisure activities, Chinese urban consumers can generally afford to spend such a high percentage of their monthly income on cosmetics and other personal care items.

Foreign manufacturers of cosmetics have seen their sales in China increase ten fold since 1985. Imports of cosmetics, for example, increased by 77 percent between 1992-93 alone. Although a significant percentage of these imports originate in Asia, sales of products from the United States, France, and Switzerland have been increasing in recent years.

Marketing efforts in China for Asian cosmetics generally focus on the products themselves and avoid emphasis on brand names. Asian exporters also promote their products with either English or Chinese names. These strategies seem to be working as sales of imported Asian products have been as high as domestic and joint-venture goods in China. Imported foreign brands produced in Western countries, though prized by Chinese consumers, generally tend to be too expensive for the average consumer (*see* Table).

A closer look

Within this thriving market, skin care products account for 44 percent of sales

■ **Mitzi Swanson is a director at Asian Strategies Ltd. (ASL), a Hong Kong-based consulting company that recently completed a report on China's cosmetics industry.**

revenues, followed by hair care products (29 percent) and perfumes (21 percent). Foreign brands, including Oil of Ulan, Pond's, and Yin Fong, have captured over 20 percent of the skin care market, while domestically manufactured brands such as Maxam and Phoenix are also popular.

With a thorough sales and distribution network and strong connections with retail and government authorities, The Procter & Gamble Co., one of the earliest foreign investors in China, has successfully positioned its hair care products. Procter & Gamble gained a 30 percent share of the hair care market through sales of Rejoice and Head & Shoulders brand shampoos. These products are made in Guangzhou by a P&G joint venture. Wella Corp., the first foreign manufacturer of hair care products within the China market, successfully penetrated the market in the early 1980s and still maintains a leading position by pricing its joint-venture products close to locally produced Chinese products (*see* p.30). Leading Chinese brands of hair care products include Bee & Flower, which holds approximately five percent of market sales. Other Chinese brands, such as Maxam, Huazi, and Piaoyi, sell well because they are more affordable than many foreign brands, whether imported or made by a Sino-foreign joint venture.

According to ASL research, a typical urban resident now spends an average of 20 percent of his monthly income on cosmetics and personal care products—a significantly higher proportion than his US or European counterpart spends.

While urban Chinese have come to consider skin and hair care products basic necessities, color cosmetics, which include facial and nail care products, are likely to emerge as another important market niche as Chinese women become more fashion conscious. Color cosmetics, which accounted for six percent of the cosmetics market in 1993, is the industry's fastest growing sector. Lipsticks, which now account for three percent of industry sales, are selling quickly in Shanghai, China's fashion center, as well as in northern coastal cities.

Who's buying?

The market for cosmetics consists of a wide range of consumers of varying socioeconomic backgrounds, although young urban women, who tend to live with their parents and have their basic living expenses covered, are the primary buyers of cosmetics. Seeking to look more glamorous—or to emulate the Chinese models they see on television or in magazines—these women are willing to spend large portions of their income to keep up with fashion trends and maintain "face" among their peers. Young women are by no means the only buyers of cosmetics, as older women and young men also account for a large share of cosmetics consumers.

Though demand from urban consumers is strong, brand loyalty in China's relatively immature cosmetics market still appears weak. Consumers in Beijing tend to be more interested in quality, less influenced by the prestige associated with trying a new brand, and thus more likely to make repeat purchases of a specific brand than their counterparts in Guangzhou. Guangzhou consumers tend to be more influenced

Prices of Selected Imported, Foreign-Invested Enterprise (FIE), and Domestic Cosmetics

Cosmetics	Imported	Price (¥)	FIE	Price (¥)	Domestic	Price (¥)
Eye shadow	Christian Dior (France)	520	Aupers (Japan)	90	Dabao	44
Blush	Christian Dior (France)	340	Gaozi (Hong Kong)	30	Dabao	20
Lipstick	Christian Dior (France)	235	Aupers (Japan)	90	Dabao	28
Skin cream	Oil of Ulan (US)	60	Pond's (UK)	27	Dabao	20
Hair spray	Alberto V05 (US)	43	Dep (US)	35	ZG101	31
Shampoo	Silk Keratin (US)	36	Rejoice (US)	21	Xiafei	11

NOTE: All prices are for products sold in Beijing and are based on products of equal size or volume for each cosmetic type.
SOURCE: US-China Business Council

by what is popular in Hong Kong, since they frequently are exposed to the colony's conspicuous consumption and ever-changing fashion trends through television broadcasts. Like Guangzhou shoppers, teen consumers throughout the country, confronting peer pressure, are more likely to follow fashion trends in their choice of cosmetics than to identify with one brand because of its quality. While they may not have developed especially strong brand loyalty among consumers in general, heavily advertised foreign products usually hold more cachet than domestic brands. Many consumers still buy Chinese brands, however, especially those that are well publicized and have a reputation for high quality.

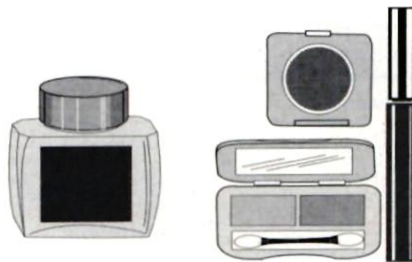
Getting the goods out

As is the case with other products, promotion and distribution of cosmetics are typically the largest obstacles to tackling the China market. Over 3,000 distributors of cosmetics products are registered in China. Collectives and township enterprises constitute approximately 52 percent of all cosmetics distributors, followed by State-owned enterprises (40 percent) and private enterprises (8 percent), whose ranks are increasing in number. The top 20 distributors currently account for 10 percent, or approximately ¥1 billion, of China's total cosmetics sales. These firms are all State-owned subsidiaries of the China General Merchandise Corp., which is a main supplier to China's department stores, and distribute goods throughout the coastal regions.

Because of China's poor transportation infrastructure, some large firms, including foreign, joint-venture, and domestic companies, have developed a "push-pull" technique to enhance the standard distribution path from manufacturer to wholesaler to retailer. Using this strategy, a company's sales force "pushes" products along the distribution path by cultivating relationships with wholesalers while also utilizing advertising, point-of-sales promotions, and other special incentives to "pull" products and induce consumers to make purchases at State retail outlets.

Many large foreign manufacturers instead opt to establish direct sales links to retail stores via branch offices and sales forces in selected cities. Some companies, such as Avon Products Inc., have moved one step further by selling directly to the consumer (*see The CBR*, March-April 1991, p.40). In 1985, Avon representatives who set out on foot to sell products door-to-door proved a welcome alternative to inattentive State-employed staff, and the company's sales skyrocketed. Several companies, including Amway Corp., Nuskin, and Herbalife International Inc., are now following Avon's lead. Other companies, including Procter & Gamble, have adopted a similar approach by distributing free samples to consumers both at home and at retail outlets, with the goal of enticing consumers to purchase their full-sized products in stores.

> While they may not have developed especially strong brand loyalty, heavily advertised foreign products usually hold more cachet and are favored over domestic brands, with the exception of well-publicized, high-quality Chinese brands.



Comparison shopping

Once on store shelves, prices for cosmetics vary widely. In general, foreign products are the most expensive, followed by moderate to expensive joint-venture and domestic products, and inexpensive domestic goods. Popular skin care products, for example, range in price from ¥0.6/g for the Japanese-made Kanebo brand to ¥0.15/g for goods produced by a Johnson & Johnson joint venture to ¥0.01/g for lower-quality domestic merchandise. While cosmetics prices have increased at the same general inflation rate, both mean and median prices for cosmetics have risen faster than inflation due to the increased availability of more expensive foreign and joint-venture goods.

Although they can be expensive, skin care products do not generate the highest overall profit margins because their retail mark-ups are relatively low (generally 10-20 percent). The highest composite retail mark-ups are for perfumes (40 percent), followed by hair care products (20-25 percent) and color cosmetics (10-30 percent).

FIE inroads

Despite their higher-priced products, foreign-invested enterprises (FIEs) seem to have sparked the cosmetic industry's growth. Many prominent multinational companies, including Procter & Gamble, S.C. Johnson & Son, Inc., Unilever PLC, and Johnson & Johnson, have manufacturing facilities in China. Though FIEs account for only 10 percent of the companies registered to manufacture cosmetics in China, their total domestic sales in 1993 exceeded ¥3 billion, about 30 percent of total industry sales.

That FIE products have captured much of China's market comes as little surprise to industry analysts, who attribute the success of foreign companies to their ability to produce high-quality products and market the foreign image consumers seek. By importing raw materials and manufacturing locally, FIEs avoid the high tariffs levied on imported personal care goods. China's low labor costs also help FIEs price their goods

Though FIEs account for only 10 percent of the companies registered to manufacture cosmetics in China, their total domestic sales in 1993 exceeded ¥3 billion, about 30 percent of total industry sales.

competitively with domestic products. Other FIE marketplace advantages include advanced technology, Western packaging designs, and better skill at promoting products, especially via advertisements, to young, affluent urban customers (*see* p.26).

Many of the FIEs also use their China ventures as a production base for exports to other Asian markets. Though China itself is fast becoming a major market for cosmetics, it enjoyed a net trade surplus of $60.5 million in cosmetics in 1993. Of the country's top 20 exporting corporations, 4 are cosmetics joint ventures. Lipsticks, powders, and eye products are leading export goods, especially to Asian countries such as Japan and Taiwan.

Domestic and joint-venture manufacturers are likely to continue exporting low- and medium-quality goods to other Asian countries, while high-end cosmetics will likely continue to be imported into the next century. As the country's cosmetics industry develops further and more Chinese companies form joint ventures, both the quantity and quality of its exports will undoubtedly improve, strengthening prospects for a continued trade surplus in cosmetics.

Just as most cosmetics consumers live in urban areas, approximately 75 percent of China's cosmetics companies make their homes in coastal cities. The FIEs in this sector, like many other FIEs, are situated primarily in areas with preferential treatment for foreign investors; approximately 80 percent of the FIEs are located in Beijing, Guangdong, Jiangsu, Liaoning, Shanghai, and Zhejiang.

Although China's coast has captured the majority of foreign investor interest, one company, Constance Carroll of Britain, has identified central China as a region with long-term potential and introduced a cosmetics line in Guangxi Province in June 1994. Constance Carroll successfully launched its initial venture, positioning itself strategically as a market leader. Central China's poor distribution system, long commuting distances, and lower consumer income have discouraged most investors from expanding into the interior, however.

Planning for the future

Many Chinese companies are now entering the cosmetics market to compete with foreign companies. Despite the increased number of market players, new market sectors present excellent investment opportunities, particularly as more Chinese women begin to use color cosmetics such as eye shadow and lipstick on a daily basis.

While foreign brands of color cosmetics are rarely seen outside of the larger department stores and foreign companies have not yet penetrated the color cosmetics sector, FIEs could gain significant market share in this potentially lucrative sector. But ventures in color cosmetics would certainly not be considered high-priority industries in Beijing's eyes and would not receive preferential treatment in the approval process.

As the distribution system in China improves, the cosmetics market will likely become more attractive, more accessible—and more competitive. New entrants to the market, though they will have to fight harder to achieve the front-runner status of such companies as Avon and Procter & Gamble, can claim a share of the world's largest make-up market if they proceed patiently. As China's urban population is forecast to become even more affluent and its youth more fashion oriented in the decades ahead, continuing demand paints a rosy outlook for cosmetics manufacturers. 完

China Venture Advisors

In the world's most complex environment, it's important to have a bi-cultural team of professionals at your side.

- China Strategies
- Joint Ventures
- Investment Opportunities
- Market Research
- Distribution Networks
- Chinese Products & Materials

Tel. (415) 564-0215
Fax. (415) 564-1879
1032 Irving Street, #716
San Francisco, CA 94122

(8610) 513-7766
(8610) 522-3451
1639 Beijing Hotel
33 E. Chongan Avenue
Beijing, China 100004

Hanging Out Your Shingle in China

■ Andrew Ness

Rental rates are rising rapidly—but so are the options

■ Andrew Ness is associate director, Research & Development Consultancy, Richard Ellis Ltd., Hong Kong. Richard Ellis Ltd. is an international real estate consulting firm.

In the 1980s—the early days of doing business in China—most multinationals set up shop in hotels in China's major cities. By the end of the decade, as the business climate in China appeared to be improving at a steady pace, these pioneers of international commerce began to outgrow their makeshift operating bases and seek out Western-style accommodations. What they found was a small stock of properties designed primarily for Chinese companies and built to meet the typically smaller power needs and less sophisticated office systems of such tenants.

Once international property developers entered the China market in the late 1980s, modern high-rise office towers began to appear on the urban skylines. Since 1992, however, demand for space in new developments built to Western specifications has outstripped supply. Between 1991-94, rental rates for Grade A office and residential space in Beijing and Shanghai rose approximately 40 percent each year. Currently, the available office space in the cities with the largest foreign business communities—Beijing, Guangzhou, and Shanghai—totals 1,390,000 sq m, a mere 27 percent of Hong Kong's total office space. Foreign companies seeking to lease prime office or residential space in China should be aware that they are stepping into a landlord's market, though China is moving towards protecting tenant rights.

Playing by the rules

The Administration of Urban Real Property Law, promulgated by the National People's Congress in July 1994, went into effect in January 1995. This is the first major piece of national property legislation to be issued in China since the 1990 promulgation of the Provisional Regulations Concerning the Granting and Assignment of Land-use Rights in Urban Areas and the Provisional Administrative Measures Governing Commercial Land Development and Management by Foreign Investors. The new law contains some 72 provisions in seven chapters dealing with almost every major issue of concern in the real estate sector. The law, however, merely lays out matters such as the registration of tenancy agreements in broad terms, deferring the promulgation of detailed implementing measures until a later date. Some localities have chosen not to wait for further national implementing regulations and have already drafted their own measures.

Shanghai has already promulgated detailed implementing regulations concerning the conversion of privately owned and occupied domestic residential property into commercially leased residential property, mandating that owners of such property first apply to and obtain permission from the Public Security Bureau (PSB). Upon obtaining this approval from PSB, the lessor and lessee must submit a Private Housing Leasing Registration

Form to the Private Housing Section of the Shanghai Real Estate Administration (REA) bureau and pay a fee equivalent to 12 percent of the total rental transaction value and a business tax of 5 percent of the transaction value.

Enforcement of the Shanghai regulations has been lax to date, and the rules have been largely ignored by many local condominium owners. This has given rise to a grey market in which owners directly lease private residential property to foreign parties. Technically, if a Shanghai resident owning private housing wishes to lease the property to an overseas national or foreign corporation, he must first apply for permission to both the PSB and the Shanghai Foreign Economic Affairs and Trade Commission to obtain a Permit for Leasing Property to Overseas Parties. Nationwide, prospective tenants who are willing to sign informal "private agreements" with the landlord without obtaining PSB approval or registering the agreement with the Private Housing Section of the REA may be quoted discounts of up to 20-30 percent off of the going rate for a legal agreement.

No procedures exist currently for registering leases of commercial and residential property with the REA bureau in Shanghai. Rather, notarization of the agreement and payment of the stamp duty are the only formal measures for concluding an agreement. Shanghai is currently drafting the Municipal Property Transaction Procedures, which will detail registration procedures and other measures for concluding commercial and residential leasing agreements within the city.

Currently, Shenzhen is the only municipality in China with a detailed and enforced body of implementing regulations to the Urban Real Property Law. The Shenzhen Special Economic Zone Building Leasing Regulations Implementing Rules, covering all types of leasing transactions within the municipality, mandate that a lessor first obtain a Building Leasing Permit or be subject to penalties.

Nationwide, while a detailed body of implementing procedures for the registration of tenancy agreements is still lacking, all tenancy agreements in China are nevertheless subject to the payment of a stamp duty. The law requires the parties to a lease to pay a stamp duty of .02 percent of the total value of the leasing transaction to the local bureau of the State Tax Administration (STA). This cost is borne evenly by the landlord and tenant.

Prospective tenants who are willing to sign informal "private agreements" with the landlord may be quoted discounts of up to 20-30 percent.

While payment of the stamp duty does not constitute official registration of the tenancy agreement, it is nevertheless an essential procedure, as it brings the agreement within the bounds of PRC contract law. Until all localities in China issue their own detailed property leasing implementing regulations, the stamp affixed to each page of the contract is usually the only piece of evidence that the tenancy agreement was concluded in accordance with the requirements of PRC law. Many multinationals leasing substantial office or residential space insist that the tenancy agreement also be notarized for added security in the event that the agreement is later the subject of dispute.

For tenancy agreements for the leasing of substantial areas of space, many foreign companies prefer to have such agreements publicly notarized so that there is no uncertainty concerning the conditions surrounding the signing of the agreements, should a dispute concerning the agreement arise. Signatories to un-notarized tenancy agreements on which the stamp duty has not been paid and for property for which the landlord has not obtained a property leasing permit (should local regulations require it) are more vulnerable to contractual violations. Increases in rental rates within the supposedly fixed-term, fixed-rent period of the lease and threats of eviction if the tenant refuses to pay the increased amount are just two common contractual violations.

Where's the manager?

Aside from a reference to property management in the Administration of the Pre-Sale of Urban Commodity Buildings Procedures promulgated by the Ministry of Construction in November 1994, no specific national regulations exist concerning a developer's responsibility to arrange for long-term management of property. The rules in Shenzhen, the only municipality to pass regulations pertaining to rental property management, apply only to residential properties.

Market forces, nonetheless, have driven many foreign and local developers of Grade A properties to draft and implement deeds of mutual covenant which stipulate management arrangements according to international practices. Because property sales often suffer when long-term management plans are lacking, many developers now attach to their sales agreements a supplementary agreement establishing a deed of mutual covenant between all of the buyers of units within a given property upon its completion. Individual condominium owners typically agree to abide by certain rules of building occupancy, to appoint a building management company, and to pay a share of management fees on a pro-rata basis. The quality of building management in China is thus entirely dependent on the reliability of the management company appointed by the developers or major investors in a property. Popular management companies for China properties include Colliers Jardine, First Pacific Davies, and Richard Ellis Ltd.

Because deeds of mutual covenant lack the legal backing of national or municipal ordinances, their violation constitutes merely a breach of civil contract. Only Shenzhen's residential property management regulations include a liability clause for violation of the deed. Throughout China, if a condominium unit is vacant, then the landlord is responsible for paying the management fee to the management company of the building. If a condominium has been leased, the tenant is responsible for the payment of the management fee. Because many of the

units in large property developments are owned by absentee landlords as investments, violations are not infrequent. Absentee condominium owners may fall grossly in arrears in paying management fees mandated by the deed of mutual covenant.

Though Shenzhen's Property Management in Residential Districts Regulations pertain only to residential districts within the municipality, they will likely serve as the basis for future commercial property legislation in Shenzhen and elsewhere. The regulations mandate that residential districts appoint a property management company for buildings in the district, that the property management company maintain an office within the district, and that owners of property within the residential district draft and sign a deed of mutual covenant containing certain provisions, such as a code of conduct for property owners and the liability terms for violation of the deed.

Know the owners

Ascertaining the ownership structure within a building should be a primary task of foreign corporate tenants who may wish at some point to lease multiple units or floors in a single building. Most developers of new high-rise buildings going up throughout urban China pre-sell many of the units, resulting in numerous strata-title owners and an extremely fragmented ownership structure.

When leasing space for residential purposes, having numerous strata-title owners in a building generally is less problematic than if the property will serve as an office, given the fact that residential units are occupied by individuals or individual families. But for companies needing to house many expatriates, having to deal with several different landlords within a single building is hardly ideal.

For office tenants, it is better to lease space in a building in which entire floors, rather than individual units, are under single ownership. Large multinational companies that require more than one floor of office space or may need to expand onto contiguous floors later still face the prospect of having more than one landlord for their extended office premises. Unless they plan ahead, they may find themselves committed to asynchronous leasing terms and conditions. If a company expects to expand its facilities onto contiguous floors at some future time, it should either lease extra space from the beginning and try to sublease the space under a time limit coinciding with its plans, or lease space from a landlord who owns contiguous floors.

For office tenants, it is better to lease in a building in which entire floors, rather than individual units, are under single ownership.

Another caveat is that tenants and owners of pre-sold units in buildings that are less strongly positioned in the market may experience delays in the date of occupancy. Despite regulations that aim to protect the owner or leaseholder of a unit in a building that is under construction—developers must show proof of good title to the development site, have injected 25 percent of the total construction cost into the project, and have received all necessary planning approvals before selling or leasing units—a property that is not strongly positioned in the marketplace is vulnerable to disappointing pre-sales. Low pre-sales could delay the completion date for a property, which could be a significant inconvenience to the condominium owners or leaseholders.

Lease haggling

Once a firm has identified property to lease, it enters the turbulent waters of lease negotiations. China's regulations governing landlord-tenant relations are loosely defined, with no comprehensive, national body of legislation describing the necessary contents of a tenancy agreement that explains the rights and obligations of parties to a lease, or the penalties to be imposed in the event of the breach of a lease agreement.

Shenzhen again stands out as an exception—the Shenzhen Building Leasing Regulations Implementing Rules are both thorough and enforced. Shanghai legislators are currently drafting the Municipal Property Transactions Procedures, which are expected to stipulate that a written leasing contract be registered with the local REA bureau. Under the Shanghai rules, a prospective lessor will have to obtain a building leasing permit and pay a leasing management fee to the REA bureau.

Foreign companies should also be prepared to negotiate in a landlord's market. The lack of regulations governing the property sector in China and the high demand/low supply of commercial space have significantly strengthened the hand of the landlord in lease negotiations. The 1988 economic retrenchment and austerity program was immediately followed by the June 4 incident in 1989. The combined effect of these two events was a slowdown in the construction of many commercial development projects in the pipeline in the late 1980s, resulting in the present undersupply of Grade A office space. Waiting lists for prime space in central business districts are common in Beijing and Shanghai. Until early 1995, in fact, landlords in these two cities were generally reluctant to negotiate lease terms with all but the largest blue-chip foreign tenants. In recent months, though, landlords have become more willing to negotiate leasing terms and conditions, perhaps in view of the number of new office facilities that will become available in Beijing and Shanghai in 1996-98.

Present market conditions, however, still demand fast action by prospective tenants. Many large foreign companies coming to China directly from their home bases in the United States and Europe have been losing out on desired leasing deals to companies headquartered in Asia, which typically have a better understanding of the need to make quick decisions in China's property sector. While swift action is required to avoid losing a prospective property, lease negotiators should also strive for maximum flexibility. They may, however, have little leeway in some important areas. Because Chinese landlords still have the upper hand in dealing with smaller tenants, leases to smaller tenants in prime buildings are generally not granted for terms

To match the beat of **Shanghai** you have to be at its **Centre**.

In every great city there is always one crossroad where business, pleasure, culture and sophisticated living meet and mix. In Shanghai, that heart, that city within a city, is Shanghai Centre.

Here are a few of the reasons why: There's the 700 room Portman Shangri-la Hotel for your five-star guests ... 472 deluxe apartments for longer-term residence ... 25,000 square meters of prime office space ... our two-level Retail Plaza to shop or sell from ... the Centre Theatre that seats one thousand and has become the new home of the performing arts in Shanghai ... and finally 4,000 square meters of exhibition hall space if you want to put on a show of your own.

Compare our great city to others you may know ... and compare Shanghai Centre to the best they have to offer.

We're confident we can match their tempo and yours, too.

SHANGHAI CENTRE

A joint venture of
AMERICAN INTERNATIONAL GROUP • THE PORTMAN COMPANIES • KAJIMA CORPORATION
SHANGRI-LA ASIA LIMITED

For more information, please contact the Shanghai Centre Marketing Offices:
1376 Nanjing Xi Lu, Suite 568, Shanghai 200040, People's Republic of China. Telephone: (8621) 279 8600 Fax: (8621) 279 8610
Shangri-La Asia Limited, 35th Floor, Bank of China Tower, 1 Garden Road, Central, Hong Kong. Telephone: (852) 820-0300 Fax: (852) 877 5011
Kajima Corporation, 3-2 Toyo 6-Chome, Koto-ku, Tokyo 135 Japan. Tel: (03) 5632 3152 Fax: (03) 5632 3156
12110 Sunset Hills Road, Suite 450, Reston, Virginia 22090, U.S.A. Telephone: (703) 715 3000 Fax: (703) 742 6059

of more than two to three years. In Beijing and Shanghai especially, landlords often refuse to include early termination clauses in leases.

Landlords nationwide tend to resist granting subleasing clauses to all but a minority of tenants who sign longer-term leases for substantial amounts of space. Owners of the most attractive office and residential properties may insist on reviewing rental rates after one year of occupancy. Upon making their review, landlords generally decide by how much, if at all, to raise rent based on prevailing market rates for the type of property in question and anticipated short-term changes in the leasing market. Landlords are generally only in a position to increase rental rates by a substantial increment if tight supply of office facilities provides their present tenants with few alternative choices in the marketplace. Foreign tenants of relatively small units (less than 250 sq m) find that it has been difficult to incorporate extension clause options into their leases. If the landlord agrees to include such a clause, it could well be the trade-off for refusal to cap the annual allowable rent increase.

Know what you're getting

In opting to develop office-cum-apartment blocks based on a construction design more suitable for apartment buildings and hotels than for offices, China's developers originally sought to maximize the number of rental units and income. What escaped the attention of these developers, however, was that demand for these properties comes largely from foreign firms and Sino-foreign joint venture companies, for whom small dual-use properties are hardly attractive since they lack open office floors that permit modular office arrangements. Office-cum-apartment buildings are seen as very inefficient compared to the easily subdividable plans of offices in the United States.

Companies coming to China from the United States, accustomed to space efficiency rates in the 80-90 percent range, tend to be discomfited by China's average space efficiency rates of 55-75 percent. Further, China has no standard measurement code, such as that of the Building Owners and Managers Association in the United States. In the absence of an established measurement code, office space can be quoted in one of three ways: gross amount (the entire external measurement of a premises including all walls, staircases, lift shafts, common areas, and office areas), lettable amount (includes all external walls and a share of common areas, but excludes lift shafts, stairwells, mechanical rooms, and other non-usable areas), or net amount (includes the area within the confines of external walls and/or party walls, and excludes all common areas, toilets, elevator shafts, and interior columns). Since space may be quoted in any of these terms, prospective tenants should be aware that rentals quoted on a gross basis by definition have less useable space per dollar than those quoted on a net basis.

Regardless of the basis on which a rental rate is quoted, the landlord should provide figures showing the efficiency of the premises so that the tenant can calculate the usable space per dollar. Although Chinese landlords and developers themselves may produce architectural drawings when questions arise about the accuracy of measurements, they will frequently resist accepting the measurements of an independent third-party architect appointed by the prospective tenant.

Finishing touches

The amount of commercial property in early stages of construction in nearly all of China's coastal cities and major centers of foreign investment suggests that the stock of office space will definitely continue to expand into 1998 and possibly beyond. Even allowing for considerable construction delays, industry analysts forecast that by the turn of the century the supply of office space in such cities as Beijing, Guangzhou, Shanghai, and Tianjin will rise by as much as 400-500 percent over 1995 levels. Capital values and pre-sale prices of commercial properties in prime locations in these cities will likely remain stable or increase. In the suburban fringes of these cities (areas that are at least 10-15 km from the core urban area), where development has been more speculative, both rental levels and capital values are likely to come under increasing downward pressure over the next 2-3 years. After 1998, demand will again overtake supply, triggering a resurgence in rental rates and capital values for all quality properties across the board.

While national and local laws for the administration of the property sector are in the works, the true test of whether China's property sector will reach maturity will be if the government can develop a sizeable cadre of knowledgeable and qualified government administrators to supervise the even-handed implementation of the growing body of real estate and leasing regulations.

From the perspective of tenants, the exponential increase in the supply of prime commercial facilities on the horizon in Beijing, Guangzhou, and Shanghai can only be a good thing. While a strong landlord's market prevailed until 1994, the tables are beginning to turn in favor of tenants, especially for larger multinational companies. With the array of projects from which to choose slated to expand in 1996-98, prospective tenants will be able to be more selective with regard to quality of construction, building management, and ownership structure. Just as important as the regulations for the sector, competition among landlords for tenants could also force change and bring the market to a new stage of maturity. 完

PACIFIC
BRIDGE,
INC.
HEADHUNTING
FOR CHINA

- *Assisting American–Chinese joint ventures with staffing in China*
- *Western educated Chinese who want to return to China*
- *Database with over 1,000 good candidates*

1155 CONNECTICUT AVE., N.W.
WASHINGTON, D.C. 20036
PHONE (202)467-8585
FAX (202)833-2279

Shifting the Center

■ Andrew Ness

Shanghai is seeking to regain its former prestige as the nation's commercial capital

■ Andrew Ness is associate director, Research & Development Consultancy, Richard Ellis Ltd., Hong Kong. Richard Ellis Ltd. is an international real estate consulting firm.

In the last five years, Shanghai has expanded east, west, upwards, and outwards. The city's original commercial and residential core, Puxi, lying to the west of the Huangpu River has expanded in the last 10 years. Outlying areas such as the former industrial and shipyard quarter on the Huangpu's eastern bank, Pudong, and a 12 km stretch along the road to Hongqiao International Airport, are now included in the greater Shanghai area. While new construction abounds, commercial property developers have been struggling to keep up with the number of foreign companies demanding prime office facilities. As Shanghai's star rises in China and Asia, property values are certain to increase, but not without some ups and downs along the way.

Starting from scratch

Prior to the mid-1980s, most foreign companies conducted their business out of hotels in the city's two central commercial districts, Huangpu and Luwan. With the granting of land-use rights in the Hongqiao Economic and Technical Development Zone near the Hongqiao International Airport to the Sun Group of Japan in 1988, the stage was set for the emergence of an internationally oriented commercial property market in Shanghai. In 1989, development of the 522 sq km Pudong area into a commercial and industrial zone began (*see* The CBR, November-December 1991, p.22). During his 1992 tour of southern China, Deng Xiaoping officially bestowed approval on the city's intention to regain its former position as China's pre-eminent commercial and financial center.

Since 1992, the Shanghai municipal government has granted development rights to 979 sites in nine districts of the greater urban area. The number of foreign companies with offices in Shanghai grew at an average annual rate of 91 percent between 1990-94. With 10,700 foreign-invested companies and over 3,300 foreign representative offices, Shanghai has the largest overseas business community of any city in China. True to its former image, Shanghai is now home to branches of 33 foreign financial institutions.

Infrastructure improvements

Seeking to bring back international financiers and attract domestic entrepreneurs to Shanghai, the city's planners have undertaken numerous infrastructure projects. Although the goal over the mid term is to shift the commercial center from Puxi across the river to Pudong, the short-term goal is to make Puxi more attractive to businesses by improving basic transport services. Four major infrastructure projects in Shanghai completed recently or still in progress stand to affect real estate development, rentals, and sales.

The Shanghai Inner Ring Road system, completed and fully operational as

of December 1994, has relieved traffic congestion between the inner city districts of Changning, Xuhui, Nanshi, Yangpu, Putuo, and Zhabei. It includes two bridges between Puxi and Pudong. Handling about one third of Shanghai's daily automobile traffic, the road makes inner-city travel much more convenient, and its bridges reduce travel time from the Hongqiao airport to Pudong. Pudong, however, will not witness its full flowering as an office location until the completion of the Shanghai Metro Line Number Two Sub-Plan I in 1998-99, providing the first mass transit connection between Shanghai's bifurcated eastern and western halves.

A second project, the Shanghai Metro Line Number One, began operating in April. The line consists of 13 stations and covers 16.1 km between Jingjiang Park in Xuhui district and the railway station in Zhabei district. The Xuhui district, with approximately 800,000 residents, contains 6 of the subway's 13 stations and has become home to 3 major foreign-invested department stores. Easy access to the subway likely figured into the decision to construct 14 multi-use complexes in Xuhui within the next four years.

Zhabei, historically one of the most disadvantaged of Shanghai's inner-city districts, now boasts the massive Everbright City redevelopment scheme. Consisting of 22 projects near the train station, the Everbright plan will substantially augment the city's stock of dedicated office facilities. Though Zhabei offers extremely convenient transportation access, it likely will not shed its working-class industrial image until the Everbright projects are complete. In Luwan district, an entire section of Huaihai Middle Road with three metro stations has been targeted by major overseas development companies as the site for nine multi-use complexes, all of which are now under construction.

> Since 1992, the Shanghai municipal government has granted development rights to 979 sites in the greater urban area.

Third, the Chengdu Road Elevated Freeway is scheduled to be fully operational by early 1996. The road will provide six lanes of elevated freeway and eight lanes of ground roadway, directly linking the northern and southern sections of the Inner Ring Road. The freeway will improve access to Zhabei's Tianmu Road, Yan An Middle Road, and Huaihai Road, which in turn should make office developments in those areas more attractive.

The fourth project, the Yan An Tunnel Expansion Project, is scheduled for completion in late 1996. The project will complement the Inner Ring Road system by providing two additional traffic lanes between Puxi's Zhongshan East Road (the Bund area) and Pudong's Lujiazui district. Once complete, the new tunnel will be used for eastbound traffic and the older tunnel will be dedicated to westbound traffic. Pudong will become a more viable office location for foreign companies when the tunnel expansion project is completed.

The major shift in the city's commercial center of gravity from Puxi to Pudong, which will include the relocation of the Shanghai Stock Exchange and municipal government offices to Lujiazui, will have to wait until full completion of Metro Line Number Two in 2000. Running 26 km from the eastern end of Pudong to the western part of Puxi, the subway will make commuting from residential areas in Puxi to offices in Pudong much more feasible. Until the subway is complete, however, the less strongly positioned among the over 100 commercial complexes now at various phases of planning or construction in Pudong are likely to garner tepid interest from renters and buyers. Short-term demand for office space in Pudong will come largely from companies with manufacturing operations in the zone.

Table 1
Office Rental Rates in Shanghai

Districts/Selected Properties	Rent* ($ per sq m/month)
CHANGNING	
Golden Bridge Mansion	83
Shartex Plaza	66
Shanghai International Trade Centre	66
Wanke Plaza	36
HUANGPU	
Central Place	83
JF News Building	76
Union Building	60
JING AN	
Apollo Building	63
Hotel Equatorial Office	61
Shanghai Centre	90
Universal Mansion	63
LUWAN	
Jinjiang Club Office Annex	42
Ruijin Building	66
PUDONG	
Huadu Building	45
Yu An Building	27
PUTUO	
Shanghai Materials Trade Centre	35

SOURCE: Richard Ellis Research & Development Consultancy
* Excludes management fees.

In mid-stream

Currently, Shanghai has a total of 24 Grade A office buildings with space available for rent or purchase. Space in these facilities totals 420,000 sq m, representing a 56 percent increase over the total space in dedicated office buildings at the end of 1994. Eight of the buildings were completed this year. Of the 24 office facilities, 15 are located in major commercial areas and have full modern electrical and mechanical services as well as quality finishes and fittings in the lobbies and public areas. While rental levels for most dedicated office buildings continued to edge upwards by 3-5 percent in the first half of 1995, the new supply eased rental levels by roughly the same 3-5 percent for a handful of prime office properties. Rental levels for prime offices in Shanghai in mid-1995 averaged $72 per sq m per month.

The facilities commanding the highest rental rates in Shanghai are located in the Puxi districts of Huangpu, Luwan, Jing An, and Changning (*see* Table 1). Office rentals in Pudong's Lujiazui, where the first facilities dedicated exclusively to commercial offices are only now reaching completion, currently are approximately 50 percent less expensive than prime Puxi facilities. While the city's real estate market is still in the formative stages, prime commercial areas in the next three years are likely to be these four districts.

Leaseholds on the buildings along the Bund, the area along the Huangpu River long viewed as a symbol of Shanghai's commercial orientation, are in the process of changing hands. The Shanghai Bund Buildings Function Transformation Corp. Ltd. currently manages the disposition of leaseholds on the Bund's 130 structures that pre-date the founding of the PRC. All of the buildings along the Bund are under historical preservation, which requires companies acquiring leaseholds to maintain the facades and external structures. Of the 130 buildings, 37 have been selected for disposition to private parties and 18 had been offered for sale or leasing as of December 1994. Of the 18 offered for sale or leasing, 6 are occupied by financial institutions.

Capital values

The wave of short-term investment fever that swept Shanghai in the early 1990s subsided after the tightening of credit to capital construction projects in mid-1993. Despite the overall slowing of pre-sales activity in the marketplace, the pre-sale of units in the Shanghai Financial Centre, located along the Bund, in mid-1994 set an all-time record in the asking pre-sale price for office property of $4,100 per sq m. Speculative activity has subsided in 1995 and sales prices seem to have stabilized at different levels depending on the district in which a property is located (*see* Table 2).

> Pudong will become a more viable office location for foreign companies when the Yan An tunnel expansion is completed.

The highest asking sales prices for office properties have been for those located in Huangpu district—once considered the Wall Street of China—where a prime office address fetches developers an average of $3,500-$4,000 per sq m. Properties along Luwan district's Huaihai Road, the main shopping street of the former French Concession and now a major tourism and shopping enclave, are second to Huangpu in price range. Jing An district, formerly an affluent residential area, has emerged as a hub of commerce and tourism and is the site of the city's largest operational commercial complex, two foreign-funded hotels, and three additional dedicated office blocks.

Plenty in the pipeline

Between 1995-97, a total of 51 prime developments with 1.56 million sq m of office space in Puxi are scheduled for completion and 59 Grade A office developments with 1.95 million sq m of office space in Pudong are scheduled to come on stream as well, provided that con-

Table 2
Sales and Pres-sales Prices for Offices in Shanghai

Districts/Selected Properties	Price ($ per sq m)
CHANGNING	
Shanghai Plaza	3,300
Sun Plaza	3,000
HONGKOU	
Shanghai Trade Square	2,500
HUANGPU	
Financial Square	4,100
Lucky Target Square	3,500
JING AN	
Concord Plaza	2,800
Jiu An Plaza	3,350
LUWAN	
Hong Kong Plaza	3,500
Shanghai Novel Building	2,900
PUDONG	
Hua Du Building	2,350
Oriental Plaza	1,600
Tomson Financial Building	2,800
PUTUO	
Jin Yuan International Building	1,550
XUHUI	
Kuen Yang International Business Plaza	2,300
ZHABEI	
Shanghai Sky City	2,000

SOURCE: Richard Ellis Research & Development Consultancy

struction of the projects proceeds on schedule. If these projects are not delayed or abandoned, the additional facilities will raise the city's total stock of office facilities to approximately 3.5 million sq m by 1998—equivalent to the amount of office space developed in Hong Kong between 1980-95.

Given the precipitous rate at which the supply of Shanghai office facilities is set to increase over the next five years, some analysts predict an oversupply of flood-tide proportions. Because construction at numerous sites is currently delayed for regulatory or financial reasons, however, an oversupply of such magnitude is unlikely. While an office space surplus in the range of 25-40 percent is likely to result in 1998, vacancies are unlikely to last long.

Since the State Council imposed a moratorium on the granting of development sites for "high-end residential, commercial, and leisure-oriented development projects" from 1995 through 1998, the projects currently under way will have to meet demand until another wave of buildings are completed, perhaps by the year 2005.

Demand from domestic sources is likely to supplement demand from foreign companies in the future. Research suggests that demand for office space from privatized State enterprises and collectives in and around Shanghai and the eastern seaboard will grow considerably, compensating for the expected leveling off in the number of new overseas companies setting up shop in Shanghai. Such demand is likely to give the Shanghai property market a much more solid underpinning than the highly speculative markets in Haikou on Hainan Island, and Dongguan and Shenzhen in Guangdong Province, where overseas investors began construction projects amidst the investment boom of 1992-93 but where rental demand from foreign companies was minimal.

The scenario in 1998 of surplus Grade A space will almost certainly force rental rates down, though by exactly how much will depend on the quality and location of individual properties. Landlords may begin offering inducements to foreign tenants—especially China representatives of well-known multinational firms—to remain in their buildings. Properties likely to experience the sharpest drop in rental rates are those in immature commercial locations where interest is mild even now. Landlords in prime office buildings and locations will be among the last to make major rental concessions.

With its high land values and the added costs of site clearance, Shanghai is an especially expensive city in which to undertake real estate development. Most developers who have obtained land-use rights for development sites in the central city area are well backed financially, and their building projects will likely be followed through to completion. As a result, capital values of prime Shanghai office property in the mid term are likely to be less volatile than rental rates. Companies with the financial wherewithal to enter this development market have been unwilling to lower the pre-sales prices of their properties despite the current sluggishness in the property sales market.

Because the land bank in prime locations in Shanghai is small, developers and landlords with the stamina to hold their properties through the present period of slow sales will ultimately be rewarded when interest in leasing and purchasing property exceeds the stock of property now in the construction pipeline. In regaining its pre-eminence as a commercial hub in the coming decade, Shanghai's skyline will remain thick with construction cranes—a cause of traffic delays, perhaps, but a sign of increasing office space options down the road. 完

A Toehold in the South

■ **Andrew Ness**

Urban development rides the foreign investment wave

■ **Andrew Ness is associate director, Research & Development Consultancy, Richard Ellis Ltd., Hong Kong. Richard Ellis Ltd. is an international real estate consulting firm.**

Long a nexus between the overseas Chinese diaspora and mainland China, Guangzhou was one of China's first cities to pack up its Mao jackets in favor of Western business suits when Beijing gave the nod to foreign investors in the early 1980s. Like Shanghai, Guangzhou is in the throes of major commercial development in areas formerly dedicated to agriculture and manufacturing. Growth in the commercial property sector began with the establishment of the first better-class hotels to accommodate overseas businesspeople in the early 1980s. Now the city is home to 7,000 foreign-invested enterprises (FIEs) and 3,000 representative offices, compared to 421 and 240, respectively, in 1990.

Exceeding boundaries

Geography has largely determined the shape of Guangzhou's development. Traversed by the Pearl River and bounded by the Baiyun Mountains, the city has developed along major water and land transport routes. To the north of the Pearl River are the more established districts of Dongshan, Yuexiu, and Liwan. On the river's southern bank are the formerly industrial districts of Haizhu and Fangcun,

where property development aimed at domestic and foreign buyers is under way or in the planning stages.

Yuexiu, home to the Guangzhou Commodities Fair building and the train station, was the initial focus of foreign commercial property developers in the mid-1980s. Encompassing two of the city's largest recreational parks, the district is attractive to commercial developers because of its central location, dense concentration of government offices, and access to the train station. Dongshan district was one of the first areas selected for commercial development when Guangzhou began granting land-use rights in 1988. By 1992, a second cluster of office facilities was completed in Dongshan district along Huanshi East Road, the oldest inner-city ring road. This area has now emerged as the city's pre-eminent central business area.

Liwan has come back to life as a commercial district only in the past year. Centered around Sun Yat Sen Memorial Hall Park, Liwan is one of the city's oldest settled central districts. Numerous foreign retailers and restaurants, including Giordano and McDonald's, have opened stores along the district's main commercial boulevard, Renmin South Road. Although the district currently does not offer a suitable environment for offices of foreign companies, this likely will change when the metro line begins operation.

While Yuexiu, Dongshan, and Liwan have long been commercial or residential, Haizhu and Fangcun have acquired these hues only in recent years. Haizhu district, with a very dense residential population residing alongside manufacturing plants, has long enjoyed access to the central city area across the river via four bridges. In recent years, the district has been a target for residential property developers hoping to attract overseas and domestic buyers. Four office buildings have gone up along the district's main transportation artery, Jiangnan Road, but they are of secondary quality and targeted at the local market. The district likely will not be oriented towards commerce in the future, but towards residences and their supporting facilities.

Fangcun district still contains a sizeable concentration of manufacturing plants, along with some municipal government offices and large areas of undeveloped land. In 1985 the district was designated a central urban district, which permitted the development of residential and commercial properties on land previously zoned for agricultural and industrial uses. Several local and foreign developers have acquired land in Fangcun, but because the area currently is accessible only by ferry from central Guangzhou, it likely will not emerge as a focal point for development activity until Metro Line Number One is completed in 1998-99.

Another outlying area that witnessed the arrival of earth-moving and construction equipment in the early 1980s is Tianhe. Previously an agricultural area 5 km from the city center, Tianhe has much in common with Shanghai's Lujiazui in Pudong. Due to the high cost of undertaking large-scale urban redevelopment

> Although office rental rates in Guangzhou dropped significantly following the June 4 incident of 1989, rates have been climbing since 1990 in step with increases in demand.

Table 1
Office Rental Rates in Guangzhou

Districts/Selected Properties	Rent* ($ per sq m/month)
DONGSHAN	
Dong Jun Plaza	31
Garden Hotel Office Tower	50
GITIC Plaza (Main Tower)	48
Guangzhou World Trade Centre Complex	32
YUEXIU	
Broadway Plaza	31
China Hotel Office Tower	57
Dong Fang Hotel	65
Guangzhou International Financial Building	45
TP Plaza	34

SOURCE: Richard Ellis Research & Development Consultancy
* Excludes management fees.

Table 2
Pres-sales Prices for Offices in Guangzhou

Districts/Selected Properties	Price ($ per sq m)	Scheduled Completeion Date
DONGSHAN		
Peace World Plaza	3,750	1995
Yi An Building	2,790	1995
LIWAN		
Bank of America Plaza	3,400	1996
Universal Plaza	2,225	1995
TIANHE		
Jonsim Plaza	3,040	1996
Nan Fang International Square	2,067	1997
Sky Central Plaza	3,336	1997
YUEXIU		
Guangzhou Exchange Square	3,737	1996
Top Spring Development Building	1,951	1996

SOURCE: Richard Ellis Research & Development Consultancy

within the aging central city, Guangzhou planning authorities designated this undeveloped suburban area a central district in 1985. The district has since added a sports stadium and attracted a sizeable residential population. Eleven multi-use projects are currently under construction.

Rents reach plateau

Although office rental rates in Guangzhou dropped significantly following the June 4 incident of 1989, rates have been climbing since 1990 in step with increases in demand. Currently, 27 buildings with office facilities of varying quality are scattered throughout the city. Of these, 21 are dedicated office blocks or office blocks embedded within larger commercial complexes, and 6 are hotels that have converted a portion of their guest rooms into offices. Only 9 of these facilities, however, have convenient access to main arterial roads, quality building finishes and fittings, sound mechanical and electrical services, good property management, and other characteristics attractive to foreign companies. Total office space in Guangzhou is roughly 459,000 sq m, or 9 percent of Hong Kong's present supply.

Developers with strong financial backing are no longer aggressively marketing the remaining stock but are holding onto the properties.

Rental rates for Grade A office facilities in Guangzhou range from $31-$65 per sq m per month (*see* Table 1). The median monthly rental in Guangzhou is $41 per sq m, compared to $81 per sq m in Beijing, $72 per sq m in Shanghai, and $100 per sq m in Hong Kong's Central district. In 1994, office rental rates in Guangzhou rose 15-20 percent, in step with China's urban inflation rate but at a slower pace than increases in rents in Beijing and Shanghai during the same period, reflecting weaker demand in Guangzhou. In 1995, the supply of office space in Guangzhou increased somewhat, perhaps explaining the slowdown in rental rate increases in the first half of 1995 to 5-8 percent. Indeed, facilities that typically have been occupied to capacity, such as the Guangzhou World Trade Centre, the Guangzhou International Financial Centre, and the GITIC Plaza Main Tower, currently are 5-10 percent vacant.

Holding out for more

Although investors continued to develop commercial real estate in Guangzhou after the credit clampdown of 1993, buyers are becoming more selective and are acquiring properties to hold as long-term investments rather than for short-term gains. Over the past three and a half years, office space in 56 multi-use complexes has been offered for pre-sale. Five of the buildings have been completed within the past year and 51 are still under construction. Measures taken in late 1994 by the Hong Kong government to halt speculation in the colony's real estate market—including lowering the ceiling for the maximum loan for mortgage finance that banks could offer—triggered a downswing in Hong Kong investors' interest in other markets as well, including Guangzhou. When Hong Kong investors' interest in purchasing Guangzhou properties cooled, sale prices ceased their precipitous rise and began to move along a plateau.

In 1995, prices for commercial Guangzhou property have remained stable, despite high urban inflation that has increased the costs of labor, materials, and other building inputs (*see* Table 2). Buyers in the market for substantial floor space in properties that have been experiencing slow pre-sales now reportedly have a wider margin of negotiability in contracts, as these developers are under pressure to recoup their initial investment through pre-sales. Developers with strong financial backing, however, are no longer aggressively marketing the remaining stock but are holding onto the properties, anticipating appreciating property values over the longer term.

Down the road

Long-term real estate investors should consider access to major modes of transportation a top priority, since Guangzhou's core central area is rather extensive—1,443

Stay where modern comfort is enhanced by ancient traditions.

For over 12 years, business travellers to Beijing have found that our unique blend of western technology and eastern hospitality makes a trip both productive and pleasurable. We look forward to showing you why.

swissbelhotel international

建国饭店
JIANGUO HOTEL
BEIJING

sq km, compared to Beijing's 1,370 sq km. Already an area that attracts large numbers of foreign visitors and residents, Huanshi East Road possesses six traffic lanes and includes three joint-venture hotels. Eighteen of the 55 buildings presently under construction in the city are located along Dongshan's Huanshi East Road and are likely to bolster the status of the district as the city's major office hub.

Liwan's Zhongshan Road, where eight buildings are under construction, was one of Guangzhou's prime commercial boulevards in the early 20th century but only recently emerged as a focal point for overseas property developers when construction began on Metro Line Number One. With 7 of the 19 metro stations slated to stop along Zhongshan Road, the boulevard stands to reclaim its fame as a major commercial area. A number of new property developments are going up in the nearby Dongfeng Road area, but since no new transportation projects are slated for the area it is likely to remain the domain of government offices.

The Guangzhou municipal government has targeted for redevelopment substantial portions of the old waterfront area along Yanjiang Road, running through Dongshan, Liwan, and Yuexiu districts. Since the area will not be served by the metro it may not be the first choice of multinational companies, though property values along Yanjiang Road are still likely to increase. A cluster of eight multi-use complexes with sweeping views are now under construction at sites along or near the waterfront.

The site of 11 office blocks already under construction and on the market and numerous other projects in the drafting stages, Tianhe is the most speculative district of Guangzhou's newly emerging commercial areas. Because Tianhe currently lacks a mature commercial environment—hotels, department stores, and other office and multi-use complexes—foreign companies have tended to shy away from this area. Three metro stations scheduled for completion in 1999, however, should brighten its prospects.

Choosing an address

With Guangzhou so close to modern, efficient Hong Kong, foreign companies must weigh the pros and cons of establishing an office in one city over the other. Guangzhou offers not only less expensive rent, but also a toehold in the economic center of the increasingly affluent Guangdong consumer market. On the downside, however, Guangzhou's standards of building management, though improving, are still lower than those in Hong Kong. When leasing Guangzhou properties, a company also must ensure that the building's power supply is adequate to meet present and future needs.

With Guangzhou so close to modern, efficient Hong Kong, companies must weigh the pros and cons of establishing an office in one city over the other.

For companies that decide to set up a base in Guangzhou, certain districts offer different benefits. For a company that seeks a prestigious address, most of the properties to consider are along or near Dongshan's Huanshi East Road in buildings such as the GITIC Plaza Main Tower, Guangzhou World Trade Centre, and Garden Hotel Office Annex. The Broadway Plaza or Guangzhou International Financial Building in Yuexiu would offer companies easy access to offices of the Guangdong provincial government or Guangzhou municipal government. For a company with a staff that commutes often between Hong Kong and Guangzhou by train, an address in Yuexiu district's China Hotel Office Annex or Dong Fang Hotel would be convenient.

Market prospects

Like Shanghai's property market, Guangzhou's could soon witness a glut of office space. Assuming all the office blocks presently under construction are completed according to schedule, the supply of office facilities will increase 65 percent in 1995, 66 percent in 1996, and 42 percent in 1997. Since 1989, the number of companies leasing office space in Guangzhou has grown roughly 35 percent each year, and is likely to increase annually at 25-35 percent until the turn of the century. While it is impossible to project precisely the exact number of projects that will be substantially delayed, developers of projects still in the blueprint stages or only recently launched are likely to delay construction until demand can keep pace. Consequently, developers are likely to be cautious in the short term, but more optimistic about the mid- and long-term prospects of Guangzhou's commercial property market.

Hong Kong's return to PRC sovereignty in 1997 will have only an indirect impact on Guangzhou property values. Because the possibility exists for a contentious transition, the Hong Kong property market appears potentially more volatile than Guangzhou's. Any downswing in the Hong Kong property market itself, however, should have little impact on Guangzhou's property market, since short-term investment funds from Hong Kong have ceased to be a major driving force there. 完

Investment Capital for China

We are interested in investing in Chinese joint ventures which are run and controlled by established and successful western companies.

ORCHID HOLDINGS, L.P.
555 California Street, Suite 5180
San Francisco, CA 94104-1716
415/781-2200 telephone • 415/781-2189 facsimile
Contact Peter M. Joost or Christopher J. O'Brien

Sprucing Up China's Cities

■ Timothy Geisler

US design firms look to frame the modern skyline

A walk down any street in China, where stark concrete buildings dominate the landscape, confirms the need for architectural advice to support the multitude of construction projects already under way. With one of the world's highest levels of new construction each year, China's market for architecture services is flourishing. Because Chinese architects have little experience in handling such a dramatic increase in the need for commercial building designs, opportunities for foreign cooperation with Chinese design firms abound.

Few foreign architects have experience in the Chinese construction and real estate sectors, however, and many have been reluctant to explore opportunities in the PRC. Limited access to government regulations and low design fees continue to present real obstacles to establishing a profitable design business in China. But by following some simple guidelines and taking the time to find the proper project and the right partner, Western architects can become an integral part of the industry's continued growth.

China's architecture industry

According to official 1994 statistics, nearly 97 percent of the 2,000 existing "design institutes" or architecture firms in China are State owned, with the remainder classified as collectives. The Ministry of Construction (MOC) registers each of the institutes into one of four groups according to the geographical area in which the firm is allowed to operate and the size of the projects it is allowed to accept. Class A institutes are allowed to undertake design or construction of buildings of any size and/or complexity in China, while Class B, C, and D institutes are restricted to working on non-high-rise projects within a given province.

Though the United States has currently approximately 340 architects per million citizens, China has only 35 architects per million citizens. Chinese architects are not yet required to complete standardized certification examinations, although MOC plans to hold the first nationwide certification examination in November 1995. MOC has also announced plans to allow independent Chinese design firms in Guangzhou, Shanghai, and Shenzhen on an experimental basis. Independent design institutes will be allowed throughout China as soon as the certification system is in place. Many young Chinese architects are now preparing for the certification examination with the goal of beginning their own firms once they pass the national certification requirements.

Rules for foreigners

For foreign architects hoping to gain a foothold in the fast-growing China market, the process of setting up an individual design firm is far from simple. According to MOC's 1992 Regulations on

■ Timothy Geisler is a Beijing-based architect for Toyu Design International, Ltd., a Sino-American joint venture.

Establishing Jointly Managed Sino-Foreign Design Projects, foreign architecture firms are required to work in cooperation with an officially licensed Chinese design institute, either by undertaking projects on an ongoing basis or by setting up a permanent joint venture. Local developers, planning commissions, or large work units often hold design competitions to locate potential joint-venture partners. Foreign architecture firms can also try to find their niche in China's architecture market by winning bids for planned real estate developments or acting as consultants to a Chinese design institute.

Joint ventures between foreign architecture firms and Chinese design institutes can take one of two forms: a full-fledged equity joint venture (EJV) (*hezi qiye*) or a contractual joint-venture (CJV) partnership (*hezuo qiye*) for one or more specific projects. While setting up a project-specific, short-term CJV requires the same amount of paperwork as a long-term EJV capable of undertaking an unlimited number of projects, forming a CJV lowers the financial and legal risks to both sides. Establishing a CJV can also help the venture avoid some of the taxes EJVs face. The American firms RTKL Associates Ltd.; Skidmore, Owings & Merrill; and Helmut, Obata & Kassabaum all established CJVs rather than EJVs for their China projects (*see* p.52).

Regardless of whether the firm decides to form an EJV or a CJV, the resulting entity will be subject to the 1979 Law of the PRC on Joint Ventures Using Chinese and Foreign Investment and the law's implementing regulations, which were promulgated by the State Council in 1993 (*see The CBR*, May-June 1995, p.10). The application procedure for establishing a design firm in China is similar to that of other foreign-invested enterprises, but as a service industry bringing little in terms of investment capital or new technology, design firms may encounter more difficulty than manufacturing firms in obtaining approval.

In Beijing, moreover, foreign firms may not be able to engage in the full range of architectural services they are capable of providing. The Beijing municipal government last December issued a new set of regulations excluding foreign architects from involvement in the design of a building's mechanical system and the production of construction documents—drawings, materials, lists, and schedules that appear on the blueprints. The new regulations will likely mean financial losses for foreign architects in Beijing.

Choosing an appropriate project in China requires research into the project's budget, financing possibilities, and the politics of the locality.

The regulations also effectively place quality control in the hands of the local design institute since foreign architects have little or no say in managing the actual building construction or supervision of workers.

The right match

Because of the importance of personal connections in China, the choice of a suitable partner will make a difference in the firm's access to the emerging real estate market. Western firms may find themselves at a disadvantage, however, as most design joint-venture partners in China are from Hong Kong and other East Asian countries with strong ethnic ties to China. Approximately 95 percent of the foreign architects operating in China are overseas Chinese.

Among the most important criteria in establishing a design venture in China is finding an appropriate Chinese design institute partner. The ideal design institute should be sufficiently reputable to attract contracts for the venture, sophisticated enough to work efficiently, and reliable enough to meet the venture's production schedule and protect the venture's designs. Many large institutes, such as the China Building Technology Development Center and the Beijing Design Institute, have proven able partners.

Although the PRC has classified Chinese design institutes according to geographical jurisdiction and project specialties, foreign architects should be aware that seeking Class A partners may not necessarily be in the venture's interest. If the foreign firm plans to concentrate on a given geographical area, for example, a design institute with a more concentrated scope may be a better match.

Further, within the larger institutes, foreign partners should specify the individual architect or architects with whom they want to collaborate. Senior architects in China participate little in the actual design process and may pass on much responsibility to their younger colleagues. To avoid allowing the venture's work to end up in the hands of the design institute's junior staff, a foreign architecture firm should get to know the design institute and its work style before beginning to negotiate a joint-venture contract.

Before beginning negotiations, parties to a joint venture should also clarify the responsibilities of each partner. Gao Xiao Hui of MOC's Policy Research Committee recommends that the foreign architecture firm and its prospective Chinese partner submit a proposal including a schematic site plan, preliminary elevations, and essential data to potential investors and the local planning bureau before even negotiating a contract to establish the design venture. In this way, both sides can be assured of a venture's potential before going to the trouble of setting up a formal partnership.

Most of the burden of obtaining approval for establishing the joint venture usually rests on the Chinese partner, who must convince the central government that the contract and the venture arrangements are in order and that the venture's design projects will serve China's development interests. Once the joint venture has been approved, executing the actual job of producing designs is not that much different from the work of an architect in the United States, except for the logistical difficulties of operating on both sides of the Pacific and in two languages.

Putting pen to paper

Choosing an appropriate project, another important step, requires research into the project's budget, financing possibilities, and the politics of the locality, as

well as the intended use of the site itself. A housing project for Chinese occupants, for example, may carry little profit for the foreign architect, but may provide an opportunity to experiment with low-cost housing. In contrast, a foreign-invested shopping center in a prominent location may promise a large profit, but may present a multitude of obstacles and red tape from urban planning officials when the venture attempts to obtain approval for the project.

The actual design work can usually be divided up in any way the partners find agreeable. Some foreign joint-venture partners cooperate throughout the entire design project, bringing Chinese representatives to the United States for the planning, schematic design, and design development phases, and sending Americans to China to be involved in preparing the construction documents and overseeing the actual construction. For project-specific CJVs, foreign partners typically

Design work can usually be divided up in any way the partners find agreeable.

handle the early phases of design and leave responsibility for the construction documents to the Chinese partner.

A foreign-invested design venture should also make sure it has access to an adequate supply of skilled labor if the construction process is complex. Although there is an abundance of construction laborers in China, many lack specialized skills and require the close direction of a site supervisor. When the supply of skilled labor for a particular project is not adequate, some design firms may consider bringing laborers from overseas or having certain items built overseas and assembled on-site.

Reaping rewards

Compensation for design firms in China is calculated according to the total cost of the construction project. As in any Sino-foreign partnership, firms should stipulate in the joint-venture contract how revenues are to be divided among the partners. Arrangements should also be made governing the pay schedule used to collect client fees. Most firms require part of the payment up front and structure contracts such that payment follows the work phases closely.

Because labor is relatively cheap in China, construction costs are very low—about $125 (around ¥1,000) per sq m. The official compensation rate for State-owned design institutes is 3.5 percent of total construction costs, although foreign design joint ventures can negotiate this

Bridging Cultures

RTKL Associates Ltd., one of the world's largest architecture, planning, and engineering firms, is currently undertaking extensive design projects in China. CBR Assistant Editor Maria Valdecañas recently discussed the firm's activities with RTKL Vice Chairman and Executive Vice President David J. Brotman.

CBR: *How did RTKL first become involved in design projects in China?*

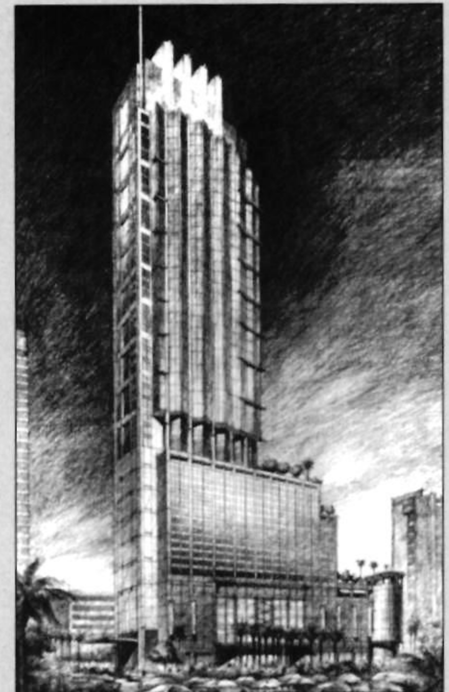
Brotman: As part of our Asian expansion efforts, RTKL headed to China just over three years ago. Today, the firm has become a major player in the market with a multitude of projects that range from major urban mixed-use projects and office buildings to urban master plans and tourist destination resorts. Currently, 17 projects are either under construction, awaiting approvals, or in the planning stages.

At the outset, we really did not know the "magic combination" to the real estate market in China. We knew other firms had been awarded a number of projects, but there appeared to be no single formula for success. What we did know from our experience in other Pacific Rim nations is that the work tends to be driven by personal connections.

Through relationship-building with developers well poised to invest in China, RTKL won its first major commission: Sun Dong An Plaza, a $300 million landmark redevelopment project in Beijing. A 50-50 joint venture between the Dong An Group of Beijing and Sun Hung Kai Properties Ltd. of Hong Kong, this 2 million sq ft state-of-the-art center with retail, entertainment, and office facilities is currently under construction in Wangfujing, Beijing's premier retail corner.

CBR: *What other kinds of projects has RTKL undertaken in China?*

Brotman: Since designing Sun Dong An Plaza, we have moved on to a wide variety of projects located throughout the country, acquiring commissions for design projects in a number of different ways. We worked with the PRC government on a design competition for the international headquarters of the China Ocean Shipping



RTKL's 1 million sq ft Sui Bao Tower will be home to office, residential, and commercial facilities in Shenzhen.

Photo courtesy of RTKL Associates Ltd.

Co. in Beijing. The 12-story, 1 million sq ft office building is designed with an illuminated top and is intended to be a significant landmark in downtown Beijing.

rate with the client. Some foreign architects have commanded rates as high as 15 percent. Moreover, because foreign architects typically work on large-scale projects backed by prominent investors, they can expect generous compensation. Construction costs for a three-star project in a major city, for example, will be about $450-$550 per sq m.

Designers beware

The best of plans and promises may not be enough to guarantee success, however. Despite the continued need for architecture services in China, the 16-point austerity program undertaken by the Chinese government in 1993 dampened the market for architecture services by slowing down growth in the property market. Because Chinese investors hoping to undertake real estate projects had to petition the central government for credit, funds were in short supply and many large-scale projects were delayed. The 1993 austerity measures had a short-lived impact on real estate, as Beijing succumbed to pressures from eager and powerful developers within a year, and rolled back the austerity plan. Recent data suggests that the construction market is tightening again (*see* p.38).

The protection of intellectual property is an additional problem faced by foreign design institutes. Clients rarely violate architecture firms' proprietary interests; rather the Chinese partner may try to take advantage of its relationship with the foreign design firm or use the venture's joint products for its own gain. Foreign architects should be especially careful to protect their drawings, which can be reproduced easily. Foreign architects should include specific clauses within the joint-venture contract to protect their work.

Foreign architects should be especially careful to protect their drawings.

Despite the obstacles and headaches, practicing architecture in China can be professionally rewarding and profitable for foreigners. The new regulations on acceptable foreign design activities in Beijing, if adopted in other locations, may narrow the range of opportunities. But once the MOC certification procedures are in place and private Chinese design offices begin to emerge, the market for architectural services and the pool of Chinese partners will grow. With a little research, a few connections, and a lot of patience, American architects can begin to find their way in this complex and elusive market, helping to light up China's urban skyline. 完

RTKL has also worked with a number of private developers in China. For Shirble Holdings Ltd., we designed the 52-story, 1 million sq ft Sui Bao Tower in downtown Shenzhen. Shiang Sheih Tower in Hangzhou, a proposed 22-story, 300,000 sq ft project with office and retail facilities that is currently under review, was also designed for a private developer.

Municipalities aware of our international planning reputation have hired us for a number of new community or urban extension projects. Working with the Planning Construction Bureau of the Dalian Economic & Technical Zone, RTKL has master planned a 4 sq mi new town development adjacent to Xiao Yao Bay, outside of Dalian. To help the city achieve its goal of becoming northeast China's most important port, the development was planned to encourage international trade and tourism while incorporating sea and land transportation facilities. Designed to serve an estimated population of 300,000, the new town includes a central business district with office and government buildings, a waterfront entertainment district, a commercial district, and residential and recreational areas.

CBR: *What strategies seem to work best in the China architecture market?*

Brotman: Part of our success is due to our commitment to responsible architecture and sensitive urban planning. It's a mind set that takes us far beyond designing buildings as isolated objects in space. Our focus instead is how they fit in a broader context—how they work with other buildings and how they respond to a city and its culture. Sun Dong An Plaza, for example, responds to political, social, historical, cultural, and aesthetic issues while also meeting planning requirements.

As we learned in other countries, working with a local design institute or local architect also helps to ensure the success of a project—from both a technical and a design standpoint. Sun Dong An Plaza was a team effort by the developer and local architects from the Architectural Design and Research Institute and the Institute of Project Planning and Research under the Ministry of Machinery and Electronics Industry. Approvals for the project were granted within three months—unbelievably fast for a project of this scope. Following the groundbreaking in October 1993, the project is on schedule for completion in late 1996.

Our involvement in US and Chinese State foreign-trade delegations has also proven to be fruitful. As a result of a tour recently organized by the state of Maryland to its sister province of Anhui, RTKL signed an agreement with Anhui's main planning design academy to design a $150 million tourist facility at Huangshan, a scenic attraction in southern Anhui Province.

CBR: *What advice would you give other architecture firms hoping to gain a foothold in China?*

Brotman: Over the last several years, we have learned that there is no set way to ensure success in the China market. The government approval process is different for each city, and even tends to change within the same city, from time to time—one solid reason to team up with a local design institute. The key is to be flexible, responsive to the requirements of each client, and adaptable to a set of rules that is often in flux.

Finally, you need money—a good deal of it. The scope of this market is such that you can't tackle it on a shoestring.

you can twiddle your thumbs

wondering why the Chinese haven't responded to your last three urgent faxes...

or you can join the US-China Business Council

PUT OUR RESOURCES TO WORK FOR YOU

WRITE, CALL, OR FAX FOR FULL MEMBERSHIP INFORMATION:

US-CHINA BUSINESS COUNCIL

1818 N Street, NW ■ Suite 500 ■ Washington, DC 20036

Tel: 202/429-0340 ■ Fax: 202/775-2476

CHINA BUSINESS

■ **Alan R. Kahn**

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

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

SALES AND INVESTMENT May 1 - June 30, 1995
Foreign party/Chinese party **Arrangement, value, and date reported**

Accounting and Insurance

OTHER

Chubb Group of Insurance Companies (US)
Will open The Chubb School of Insurance in Shanghai to train Chinese insurance industry regulators, officials, agents, and brokers. $1 million. 6/95.

ITT Hartford Insurance Group (US)
Opened representative office in Xiamen. 6/95.

National Mutual Life Association of Australasia Ltd. (Australia)
Opened representative office in Guangzhou. 6/95.

New York Life Global Co., Ltd., a subsidiary of New York Life Insurance Co. (US)
Opened representative office in Shanghai. 6/95.

Chartered Institute of Management Accountants (UK)
Opened liaison office in Guangzhou. 5/95.

John Hancock Mutual Life Insurance Co. (US)
Opened office in Beijing. 5/95.

Advertising and Public Relations

INVESTMENTS IN CHINA

Onyx Computers (Canada)/CCTV-China Central Television (Beijing)
Formed sports broadcasting equity joint venture to be exclusive agent for CCTV5 sports channel commercial advertising sales. $12 million. (US:85%-PRC:15%). 5/95.

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

Banking and Finance

INVESTMENTS IN CHINA

Morgan Stanley (US), Mingly Corp. (HK), Government of Singapore/People's Construction Bank of China, China National Investment and Guarantee Corp.
Formed China International Capital Corp. joint-venture investment bank to make direct investments in infrastructure projects, finance enterprise restructuring, and provide consulting services. (US:35%, HK:7.5%, Singapore: 7.5%-PRC:50%). 6/95.

Visa USA Inc. (US)/Ministry of Electronics Industry (Beijing)
Will build nationwide credit card network with regional centers in Beijing and Guangzhou. $10 million. 6/95.

Schlumberger Smart Cards and Systems (France)/Hua Xu Golden Card Co. (Beijing)
Will jointly develop smart-card technology and establish network maintenance service center. 5/95.

CHINA'S INVESTMENTS ABROAD

Agricultural Bank of China
Will open branch office in Singapore. 6/95.

Industrial and Commercial Bank of China
Opened office in Tokyo. 5/95.

OTHER

Credit Suisse Bank (Switzerland)
Will open branch office in Shanghai. 6/95.

Development Bank of Singapore (Singapore)
Opened branch office in Shanghai. 6/95.

Chemicals, Petrochemicals, and Related Equipment

INVESTMENTS IN CHINA

Zeneca Group PLC (UK), Advanced Chemicals (HK)/NA (Shenzhen)
Established Shenzhen Zeneca Advanced Colours and Chemicals joint venture in Guangdong Province to produce specialty chemicals for textiles and coatings. $24 million. (UK:80%, HK:15%-PRC:5%). 6/95.

BOC Group PLC (UK)/NA (Liaoning)
Established Shenyang OC Gases to produce gas-related equipment. 5/95.

Consumer Goods

INVESTMENTS IN CHINA

Firmenich SA (Switzerland)/Kunming Spice Plant (Yunnan)
Will establish Firmenich Spice Corp. Ltd. joint venture to produce perfumes and spices. $27.4 million. 6/95.

Mizui Co. (Japan)/Bang Ri De Health Care Products Co. (Beijing)
Formed Beijing Shuangri Pharmaceutical Co. to manufacture health care products. 6/95.

Mobius Green Energy Inc. (US)/Sunlee Hitech Industry Co. of Nankai University (Tianjin), Baodi County Development Zone (Tianjin)
Established BTU Hitech Tianjin Co. joint venture to produce nickel hydride rechargeable batteries. $7.1 million. 6/95.

Sanyo Electric Co., Ltd. (Japan)/Shenzhen Huaqiang Holding Ltd. (Guangdong)
Established joint venture to produce nickel-cadmium batteries. $3 million. 6/95.

Philips Electronics NV (Netherlands)/Suzhou Chunhua Vacuum Cleaner Factory (Jiangsu)
Established Chun Fei Domestic Appliances joint venture to produce and distribute floor-care products throughout Asia. $25 million. 5/95.

Sitram Cooking Pots Manufacturing Co. (France)/Shanghai Jingyi Stainless Household Utensils Factory
Established Shanghai Jingyi Sitram Stainless Steel Products Co. Ltd. joint venture to produce stainless steel pots for export. $8.3 million. 5/95.

CHINA'S INVESTMENTS ABROAD

China Department Store Chain (Group) Co., Ltd./NA (HK)
Will establish joint venture in Hong Kong to promote sales of goods produced in China and sales of Chinese goods abroad. $20 million. 6/95.

Electronics and Computer Software

INVESTMENTS IN CHINA

Casio Computer Co., Ltd. (Japan)/NA (Guangdong)
Formed Casio Electronic Zhuhai Co., Ltd. joint venture to manufacture musical instruments. $4.8 million. 6/95.

Hewlett-Packard Co. (US)/Shanghai Analytical Instrument Factory
Will form Hewlett-Packard Shanghai Analytical Products Ltd. joint venture to produce advanced chemistry equipment for electronic instrument production. $8.5 million. 6/95.

IBM Corp. (US)/China Great Wall Computer Group Corp. (Shenzhen)
Will establish joint venture to produce computer mother boards. $10 million. 6/95.

Intel Corp. (US)
Will build microprocessor assembly and testing plant in Shanghai. $50 million. 6/95.

LG Group (S. Korea), Getfit Co. (HK)/Beijing Peony Electronics Corp.
Will form joint venture to produce transformers. $16.5 million. (S. Korea:60%, HK:10%-PRC:30%). 6/95.

Philips Electronics NV (Netherlands)/Shanghai Electronic Sensors Co.
Established joint venture to produce electronic sensors. $24 million. 6/95.

Thomson Group (France)/Shenzhen Electronic Group (Guangdong)
Formed joint venture to produce integrated circuits. $82 million. 6/95.

Toshiba Corp. (Japan), NA (HK)/NA (Shanghai)
Established Shanghai Jinzhi Electronics joint venture to produce cable television receivers. $5 million. (Japan:40%,HK:NA-PRC:NA). 6/95.

Casio Computer Co. (US), Onflo Components Ltd. (HK)/Xinlong Economic Development Industrial Co. (Guangdong)
Established joint venture to manufacture and market scientific calculators and electronic diaries. $4 million. (US:70%, HK:25%-PRC:5%). 5/95.

Matsushita Industrial Electric Co., Ltd. (Japan)/Beijing No. 2 Radio Component Factory
Formed Beijing Matsushita Precision Capacitor joint venture to produce and market film capacitors for video recorders. $15.6 million. (Japan:60%-PRC:40). 5/95.

Micro Metallic Co. (UK)/Enping city government (Guangdong)
Established joint venture to produce etched lead frames for microchip production. (UK:85%-PRC:15%). 5/95.

NEC Corp. (Japan)/Changjiang Computer Union Corp. (Shanghai)
Will form NEC Shanghai Computers joint venture to produce, sell, and service computers and printers. $10 million. 5/95.

Samsung Corp. (S. Korea)/NA (Jiangsu)
Will establish joint venture in Suzhou Singapore Investment Park to produce semi-conductors. $23 million. 5/95.

OTHER

Siemens AG (Germany)
Will open branch office of Siemens (China) Co. in Fuzhou. 6/95.

Engineering and Construction

CHINA'S IMPORTS

British Steel PLC (UK)
Will supply structural steel for China Shanghai Jin Mao building and surrounding structures. $6.4 million. 6/95.

INVESTMENTS IN CHINA

Nabco Ltd., Shinsho Corp., Huacheng Construction Co., Ltd., affiliates of Kobe Steel Ltd. (Japan)/China State Construction Engineering Corp. (Beijing)
Established CSCEC Nabco Autodoor Co. joint venture in Beijing to produce and market automatic doors. (Japan:50%-PRC:50%). 6/95.

Owens-Corning Fiberglass Corp. (US)/Shanghai Building Materials Corp.
Will establish joint venture to produce thermal insulation materials. $25 million. 6/95.

Stow Storage Solutions, Inc. (Belgium)/China National State Forest Farm Development Corp. (NA)
Will form Stow Beijing joint venture to manufacture steel storage systems. $2.4 million. (Belgium:70%-PRC:30%). 6/95.

OTHER

NA (Russia)/NA
Will construct bridge connecting Heilongjiang Province and Russia's Amur region. 6/95.

Food and Food Processing

INVESTMENTS IN CHINA

Dole Food Co., Ltd. (US)/NA (Guangdong)
Established joint venture in Huizhou, Guangdong Province to produce juice drinks. $15 million. 6/95.

Bass PLC (UK)/Ginsber Beer Group, a subsidiary of Hong Zui Corp. (Jilin)
Will establish Bass Ginsber Beer Co. joint venture to produce and market Tennent's Lager. $40 million. (UK:55%-PRC:45%). 5/95.

Baycan Foodstuffs Co. (Turkey)/Wine, Drink and Foodstuffs Import & Export Co., a subsidiary of China National Cereals, Oils & Foodstuffs Import & Export Corp. (Beijing)
Established Beijing Baycan Befoco Foodstuffs Co. joint venture to produce chewing gum. $14 million. 5/95.

British Sugar PLC, a subsidiary of Associated British Foods PLC (UK)/Guangxi Yizhou Sugar Development Head Co.
Formed Bo Qing Co. joint venture to refine sugar in Shibie, Guangxi Province. $16 million. (UK:60%-PRC:40%). 5/95.

Carrier Corp., a subsidiary of United Technologies Corp. (US)/Shanghai Air Conditioner Factory
Will form Shanghai Carrier Transport Air Conditioning Equipment Co. Ltd. joint venture to produce transport air conditioning and freezing equipment. $10 million. 5/95.

Guinness PLC (UK)/Putian Brewery (Fujian)
Established joint venture to produce Guinness stout beer. 5/95.

ING Beijing Fund, a subsidiary of ING NV (Netherlands)/ Kunpeng Food Group (Beijing)
Formed Beijing Peng Cheng Food large-scale farming and food-processing joint venture. $10.6 million. (Netherlands:35%-PRC:65%). 5/95.

Winter Garden Co. (US)/Hebei Food Import & Export Co.
Will jointly produce Whole Sun-Airen brand orange juice. 5/95.

OTHER

Coca-Cola Co. (US)
Will establish Coca-Cola China Investment holding company and will build bottling plant in Shanghai. $30 million. 5/95.

Foreign Assistance

Government of Germany
Will provide aid for developing sewage disposal, afforestation, and small enterprises in Shandong Province. $167 million. 6/95.

World Bank
Will provide $47.5 million loan and $200 million IDA credit for the Southwest Poverty Reduction Project to improve health and education and provide farming tools and jobs. 6/95.

World Bank
Approved loan to improve waterways in eastern Zhejiang Province, central Hunan Province, and southern Guangxi Zhuang Autonomous Region. $210 million. 6/95.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Komatsu Ltd. (Japan), Sumitomo Corp. (Japan), NA (Japan), NA (Japan)/Shandong Bulldozer Factory
Formed joint venture to produce and market hydraulic excavators in Jining, Shandong Province. $21 million. (Japan:50%-PRC:50%). 6/95.

Matsushita Electric Industrial Co., Ltd. (Japan)/China Wuxi Little Swan Co. (Jiangsu)
Established Wuxi Matsushita Freezer Co. joint venture to produce freon-free refrigerators. 6/95.

Matsushita Electric Industrial Co., Ltd. (Japan)/Tangshan Electronic Equipment Factory (Hebei)
Formed Tangshan Matsushita Industrial Equipment to manufacture welding equipment and air plasma cutting machines. $15 million. 6/95.

OTHER

Ricoh Co., Ltd. (Japan)
Opened after-sales technical services office in Beijing. 5/95.

Metals, Minerals, and Mining

INVESTMENTS IN CHINA

Orbit Technologies Inc. (US)/NA
Will form titanium refining joint venture. $18.4 million. 6/95.

Veitsch-Radex, a subsidiary of Radex-Heraklith Industriebeteiligungs (Austria)/Liaoning Metallurgical Import & Export Corp.
Established magnesite mining joint venture. $27 million (Austria:55%-PRC:45%). 6/95.

Ka Wah International Group (HK)/Guangzhou City
Established Ka Wah (Huang Pi) Quarry joint-venture mining venture. $11 million. 5/95.

NA (US)/Lanzhou Aluminum Plant, an affiliate of China Nonferrous Industry Corp. (Gansu)
Will establish Yellow River Aluminum Co., Ltd. joint venture to smelt nonferrous metal and produce raw materials and processed aluminum. $188.4 million. (US:51%-PRC:49%). 5/95.

Packaging, Pulp, and Paper

INVESTMENTS IN CHINA

Amer-Asia International Inc. (US), Beloit Corp., a subsidiary of Harnischfeger Industries, Inc. (US)/Tianjin Paper Mill
Established joint venture to produce high-quality paper. $350 million. (US:90%-PRC:10%). 5/95.

Boise Cascade Corp. (US)/Shenzhen Leasing
Formed Zhuhai Hiwin Boise Cascade Speciality Paper Co. joint venture in Guangdong to produce carbonless paper. $12 million. (US:60%-PRC:40%). 5/95.

NA (S. Korea)/Shanghai Datong Co.
Formed container manufacturing joint venture in Shanghai. $22 million. (S. Korea:60%-PRC:40%). 5/95.

CHINA'S INVESTMENTS ABROAD

Tianjin Fortune Timber Co., Ltd./NA (Brazil)
Leased veneer board company and machinery to process wood. 6/95.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

NA (Iran)/NA (PRC)
Will sell 60,000 barrels of oil per day to China. $400 million. 6/95.

Statoil (Norway)/SINOCHEM (Beijing)
Will sell 1 million tonnes of crude oil. 6/95.

INVESTMENTS IN CHINA

Continental Grain Co. (US), Mitsubishi Corp. (Japan)/Shanghai Petrochemical Co.
Established Golden Conti Petrochemical joint venture to make liquefied petroleum gas refrigerated containers. $60 million. (US, Japan:52%-PRC:48%). 6/95.

GATX Leasing Ltd., a subsidiary of GATX Corp. (US)/SINOCHEM (Beijing)
Established joint venture to build liquefied oil storage and delivery facilities in Qingdao, Shandong Province. 6/95.

Keppel Integrated Engineering (Singapore), BOX Group PLC (UK)
Established joint venture to market and supply industrial gases in Suzhou, Jiangsu Province. $25 million. 6/95.

Marubeni Corp. (Japan)/SINOPEC, China Natural Gas Corp. (Beijing)
Will form joint venture to develop oil fields and refineries throughout China. 6/95.

Hong Kong and China Gas Co. (HK)/Guangzhou Gas Co.
Will establish joint venture to build two natural gas plants and build natural gas supply networks in Guangzhou. $21.4 million. (HK:60%-PRC:40%). 5/95.

Royal Shell Group (Netherlands)/NA (Guangdong)
Will form joint venture in Huizhou, Guangdong Province to refine crude oil and produce ethylene. $6 billion. (Netherlands:50%-PRC:50%). 5/95.

Royal Shell Group (Netherlands)/NA (Qingdao)
Will form joint venture to produce liquefied petroleum gas. 5/95.

Royal Shell Group (Netherlands)/NA (Zhejiang)
Will form joint ventures in Zhapu, Zhejiang Province to process lubricants and produce asphalt. $90 million. 5/95.

Yuan Shun Xing Grease Industrial Group Corp. (Malaysia)/Shanghai Reclamation Cereal and Oil Industrial General Corp.
Established Shanghai Huaxing Grease Industrial Co., Ltd. oil refining joint venture. $9.6 million. 5/95.

Ports and Shipping

INVESTMENTS IN CHINA

Coslink (Singapore), Air Express International (HK)/Shanghai United International Air Freight Co., Beijing International Ocean Freight Forwarding Co.
Formed joint venture to store and transfer containers in Shanghai. $1.4 million. 6/95.

Nissin Corp. (Japan)/China Ocean Shipping Co. (Jiangsu)
Formed Changshu Nissin Zhongwaiyun Shipping Co. joint venture to import and export raw materials. $700,000. (Japan:50%-PRC:50%). 5/95.

CHINA'S SALES ABROAD

China National Machinery Import and Export Corp. (Beijing)/Krey Shipping Co. (Germany)
Sold eight multi-functional container ships made by Jiangyang Shipbuilding Group, Jiangsu Province. $73 million. 5/95.

OTHER

Compagnie Maritime d'Affretement (France)
Will open office in Beijing. 6/95.

NA (HK)/NA (Fujian)
Formed passenger shipping line between Hong Kong and Dongshan, Fujian Province. 6/95.

Port of Olympia (US)/Port of Yantai (Shandong)
Formed sister port relationship. 6/95.

Port of Seattle (US)/Port of Qingdao (Shandong)
Formed sister port relationship. 5/95.

Power Generation Equipment

CHINA'S IMPORTS

Babcock International Group PLC (UK), Sargent & Lundy (US), Westinghouse Electric Corp. (US)/Huaneng International Power Development Co. (Beijing)
Will sell four 350MW coal-fired generator units to plants in Dalian and Dandong, Liaoning Province. $596 million. 6/95.

GEC-Alsthom (France)/Huaneng International Power Development Corp. (Beijing)
Will sell two 360MW coal-fired generators to Luohuang plant in Chongqing, Sichuan Province. $296 million. 6/95.

Air Products and Chemicals (US)/State Development Bank of China
Will build air separation fertilizer plant in Nanjing. $21 million. 5/95.

INVESTMENTS IN CHINA

Kanematsu Corp. (Japan)/NA (Guangdong)
Will form joint venture to build and manage three thermal-power generators in Shenzhen. $300 million. 6/95.

General Electric Co., PLC (UK)/NA (Tianjin)
Established Tianjin GEC Alsthom Hydropower joint venture to manufacture and sell hydraulic turbines and generators. 5/95.

Peebles Electric, a unit of the Rolls-Royce Industrial Power Group (UK)/Shanghai Transformer Works
Will establish joint venture to produce 500KV transformers and other power generation equipment. (UK:51%-PRC:49%). 5/95.

YTL Corp. (Malaysia)/NA (Inner Mongolia)
Will form equity joint venture to produce coal-fired power plant. $59 million. (Malaysia:50%-PRC:50%). 5/95.

OTHER

Black & Veatch International (US)
Opened representative office in Beijing. 5/95.

Government of Russia/China National Nuclear Materials & Equipment Corp. (Beijing), Liaoning provincial government, Northeast Power Group (Liaoning)
Sold two WWER-1000 pressurized reactors and granted loan to build nuclear power station in Liaoning Province. $3.2 billion. 5/95.

Price Waterhouse (US), Morrison and Foerster (US), PowerGen Corp. (UK)/NA (Shanghai)
Will arrange financing for Waigaoqiao II coal-fired power project. $1 billion. 5/95.

Property Management and Development

INVESTMENTS IN CHINA

Matsushita Electric Industrial Co., Ltd. (Japan)/Hangzhou Goldfish Electrical Appliances Group Co. (Zhejiang)
Established Hangzhou Goldfish & National Industrial City development zone in Hangzhou, Zhejiang Province covering 19.8 ha. 6/95.

NA (Singapore)/Shantou Business and Trade Centre (Guangdong)
Will build five-star hotel in Shantou, Guangdong Province. $90 million. 6/95.

New World Hotels (Holdings) Ltd., a subsidiary of Renaissance International Hotels, Inc. (HK)
Will build New World Hotel in Dalian. 6/95.

Pidemco Land (Singapore), Marriot International, Inc. (US)/Suzhou Panmen Tourism Development Co. (Jiangsu)
Established joint venture to build five-star hotel in Suzhou, Jiangsu Province. $80 million. (Singapore.:55%, US:15%-PRC:30%). 5/95.

OTHER

P&O Steam Navigation Co. (UK)/CCPIT (Beijing), Shanghai municipal government, Hongqiao ETDZ (Shanghai)
Will jointly operate Shanghai Intex 12,000 sq m exhibition center. $22 million. 5/95.

Telecommunications

CHINA'S IMPORTS

Motorola Inc. (US)/Hangzhou Telecommunications Equipment Plant (Zhejiang)
Sold base and ground stations for mobile telecommunications. $268 million. 6/95.

Siemens AG (Germany)/MPT
Sold synchronized digital hierarchy transmission equipment to increase phone capacity between Shanghai and Guangzhou. $14 million. 6/95.

AT&T (US)/Shanghai Posts and Telecommunications Administration
Will sell synchronous digital transmission equipment. $12 million. 5/95.

General Electric Co. (US)/Shandong Posts and Telecommunications Administration
Will supply EDISWITCH platform to provide commercial services for electronic business management. 5/95.

Nippon Telegraph and Telephone Corp. (Japan)/NA (Shanghai, Jiangsu, Zhejiang)
Will lease fiber-optic network and equipment to link Shanghai, Nanjing, and Hangzhou. $5.5 million. 5/95.

Northern Telecom Inc. (US)/Hebei Posts and Telecommunications Administration
Sold digital cellular telephone network to link 11 cities in Hebei Province. 5/95.

INVESTMENTS IN CHINA

Leader Universal Holdings Bhd. (Malaysia)/NA (Guangdong)
Will establish New Galaxy International Electronics Co., Ltd. joint venture to establish digital wireless communications in Guangdong and Fujian provinces. $120 million. (Malaysia:51%-PRC:49%). 6/95.

Mitsui and Co., Ltd. (Japan)/UNICOM (Beijing)
Formed joint venture to construct telecommunications facilities in Shanghai. $16 million. 6/95.

News Corp. Ltd. (Australia)/People's Daily (Beijing)
Established Beijing PDN Xinren Information Technology Co. to publish databases electronically, form data transmission networks, and create digital mapping technologies. $5.4 million. (Australia:50%-PRC:50%). 6/95.

Singapore Telecom (Singapore)/UNICOM (Beijing)
Will assist in developing local and mobile phone networks in Suzhou and Shanghai. 6/95.

AT&T (US)/China Huaxun Telecommunications Group (Beijing)
Established joint venture to build CT2 wireless telephone network for Shijiazhuang City, Hebei Province. $12 million. 5/95.

Fruition Goal, a subsidiary of News Corp. Ltd. (Australia)/Tianjin Sports Commission
Formed Golden Mainland Development joint venture to construct four television studios for sports programs. $20 million. (Australia:60%-PRC:40%). 5/95.

Hong Kong Telecommunications (HK)/MPT
Will build fiber-optic cable link between Hong Kong and Beijing. 5/95.

Motorola Inc. (US), Alcatel Alsthom Compagnie Generale d'Electricite (France)/Zhejiang Posts and Telecommunications Administration
Will form digital mobile equipment network in Zhejiang Province by linking existing networks in Shanghai and Jiangsu. $13 million. 5/95.

Northern Telecom Inc. (Canada)/Liaoning Posts and Telecommunications Institute
Formed Shenyang Northern Telecom Co., Ltd. to manufacture high-capacity fiber-optic systems. 5/95.

OTHER

Overseas Economic Cooperation Fund (Japan)
Will provide $235 million long-term low-interest loan for the China State Economic Information System to enhance collection and handling of economic information. 6/95.

British Telecommunications PLC (UK)
Will open representative office in Beijing. 5/95.

General Electric Co., PLC (UK)
Will open representative office in Beijing. 5/95.

Telstra Corp. (Australia)
Opened Beijing office to manage East Asia region. 5/95.

Textiles and Apparel

CHINA'S IMPORTS

Mackie International Group (Ireland)/Harbin Linen Co. (Heilongjiang)
Will supply flax preparing and spinning machinery to Harbin Flax Spinning Mill. $4.4 million. 6/95.

NA (Italy), NA (Japan)/Hainan Textile Industry Corp.
Sold jet looms and high-speed twisters to build processing, printing, and dyeing base for silk-like polyester fabrics. $17.6 million. 5/95.

Transportation

CHINA'S IMPORTS

The Boeing Co. (US)/Shandong Airlines
Sold three 737-300 aircraft. $120 million. 5/95.

Saab Automobile, a subsidiary of Investor AB (Sweden)/NA
Will sell 1,700 Saab 9000 CD cars and spare parts. $22 million. 5/95.

INVESTMENTS IN CHINA

Cummins Engine Co. (US)/Chongqing Engine Co., a subsidiary of China National Heavy-Duty Truck Corp. (NA)
Will establish joint venture to produce diesel engines. $93 million. (US:50%-PRC:50%). 6/95.

Fiat SPA (Italy)/NA
Will form equity joint venture to produce light trucks. 6/95.

Haden Drysys Ltd., a subsidiary of Haden Maclellan Holdings PLC (UK)/Jiangxi Motor Co.
Will build paint shop for auto detailing. 6/95.

Hamilton Standard, a division of United Technologies Corp. (US)/Aviation Industries of China (Beijing)
Formed agreement to design, develop, and maintain aircraft systems. 6/95.

Kawasaki Heavy Industries Ltd. (Japan)/Wuhan Marine Machinery Plant (Hubei)
Established Wuhan Kawasaki Marine Machinery Co. Ltd. joint venture to manufacture marine engines. $13 million. (Japan:55%-PRC:45%). 6/95.

Stanley Electric Co. (Japan), Nomura Asset Management (Asia) Ltd., a subsidiary of The Nomura Securities Co., Ltd. (Japan)/Tianjin municipal government
Will form Tianjin Stanley Electric Corp. to produce electronic lamps and other devices for automobiles. (Japan:95%-PRC:5%). 6/95.

Ensure Corp. (Taiwan)/Shanghai Non-ferrous Casting Plant, a unit of Shanghai Automobile Industrial Corp.
Established joint venture to produce alloy wire pieces for Shanghai Volkswagen. $12.5 million (Taiwan:80%-PRC:20%). 5/95.

General Motors Corp. (US)/First Automobile Works (Jilin)
Re-established Jinbei Auto Co. joint venture in Shenyang, Liaoning Province with new owner. 5/95.

Packard Electric, a unit of General Motors Corp. (US)/Shanghai Sanlian Automotive Harness Co.
Will form Packard Electric Shanghai Co. joint venture to provide power and signal distribution systems for foreign and domestically produced vehicles. $18 million. 5/95.

Walter Alexander PLC, a subsidiary of Kowloon Motor Bus Co. (HK)/Jinbaoma Bus Industry Co. (Guangdong)
Formed bus manufacturing and assembly joint venture. $15.7 million. 5/95.

CHINA'S INVESTMENTS ABROAD

China National Aviation Industry Corp. (Beijing)/ Daimler-Benz Aktiengesellschaft (Germany), Samsung Aerospace Industries, Ltd., a subsidiary of Samsung Group (S. Korea)
Will jointly develop commercial jet airliner to carry 120 passengers in S. Korea. $1.3 million. 6/95.

CITIC (Beijing), China National Technical Import & Export Corp. (Beijing), NORINCO (Beijing)/Tehran Urban & Suburban Railway Co. (Iran)
Will supply equipment and facilities for subway system and electrified railways in Tehran. $573 million. 5/95.

OTHER

Ford Motor Co. (US)
Established Ford Shanghai Research and Development Programs at Shanghai Jiaotong University, Fudan University, and Shanghai Institute of Organic Chemistry. $2 million. 6/95.

World Bank
Will provide loan to improve China's railway system. $400 million. 6/95.

Miscellaneous

OTHER

World Bank
Will provide $7 million loan and $20 million IDA credit to assist in salt iodization, packaging facilities, and technical assistance to reduce iodine deficiency disorders. $27 million. 6/95.

United Parcel Service (US)/SINOTRANS (Beijing)
Will form joint ventures in Beijing, Guangzhou, and Shanghai to expand air express packaging service in China. 6/95.

Mitsubishi Corp. (Japan)
Will form holding company to coordinate Mitsubishi marketing efforts in China. $30 million. 5/95.

CLASSIFIEDS

POSITIONS WANTED

US/Part Chinese, BSC/MBA equiv, 15 yrs Asia/Pacific exec for mrktng/ mgmnt/bus planning w/ airline/ tourism/airport admin seeks long-term posn in PRC. Chinese spkr/part-time univ instructor w/ contacts in PRC aviation/tourism & others. Contact: Thomas, Tel: 808/591-0484, Fax: 808/941-2108.

Analytical & organized mind. MA Chinese lit/hist. US citizen. Seeks work in intn'l PR/communications. Strong oral & writing skills. Tel: 310/204-1631.

Attorney w/ 3 yrs corporate transactional exp in intn'l firm seeks similar posn w/ law firm or in-house. Led firm in developing China mrkt. Top 10 law school, grades, & fluent Mandarin. Relocate domestically or overseas. Contact: 215/295-7092.

POSITIONS OFFERED

Intn'l mrkt research w/ emphasis on Greater China (PRC, Hong Kong, Taiwan); resp for setting up a research & consulting jv in Guangzhou; provide bus consulting to US cos doing or planning to do bus in Greater China; other duties incl: research methodology design, questionnaire design, feasibility studies, programming (using Ci3-CATI), sampling design, data analysis, forecast model design. F/T, 8 am - 5:00 pm, 40 hrs/wk, Mon-Fri, $632.00/ wk. Must have MBA and minimum 3 yrs work exp in field. Candidate must also have broad understanding of PRC bus environment, oral & written fluency in Eng & Chin, & oral Cantonese also req'd; demonstrated skills in mrktng, mrkt research, & comp software application (Ci3-CATI, MS Office, Quattro Pro, FoxPro, Compact Disclosure, CompuStat, etc), & data analysis using SPSS & SAS, expertise in proj mgmnt, feasibility studies, financial analysis, capital budgeting, jv start-up & mgmnt, exp in PRC mrkt. Must have legal authority to work in US. Deadline: 30 days from date ad appears. Employment/interview in Boise, Idaho. Send resume to: Idaho Dept of Employment, Attn: J.O.ID 6205651, 317 Main Street, Boise, ID 83735.

CLASSIFIED AD RATES

$10/line, four-line minimum ($40). 36 characters per line, including all spaces & punctuation. Submit only typewritten ads and send with payment 6 weeks before issue to:

THE CHINA BUSINESS REVIEW
Classified Advertising
1818 N Street, NW
Suite 500
Washington, DC 20036, USA

In the Next Issue of *The CBR*:

■ China's Tax Treaties
How the PRC's tax treaties with different countries affect foreign enterprise operations.

■ New Banking Regulations
The implications for foreign financial institutions of several banking regulations issued earlier this year.

■ The US-PRC-Taiwan Triangle
In balancing policies toward the PRC and Taiwan, the Administration walks a fine line between commercial and foreign policies.

■ Military Might
A look at the PLA's military and commercial undertakings.

■ Life in the Post-COCOM World
Export controls continue on some China-bound products.

■ On Shaky Ground
Land use rights are coming under greater scrutiny as Beijing begins to recognize the value of real estate.

■ Plugging into China
Companies look to link China into the global telecommunications village.

■ Opportunities in Hong Kong
Rushing to enter the China market, foreign investors shouldn't overlook business opportunities in Hong Kong.

ADVERTISERS IN THIS ISSUE

China Venture Advisors	p.37
Dun & Bradstreet	p.11
Greater China Business Network	p.16
HongKong Bank	p.64
Institute for International Research	p.29
International Strategic Alliances	p.10
Jianguo Hotel	p.48
MTI	p.25
Orchid Holdings	p.43
Pacific Bridge	p.53
Pacific Business Technology Corp.	p.18
Palace Hotel	p.17
Science Center International	p.28
Shanghai Centre	p.41
Shangri-la Hotel	p. 2
The US-China Business Council	p.54

THE US-CHINA BUSINESS COUNCIL

OFFICERS

Chairman: Maurice R. Greenberg
Vice Chairmen: Patrick J. Martin, Donald L. Staheli, Eugene Theroux
Secretary-Treasurer: James T. Clarke
Counsel: Lionel Olmer, *Paul, Weiss, Rifkind, Wharton & Garrison*
President: Robert A. Kapp

BOARD OF DIRECTORS

Michael R. Bonsignore, chairman and chief executive officer, *Honeywell, Inc.*
James T. Clarke, vice chairman, International, *Coopers & Lybrand*
Douglas N. Daft, president, Pacific Group, *Coca-Cola International*
George David, president and chief executive officer, *United Technologies Corp.*
George M. C. Fisher, chairman, president, and chief executive officer, *Eastman Kodak Co.*
Robert J. A. Fraser, group vice president, and president, Food and Functional Products Co., *Hercules Inc.*
Maurice R. Greenberg, chairman and chief executive officer, *American International Group, Inc.*
Carla A. Hills, chairman and chief executive officer, *Hills & Co.*
Edgar Hotard, president, *Praxair, Inc.*
Daniel R. Huber, president, Agricultural Sector, *Cargill, Inc.*
Dale P. Jones, president, *Halliburton Co.*
Michael H. Jordan, chairman and chief executive officer, *Westinghouse Electric Corp.*
John M. Kucharski, chairman, president and chief executive officer, *EG&G, Inc.*
Stephen K. Lambright, vice president and group executive, *Anheuser-Busch Co.*
James A. Lawrence, chief operating officer, Asia/Middle East/Africa, *Pepsi-Cola International*
Harry J. Longwell, senior vice president, *Exxon Corp.*
Robert H. Malott, chairman of the executive committee, *FMC Corp.*
Patrick J. Martin, president, Office Document Products Division, *Xerox Corp.*
Leslie G. McCraw, chairman and chief executive officer, *Fluor Corp.*
James E. Perrella, chairman, president, and chief executive officer, *Ingersoll-Rand Co.*
Pam Myers Phipps, vice president, *China Products North America, Inc.*
Robert W. Reynolds, corporate vice president, International Operations and Development, *Monsanto Co.*
George W. Sarney, president, *The Foxboro Co.*
Kevin Sharer, president and chief operating officer, *Amgen Inc.*
Frank Shrontz, chairman and chief executive officer, *The Boeing Co.*
Donald Staheli, president and chief executive officer, *Continental Grain Co.*
Eugene Theroux, partner, *Baker & McKenzie*
Lawrason D. Thomas, vice chairman, *Amoco Corp.*
Alex Trotman, chairman, president, and chief executive officer, *Ford Motor Co.*
William J. Warwick, chairman and chief executive officer, *AT&T China, Inc.*

WASHINGTON OFFICE

President: Robert A. Kapp
Business Advisory Services: Richard Brecher
China Business Review: Vanessa L. Whitcomb
Program Manager: Paul J. Lamb
Management and Budget: Richard L. Peterman

1818 N St., NW, Suite 500
Washington, DC 20036 USA
Tel: (202) 429-0340 Fax: (202) 775-2476

BEIJING OFFICE

Director of China Operations: Anne Stevenson-Yang
CITIC Building, Suite 26D
19 Jianguomenwai Dajie
Beijing 100004
Tel: (8610) 500-2255, ext. 2664, 2670
Fax: (8610) 512-5854

HONG KONG OFFICE

Director of Hong Kong Operations: Pamela Baldinger
Harbour International Business Centre
Suite 20
2802-2804 Admiralty Centre, Tower 1
18 Harcourt Road
Hong Kong
Tel: (852) 2527-5397 Fax: (852) 2527-1516

US GOVERNMENT OFFICES IN CHINA

EMBASSY

Ambassador: *Vacant*
Deputy Chief of Mission and Chargé d'Affaires: Scott Hallford
Counselor for Economic Affairs: Jack Gosnell
Agricultural Counselor: William Brandt
Commercial Counselor: Ying Lam
Commercial Officers: Jamie Horsley, Craig Allen, Charles Martin, Gwen Lyle
3 Xiushui Bei Jie
Jianguomenwai, Beijing 100600
Tel: (8610) 532-3831
Fax: Ambassador/Economic: (8610) 532-6422
Commercial: (8610) 532-3178
Visas: (8610) 532-3178

CHENGDU CONSULATE GENERAL

Consul General: Donald A. Camp
Economic/Commercial Officer: Richard Riley, IV
4 Lingshiguan Lu
Chengdu, Sichuan Province 610042
Tel: (8628) 558-9642 Fax: (8628) 558-3520

GUANGZHOU CONSULATE GENERAL

Consul General: G. Eugene Martin
Economic Section Chief: E. Mark Linton
Agricultural (FAS) Officer: Ralph Gifford
Commercial (FCS) Officers: Neil Peretz, Robert Strotman
Economic Officer: Jeffrey Zaiser
Consulate address:1 Shamian Nan Jie
Guangzhou, Guangdong Province 510133
Tel: (8620) 888-8911 Fax: (8620) 886-2341
FCS/FAS: China Hotel Office Tower
Suites 1262-64
Guangzhou, Guangdong Province 510015
Tel: (8620) 667-4011 Fax: (8620) 666-6409

SHANGHAI CONSULATE GENERAL

Consul General: Joseph Borich
Economic Section Chief: Robert Wang
Commercial Officers: David Murphy, William Marshak
1469 Huaihai Zhong Lu
Shanghai 200031
Tel: (8621) 433-6880 Fax: (8621) 433-4122, 1476

SHENYANG CONSULATE GENERAL

Consul General: Gerard R. Pascua
Commercial Officer: Jennifer Young
No. 52, Shi Si Wei Lu
Heping District
Shenyang, Liaoning Province 110003
Tel: (8624) 282-0057 Fax: (8624) 282-0074

HONG KONG CONSULATE GENERAL

Consul General: Richard W. Mueller
Deputy Principal Officer: Jeffrey Bader
Economic Section Chief: Blaine Porter
Agricultural Officer: LaVerne E. Brabant
Commercial Officers: David Katz, William Brekke, Rosemary Gallant
26 Garden Road
Hong Kong
Tel: (852) 2523-9011 Fax: (852) 2845-9800

PRC GOVERNMENT OFFICES IN THE US

EMBASSY

Ambassador: Li Daoyu
Minister Counselor for Commercial Affairs: Wang Tianming
2300 Connecticut Avenue, NW
Washington, DC 20008
Tel: (202) 328-2500, 2501, 2502
Fax: (202) 328-2582
Visas: (202) 328-2517 Fax: (202) 328-2564
Office of Commercial Affairs Address:
2133 Wisconsin Avenue, NW
Washington, DC 20007
Tel: (202) 625-3380 Fax: (202) 337-5864

CHICAGO CONSULATE GENERAL

Consul General: Wang Dongdi
Economic/Commercial Consul: Zhang Ruizhen
100 W. Erie Street
Chicago, IL 60610
Commercial: (312) 803-0115, 0213
Visas: (312) 803-0098 Fax: (312) 803-0114

HOUSTON CONSULATE GENERAL

Consul General: Qiu Shengyun
Economic/Commercial Consul: Luo Jizhong
3417 Montrose Boulevard
Houston, TX 77006
Commercial: (713) 524-4064
Visas: (713) 524-4311, 2304 Fax: (713) 524-7656

LOS ANGELES CONSULATE GENERAL

Consul General: Zhou Wenzhong
Economic/Commercial Consul: Deng Yunxing
443 Shatto Place
Los Angeles, CA 90020
Commercial: (213) 380-0587, 0669
Visas: (213) 380-2506, 2507, 0372
Fax: (213) 380-1961

NEW YORK CONSULATE GENERAL

Consul General: Zhang Weichao
Economic/Commercial Consul: Song Guibao
520 12th Avenue
New York, NY 10036
Commercial: (212) 330-7428, 7427
Visas: (212) 330-7410 Fax: (212) 502-0248

SAN FRANCISCO CONSULATE GENERAL

Consul General: Song Zengshou
Economic/Commercial Consul: Ding Hengqi
1450 Laguna Street
San Francisco, CA 94115
Commercial: (415) 563-4858
Visas: (415) 563-4857, 563-9232
Fax: (415) 563-0494, 0131

What a Difference a Decade Makes

There are basically two types of travelers to China: those who go once and proclaim that "It was the trip of a lifetime!" and those who travel there all the time, recounting that this excursion is their fourth trip this year and their thirty-second since 1979. But it strikes me that neither group has a very realistic perspective on the changes now afoot in the Middle Kingdom. The first type only has one set of observations and no basis for comparison, and the second group is there so frequently that more subtle changes are difficult to perceive. I have made only two trips—spaced almost 10 years apart—but together they have provided me an unusual outlook on life in China.

My first trip was in February 1986. Yes, only a first-time China traveler would choose the coldest weeks of the year to visit. My second trip occurred this past July. Yes, only a second-time China traveler would pick the two weeks of the year when Beijing received about half its annual rainfall. Frozen fingers and soggy feet aside, I learned a great deal from the two experiences, not only of the economic revolution underway but also of its deeper social implications.

During my 1986 trip, our cab was pulled over by the police. My friend asked the driver why he had been stopped.

"For speeding," the driver answered.

"What's the speed limit on this road?" she asked.

"I don't know," he responded.

"Well, how do you know you were speeding?" my friend inquired.

"Because the policeman said so," he answered.

Such deference for the system, however, was not apparent during my recent trip. On our first day in China, another American friend met us at the airport with a hired taxi. The driver pulled out of a long line of cars waiting to pay the parking fee at the only open exit gate. He pulled up to a closed exit with an attendant seated on a chair in front of the gate. The attendant slowly came up to the driver's window and harangued him about coming to a closed gate. The driver handed the attendant the parking fee, the fee went into the attendant's pocket, the chair was moved, and we were on our way. Petty corruption beats out authority in 1995.

Unfortunately, some of the changes are less innocuous. One of the pleasures of my first trip was walking along Jianguomenwai Avenue and, despite the frigid weather, watching people practice the traditional exercise of tai chi. On this recent trip, I looked forward to seeing this graceful spectacle again, but found no people practicing tai chi. Instead, there were at least a half-dozen beggars who had come from the provinces. The transients came to the city seeking a better life, but merely found floor space at the railroad station as a makeshift home.

Even the open-air markets are succumbing to the forces of modernization. I remember visiting one such market nestled in an alley, filled with artists and other vendors. The entire market seemed to be presided over by an old cobbler whose face looked like the leather he was pounding. Now, I discovered that the market has since been turned into "Silk Alley," packed wall-to-wall with foreign tourists and Russian entrepreneurs buying silk Tweety-Bird boxer shorts and other Western-style wares. Instead of being greeted by the cobbler, I was approached by a young man hawking compact discs.

But China's lust for things modern does not end there. In 1986, friends took me to the section of the Great Wall at Badaling. On the walk up to the wall, we passed a rather moth-eaten camel strategically placed for intrepid tourists who wanted to jump on for a photo opportunity. Mr. Camel seemed more intent on spitting on as many passersby as possible, however. On the trip last month, my friends and I trekked to the section of the wall at Simatai—expecting a similar photo opportunity. As we approached the wall, we saw swatches of brilliant red. From a distance, we mistook the colorful array for some type of flower. When we got closer, we found thousands of red umbrellas stationed along the wall and the walkways leading up to it. We discovered that the umbrellas were part of a Christo-like art project, where each person was to take one umbrella and carry it as he or she walked up and down the wall, creating a "motion painting." The spitting camel somehow seems a more realistic image of the Great Wall's history.

Some of the changes we noticed were positive ones. Until late 1988, the Council's Beijing Office was located in the Beijing Hotel. When I visited in 1986, our office was housed in one of the more dour sections of this multi-sectioned facility. I also recall that the elevators servicing the Council's particular section had a mind of their own, sometimes stopping at the floor indicated and sometimes not. And, every year or two, we would receive a notice that within a week we had to move to a new suite because of "redecorating"—although the newly "redecorated" suite always looked very much like the old suite we had vacated. Hence, during the July trip when friends announced that we were going to the Beijing Hotel for a drink, I expected the same austere surroundings.

Upon arriving at the hotel, I discovered that yet another section had been added to the complex, but that this section was equipped with glass canister elevators rising through a multi-storied atrium delivering us to a roof-top terrace overlooking the Forbidden City. As we enjoyed watching the sun set over such a commanding scene, it occurred to me that perhaps 10 years between trips is far too long. After spending three weeks in the Middle Kingdom, I concluded that change in China means every trip—the first, the second, or the thirty-second—is always a once-in-a-lifetime experience.

—Rick Peterman

Rick Peterman is the Council's management and budget director.

SUCCESS IN CHINA REQUIRES GUIDANCE AS MUCH AS PURPOSE

Just as ancient Chinese armies relied on the compass cart for direction, companies venturing into China need an experienced guide to point the way.

At HongkongBank, our aim is not only to help you conduct your business efficiently, but to complement that service with sound advice and clear guidance.

With 130 years of experience in financing trade and business between China and the rest of the world, we are well prepared to provide you with professional and efficient services. We have branches in major business cities like Beijing, Tianjin, Qingdao, Shanghai, Shenzhen and Xiamen to provide a wide range of banking services to our customers in China. We also have representative offices in Dalian, Guangzhou and Wuhan to update customers on the constantly changing China market.

When you venture into the China market, you'd be well advised to stay on track with a partner who can point you in the right direction.

After all, the only way we'll succeed is by helping you to do the same. For more information, please contact HongkongBank China Services Limited at telephone: (852) 2822 2652, facsimile: (852) 2868 1646.

HongkongBank

Member HSBC Group