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SPECIAL ISSUE

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THE SUPPLY CHAIN

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Short Takes

Chinese Cities Rank Among the World's Most Expensive

According to a cost-of-living survey published by Mercer Human Resource Consulting LLC in June, half of the world's 20 most expensive cities are in Asia. Although Tokyo has replaced Hong Kong as the world's most expensive city, many other cities in China ranked among the top 20. Hong Kong now ranks number 4, followed by Beijing at number 5; Shanghai drops to 11th place; and Shenzhen and Guangzhou tie for 18th place.

The survey examines the comparative cost of more than 200 items—including housing, food, clothing, household goods, transportation, and entertainment—across 144 cities. According to Mercer, the data is designed to help multinational corporations and governments determine compensation allowances for expatriate workers.

Star-Rated Hotels on the Rise in China

The China National Tourism Administration (CNTA) reports that China had 8,880 star-rated hotels at the end of 2002—up by 1,522 hotels from 2001. CNTA's 2002 statistics record 175 five-star, 635 four-star, 2,846 three-star, 4,414 two-star, and 810 one-star hotels. Though hotel ratings are determined differently in each country (and even in regions within a country) the more stars a hotel has, the more services and amenities it should offer.

Olympic Committees Unveil Beijing 2008 Olympics Logo

The Beijing Organizing Committee for the Games of the XXIX Olympiad (BOCOG) presented the official Beijing 2008 Olympic Games emblem during a joint BOCOG and International Olympic Committee ceremony in August. The emblem, which is entitled "Dancing Beijing," was chosen from among 1,985 entries and resembles a dancing figure reminiscent of the character for "capital" carved into a red Chinese seal. According to BOCOG, the logo combines elements of traditional Chinese culture with Olympic spirit and values. To view the logo, visit *www.beijing-2008.org*.

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The Value of the Renminbi

The value of the renminbi (RMB) against major currencies has become a contentious issue in political circles in recent months (*see* p.6). China's effective peg to the US dollar has led to a decline of the RMB exchange rate against other major currencies, particularly the euro and the yen. European, Japanese, and even US companies and their government representatives have accused China of purposefully undervaluing the RMB to make already competitively priced Chinese exports even cheaper in overseas markets. Many China-based businesspeople are familiar with this debate. The question is, are the critics right? And if so, what, if anything, are PRC officials likely to do?

China Facts:

- **Exchange rate**: ¥8.276-8.28 to $1
- **Current account surplus, 2002**: $35.4 billion
- **Current account surplus, January-June 2003**: $4.5 billion
- **Foreign exchange reserves, 2002**: $286.4 billion
- **Foreign exchange reserves, January-June 2003**: $346.5 billion
- **Foreign direct investment (utilized), 2002**: $50.7 billion
- **Foreign direct investment(utilized), January-June 2003**: $30.3 billion
- **Foreign-invested enterprises' share of China's total exports in 2002**: 52 percent

RMB basics

Large inflows of foreign funds and large export volumes are putting upward pressure on the value of the RMB. This seems hard to dispute. The reason for this pressure is that first, more foreigners want to buy goods and services valued in RMB, so they need to convert foreign currency to RMB to make their purchases. Second, more RMB holders are selling things for dollars and needing to convert the dollars back to RMB.

This demand for RMB drives up its value relative to other currencies—even the US dollar, to which it is tied. The PRC government is concerned about the value of the RMB against the dollar and other currencies for several reasons, though not the same ones that concern foreign firms or the politicians whose ears they bend.

One reason is that a higher RMB could hurt PRC-based exporters, at least in theory, by making their goods more expensive overseas relative to goods denominated in other currencies. Since exports are crucially important to China's economic growth, the government is loath to make life harder for exporters. (Of course, if the RMB were to rise against other currencies, imports used as inputs for finished exports would become cheaper, easing the pain to some extent—and also undermining the argument that a higher RMB would help foreign-made goods competing against Chinese-made goods.)

Another is that China is just emerging from years of deflation. Deflation, which is defined as a fall in the general price level, suppresses consumption and can cause an economy to stagnate. A higher RMB could push China back into

Continued on page 55

THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

Robert A. Kapp
PRESIDENT, THE US-CHINA BUSINESS COUNCIL

The RMB Controversy and Beyond

As the US Congress departed from Washington for its long summer recess, more than a few members took time to put statements on the record, or to propose legislation, with regard to the following:

- The value of China's currency, the renminbi (RMB), against the US dollar;
- The rapid growth of Chinese exports to the United States;
- The growth of US investment in China, including manufacturing investment;
- The difficulties facing workers in the US manufacturing sector;
- The allegedly causal relationships among the preceding.

The executive branch felt the heat. Letters from Congress to the president and other messages from the Hill to the executive agencies urged the administration to convince China to float or revalue its currency against the dollar, or else to strike back at China for its alleged manipulation of the currency to cheapen its goods in US markets and suck employment-creating US investment into China. A publicity trip by cabinet members to midwestern plants unleashed a torrent of anxiety over China's economic prowess.

This wave of American resentment toward China is not universal. It is focused, as trade-related concerns have been in the past, on sectors of the US economy most directly affected by foreign competition. It is impelled forward in part by American companies facing diminished business prospects in a slow US economy, rising competition from Chinese rivals, and layoffs of American employees. It draws as well on familiar constituencies and political figures who, a few years ago, vigorously opposed US granting of Permanent Normal Trade Relations (PNTR) during the great congressional debate on PNTR. But it also includes the voices of some traditional supporters of expanded trade with China.

Concurrently, American textile trade groups are fiercely making the case that unless the US government acts quickly to protect endangered textile firms and workers, China's overwhelming prowess in textile and apparel manufacturing will doom the entire US industry.

On the non-trade front, ironically, the United States and China are getting along on the surface better than they have in years. There is cooperation on North Korea and counterterrorism. The two sides have reached a new maritime agreement after 10 years of discussion. The Chinese defense minister will soon visit Washington after years of estrangement between high military authorities in the two nations. The battles against HIV/AIDS and severe acute respiratory syndrome have brought about closer bilateral contacts. Old frictions seem under control for the time being.

Does the current furor over the RMB and China's impact on the US economy mean that despite these positive developments we are falling into a crisis with China? It could, but I don't think it does.

At the heart of this summer flareup is a paradox. No practically imaginable increase in the RMB's value would eliminate the very phenomena that have led to US demands for PRC action on the currency in the first place: rising exports to the United States, growing US investment in China, increasing competitiveness of Chinese firms both in the Chinese market and abroad, and job losses in the US manufacturing sector.

Widening the RMB trading band by 1 or 2 percent—a possible PRC response to American, European, and Japanese unhappiness over the RMB's value—will make little difference on those three fronts. Even if China takes the advice of some economists and undertakes a one-time revaluation of the RMB of, say, 15 or 20 percent, the move would not invalidate China's positive economic fundamentals: a large and rapidly expanding domestic economy, increasing technological and managerial sophistication, prospects for at least gradual further improvement in the Chinese business environment under World Trade Organization (WTO) rules, a high domestic savings rate, and a large supply of low-cost labor.

Unless those fundamentals shift—and it is no secret that China's economy lives under multiple threats ranging from high unemployment to the HIV/AIDS time bomb to a notoriously frail banking system—the recent pattern of interconnected, rapid economic growth and increasing foreign direct investment is likely to persist whether the RMB rises or not.

Out of this barely explored thicket emerge the following observations.

First, whether the US economy is in the midst of a relatively cyclical downturn or something more worrisome, the central policy issues facing the US economy are domestic ones. Focusing on the RMB question is no substitute for a forthright discussion between policymakers and the public about the causes of the current painful condition of certain sectors of the US economy and on how to respond to them. The abysmal US savings rate and continuing weakness in the country's education system are two perennial, but unresolved and very salient, issues.

Second, to the extent that those who have energized the fracas over the RMB realize that RMB revaluation is unlikely to make much difference to the deeper problems it is supposed to resolve, other motives may be at work. US economic and trade relations with China should not become a safety valve for the relief of domestic pressure simply because the search for long-term solutions to bigger economic questions proves politically difficult.

Third, China's decisive implementation of its outstanding WTO commitments is critical. Substantively, WTO implementation remains the key to major new opportunities for American businesses in China, while increased Chinese purchases of foreign goods and services will help to moderate the growth of China's trade surplus with the United States. Politically, the failure to demonstrate clearly its attainment of its WTO targets will leave China far more vulnerable to political and popular criticism in the United States.

While the current RMB controversy has evoked a modest "I told you so!" chorus from people who never wanted to see China in the WTO in the first place, the logic that prevailed in the US debate on PNTR in 1999 and 2000 remains valid. The United States and the world are far better off with China committed to global rules of the road and subject to WTO remedies if it violates those rules. The elimination of barriers to international products and services in China offers the best chance for key sectors of the American economy to maximize the benefits of China's broad economic emergence, and for China to maximize the benefits it enjoys in the global economy.

The paradox: No practically imaginable increase in the RMB's value would eliminate the very phenomena that have led to US demands for PRC action on the currency in the first place.

The controversy of the hour, sparked by the convergence of a slow US economy, the US dollar's decline against other key currencies, and the Chinese economy's rapid growth, points toward bigger, more tidal trends with which the United States must grapple. The problem was foreshadowed by the arrival of Japanese industrial might on the world scene in the 1960s and 1970s but is not altogether the same. By mastering the coordination of labor resources, advanced technology, and modern managerial skills, China and other lower-income developing countries are increasingly able to perform tasks that once could only be undertaken by the most advanced economies. (A cognate, sadly, of this economic trend in the national security arena is the widespread evidence of developing countries' progress toward the production of weapons of mass destruction.)

Thus, the anguish now felt in some parts of the US economy points not only to the pains associated with the low point of the business cycle, but also to longer-term and more difficult challenges for American policymakers and corporate strategists. Today's RMB controversy will likely fade; the bigger questions implied by China's arrival as an effective player in the global economy, with all the benefits and difficulties for China itself as well as for its global trade partners, will not. These questions require analysis, thoughtful policymaking, and international consultation. Unfortunately, if the present RMB firestorm is any example, the signals from Washington these days do not point in that direction. 完

THE SUPPLY CHAIN

Distribution and Logistics in Today's China

Jamie M. Bolton and Yan Wei

China's attractiveness as an investment environment for multinational corporations (MNCs) in a variety of industries—such as consumer goods, automotive, electronics, and telecommunications—is well known. But the country's underdeveloped transportation infrastructure, fragmented distribution systems, limited use of technology in the distribution and logistics sector, dearth of logistics talent, regulatory restrictions, and local protectionism combine to hinder the efficient distribution of domestic and imported products—and thus reduce returns on investment. The barriers

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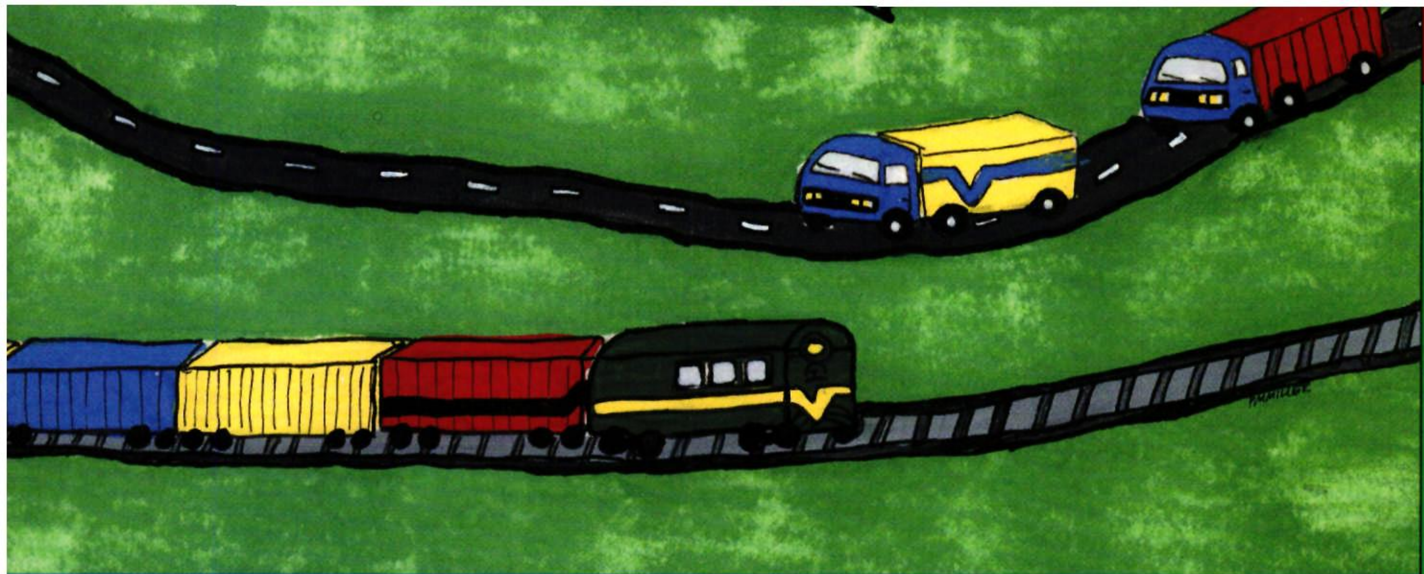

Taking risks can reap rewards in China's distribution and logistics sector

have increased the cost of doing business in China and have restricted consumers' choices.

This article provides an overview of China's distribution and logistics sector and includes practical advice for foreign companies—both small and large—that are planning to establish an effective presence in China or are looking for ways to improve their distribution system efficiency. We discuss the impact of World Trade Organization (WTO) entry on China's distribution and logistics sector, key trends in the sector, the risks of operating in China that remain even after WTO entry, and strategic recommendations for companies entering China.

WTO entry: Distribution and logistics

As part of the terms of its WTO entry, China agreed to open market sectors and services that, in the past, were protected from global competition. The opening of the distribution and logistics sector is expected to spur the modernization of the sector over the next three to five years (*see* Tables).

Nevertheless, the distribution and logistics sector remains highly fragmented, with strongly protected local interests. Although foreign companies often possess better management systems and technologies, knowledge of the local operating environment, culture, and customer needs helps local firms create and maintain competitive advantages.

Trends in distribution and logistics in China

The distribution and logistics sector has long challenged companies seeking to move and sell products within China. Morgan Stanley estimated that in 2001, logistics spending in China amounted to one-fifth of the nation's GDP and twice the proportion spent on logistics in the United States. According to a December 2001 Economic Intelligence Unit report, on average, 90 percent of a Chinese manufacturer's time is spent on logistics and 10 percent is spent on manufacturing.

Today, selling costs in China are significantly higher than those in the West. Annual working capital turnover (a measurement that compares the depletion of working capital [current assets minus current liabilities] to the production of sales over a specific time) in China is, on average, 1.2 times for manufacturing state-owned enterprises (SOEs) and 2.3 times for commercial SOEs. These figures compare with averages of 15 to 20 times in the United States. For many commodities, logistics costs are proportionally 40 to 50 percent higher than they would be in the United States. Accounts receivable—a key measure of inefficient logistics practices—often exceeds 90 days.

Despite these weaknesses, China's distribution and logistics sector is growing rapidly. In fact, the logistics industry has reported annual revenue growth rates of 31 percent for 1999, 35 percent for 2000, and 55 percent for 2001 and is forecast to grow 50 percent annually for the next three years. The sector has changed significantly

as a result of overall market growth, evolving customer requirements, liberalization of government policies, and China's WTO entry.

Yet of the more than 18,000 registered companies claiming to offer logistics services in China, not one can offer nationwide distribution services today. No single logistics provider commands more than 2 percent of the market. Because of this industry fragmentation, consolidation of logistics providers and the development of third-party logistics providers are inevitable—especially given shippers' demands for greater efficiencies, scale, breadth of service offerings, and network coverage. Competition is already intensifying in the third-party logistics market, forcing a consolidation of this industry as a whole in China. Foreign companies with strong international networks and better management are gaining market share, while many domestic companies rely on underdeveloped domestic operations. And local and regional distribution systems are replacing state-owned and centrally managed trading and distribution systems.

According to a 2002 report jointly published by the China Federation of Logistics and Purchasing and Mercer Management Consulting, the outsourcing of logistics and transporation will continue to expand roughly 25 percent annually through 2005 because of stronger MNC interest and demand for third-party services. MNCs relying on China as a global sourcing base are inclined to use, and are experienced in using, third-party services—especially those of third-party providers with which the MNCs have established relationships at home. More than 90 percent of MNCs in China currently contract at least a portion of their logistics business to third-party logistics service providers.

To remain globally competitive, Chinese companies must cut costs and expand services. This commercial reality will force local companies to concentrate on their core business, rather than on the traditional SOE goal of establishing a "small and complete" company. The "small and complete" mindset is entrenched, according to a study published in 2002 by China's Development Research Center of the State Council: 70 percent of China's commercial enterprises and 53 percent of industry enterprises own their own vehicle fleet, and 80 percent and 59 percent, respectively, own warehouse facilities.

Though the concept of outsourcing these basic logistics functions is still relatively new to most Chinese companies, many leading foreign firms in China—such as McDonald's Corp. and Dell Computer Corp.—have demonstrated great success by using third-party service providers' expertise, capabilities, and assets to offer nationwide distribution and logistics service. These foreign companies have shown Chinese companies

Trading Rights and Distribution: Two Different Things

Contrary to popular belief, China's World Trade Organization (WTO) trading rights liberalization commitments do not encompass distribution rights. According to China's WTO commitments, these are two separate areas of agreement.

Trading rights

China's WTO entry documents define trading rights as "the right to import and export goods" and state that "China shall progressively liberalize the availability and scope of the right to trade, so that, within three years of accession, all enterprises in China shall have the right to trade in all goods throughout the customs territory of China except for [state-traded goods]." (Imported goods subject to state trading include grain, vegetable oil, sugar, tobacco, processed oil, chemical fertilizer, and cotton. Exported goods subject to state trading include tea, rice, corn, soybeans, tungsten ore, ammonium paratungstates, tungstate products, coal, crude oil, processed oil, silk, unbleached silk, cotton, cotton yarn, woven fabrics of cotton, antimony ores, antimony oxide, antimony products, and silver.)

Distribution services

China's WTO entry documents define four main sub-sectors of distribution services: commission agents services; wholesaling; retailing; and franchising.

"The principal services rendered in each subsector can be characterized as reselling merchandise, accompanied by a variety of related subordinated services, including inventory management; assembly, sorting and grading of bulk lots; breaking bulk lots and redistributing into smaller lots; delivery services; refrigeration, storage, warehousing and garage services; sales promotion, marketing and advertising, installation and after sales services including maintenance and repair and training services. "

Commission Agents' Services: "...[S]ales on a fee or contract basis by an agent, broker, or auctioneer or other wholesalers of goods/merchandise and related subordinated services."

Wholesaling: "...[S]ale of goods/merchandise to retailers to industrial, commercial, institutional, or other professional business users, or to other wholesalers and related subordinated services."

Retailing: "...[S]ale of goods/merchandise for personal or household consumption either from a fixed location (e.g., store, kiosk, etc.) or away from a fixed location and related subordinated services."

Franchising: "...[S]ale of the use of a product, trade name or particular business format system in exchange for fees or royalties. Product and trade name franchising involves the use of a trade name in exchange for fees or royalties and may include an obligation for exclusive sale of trade name products. Business format franchising involves the use of an entire business concept in exchange for fees and royalties, and may include the use of a trade name, business plan, and training materials and related subordinated services."

SOURCE: *Compilation of the Legal Instruments on China's Accession to the World Trade Organization*

—The US-China Business Council

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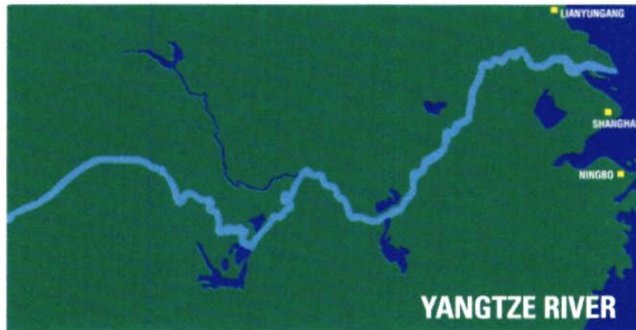

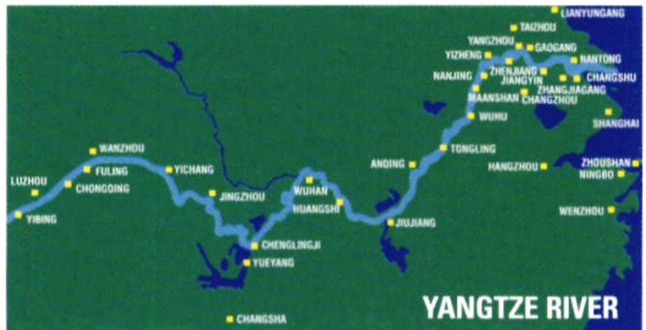

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China's WTO Trading Rights Commitments

Upon Entry: December 11, 2001	Status*	Year One: By December 11, 2002	Status*	Year Two: By December 11, 2003	Year Three: By December 11, 2004
Eliminate, for both Chinese companies and FIEs, any export performance, trade balancing, and prior experience requirements. Foreign-invested international logistics companies may offer import, export, and entrustment services for export processors (*see* p. 16).	Limited trading rights granted to FIE manufacturers, holding companies, and research and development centers as of July 18, 2001. Registered capital requirements for domestic PRC trading companies lowered as of July 10, 2001.	Minority foreign JVs granted full trading rights. Registered capital requirement for domestic PRC trading companies lowered to ¥5 million.	Free-trade zones in 4 cities may grant full trading rights to enterprises in the zones. Implementing rules to be drafted. Rules that say how qualified FIEs may obtain trading rights, or that state that the granting of trading rights will be automatic, have not yet been issued.	Majority foreign JVs granted full trading rights. Registered capital required for domestic PRC trading companies lowered to ¥3 million.	Rights will be granted to all enterprises in China except for sectors reserved for state trading. *Such right does not permit importers to distribute goods within China.* Trading rights examination and approval system will be eliminated. Registered capital required for domestic PRC trading companies lowered to ¥1 million.

NOTES: The latest version of China's Catalogue Guiding Foreign Investment in Industry, revised in March 2002, reflects the country's WTO commitments.
*As of August 2003; status of years two and three commitments unknown. JV=joint venture. FIE=foreign-invested enterprise.
SOURCES: Compilation of the Legal Instruments on China's Accession to the World Trade Organization; The US-China Business Council.

that they do not need to own all of the assets involved in service provision to gain the capability and expertise to offer a full line of services. To reap the benefits of scale, small firms will soon aim to partner with large-volume players in sales and distribution because volume influences the market, strengthens control over the supply chain, and most important, improves efficiency.

Another major trend in the distribution and logistics sector has been the rise of alliances and joint ventures (JVs) as the top companies in China combine forces to build competitive national distribution chains targeting specific industries. In June 2002, Legend Group Ltd. and APL Logistics (the logistics branch of the NOL Group) announced the formation of a third-party logistics service JV to offer specialized logistics services for the information technology (IT) industry. The JV seeks to capitalize on Legend's position as the leading personal computer vendor in China and APL's globally recognized brand name and expertise in the logistics field. Similar joint ventures have been formed between the TNT Group and the Shanghai Auto Industry Group, among others.

Chinese and foreign companies across many industries in China have achieved success through the support of strong, modern distribu-

China's Distribution Infrastructure Expands

China's 10th Five-Year Plan (FYP, 2001–05) mandates massive construction of rail, road, port, and aviation infrastructure, particularly in China's most underdeveloped regions. China aims to invest more than $30 billion in rail infrastructure projects during this period, adding roughly 6,000 km of track across the nation. Half of the rail investment is planned for western China projects, including the world's highest railway, linking Qinghai and Tibet.

China intends to invest roughly $120 billion in road construction, adding 200,000 km of roadway and bringing China's total length of highway well beyond 1.5 million km.

The country also aims to construct 141 deepwater berths during the 10th FYP, including 50 container berths. Specific deepwater port projects include Dalian, Liaoning; Shanghai; Tianjin; Qingdao, Shandong; and Shenzhen. The PRC government expects cargo handling capacity for China's waterways to reach 260 million tons per year by 2005. The plan also calls for the construction or renovation of 57 airports.

But figures in government plans should be viewed as indicators rather than concrete figures. China may or may not reach the goals set out in the 10th FYP, but one thing is certain—these goals indicate that the PRC government has made infrastructure construction a high priority. The result will be better physical infrastructure that should ease distribution bottlenecks.

—The US-China Business Council

China's Transportation Infrastructure in 2001

Length of Transport Routes	
Track in Operation	70,100 km
Highways	1.7 million km
Navigable Inland Waterways	121,500 km
Total Civil Aviation Routes	1.6 million km
Total Freight Traffic	
Rail	1.9 billion tons
Highways	10.6 billion tons
Waterways	1.3 billion tons
Civil Aviation	1.7 million tons
Volume of Freight Handled in Major Coastal Ports	**1.4 billion tons**

SOURCE: *China Statistical Yearbook, 2002*

tion networks. Guangdong Honda Automobile Co. Ltd. initiated exclusive four-in-one franchises (sales, repair and maintenance, supply of parts and components, and information service) in China that enabled it to strengthen its brand name and position by better controlling service quality, product price, and market information. Other foreign companies similarly have sought to control more aspects of their distribution system in China. The formation of the SAIC-Volkswagen Sales Co., Ltd. in 2000 is another example of a foreign company seeking to participate directly in distribution business by building a dedicated distribution and after-sales support network.

Risks remain

More than 80 percent of Fortune 500 companies have already invested significantly in China and have gained many years of local market knowledge. At the other end of the scale, small and medium-sized foreign companies are just now entering the country. Regardless of the depth of their experience in China, all companies face risks in the regulatory, political, and market arenas that are likely to persist for the near future.

- **WTO commitment delays**

China may delay WTO implementation and regulate competition to help local companies compete in the market. As other WTO members have done, China may find ways to work around WTO rules to maintain barriers against imports, for example by erecting WTO-compatible non-tariff barriers, such as licensing, health, technical, and packaging standards. As a case in point, China recently released a draft regulation that would require "one license, one product" dealership licenses in the auto sector. Such licenses would prevent newcomers from using existing distribution channels and give existing manufacturers more time to prepare for direct competition. Such requirements will likely create tension between customer expectations and the quality of service available, which may force change faster than the PRC government anticipates.

- **Regulatory fragmentation**

The distribution and logistics industry has been micro-regulated for years, with different logistics service components governed as distinct subsectors by various government departments: the Ministry of Communications governs land and waterway transportation; the Ministry of Commerce administers trading rights and international freight forwarding licenses; and the PRC General Administration of Customs controls brokerage services. Despite central-government efforts to promote coordination—as demonstrated by the March 2001 initiative by six ministries, including the ministries of Railways and Communications, to issue a plan to promote the country's logistics industry development—the shared jurisdiction system for the logistics sector is unlikely to change in the near future. Companies still must acquire separate licenses through various governing bodies to undertake different activities.

- **Lack of enforcement capability and local protectionism**

China's governing structure encompasses multiple layers of central and local governments. Despite central-government efforts to liberalize the market, local-level interpretation and enforcement of laws and regulations can often be arbitrary, favoring local interests.

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China's WTO Distribution and Transportation Services Commitments

Sector	Upon Entry: December 11, 2001	Status*	Year One: By December 11, 2002	Status*	Year Two: By December 11, 2003	Status*
Distribution						
Wholesale and Commission Agents' Services (excluding salt and tobacco)	FIEs can distribute all of their products made in China. Foreign service suppliers can provide full range of related services for products they distribute. FIEs can distribute all of their products made in China. Foreign service suppliers can provide full range of related services for products they distribute.	July 2001: First wholesale enterprise with foreign investment approved. Japan's Marubeni Co. holds 49% of Baihong Commercial Trading Co., which buys daily-use products from domestic producers (including FIEs) and has limited import and export rights to sell international products.	Minority foreign equity permitted, except for books, magazines, and newspapers (BMN), pharmaceutical products, pesticides, mulching films, chemical fertilizers, and processed and crude oil.	Permitted for international logistics companies as of August 24, 2002, with certain conditions and geographic restrictions (*see* p. 16).	Majority foreign equity permitted. No geographic or quantitative restrictions.	Permitted for third-party logistics companies as of August 24, 2002, with certain conditions and geographic restrictions (*see* p.16).
Retail (excluding tobacco)	Minority foreign equity permitted in 5 special economic zones and 8 cities. FIEs can distribute all of their products made in China. Foreign service suppliers can provide full range of related services for products they distribute. Quantitative restrictions apply for each city/zone.		FIEs may retail BMN.	Permitted as of May 1, 2003, subject to registered capital and other requirements.	Majority foreign equity permitted. All provincial capitals and 2 other cities open to retail JVs.	
Franchising						
Wholesale or Retail Away from a Fixed Location						
Selected Transportation Services (*see* p.16)						
Rail Transportation	Up to 49% foreign equity permitted.	Permitted 2002-03 (freight only).				
Road Transportation	Up to 49% foreign equity permitted.		Majority foreign equity permitted.	Permitted as of December 1, 2002, but capped at 75%. Higher proportion permitted in certain sectors and in western areas.		
Warehousing and Storage	Up to 49% foreign equity permitted.		Majority foreign equity permitted.	Warehousing permitted for road transport and BMN.		
Freight Forwarding	Up to 50% foreign equity permitted, with certain conditions. 5 year waiting period for second JV.		Majority foreign equity permitted with certain conditions.	Permitted as of January 11, 2003, but foreign equity capped at 75%.	Waiting period for second JV reduced to 2 years. National treatment for registered capital requirements for branches.	

NOTES: The latest version of China's Catalogue Guiding Foreign Investment in Industry, revised in March 2002, reflects the country's WTO commitments.
*As of August 2003. JV=joint venture. FIE=foreign-invested enterprise. BMN=books, magazines, and newspapers.
SOURCES: Compilation of the Legal Instruments on China's Accession to the World Trade Organization; The US-China Business Council.

Year Three: By December 11, 2004	Status*	Year Four: By December 11, 2005	Status*	Year Five: By December 11, 2006	Status*	Year Six: By December 11, 2007	Status*
100% foreign equity permitted except for chemical fertilizers, processed oil, and crude oil. May distribute BMN, pharmaceutical products, pesticides, and mulching films. No geographic, quantitative, or equity restrictions.	Permitted for BMN as of December 1, 2004. Must meet registered capital and other requirements. China approved first pharmaceutical JV, Zuellig Xinxing Pharmaceutical Co., in May 2003. Zuellig Pharma holds 49%; China Xinxing Medicine Corp. holds the rest.			100% foreign equity permitted for all products. No limits of foreign participation after 2006. May distribute chemical fertilizers and crude and processed oil.			
100% foreign equity permitted except for certain products. FIEs may retail pesticides, pharmaceutical products, mulching films, and processed oil. No geographic restrictions. No quantitative restrictions except for certain products. Majority foreign investment prohibited in chain stores with more than 30 outlets.				100% foreign equity permitted, but limits on large chain stores and those selling certain products. FIEs may retail chemical fertilizers. Foreign majority investment in motor vehicle JVs permitted.			
Permitted. No geographic, quantitative, or equity restrictions.	Rules to remove all restrictions by December 11, 2004 reportedly drafted.						
Permitted. No geographic, quantitative, or equity restrictions.	Status of new rules uncertain. Nationwide crackdown on pyramid schemes and direct selling under way.						
Majority foreign equity permitted.	Permitted 2004-06 (freight only).					100% foreign equity permitted.	No limits on foreign participation after 2006.
100% foreign equity permitted.							
100% foreign equity permitted.							
		100% foreign equity permitted. National treatment for capital requirements for subsidiaries.					

- **Capacity vs. demand**

China has one of the most dynamic markets in the world, making errors in market demand forecasts more frequent and severe than those in more-developed markets. Abundant funds are available in China (both from foreign and domestic sources), and cities are tempted to build up too much capacity rapidly, so that capacity exceeds true market demand. Almost all major cities and regions in China have invested in some form of distribution or warehousing center or logistics park. According to research conducted by the China Storage Association in 2002, 60 percent of logistics centers are empty.

- **Social and political risks**

Foreign companies planning to enter China through a partnership or JV must be extremely careful about their potential partners' visible and invisible liabilities. For example, protecting local employment is a high priority for PRC governments, so appropriate benefits for excess workers can be a huge issue in contract negotiations.

Corruption also looms large in China—especially in some smaller cities and at local levels—in every industry. Appropriate handling of corruption is essential for success.

Recommendations for foreign companies

To help foreign companies enter and operate in China successfully, we have identified seven key recommendations for their distribution and logistic operations:

1. **Seek deep knowledge of the market**

Contrary to what some experts think, there will not be a mad rush by shippers to develop their own sales and distribution channels or networks once China implements its WTO commitments in distribution services—the cost and time needed to establish a network will prevent this. Smart players are building up the capabilities of the PRC distributors with which they already have relationships and are providing incentives and performing audits to improve efficiency of, and control over, distribution and points of sale.

Apart from normal business considerations, such as market size, growth, competition, channel mix (the different paths to market), and regulations, companies must also pay attention to regional and local particularities and relationships (*guanxi*). Every city or investment zone has different policies designed to attract certain types of foreign investment (*see* p.24). For example, some zones provide local tax incentives, land leasing, and lower utility fees. Organizations such as The US-China Business Council and the American Chamber of Commerce can help find appropriate locations. A well-connected and trustworthy local partner is also often critical.

China's Logistics Rules Obscure the Way Forward

A notice on foreign-invested logistics companies in China, released in summer 2002 by the now-defunct Ministry of Foreign Trade and Economic Cooperation, meets China's World Trade Organization (WTO) commitment to allow foreign investment in joint ventures for wholesale and commission agent business for most imported and domestic products, but does not address specific products and does not cover retail operations. The geographic area covered by this provisional notice includes the cities of Beijing, Tianjin, Shanghai, and Shenzhen, and the provinces of Zhejiang, Jiangsu, and Guangdong. Presumably, the geographic scope of the notice will gradually be broadened until the whole country is covered.

The Notice on Relevant Issues Regarding the Experimental Establishment of Foreign-Invested Logistics Companies defines and permits two general types of logistics operations: international logistics and third-party logistics. International logistics operations have import and export rights but are limited to 50 percent foreign investment, while third-party logistics companies may possess foreign ownership of more than 50 percent. Minimum registered capital for companies of either type is $5 million, and the project must be either an equity or cooperative joint venture. Either the largest foreign partner or the largest Chinese partner must be a company with "outstanding" logistics expertise, clearly a subjective definition.

The notice raises three difficulties for potential foreign investors in logistics operations:

- China's WTO commitments require the gradual phase-in of trading rights for all FIEs, beginning with minority FIEs in December 2002 and expanding to include wholly foreign-owned enterprises by 2004. The new notice allows two types of logistics companies— one with trading rights and one without. But given the trading rights phase-in (with minority foreign-owned third-party logistics companies being granted trading rights from December 11, 2002), the difference between the notice's two types of logistics companies is unclear.
- Existing FIEs seeking to expand their business scopes to include logistics apparently qualify if they have existing investments of at least $5 million and do not need to add $5 million to their existing investments. Nevertheless, FIEs will be discouraged by the requirement that one of the partners have distribution expertise.
- FIEs are currently allowed to distribute the products they manufacture in China; within three years, all FIEs will be able to import products. Will FIEs be allowed to ship imported products to their wholesale distributors—as they currently do with domestic products—or will they be required to continue to use a licensed logistics provider or importer to channel the imported products to their wholesalers?

The notice, which took effect August 24, 2002, overlaps with—and contradicts parts of—a Ministry of Communications rule on foreign investment in road transport that was released in November 2002. As more of China's WTO commitments come due, these and other questions will surely be answered, but whether they will be resolved quickly enough for foreign investors is another matter.

—The US-China Business Council

2 Focus on value

Companies should bypass inefficient parties and middlemen, thus removing unnecessary layers of bureaucracy and streamlining distribution chains, as is already happening in many industries such as personal computers and consumer electronics. As the middlemen are removed, the capabilities of smaller players are improving. Dell has adopted this strategy through its direct customer model and by outsourcing logistics. Many other companies are quickly following suit. In selected cities in China, Nokia Corp. broke the widely used industry distribution model that follows a "manufacturer, general agent, regional distributor, second-tier distributor, retailer, consumer" pattern and supplied large regional distributors and retail outlets directly, thus cutting distribution costs and raising the company's market responsiveness.

3 Streamline distribution and logistics

Companies and their distributors must integrate, centralize, and streamline distribution and logistics functions, assets, infrastructure, staff, and operations. The goal is for a supply chain to become a separate, yet shared, organization across different business units—one just as important as sales and marketing.

4 Avoid duplicating services

As seen in mature markets, few companies can build or provide the full range of distribution services alone; partnerships and alliances with local distribution service providers are keys to success. By focusing on improving flows, companies' distribution and logistics functions in China can be based more on the transmission of reliable and timely information and less on direct control of the physical movement of consignments.

5 Use technology as a key differentiator

The distribution and logistics sector in China is typically slow to adopt new technologies, partly because of the complexity and seemingly daunting investment requirements of setting up an integrated IT platform. Growth of the sector will require greater sophistication in supply chain planning and will require companies to set up systems that make product movement visible, as a way to track demand in real time. Businesses seeking an efficient distribution chain will increasingly use technology to help make optimal decisions, integrate parts of the chain, and link the beginning of the supply chain to the end.

6 Manage risk effectively

A company's ability to recognize the many risks of conducting business in China, and to plan for them, can spell the difference between success and failure. The companies that understand the baseline cost structure and motivations of their distribution and logistics operation, and track the total cost, will be in a better position to mitigate risks.

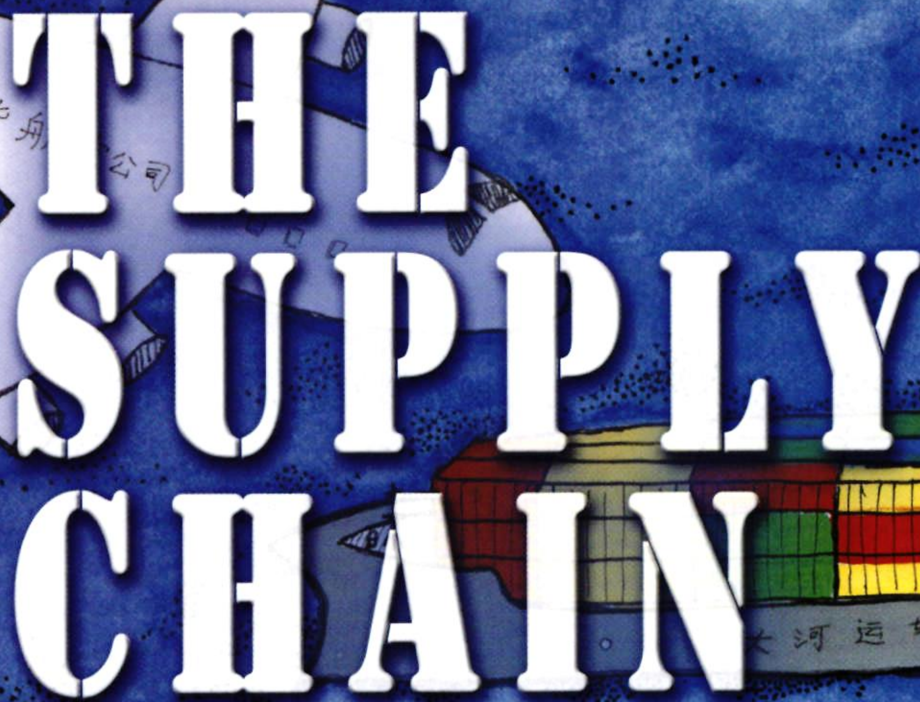
7 Build and retain talent for long-term success

According to a survey conducted in 2002 jointly by The Logistics Institute-Asia Pacific in Singapore and the Logistics Institute of the Georgia Institute of Technology, both global and domestic third-party logistics service providers have identified lack of talent as one of the key challenges of operating in China. Value-added services in distribution and logistics require more expertise and skills than most PRC providers currently possess. In general, the concept of functional or service excellence is relatively weak in the distribution and logistics sector. Untrained PRC staff in many domestic distribution firms often have few incentives to perform well; some observers argue that 85 to 90 percent of distribution initiatives fail in China because of workforce errors. For the foreseeable future, training will be an integral part of any company's relationship with a PRC distribution service provider.

Proceed with caution, but do proceed

As some successful companies are proving, effectiveness in distribution and logistics helps to achieve market share and profitability growth in China. To realize the potential of their China investments, companies need to understand and plan for the market's potential and risks. Companies must also recognize that the distribution and logistics operating model in China is very different from what they would find in the United States, Europe, and other developed markets.

Careful self-assessment and diagnostics should determine the purpose of a company's entry. Companies should ask themselves a series of questions that go beyond the supply chain: What does our company have to offer, and want to bring, to China? What does the company need to do to establish an effective presence in China? Where do we stand today? Is our company developing sufficient knowledge of the market? Have we factored in all of the complexities in distribution and logistics that are inherent in selling and moving our products in China? Will the service, technological know-how, existing international network, or management skills give our company a competitive advantage over potential international and local competitors? Do we know how to lower operating costs to support attractive pricing? Any company investing in China must identify and address these questions. The answers should provide a template for easier market entry and better performance. 完



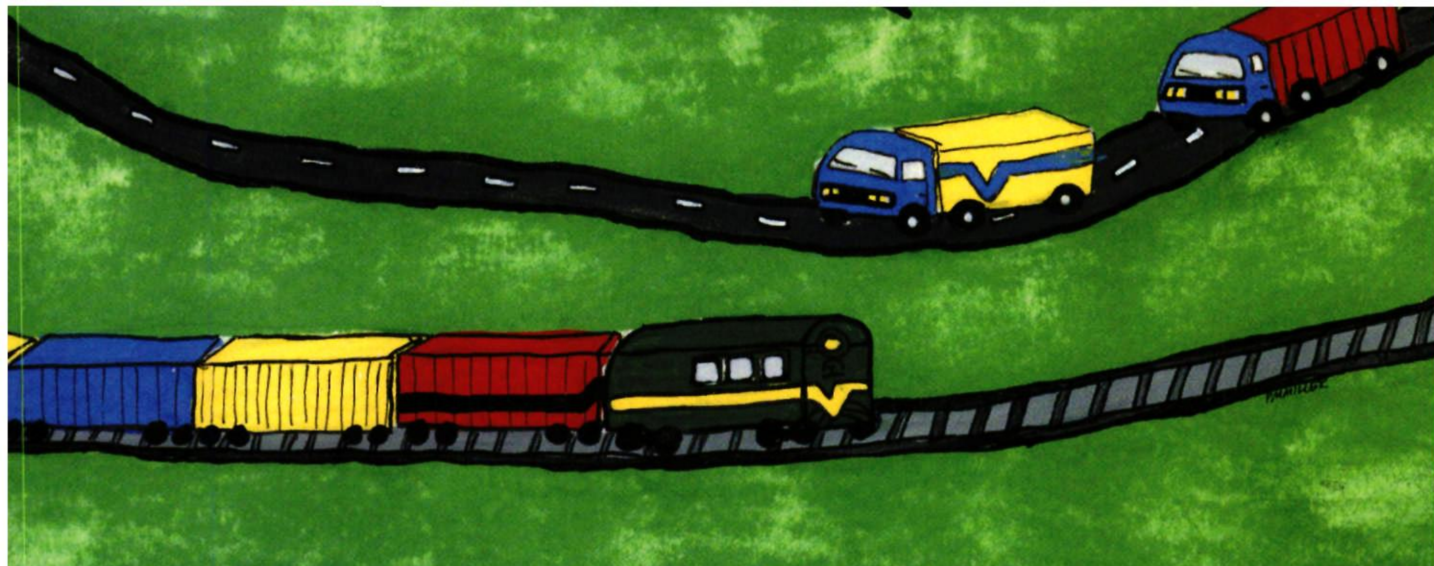
Wal-Mart in China: Challenges Facing a Foreign Retailer's Supply Chain

Ted P. Huffman

Operating 31 retail stores across China—from Shenzhen in the south, to Kunming, Yunnan, in the west, and Harbin, Heilongjiang, in the north—Wal-Mart China Co. Ltd. is rapidly expanding in China's increasingly modern business environment. But certain aspects of China's distribution sector pose challenges for Wal-Mart and its suppliers, and overcoming these challenges through innovative and flexible supply chain management and logistics strategies are vital to Wal-Mart's success in China.

The effective management of a supply chain is high on many foreign companies' lists of goals. China's marketplace today is tremendously competitive, and the advantages foreign companies

Ted P. Huffman,
based in Shenzhen, is logistics director for Wal-Mart China Co. Ltd.



Supply chains encounter greater hurdles in China than elsewhere

can gain over local companies are often narrowed by the inefficiency of their supply chains. Every day saved in lead time (the time between the placement of an order and receipt of goods), every percent gained in fill rate (the percentage of a purchase order filled), and every dollar saved on inventory can mean the difference between success and failure. To succeed in China, companies must address several key challenges: regionalism, technology, nontariff barriers, and financial issues.

Regionalism in China

Multinational corporations (MNCs), typically used to operating at national and multinational levels, face unfamiliar supply chain fragmentation and local protectionism within China. Like other foreign MNCs in China, Wal-Mart confronts the consequences of centuries of provincial autonomy and self-sufficiency. But modernization, which brings with it the potential for the application of advanced communication and infrastructure, diminishes the rationale for regional self-reliance. Indeed, such self-reliance hinders interprovincial cooperation, particularly interprovincial trade.

Local administrative bodies and physical infrastructure built to protect local interests pose difficulties for road transportation, private and commercial trucking, Customs clearance for imports, and interprovincial purchasing, whether distribution or wholesale. Such regionalism also affects domestic regulatory control of retail consumer and agricultural products. For example, health and sanitation certificates with local conditions apply to nationally approved food products, and local laws may require local wholesale purchases of alcohol and tobacco products. Local governments can use both of these means to regulate or hinder the interprovincial transportation and distribution of the products they cover.

Photograph courtesy of Wal-Mart China Co. Ltd.

Furthermore, regional or local governments may not operate in concert with central-government mandates or laws. Local governments can pass rules and regulations at any time without notice. This situation creates a confusing and costly business environment for companies try-

Businesses in China still depend heavily on a hard-copy paper flow of documentation, which adds cost, requires excess manpower, and creates opportunities for human error.

ing to operate on a national level. Ideally, distribution and supply chains can be managed to achieve optimum efficiency and cost. Today in China, regional fragmentation of the supply chain due to local protectionism decreases efficiency and increases costs—resulting in fewer choices or higher prices for consumers.

Nevertheless, Wal-Mart strives to provide customers with the widest choice and selection possible, at an "everyday low price." The flexibility and efficiency that nationwide procurement and centralized distribution allow are key to achieving this goal. Wal-Mart's supply chain in China is centralized in south China through the Shenzhen distribution center and will soon be centralized in north China through the Tianjin distribution center, scheduled to open in October 2003. Wal-Mart does not require local suppliers that sell products exclusively to local stores to use its distribution center, but encourages suppliers that sell nationwide to use the distribution center because it is more efficient for a supplier to deliver to one location than to all the Wal-Mart stores across the country. For suppliers that have difficulty making a long journey to the distribution center, and that still wish to sell nationally, Wal-Mart offers back-haul services from their local marketplaces, giving these suppliers access to markets that they would otherwise be unable to reach. The company believes that the use of distribution centers and back-haul trucks is efficient and allows Wal-Mart to maintain control over most of its distribution chain. (Though the trucking is contracted out, Wal-Mart manages the rest of its supply chain directly.)

Appropriate technology levels

China's abundant labor supply means that companies can choose to use manual processes instead of automated processes and still save money. The tradeoffs are accuracy and quality, two standards that are rapidly changing in China. Whether a company chooses to use manual or automated processes will likely depend on the sector in which it operates.

In high-end technology and electronics manufacturing, which is moving from Japan, South Korea, and the United States to China, Chinese and foreign manufacturers alike are under pressure to produce goods that meet world-class quality standards. These standards require manufacturers to invest in robotics or automation. In stark contrast are the businesses of transportation, distribution, and retail, in which profit margins are low and competition is fierce. As a result, foreign companies and their local providers still opt either to process manually or to contract out to local, third-party logistics companies that use manual processes.

Companies thus often end up somewhere between the fully automated and fully manual options, particularly companies that employ educated and technically capable workers who are interested in careers that enable them to use their expertise. Finding an appropriate level of investment in technology or automation may mean considering "mid-tech" processes for supply chain management, such as radio-frequency-equipped forklifts instead of fully automated picking or order retrieval systems, or off-the-shelf warehouse-management systems instead of custom-designed ones. Rising labor costs may also lead companies to choose partially automated solutions.

Nontariff trade barriers

Nontariff trade barriers—often in the guise of geographical limitations, quality or safety standards, or, in retail, a cap on the number of stores a company can open—are among the most frequently discussed topics within China's retail supply chain sector these days. As China complies with World Trade Organization (WTO) terms and lowers its import tariffs, it will inevitably seek ways to protect its huge domestic market. For instance, many companies find vague testing and labeling laws to be particularly troublesome.

Like the United States, China needs domestic consumer demand to drive growth. But unlike the United States, China's domestic demand is underdeveloped. Since retail companies are at the heart of supporting consumer demand, foreign retail companies in China will be under the microscope when it comes to the watchful eye of government authorities and should anticipate government efforts to keep Chinese products on, and imported products off, shelves.

In reality, though, customer preferences in China, as elsewhere, will usually dictate what is on the shelves, and since local products often sell best, many retailers will willingly stock their shelves with local goods. In addition, many international brands are now manufactured in China and also count as "local" in the eyes of the government. At the same time, Chinese cus-

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In a promising sign for retailers, several joint ventures between Chinese state-owned transport firms and foreign freight or parcel companies have recently been established.

tomers are still interested in trying new, imported goods, particularly when it comes to food.

Financial matters

China's current banking, finance, insurance, and taxation structures are bureaucratic and cumbersome. The goal of any supply chain or logistics manager is to create a seamless flow of product going one way and payment going the other way. Regional fragmentation of finance regulation, tax laws, and other institutions has the same effect on the payment side of the supply chain as regional protectionism has on the transport and distribution side. For instance, a company with joint ventures in several locations supplied by one supplier may have to make a separate payment from each venture to the supplier. Wal-Mart, however, has worked with the Chinese government to set up a holding company to consolidate joint venture distribution and finance. Also, since modern insurance is relatively new to the PRC, claims processing can be time consuming and confusing.

Businesses in China still depend heavily on a hard-copy paper flow of documentation, which adds cost, requires excess manpower, and creates opportunities for human error. The requirement for "chops" on official documents further complicates matters. Because there is no widely accepted way yet for such chops to be electronically authenticated or transmitted, paperwork must be in hard copy.

Pending reforms and modernization in finance, insurance, and taxation could pave the way for approval of technology that could improve the flow of documents and payments. Reforms will enable foreign companies with supply chain interests in China (including third-party logistics providers) to create seamless services and networks across the country.

LTL and private, nationwide parcel delivery

One thing most supply chain and logistics managers around the world take for granted is the readily available supply of less-than-truckload (LTL) service providers or express parcel delivery. In the United States, such services can handle anything from a single carton to a full shipment in a 53-cubic-foot trailer. By the carton, by the pallet, or by the trailer, door-to-door nationwide freight services are reliable and affordable. Always just a phone call away, shipments are tracked by tracking label and global positioning systems (GPS) to ensure minute-by-minute efficiency.

Such services are relatively undeveloped in China, but are making headway and will fill a niche in the transport industry. This development will have a huge impact on retail business, largely by allowing more flexibility through more delivery and transport options. Urgent or exception delivery, just-in-time inventory management, catalogue or mail order sales, and Internet sales are all business models that have been made possible around the world by these types of transport services. Although some service providers in China such as China Post or China Rail can arrange for such shipments today, the choice of service providers is limited, and tracking, pickup, and delivery are unreliable. In a promising sign for retailers, several joint ventures between Chinese state-owned transport firms and foreign freight or parcel companies have recently been established.

Perseverance pays off

Although these issues and concerns are noteworthy, they are by no means factors that would severely limit any enterprising manager or company from expanding in China. Despite the lack of national and advanced systems described above, for more than seven years Wal-Mart has operated and aggressively expanded its retail business in partnership with dedicated associates, joint venture partners, suppliers, and government officials. Wal-Mart's experience has shown that even the most daunting problems tend to transform themselves into opportunities. For instance, Wal-Mart has used case studies of fragmented transportation and distribution to educate its suppliers to help them streamline their operations and reduce costs—to the benefit of both parties. Sometimes these issues require company participation in the debate for liberalization and standardization. As a result, Wal-Mart has become heavily involved in government relations and has participated in these debates by talking directly with Chinese government officials at both local and national levels and through trade groups in both the United States and China. To overcome the difficulties of distribution and supply chain management in China, supply chain managers will have to be creative and persevere to achieve success in a market that will be central to them and their customers in the twenty-first century. 完

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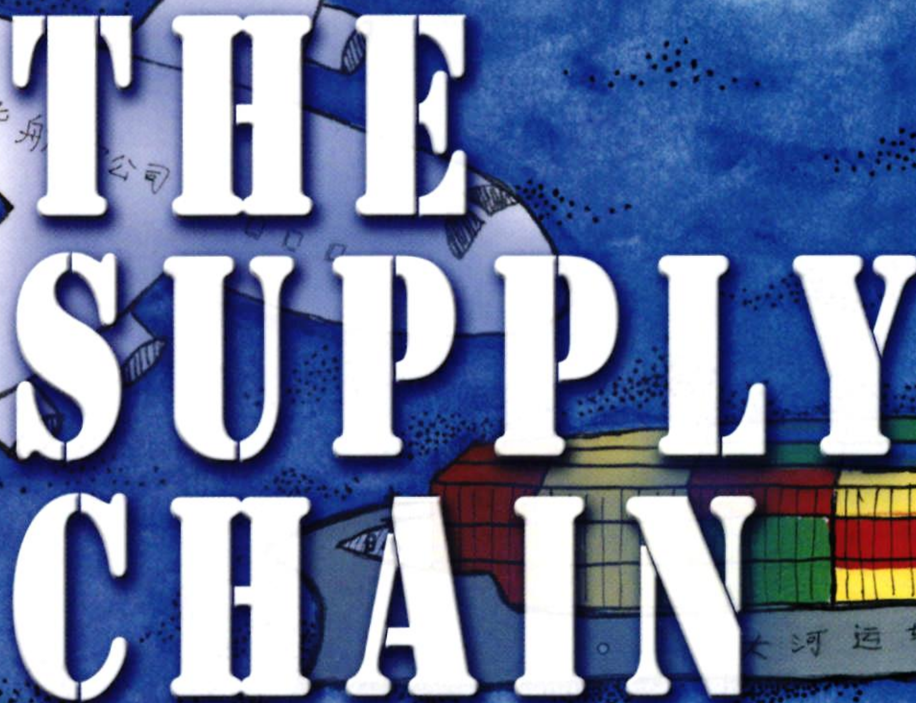

Zoning In

Julie Walton

Initially set up to attract foreign investment, China's special development zones have become central to many foreign companies' China strategies. Because they allow companies to import, process, and export with fewer taxes and less red tape than other places in China, development zones have helped foreign firms integrate China into their global supply chains. As export-processing trade in these zones took off in the mid-1980s, the zones' popularity prompted the PRC government to offer incentives to encourage still more growth, and China now boasts dozens of zones with a confusing array of options. A review of just two of the most popular types of zones illustrates the factors a foreign company needs to consider before setting up operations—or incorporating China more broadly into its supply chain.

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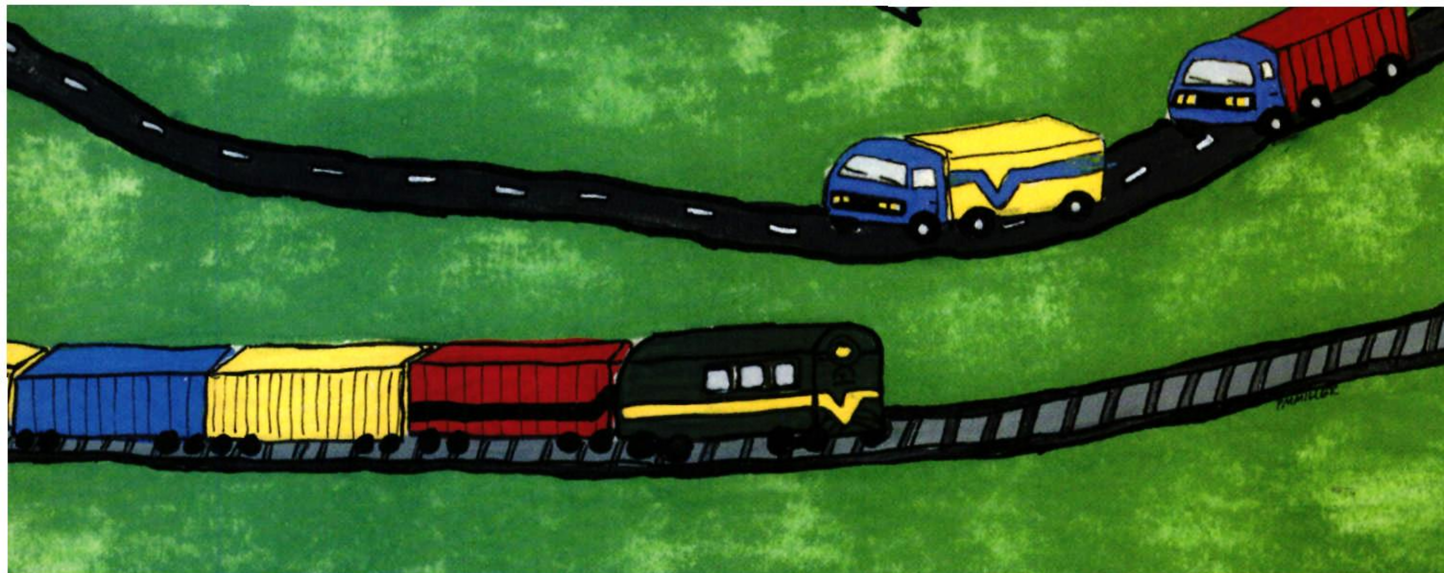
is a Business Advisory Services associate at The US-China Business Council in Washington, DC.



Free-trade zones and export-processing zones offer advantages unavailable elsewhere in China

Zones and more zones

China has many types of zones and bonded areas (both of which offer relaxed import restrictions) at the state, provincial, city, and district level. Both foreign and Chinese companies may set up in all types of zones. National-level zones fall into seven main categories:

- **Economic and technological development zones** are areas that provide international-standard facilities and supporting services.
- **Free-trade zones** (FTZs) are specialized areas for international trade, foreign investment, bonded warehouses, and export processing.
- **High-technology industrial development zones** encourage the transformation of scientific and technological advances into marketable products.
- **Border and economic cooperation zones** encourage frontier trade and export processing, improved relations with neighboring countries, and better economic conditions in areas populated by national minorities.
- **Export-processing zones** (EPZs) are special enclosed areas supervised by the General Administration of Customs.
- **Tourist and holiday resort zones** encourage foreign investment in certain resort areas.
- **Taiwan investment zones** aim to attract investment from Taiwan.

Of these various types of zones, free-trade and export-processing zones offer the incentives most attractive to a broad class of foreign investors.

What is a free-trade zone?

In an effort to increase exports and foreign investment, the central government approved 15 national-level free-trade zones in the 1990s (*see* Table 1). FTZs are geographically defined areas of 6 km^2 to 10 km^2 that permit a wide range of business activity such as warehousing, foreign exchange transactions, marketing, trading, and export processing. FTZs generally allow only simple processing, such as freight classification, parts loading, storing, packing, and branding. In practice, however, most companies engage in trading and warehousing operations. Of the more than 4,000 companies that operated in Shanghai's Waigaoqiao FTZ in 2002, only 167 engaged in export processing.

Various incentives, such as exemption from customs duty and value-added tax (VAT), liberal foreign exchange rules, and the absence of bond requirements for imports within the zone, were designed to attract new investment and to lure existing investment away from other structures, such as bonded warehouses, which the central government found difficult to oversee.

The national government has standardized most preferential policies for FTZs, including a package of tax incentives: For the first two years of operations, companies are exempt from enterprise income tax. During the next three years, companies are taxed at 50 percent of the normal foreign-invested enterprise (FIE) tax rate of 15 percent. After five years, in-zone enterprises pay the full FIE tax rate.

More important, the standard FTZ package also offers various customs incentives, such as

duty exemptions on all construction or infrastructure imports necessary for production and on all equipment, parts, and components imported for self-use. Imports entering the FTZ from outside China proper are exempt from customs duties and VAT; customs duties and VAT are assessed only after the finished products leave the FTZ for regions outside the bonded area. If more than 70 percent of the finished product is re-exported outside PRC territory, any remaining product is taxed at a reduced rate based on the original imported components. All finished goods "imported" from the FTZ into China proper will have customs duty and VAT assessed based on a ratio of locally sourced inputs to imported components.

Each zone can, and often does, offer its own incentives on top of the central government ones. Local authorities can establish land-use or utility incentives and may also decide to exempt in-zone enterprises from local income tax.

Notably, FTZs remain the only locations in which a foreign company may establish a wholly foreign-owned trading company—though these wholly foreign-owned companies did not possess trading rights (the right to import and export) until very recently. To sell products in mainland markets, these companies were required to engage agents with trading rights to handle customs procedures for transactions with the non-FTZ enterprise.

FTZs offer a Bonded Commodities Exchange Market or exhibition center through which in-zone enterprises sell their products to Chinese buyers and distributors for sale in mainland markets. Exchange market administrators clear the goods through Customs and issue VAT invoices. Given these restrictions on trading companies in the FTZs, only five were set up between 1997 and 2003 (three in Shanghai and two in Shenzhen), and none is wholly foreign owned.

In June 2003, the State Council, the Ministry of Commerce, and Customs issued a notice allowing enterprises in Futian-Shatoujiao, Tianjin, Waigaoqiao, and Xiamen Xiangyu FTZs to register for the right to conduct domestic trade without using an intermediary with trading rights. Because the notice leaves the drafting of detailed application rules to the zones themselves, it will be some time before the effects of this new policy on the zones, on the companies in the zones, or on future investment become clear.

Table 1: China's Free-Trade Zones (FTZs)

Zone	Contact Information
Fujian	
Fuzhou FTZ	www.fzftz.gov.cn
Xiamen Xiangyu FTZ	Tel: 0592-603-6831 Fax: 0592-603-5830
Guangdong	
Futian FTZ (Shenzhen)	www.szftz.gov.cn
Guangzhou FTZ	www.getdd.com
Shantou FTZ	www.stftz.gov.cn
Shatoujiao FTZ (Shenzhen)	www.szftz.gov.cn
Yantiangang FTZ (Shenzhen)	www.szftz.gov.cn
Zhuhai FTZ	www.zhfreetradezone.org
Hainan	
Haikou FTZ	www.hkftz.gov.cn
Jiangsu	
Zhangjiagang FTZ	www.zjgftz.gov.cn
Liaoning	
Dalian FTZ	www.dlftz.gov.cn
Shandong	
Qingdao FTZ	www.qdftz.com
Shanghai	
Waigaoqiao FTZ	www.china-ftz.com
Tianjin	
Tianjin Port FTZ	www.tjftz.gov.cn
Zhejiang	
Ningbo FTZ	www.nftz.gov.cn

SOURCE: The US-China Business Council

What is an export-processing zone?

Customs and the State Council approved the establishment of 15 EPZs in 2000. That number has since grown to 38 (*see* Table 2). Limited to an area of 2 km^2 to 3 km^2, all EPZs must be established within the confines of an existing economic or development zone. The central government set up these small areas, completely fenced in and under 24-hour Customs supervision, to promote exports *and* crack down on the illegal sale of duty-free imports of raw materials. Establishing EPZs at central locations throughout the country has helped Customs achieve these goals.

EPZs differ from FTZs in several ways. First, EPZs permit fewer types of business activities. Only export processing, warehousing related to the processing activities of in-zone enterprises, and freight transport are allowed. The narrow purpose of the EPZ allows China to offer incentives to export processors that are not available in the FTZs or at a standalone, bonded facility. Second, unlike in FTZs, there are no VAT charges on public utilities. Third, only companies that export more than 70 percent of their output are eligible for the income tax breaks available to all companies in FTZs. And because EPZs are export oriented, all companies located in an EPZ qualify for trading rights and do not need to work through an in-zone commodities market if they have product to sell on the domestic market.

EPZs share some traits with FTZs—the import duty on a product sold in China will depend upon the item's specific product category. Also, as in FTZs, VAT is not levied on any activity that takes place within the EPZ, and imports are tax-exempt.

Though the PRC designates EPZs as "closed," this term only refers to the fact that EPZs are physically segregated from the rest of the economic development area in which they are located. All goods, persons, and vehicles must be inspected upon entry and exit of the zone; no personnel may reside within the EPZ. Legally and practically, however, the EPZs are open and accessible to foreign investment.

Because EPZs focus exclusively on export processing, the most significant difference between them and FTZs is the export rebate policy. If a company within an EPZ purchases goods from an enterprise within China, the selling enterprise will receive an export rebate, and

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Duty Calls

The illegal sale of goods imported duty free into free-trade zones and export-processing zones—not to mention bonded facilities—is a serious problem for the PRC government. Bonded zones and facilities allow companies to store, and sometimes process or package, goods without paying taxes on them until they are sold. Such far-flung operations ostensibly engaged in export processing have stretched Customs' supervisory abilities and created enormous incentives for graft and smuggling.

To crack down on this problem, the central government has instituted a classification system that grades all export-oriented companies based upon the veracity of their customs declarations and how frequently they failed to pay applicable duties. Companies that have had more than two infringements per year earn a C or a D rating, requiring them to place deposits with Customs officials for all imported materials used in production. Companies receiving A or B grades are exempt from such import bonds.

—Julie Walton

the in-zone buying enterprise will not have to pay VAT. In contrast, companies in FTZs, or bonded facilities outside of zones, must pay VAT up front on any good sourced in China and apply for an export rebate only after the good has been exported.

Enterprises in EPZs also benefit from priority Customs clearance over those located outside the zone and more streamlined clearance than those in FTZs. All companies in an EPZ must have a computerized database connected with Customs to clear goods electronically. Currently, companies that pay customs duties on time (A or B grade [*see* left]) and have a reliable, computerized tracking system can apply for paperless customs clearance. EPZs enjoy 24-hour Customs support and make no distinction between bonded and non-bonded imports, a practice that results in faster processing.

Choosing a base: FTZ vs. EPZ

As evidenced by the thousands of companies located in free-trade zones across China, FTZs can be strategic places to invest, depending upon a company's business scope and structure. Many companies currently use these FTZs to warehouse high-end imports, sell across the Asia-Pacific region, or coordinate exports among their PRC-based original equipment manufacturing operations.

Export-processing activities are listed among the activities permitted in FTZs, but most companies that want to focus exclusively on the export market find better incentives in the export-processing zones. Some companies have reported that FTZs such as Waigaoqiao, TEDA, or Futian-Shatoujiao are preferable for logistics and warehousing activities rather than export processing. One manufacturing company currently located in an EPZ had originally planned to invest in Waigaoqiao. But after comparing Waigaoqiao's offerings against its business plan, which entailed substantial manufacturing, the company decided that Waigaoqiao's system would not support large-scale processing of mostly imported components.

Although Shanghai, in particular, has taken important steps toward improving customs practices and clearance times, the FTZs lag behind the EPZs in developing electronic customs clearance systems. In FTZs, Customs tracks imports on a piece-by-piece basis, with separate books for bonded and non-bonded imports, and checks the books with each import and export—as opposed to a monthly or quarterly reconciliation process. Companies engaged in extensive processing find this to be a paper-intensive and time-consuming process.

The compact geographic area and sole focus on exporting allows Customs to create an especially user-friendly import-export environment. Many company representatives, legal professionals, and zone commissioners agree that locating in an EPZ is ideal when a company's

China's Most Popular Zones

Most Chinese cities that have free-trade zones (FTZs) also have export-processing zones (EPZs). Thus, not only must a company decide what type of zone is preferable for its operations, but also must determine the best location. A brief description of three of the top business cities in China and their FTZs and EPZs follows.

Shanghai: Waigaoqiao FTZ and Jinqiao EPZ

Many American companies have looked at Shanghai as the main gateway to China; the city has worked hard to build the infrastructure and cosmopolitan environment needed to sustain all manner of foreign investment. Waigaoqiao and Jinqiao are on opposite ends of a swath of land that runs through Pudong in Shanghai. Both Waigaoqiao and Jinqiao have followed the rise of Shanghai as a technological development center, vying to attract investment from information technology (IT) companies. The cost of maintaining operations in the Shanghai area is significantly higher than in the rest of the country, but many companies believe that the benefits of Shanghai's highly skilled, tech-savvy work force are worth it. One company in the IT sector stated that it set up in Shanghai mainly because its operations required the ready supply of engineering professionals that Shanghai offers.

Shenzhen: Futian-Shatoujiao FTZ and Longgang EPZ

By virtue of their location within a special economic zone, both Futian-Shatoujiao and Longgang can take advantage of an environment almost exclusively focused on exporting. Traders and exporters can also capitalize on the proximity of Hong Kong—a major financial service center and free port. In the past, Shenzhen attracted significant amounts of investment from Hong Kong and Taiwan. This is still the case, although more Taiwan technology firms are moving up to the Shanghai area, while rising numbers of American and European firms are setting up manufacturing operations in Shenzhen. According to economic officers in the US Consulate in Guangzhou, manufacturers focused exclusively on the export market usually set up in Shenzhen, while manufacturers with an eye on China's domestic market as well as the global market often prefer Shanghai.

Tianjin: Tianjin FTZ and EPZ

Tianjin, for centuries the gateway to vast stretches of northeast Asian territory, has consistently attracted numerous Japanese and South Korean investors, although a Taiwan firm was the first company to begin operations in the EPZ in 2000—exporting its entire output to South Korea. Zone commissioners have not marketed the zone to attract specific industries; at the moment, companies in the zone are a mixture of machinery and light industrial manufacturing. Most foreign companies view Tianjin as a cheaper alternative to Shanghai and a prime location if the operation relies on low-skilled labor rather than technology.

—Julie Walton

Table 2: PRC Export-Processing Zones

Province/City	Location
Beijing	Tianzhu Industrial Park
Chongqing	Chongqing
Fujian	Xiamen Xinglin
Guangdong	Guangzhou Shenzhen
Guangxi	Beihai
Hebei	Qinhuangdao
Henan	Zhengzhou
Hubei	Wuhan
Inner Mongolia	Hohhot
Jiangsu	Kunshan Suzhou Industrial Park Wuhu Wuxi Nantong Lianyungang Nanjing Suzhou New District Zhenjiang
Jilin	Huichun
Liaoning	Dalian Shenyang
Shaanxi	Xi'an
Shandong	Weihai Yantai Ji'nan Qingdao
Shanghai	Songjiang Jinqiao Qingpu Minhang Caohejing
Sichuan	Chengdu
Tianjin	Tianjin
Xinjiang	Urumqi
Zhejiang	Hangzhou Ningbo Jiaxing

SOURCE: China Association for Development Zones (www.cadz.org.cn)

export and import activities are complex, as would be the case if a company were to import damaged goods for repair and re-export, for example. This type of operation involves a substantial amount of paperwork and interaction with Customs because no regulations explicitly cover the import of damaged goods for repair and re-export. Customs officials in EPZs work closely with companies on a case-by-case basis. In this re-export example, Customs can log the imports, and then inspect the goods when they are ready for re-export.

This does not mean that dealing with Customs, even in an EPZ, is effortless. Companies report that speed remains one of the most significant drawbacks of the Chinese customs system, even within the EPZs. And, regardless of location, companies still must constantly educate Customs officials about the company's business scope and import-export needs. A company must be willing to spend the time and legal resources to educate and work with Customs officials to receive all the duty exemptions to which it is entitled.

Proximity to the rest of the supply chain, as well as to the overall market, is also a factor, not only in selecting which type of zone, but also in which specific zone, to establish (*see* p.28). The Tianjin FTZ, known as a gateway to Northeast China, is the central location for most of China's car imports. In 2002, 60 percent of imported cars sold in China came through Tianjin. On the other hand, Shanghai offers a critical mass of manufacturing and skilled labor. One machine tool company selected Waigaoqiao FTZ over Hong Kong because its suppliers were there, even though the company believed that Hong Kong's port was of significantly higher quality than Shanghai's. (Port facilities were especially important to the company as it hoped to develop its China operations into a logistics hub for the Asia-Pacific region.)

Companies continue to search for incentives even after initial operations placement. When

Continued on page 54

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THE SUPPLY CHAIN

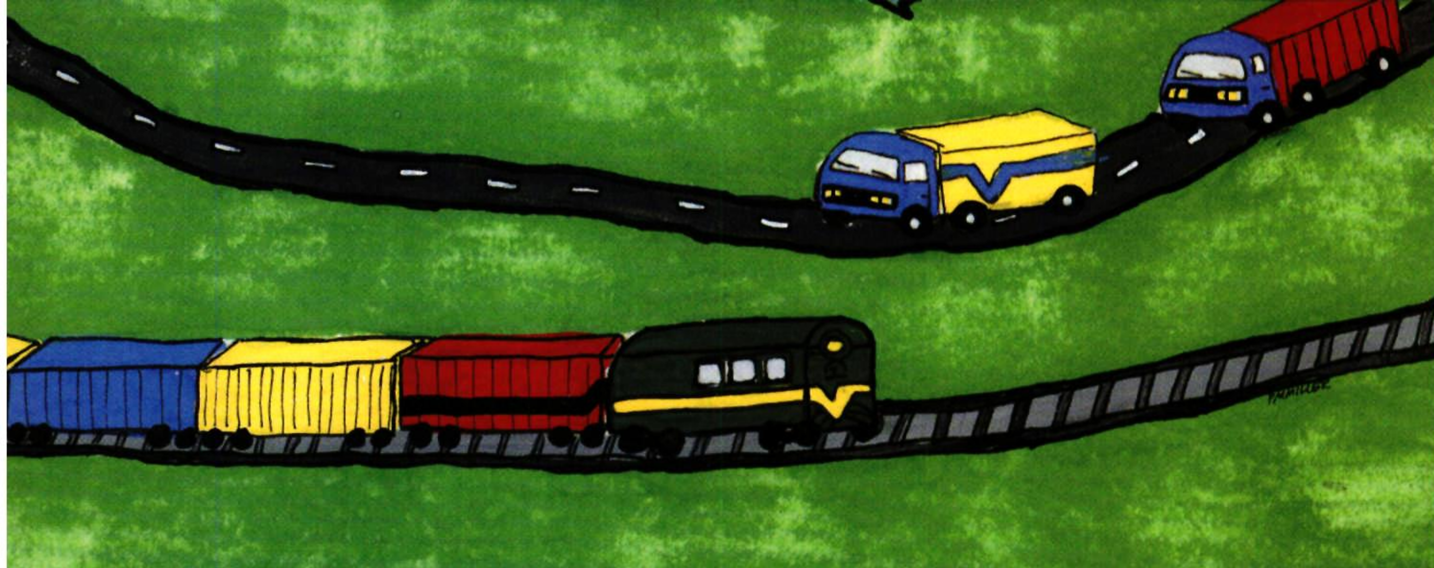
Sourcing in China

Michael D. Matteo

US small and medium-sized enterprises (SMEs) frequently view the prospect of obtaining raw or finished materials or goods from countries as far away and culturally different as China as challenging if not impossible. Though large, multinational corporations often have substantial resources and numerous overseas offices to support global sourcing operations, smaller companies with limited resources may believe they have no choice but to stay closer to home. But sourcing in China offers foreign companies of all sizes ever-increasing opportunities to acquire high-quality, low-priced products.

The popularity of China as a location of export processing facilities and a source for both components and finished goods bound for overseas markets is well known. According to the

Michael D. Matteo
is vice president of Operations at ThreeSixty Sourcing, Inc.



New changes mean cost-saving opportunities for foreign companies of all sizes

PRC's General Administration of Customs, China's exports reached an impressive $325.6 billion in 2002—a 22.3 percent increase over 2001. So while sourcing in China may seem logistically overwhelming to a smaller company, the cost savings and other benefits warrant a closer look.

Sourcing considerations

The first step for a company looking at China's sourcing opportunities is to consider the market conditions in the United States. Then the company must look at the demands of the China market.

- **Retailers demand more**

Smaller manufacturing companies now face more stringent demands from their customers. In the past, for example, a small manufacturer may have shipped one truckload of goods at a time to a large retailer. Today, the retailer's needs are far more complicated—sometimes it requires a mixture of products on the same pallet. The retailer will tell the company exactly what it needs rather than working within the company's constraints. This can be a huge burden on a small manufacturer, which will need to perform many more services, such as labeling and shrink-wrapping, that raise the product's cost. SMEs also face new requirements from larger retailers that want to minimize the amount of time their employees spend receiving products and processing inventory. They continue to push toward a simple system of scanning to get the items into inventory.

- **The China learning curve**

Many American SMEs are minimally staffed and lack expertise not only in importing from China but also in advanced supply chain management.

The complexities of ocean freight provide a good example. Ira Albucher, director of logistics for ThreeSixty Sourcing, explained that ocean container rates recently rose by roughly $1,200 per container. Small companies face huge price increases and no way to reduce them. Larger companies that import mass quantities of containers often have direct contracts with steamship lines and can mitigate some price increases. Ocean freight rates vary widely—nearly every space on a container ship has a different price that is potentially negotiable. Companies that lack expertise in importing can have a difficult time obtaining and negotiating competitive freight rates.

Though freight forwarders offer excellent service and expertise, customers could do better by using global sourcing service providers that buy ocean freight services cheaply in bulk and then pass on savings to their customers. To obtain the best prices, sourcing companies first assess an importer's freight needs and then interview qualified service providers and ocean freight carriers, ultimately selecting the best combination of service and price.

- **Security issues**

Protecting intellectual property (IP) is an area of concern when moving production into China. IP protection begins with the proper identification and evaluation of qualified suppliers. Companies must perform thorough due diligence on their selected suppliers, with constant inspections of products and facilities. Thorough IP protection requires specialized

services and the advice of qualified attorneys or organizations that specialize in this area of law.

Another security issue is the joint government/business initiative to improve cargo and supply chain security. Earlier this year the US Customs Service introduced strict requirements for anyone associated with importing goods into the United States. The Customs-Trade Partnership Against Terrorism (C-TPAT) is an initiative to increase cargo and supply chain security while improving trade flow. Under this program, businesses must conduct comprehensive self-assessments of their supply chains using the security guidelines developed jointly with US Customs.

Short-term scares vs. long-term savings

The outbreak of severe acute respiratory syndrome in Asia this spring temporarily discouraged US-based companies from sending employees overseas for product development, supplier evaluation, and selection. Despite this and other potential short-term risks, the costs of sourcing and producing in China are likely to remain low in the long term.

Advantages of sourcing in China

The advantages of sourcing in China have begun to outweigh the risks.

Rising quality, falling demand for brand names

Many retailers are growing less dependent on brand names in part because they, and their suppliers, demand—and receive—good value from Chinese suppliers. When two products are equal in specifications and one is significantly cheaper, a retailer can provide great value to the end customer by choosing the less-expensive product—as long as the customer does not demand a brand name. Many large, well-known Western retailers are thus no longer willing to pay premiums for brand-name products when they can get products of equivalent quality for less money.

Indeed, these large retailers, which buy many consumer goods from China, are responsible for having raised the bar for Chinese suppliers. In some cases, such as in the sporting goods industry, Chinese suppliers are developing and marketing their own brands, which have become quite attractive to large, US-based retailers.

Better service

China's low product and labor costs are well known; its advantages in services are often underestimated. Today, when a small or medium-sized importer needs labor-intensive, value-added services, Chinese suppliers and logistics service providers are capable of responding. Applying labels or mixing products on a pallet can be extremely time-consuming and labor intensive. Since Chinese labor costs a fraction of US labor, it is worth examining whether a particular service can be performed in China.

Supply chain management and overhead costs are also lower in China, and the education levels and expertise of personnel in logistics services are increasing rapidly.

The role of technology

Until recently, many Chinese suppliers used outdated technology. Even a few years ago, most

Continued on page 54

Sourcing Companies at Work: A Case Study

Sourcing companies are an important tool for finding good-quality, low-cost products in overseas markets. One such company, ThreeSixty Sourcing, Inc., works predominantly with US-based consumer products and light industrial companies that want to move their production to China or reduce the cost of products already produced there.

A medium-sized US manufacturer of cleaning tools with annual sales of $125 million recently approached ThreeSixty Sourcing with just such a request. For the past three years, the manufacturer's revenue and profits had been shrinking because of high US manufacturing costs and because its competitors were sourcing low-cost products from Asia. The manufacturer recognized the need to move production to China but lacked both the knowledge and resources to do so.

The sourcing process began with a detailed analysis of the manufacturer's stock-keeping unit base to determine the high-volume, low-margin items to attack first. The manufacturer then provided samples of these items to ThreeSixty. ThreeSixty then searched for key Asian suppliers with a demonstrated ability to manufacture high-quality products for export and provided samples to the suppliers for review and quotation.

ThreeSixty performs this process for each item, often obtaining more than 20 quotations from several regions of Asia. ThreeSixty also assesses the factories of each qualified supplier to narrow the list down. These assessments include a detailed social compliance review to ensure that the factory complies with local laws and regulations as well as with the codes of conduct of ThreeSixty and its customers. Selected suppliers are then asked to visit one of ThreeSixty's Hong Kong, Shenzhen, or Shanghai offices for a competitive quoting session held by one of the company's key sourcing experts. Potential suppliers are carefully interviewed and asked to provide revised pricing as competition dictates. Ultimately, the sourcing company and its customer together select two to three suppliers to produce the relevant items. ThreeSixty shares all information regarding factory selection and cost information with the customer.

ThreeSixty's cleaning tool client now saves more than 30 percent on items produced in China and is rapidly moving production of other items to China to achieve additional savings. ThreeSixty finds that clients frequently achieve cost savings of 25 to 35 percent, whether production is already in China or is moving from the United States to China for the first time.

—Michael D. Matteo

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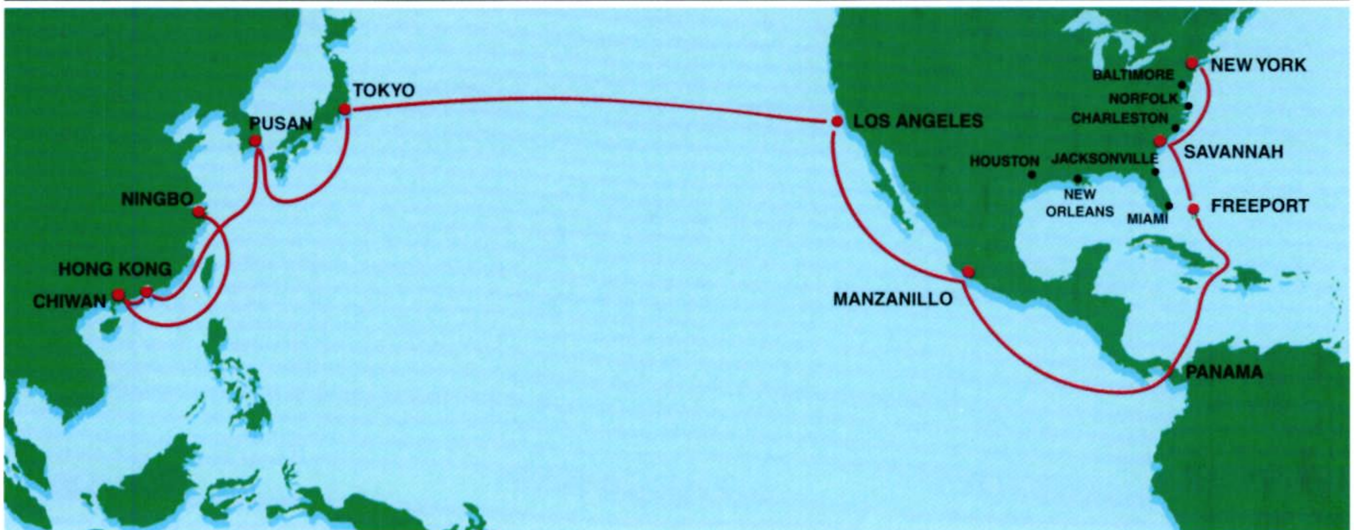

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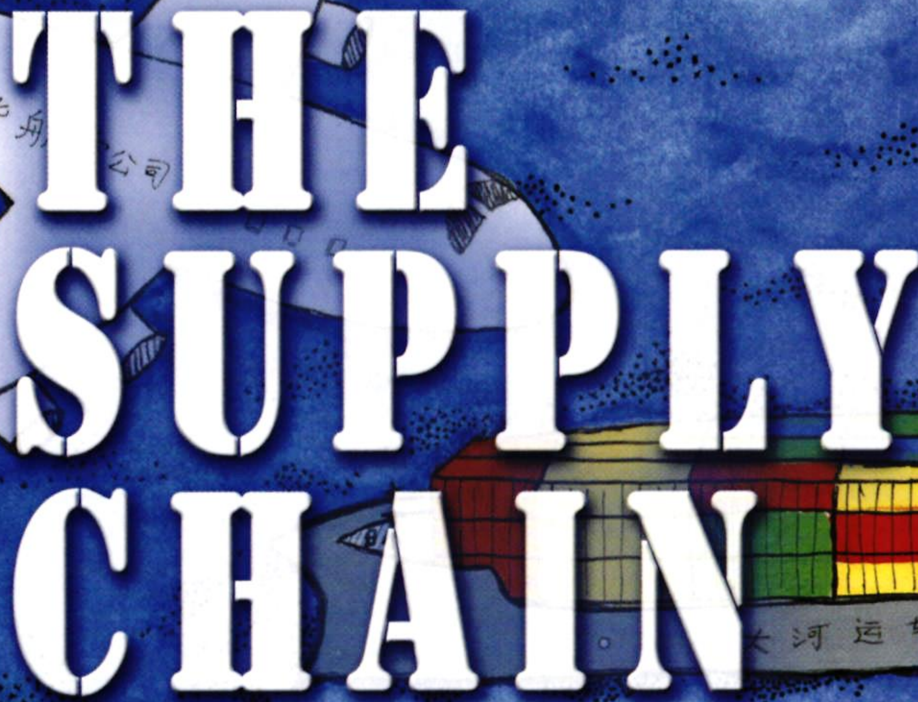

THE SUPPLY CHAIN

Buyer-Supplier Relationships in China

Brenda Sternquist, Zhengyi Chen, and Ying Huang

China has focused on helping state-owned enterprises (SOEs) in its retail sector—one of the last to be opened to foreign and private investment—often by limiting foreign competition and providing government subsidies for state-affiliated enterprises. Research on transitional economies has found that SOEs tend to use inefficient, traditional business structures and conduct business with long-term friends and acquaintances, rather than with the companies that could best serve their needs. As a World Trade Organization member, however, China must open its retail industry to foreign

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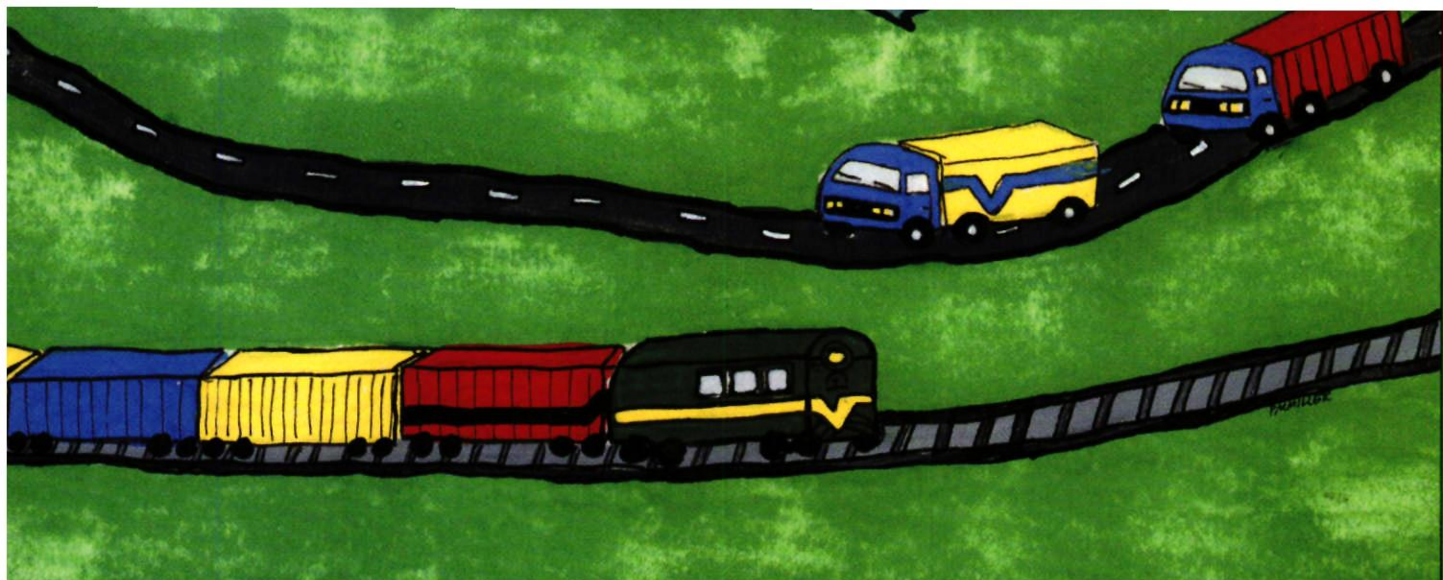
She also teaches a graduate course on retailing in China.

Zhengyi Chen and **Ying Huang**
are doctoral students at Michigan State University.



Does ownership type affect business relationships?

competition. And China's increasingly market-based system requires retailers to assemble a line of goods that will meet their customers' expectations.

Because retail buyers influence the selection of goods that will be available to consumers, we (a team of researchers from Michigan State University) conducted a study of buyer-supplier relationships to determine whether China's retail SOEs behave differently than their non-state-owned competitors. Nearly 100 retail buyers were surveyed during 2002 (*see* right). These buyers told us about their buying systems, processes for evaluating new products and vendors, and important features for determining satisfaction with their suppliers. We analyzed data for three types of retail ownership: SOEs, privatized former state-owned enterprises (PSOEs), and foreign joint ventures and organic enterprises (FJVs/Orgs). Organic enterprises are private, independent companies with no SOE ties.

According to Western literature, the key features of buyer-supplier relationships are trust, satisfaction with the other party, and long-term orientation (*see* p.36). Thus, we surveyed, for each type of ownership, these three elements of the relationship; relationship characteristics, such as China's concept of *guanxi*; and retailers' market orientation.

Supplier performance

When buyers perceive that their suppliers are performing well, they are usually highly motivated to maintain the relationship. The survey used eight criteria to evaluate supplier perfor-

Buyers and Suppliers

The buyers

Ninety-eight buyers participated in the study on buyer-supplier relations that we (a team of researchers from Michigan State University) conducted in mid-2002. Most of the respondents were from Beijing, Guangzhou, Shanghai, and Wuhan in Hubei. The rest were scattered across the country.

Of the three main types of participating retailers, state-owned enterprises (SOEs) made up 49.5 percent of the total, privatized former SOEs 11.1 percent, and foreign joint ventures and private, independent companies without SOE ties 34.3 percent.

One-quarter of the buyers had been in their current position for one year or less, 54 percent for two years or less. More than 80 percent had been in retailing 10 years or less. Seventy percent had been with their current company five years or less.

The suppliers

We asked the retail buyers to identify a new product that they had begun to carry during the previous year, but had carried for at least six months, and respond to the questionnaire with that supplier in mind. Respondents who had not added a new product in the last year were asked to respond to the questionnaire with the most recent product they had added in mind.

More than three-quarters of the retail companies had been doing business with the supplier for three years or less. Fewer than 7 percent had been doing business with the company for six years or more. Ninety-five percent of the respondents indicated that they had *personally* been doing business with the supplier for less than five years, half for two years or less.

The buying system

Forty-four percent of respondents indicated that their company purchases all of its products through a central buyer. About half of the companies use a buying committee. More than 75 percent indicated that imported products accounted for less than 5 percent of what they sell. The percentage of profits that they earned from imports accounted for about the same amount. Finally, 20 percent of the buyers said that all of the merchandise they purchased could be returned to the supplier. Most of the buyers indicated that 85 to 100 percent of the merchandise they purchased could be returned. There were no differences in these areas across ownership type.

—Brenda Sternquist, Zhengyi Chen, and Ying Huang

If our results are representative of the industry as a whole, retail SOEs have been quick to adopt a market-based organizational structure.

mance: reasonable margin, unique products, delivery of goods, well-known/respected brands, level of advertising support, level of slotting fees (fees paid to place a new product within a store), level of yearly rebates, and product quality. Most buyers responded that their suppliers provided acceptable margins for the retailer, unique products, and favorable advertising support, slotting fees, yearly rebates, and product. The major problem was with delivery of goods. When asked to evaluate the importance of these performance factors, buyers responded as in the table below. We found no difference in response according to ownership type.

Importance of Performance Factors

Performance Factor	Percentage of respondents who felt this factor was "very" to "extremely" important
Product quality	89 percent
Reasonable margin	66 percent
Unique products	65 percent
Delivery of goods	63 percent
Well known/respected brand	62 percent
Level of advertising support	48 percent
Level of yearly rebates	39 percent
Level of slotting fees	33 percent

SOURCE: Brenda Sternquist, Zhengyi Chen, and Ying Huang

Factors in the Buyer-Supplier Relationship

The Michigan State University survey of 98 retail companies in China asked respondents to evaluate the following factors in their relationships with their suppliers.

- **Trust**

The survey asked respondents about the three distinct components of trust: credibility trust, benevolence trust, and lack of opportunism. (Opportunism refers to using situations for your own benefit.) Credibility trust is based on the extent to which the retailer believes that the vendor has the expertise to perform the job effectively and reliably. Benevolence trust is based on the extent to which the retailer believes that the vendor's intentions and motives benefit the retailer. Finally, the view that a supplier is not opportunistic contributes to trust between the partners.

- **Satisfaction**

The survey also evaluated the two components of satisfaction, economic satisfaction and social satisfaction. Economic satisfaction is defined as retailers' evaluation of the economic results of the relationship with the supplier, based on sales, volume, margins, and discounts. Social satisfaction is defined as a retailers' evaluation of the extent to which interactions with the supplier are fulfilling. The higher the satisfaction level, the better the relationship.

- **Long-term orientation**

A retailer's long-term orientation depends on its perception of interdependence of outcomes in which both a supplier's and a retailer's joint outcomes benefit the retailer in the long run. Retailers with long-term relationships can gain a competitive advantage by obtaining merchandise in short supply, information on new and best-selling products and competitive activity, best prices, and advertising and markdown allowances. Similarly, suppliers with long-term relationships can achieve a competitive advantage by obtaining information on best-selling products and competitive activity, better cooperative advertising, and special displays for their merchandise.

- ***Guanxi***

Business *guanxi* is defined as the process of finding business solutions through personal connections.

—Brenda Sternquist, Zhengyi Chen, and Ying Huang

Chinese retail firms, regardless of ownership structure, are learning modern retail methods quickly and will provide stiff competition for foreign firms entering the sector.

Does ownership matter?

Curiously, nearly every buyer-supplier relationship factor we examined did not vary among ownership types. For the majority of respondents, product quality, reasonable margin, unique products, good delivery, and well-known brands were important in selecting a supplier, while advertising support, slotting fees, and yearly rebates were much less important. Trust, buyer dependence on the supplier, supplier dependence on the buyer, and long-term orientation were not significantly different among the three types of ownership. The use of *guanxi* was not of great importance, though it was more important for FJVs/Orgs than for other types of businesses. This may be because the state government has actively discouraged—even forbidden—the use of personal favors in business dealings to reduce corruption. Finally, market orientation was not significantly different among the three types of ownership structure (*see* below).

Our introductory study of buyer-supplier relationships in China led us to conclude that the major differences in buyer-supplier relationships are not based on type of ownership, but on other considerations such as the degree of market orientation of the retailer and the level of risk the retailer is willing to take in product procurement. This is an important finding, since much Western literature has focused on the perceived weakness of SOEs and PSOEs. If our results are representative of the industry as a whole, retail SOEs have been quick to adopt a market-based organizational structure.

Chinese retail firms, regardless of ownership structure, are learning modern retail methods quickly and will provide stiff competition for foreign firms entering the sector. Indeed, the Chinese government announced in April that four major former retailing SOEs in Shanghai will merge. Hua Lian, Lian Hua, Number One Department Store, and Shanghai Materials Group will form the Shanghai Bai Lian Group to enable the former SOEs to withstand foreign competition. If the merger goes smoothly, the large, new PRC retailer may well achieve this goal. 完

Market Orientation

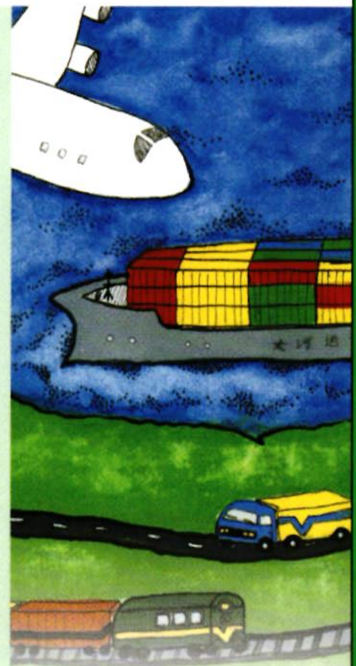
The central elements of market orientation are the dual foci on customer and competitor. Companies that are market-oriented generate market intelligence on current and future customer needs, disseminate the intelligence across departments, and respond across the organization. Because foreign retail investment was not allowed in China until 1992, market orientation is a relatively new concept in China's retail industry.

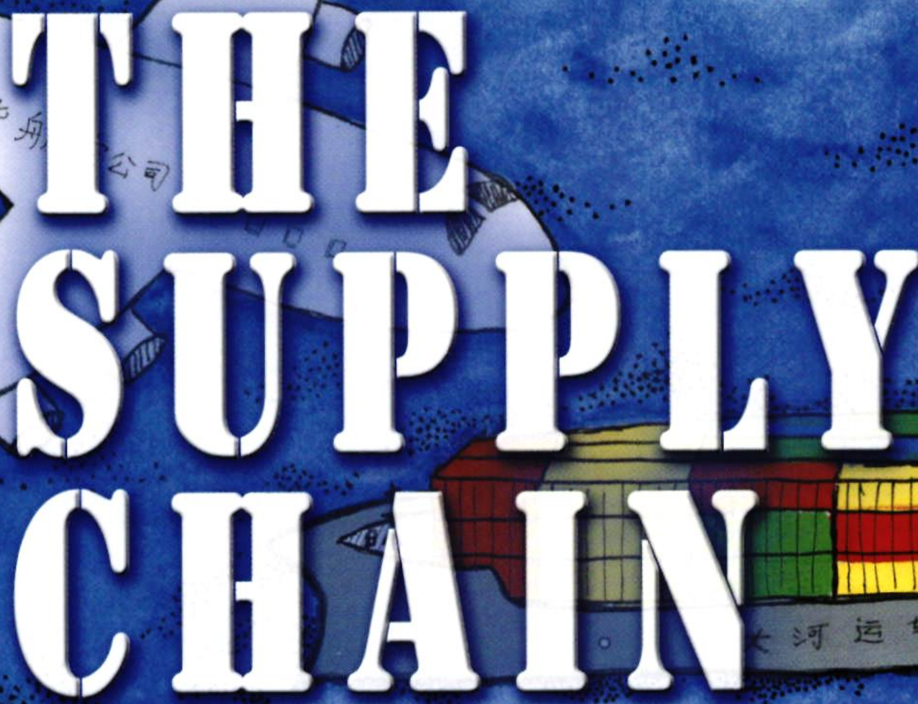
As more companies adopt a market orientation, a company with low market orientation usually finds itself in a vulnerable position. Previous studies in transitional economies such as China have shown that ownership type affects a firm's adoption and development of market orientation. Foreign joint ventures and private independent companies without ties to state-owned enterprises (SOEs) are usually found to be more market-oriented than SOEs or privatized former SOEs.

We asked respondents to rate the degree of their companies' market orientation. More than 80 percent of respondents rated their companies' market orientation degree above the midpoint. We also asked respondents to rate the degree of their suppliers' market orientation. About two-thirds of respondents rated their suppliers' market orientation degree above the midpoint.

More than 75 percent of the respondents rated their own company as being more market oriented than their suppliers. We investigated whether the levels of retailers' market orientations varied with ownership types as suggested by previous studies conducted in other countries, but did not find any statistically significant difference.

—*Brenda Sternquist, Zhengyi Chen, and Ying Huang*





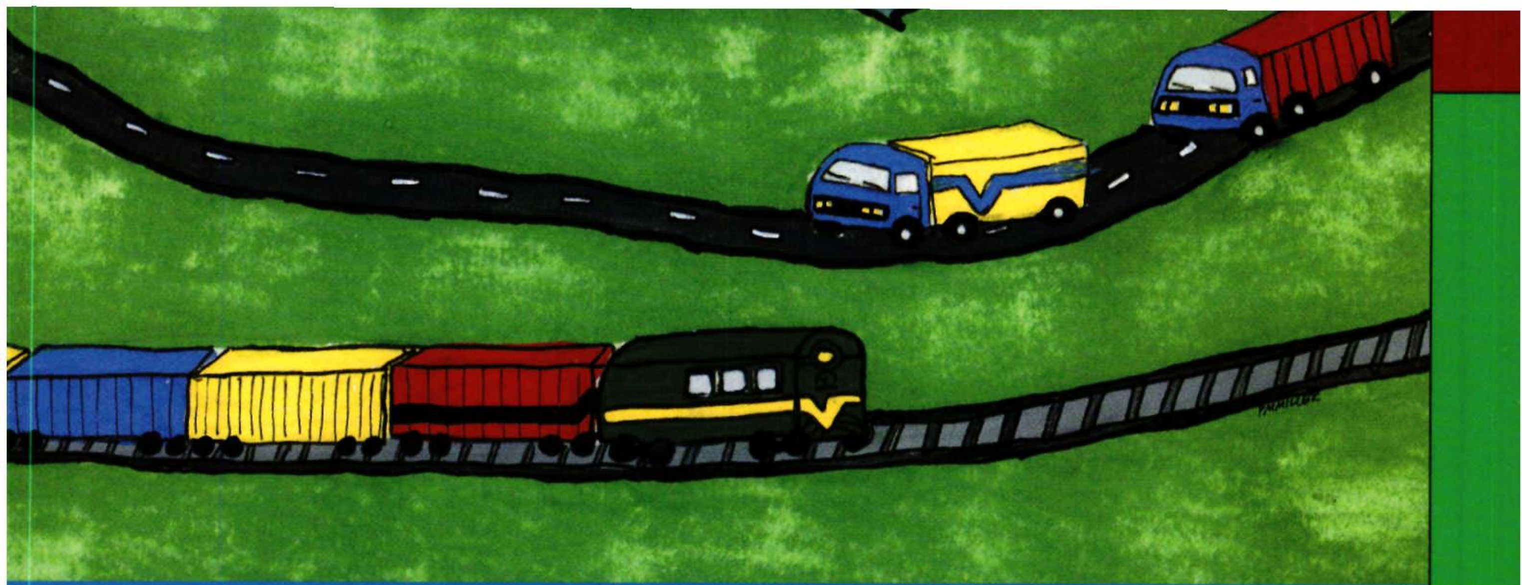
THE SUPPLY CHAIN

Can Franchising Work in the PRC?

Mark Spitalnik

In early 1999, several US investors put the finishing touches on agreements that would allow them to become the China area developer for a well-known international computerized sign and banner franchise. At that time, the franchise was operating successfully in more than 20 countries, and everyone involved believed that the China area developer would be assured of success merely by applying the franchise's proven operational template to the China market. I was hired shortly thereafter as general manager of the area developer with marching orders to begin franchise operations in Beijing and with the goal of opening franchises throughout the rest of China over the next two years.

Mark Spitalnik
(markspitalnik@hotmail.com) is a business consultant and lawyer in Beijing. From January 1999 through July 2003 he was general manager of USA Signs International Beijing Manufacturing Co., Ltd.



A Westerner's view of non-fast food franchising

The fundamental principle of the franchise is to provide all types of quality custom-made signs and banners in a comfortable and visible retail environment. Each franchise store is a "one-stop" sign shop that produces a wide range of vinyl and indoor digitally imaged signs in-house. Signs that cannot be produced in-house—such as channel letters and routed and neon signs—are contracted out to capable manufacturers and are then marked up by the franchise store for sale to its customers.

Ideally, 80 percent of a franchise store's total sign projects are the higher-margin vinyl and indoor digitally imaged items produced in-house. Each franchise generates business contacts not through mass advertising but rather through direct mail and telemarketing focused on smaller "Mom and Pop" neighborhood businesses. Salespeople and designers work with the customer throughout the design and manufacturing process, which for vinyl and digitally imaged signs takes one week at most.

In April 1999, I arrived in China intent on applying the central tenets of our franchise to the China market. Our first one-stop sign center opened in May 2000, and we subsequently attended various franchise shows hoping to sell individual franchises in Beijing, Guangzhou, and Shanghai. But by the summer of 2002, after spending more than three years trying to develop a franchise system in China, our business plan had dramatically changed its focus to manufacturing signs for export. Plans for franchising had been delayed indefinitely.

What was so different about the non-fast food franchise market in China that necessitated such a drastic change in direction? Why couldn't a franchise operational method that had worked around the world succeed in China? The answers to these questions and the issues they raise can help people considering non-fast food franchising opportunities in China determine whether their franchising concept can work in this unique market.

Is time money?

The one-stop retail sign concept originated in a desire to help consumers avoid the delays and aggravation associated with obtaining the various signs they need from several out-of-the-way industrial manufacturing locations. One-stop sign centers located in visible commercial areas enable sign consumers to buy any type of sign or banner in a comfortable retail shopping environment. These types of sign franchises became one of the most popular types of franchises soon after their introduction in the United States in the mid-1980s.

The additional overhead associated with opening a sign center in a visible commercial area with a comfortable retail shopping environment ultimately led to higher-than-market prices. In China, however, we learned that most sign consumers are unwilling to pay extra for convenience and comfort. If they can save a little money by eliminating a middleman and by spending more time purchasing signs from several different vendors, they will. The average sign consumer in China prefers the less expensive alternative, even if it is less convenient.

Is quality job number one?

In the United States and Europe, our sign franchise stores constantly try to provide their customers with higher-quality materials in their custom-made signs. The use of such materials usually adds to the life of the product, but can also significantly increase the price. Sign consumers in the United States and Europe are generally willing to pay for the value added by higher-quality materials.

Chinese consumers will not usually pay franchise fees and royalties for world-famous brand names that are unknown in China.

In China, very inexpensive sign materials are available. As a result, the use of higher-quality, imported sign materials may cause exponential increases in price. When presented with different material alternatives for what they see as a fungible good, Chinese sign consumers will generally opt for the less-durable, lower-priced sign—reasoning that such a sign can be replaced frequently, at a total price far below that of a more durable, high-quality sign.

After learning about the typical Chinese sign consumer's attitude to time and quality, our franchise focused the sales efforts of our model store in Beijing on other foreign businesses, since their consumption patterns more closely resembled those of our customers in the United States and Europe. As a result, we reached sales volumes in line with other stores in the franchise system and began our individual franchise sales efforts in China.

Factors affecting franchise sales in China

Like any established franchise, we sought to sell a recognized brand name, a track record of successful franchisees around the world, a time-tested operational system and manual, and a support infrastructure second to none in the industry. Despite these attractions, we were unable to convince enough attendees of the various franchise shows in China to purchase individual franchises. As a result, we were unable to meet the threshold level of individual stores necessary to justify starting franchise operations in China.

The first problem we encountered in our attempt to sell individual franchises was the different understanding of the concept of franchising in China. In the United States, franchising is a familiar, well-established practice. Most franchise purchasers in the United States accept the premise that there is value in a franchise's name, experience, and support and are willing to pay a franchise fee and royalties to obtain the right to take advantage of a franchise system's offerings. Most US franchise consumers know that in the United States, owners of small businesses that are a part of franchise systems are more successful than independent small businesses.

To many potential Chinese franchise consumers, however, franchising is an abstract concept and they do not believe that the benefits set forth above warrant payment of a significant franchise fee and royalties. These consumers generally believe that the purchase price of a franchise should include machinery, technology, goods, or services that are unavailable through any other means. If the machinery, technology, goods, or services that the franchise offers are otherwise available, would-be Chinese franchisees will usually conclude that they are better off putting their money into starting their own independent small business.

This conclusion can be overcome in the right circumstances. First, if the franchise brand name is already famous *in China*, the potential consumer will see added value in paying a franchise fee and royalties. On the other hand, Chinese consumers will not usually pay franchise fees and royalties for world-famous brand names that are unknown in China.

Second, if the franchise already has a significant presence in China in the form of a large support staff, Chinese-speaking personnel, and Chinese-language operational materials, the franchise consumer will feel that the franchise system has a better chance of succeeding. Chinese franchise consumers generally do not consider large overseas franchise support systems to be very useful.

Finally, if the franchise has successful company-owned stores in China, the franchise consumer will be more willing to consider purchasing a franchise. Success outside of China is nice, but most potential franchise purchasers in China do not necessarily view such success as indicative of whether the franchise will succeed inside China. Successful company-owned stores may show that a particular franchise concept works in China and may be the best way to convince skeptics.

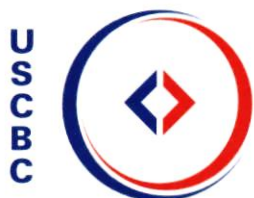
A hard sell—but not impossible

Our franchise, although well known throughout the world, was unknown to consumers when I arrived in China. Though our

headquarters' support staff in the United States can meet the needs of franchise storeowners around the world, our in-country support staff at first consisted of me and one other person. Chinese franchise consumers viewed our company-owned store as successful in terms of sales to other Western-owned businesses but thought that we lacked appeal for more typical Chinese sign consumers.

As a result, we were unable to convince Chinese consumers attending franchise shows that they would receive significant value in return for their franchise fee and royalty payments. During the franchising sales process, we also became convinced that the structural differences between the sign industries in China and the United States supported a business model based on manufacturing signs for export rather than one based on the sale of individual sign franchises.

Our experience notwithstanding, I believe that a non-fast food franchise system can succeed in China given the right conditions for success. As mentioned above, these include popularity among Chinese consumers, the existence of successful company-owned stores catering to Chinese consumers, devotion of significant resources to developing the franchise brand name in China, and the provision of machinery, technology, goods, and services otherwise unavailable in this market to franchisees. If your franchise system can meet these conditions, it has a chance to succeed in China. If not, you should consider committing your time and money to other markets. 完



THE US-CHINA BUSINESS COUNCIL
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2004 Major Events SAVE THE DATES!

Forecast 2004

January 28 and 29

The St. Regis
Washington, DC

A members-only annual conference offering in-depth analysis of China's investment, economic, and political trends. Afternoon strategy sessions by appointment.

Biennial Gala & Annual Membership Meeting

June 3 and 4

The Fairmont
Washington, DC

The Council's festive biennial celebration, with distinguished American and Chinese guests.

Members-only conference to discuss pressing operational issues in the China market.

More details forthcoming: *www.uschina.org*

COMMENTARY

PRICE WARS

Roger (Rongxin) Chen

In recent years, Chinese consumer goods, home appliance, and personal computer (PC) companies have grown increasingly competitive, often beating out multinational corporations (MNCs) in the Chinese market. Consider these cases:

- Japan's Matsushita Electric Industrial Co., Ltd. (Panasonic) was a giant in China's television industry for many years, controlling 14.6 percent of China's TV market in 1995. But in 1996, it began to lose market share to Changhong Electric Co., Ltd., a large Chinese TV manufacturer. By 1999, the eight best-selling TV brands in Beijing were all domestic.
- Before 1996, foreign brands dominated China's PC market. But beginning in 1996, the young Chinese PC firm Legend Group Ltd. surpassed IBM Corp., Compaq Corp. (now owned by Hewlett-Packard Co.), and the former AST Computer LLC

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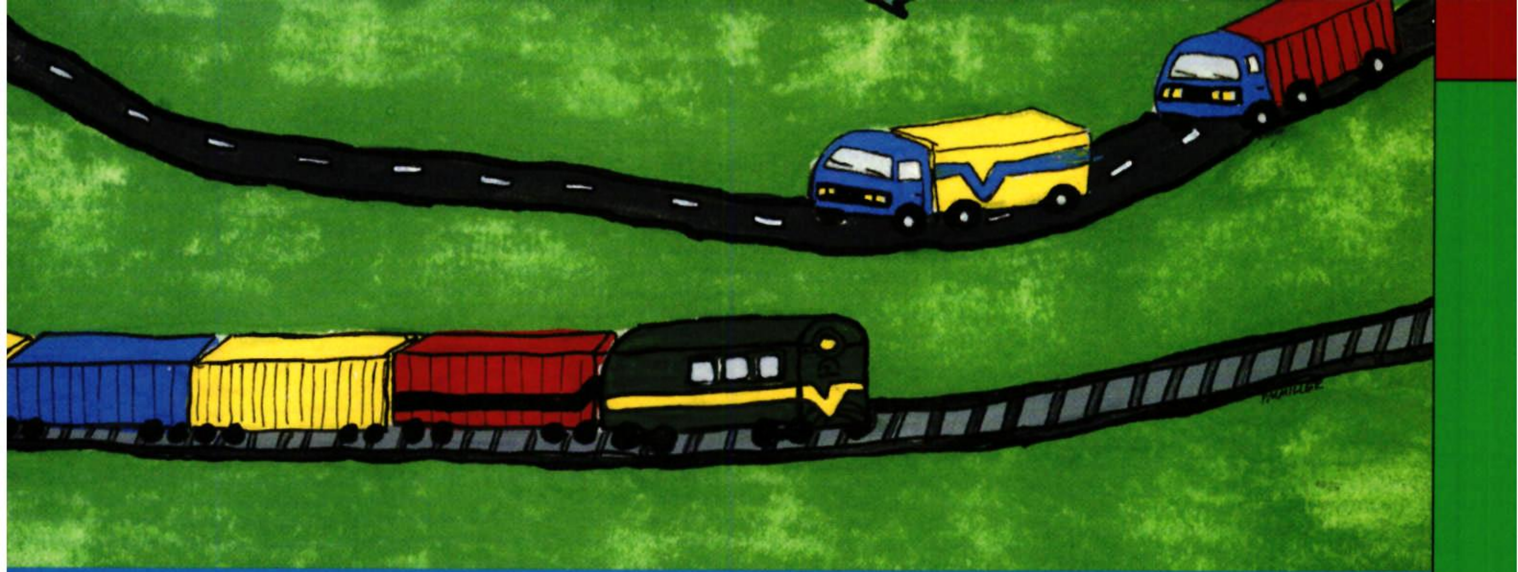

How China's domestic firms beat the foreign competition

to become the nation's top PC seller. Legend's market share reached 15.5 percent in 1998—double that of second-place IBM. More recent statistics only confirm this trend: In 2002, Legend controlled roughly 30 percent of the PC market while Dell Computer Corp., the largest foreign PC seller last year, controlled 5 percent.

- Many Chinese did not even know what microwave ovens were 10 years ago. Today, the Chinese manufacturer Galanz Enterprise Group Co., Ltd. controls more than 60 percent of China's market, and global giants such as Matsushita, LG Group, and Samsung Electronic Co., Ltd. are only minor players.
- Global companies have invested heavily in China, but few have achieved the success of the Chinese home appliance company Haier Group, which had global sales of $8.6 billion in 2002. Haier's achievements even caught the attention of Harvard Business School, which invited Haier's CEO to discuss his management philosophy and accomplishments with Harvard's students and professors.

Many of the Chinese companies listed above did not exist 15 years ago, but have since surpassed their MNC peers in China. To succeed, MNCs must learn how these PRC companies beat their foreign competition.

Missed opportunities

Many leading MNCs entered China's home appliance industry after the mid-1980s and dominated the market with expensive products. Though in 1995 China's average annual per capita income was ¥2,930 ($354)—¥4,283 ($517) in urban areas and ¥1,577.7 ($191) in rural areas—microwave ovens cost more than $300, more than 83 percent of an ordinary Chinese worker's annual income. Similarly, before 1996—when foreign brands controlled the large-screen TV market—29-inch TVs cost about ¥13,000 ($1,570), roughly three times the annual income of most Chinese.

Such high-price strategies combined with a failure to monitor market trends prevented MNCs from capturing opportunities in rapidly growing mid- to low-end market segments. For example, Chinese PC markets nearly doubled each year from the mid-1990s—mostly in low-end segments. Prior to mid-1999, brand name PCs such as IBM, Compaq, and HP only accounted for a small portion of PC sales in China; 60 to 70 percent of PCs sold were generics assembled predominantly by local firms, selling for $960 or less. A 1999 survey by the China Internet Network Information Center suggested that reducing PC prices to ¥5,000 ($604) would dramatically increase PC sales, because 70 percent of potential PC buyers could purchase PCs at that price. At the time, the prices of most domestic PCs were at least 30 percent higher than this level, and those of foreign brands were 60 percent higher. To respond to this potential opportunity, one domestic computer firm introduced PCs priced at ¥4,999 ($604) in May 1999. A second Chinese firm introduced PCs priced at ¥4,888 ($590) in June 1999 (*see* Table).

Growth in low-end segments also occurred in the microwave oven market. In 1993, only 1 percent of Chinese consumers owned microwave ovens. The market has since taken

> In the beginning, gaining market share through aggressive pricing is more important than bringing advanced products into the Chinese market.

off. In Shanghai, one of the richest and fastest-growing markets in China, 85 percent of the microwave ovens sold in the late 1990s were cheaper models.

The rise of indigenous competitors

In the absence of competition from MNCs, domestic firms were able to use low prices to expand their business in these segments. The low prices and growing market helped local firms become market leaders.

A senior executive from Galanz explained in an interview that the company's strategy is to use low prices to increase sales volume which, because of economies of scale, enables the firm to further lower its prices and gain more market share. At the beginning of 1997, most microwave oven prices ranged from ¥1,000 to ¥3,000 ($121 to $362). Such high prices were only affordable to a small number of customers. At the time, South Korea's LG controlled 25 percent of the market in Beijing and other northern markets, and 40 percent of the market in Tianjin. To compete with LG, Galanz cut all product prices by 40 percent in October 1997. By May 1998, its market share had risen to more than 70 percent, while LG's share had fallen to 10 percent. From late 1998 to early 1999, LG regained some market share in northern China because Galanz diverted its attention from domestic to foreign markets. In response, Galanz again cut some of its product prices by 40 percent. This enabled the company to regain business and control more than 50 percent of the market in areas where LG was strong.

The low-price strategy has allowed local firms to grow dramatically. For instance, Changhong dramatically increased its market share in 1996 when it initiated a price war. In 1995, it was ranked number four in the TV industry and held 7 percent of the market. After Changhong cut prices aggressively, its share increased to 20.5 percent, making it the market leader. Other leading Chinese firms also experienced similar exponential growth in the 1990s. In 1998, the total sales volume of the 35 largest Chinese companies reached $22.5 billion. This was 15 percent higher than the total sales of the 80 largest domestic companies in 1995.

To be sure, some MNCs responded to the low-price strategies of domestic firms by cutting prices. The prices of several foreign TV brands fell below ¥3,000 ($362), and LG reacted to Galanz's 40 percent price reductions in April 1999 by slashing most of its microwave oven prices by 25 percent. But these price cuts followed the price drops initiated by domestic competitors and failed to win much market share.

Lessons for MNCs

MNCs cannot simply transplant pricing models from elsewhere and hope to succeed. If an MNC enters an underdeveloped market in China, it should be prepared to offer competitive prices, especially when local firms are small and weak. In the beginning, gaining market share through aggressive pricing is more important than bringing advanced products into the Chinese market. When MNCs offer competitive prices, they can cut a domestic competitor's profit margins dramatically and curtail its ability to finance growth. Low prices also reduce a competitor's ability to develop national sales networks, improve technologies, and penetrate global markets.

The success of one US electronics company illustrates this point. The company first sold electronic components in China in 1995 for ¥6 ($0.72) a piece. The company then aggressively

Price Cuts by Domestic Manufacturers in China's Home Appliance and PC Industries in the 1990s

Products	Price Cuts
Microwave Ovens	Prices fell from more than $300 to $70 in the mid- to late 1990s.
VCD/DVD Players	Prices dropped from several thousand RMB to several hundred RMB from the mid- to late 1990s.
TVs	Average TV retail prices fell 15% in 1997. Average 29-inch TV price fell from $1,500 in 1996 to $370 in 1999, or 75.4%.
PCs	Prices fell from more than $900 to roughly $600 in 1999.

NOTE: VCD=video compact disk; DVD=digital video disk; PC=personal computers
SOURCE: Roger (Rongxin) Chen

reduced the price by 67 percent over three years. This preemptive strategy effectively curtailed the development of local competitors and deterred new entrants. Today, the US firm controls almost 100 percent of that market.

Once domestic competitors have gained strength and are aggressively targeting MNCs' core (upper-middle to high-end) business segments, competitive costs and prices will no longer be enough to succeed. As in fully developed markets, MNCs must rely on research and development and strong products to stay competitive; they must introduce better products at competitive prices.

Today, most successful Chinese companies put a lot of effort into upgrading their products and improving technologies to increase their foothold in upper-middle to high-end segments: Changhong has developed TVs that can connect to the Internet; Galanz has improved its research and development and owns more than 500 microwave oven patents (though in July, LG launched legal action against Galanz for alleged patent infringement); and several large Chinese refrigerator companies have developed advanced products that are environmentally clean. These efforts have greatly improved domestic firms' ability to compete directly with MNCs. At the same time, they are not ignoring strategic pricing.

The experience of a large Sino-American joint venture illustrates this point. The US subsidiary sells two types of central-comfort air conditioners (CCACs) in China. One CCAC was considered advanced because most of its technologies were developed in the 1990s. The second CCAC was comparatively less advanced since it was developed in the 1980s. But the less advanced CCAC sold better than the advanced one—taking roughly 70 percent of the Chinese market. The subsidiary could offer competitive prices for the less advanced CCAC because 90 percent of the final product was sourced locally. On the other hand, only 50 percent of the more advanced CCAC was sourced locally; its imported components have increased costs and lowered the product's competitiveness.

Offering competitive prices does not necessarily mean matching local prices or even offering lower ones. The key is to make the product affordable to the majority of customers. For example, the prices of Eastman Kodak Co. and Fuji Photo Film Co., Ltd. rolls of film are usually 50 percent higher than those of local brands, yet the two foreign brands dominate 90 percent of the market; Kodak holds 40 percent of the photographic film and paper markets.

A competitive price is not necessarily one that matches or beats local prices. The key is to make the product affordable to the majority of customers.

Factors affecting MNC prices

It can be difficult for MNCs to reduce costs and set competitive prices, for a number of reasons:

1 **Localization** Many MNCs have high costs because their products require imported components. Though China's entry into the World Trade Organization (WTO) will reduce some import taxes, foreign components can still be expensive because of high transportation and labor costs. Sourcing locally would cut these costs significantly. Localization of human resources is also important, not only to reduce costs through lowering managerial salaries to local levels, but also to take advantage of Chinese knowledge of local markets.

2 **Business scale** Many successful Chinese companies achieve competitive costs through large sales volume. When MNCs set up small subsidiaries in China to reduce financial risks, these subsidiaries may have difficulty achieving economies of scale.

3 **Local supply and distribution networks** Small subsidiaries also have difficulties developing local supply networks. Many MNCs in China try to develop high-quality local suppliers to cut costs. To improve the quality of local suppliers, MNCs may require the suppliers to make investments to improve their manufacturing techniques, update their equipment, and change product designs. But if these requests come from small MNC subsidiaries, the local suppliers may be less responsive because the subsidiary's small demand may not justify their investments.

Many MNCs lack strong sales and distribution networks in China. The strong distribution and service networks of Kodak and Fuji have helped them achieve remarkable success. In Shanghai alone, Kodak and Fuji have 70 and 60 exclusive printing shops, respectively, while their weak local competitor, China Lucky Film Group Corp. (LeKai), has only 10. Nationwide, Kodak had set up 5,000 printing and sales shops in 500 cities by 1999, far more than local competitors.

4 Market opportunities Many MNC subsidiaries have limited ability to monitor and capture market opportunities throughout the country. They may even have difficulty reaching customers in different parts of China. Some MNCs have mistakenly viewed China as a homogeneous market and as a result have failed to differentiate their strategies and practices in different regions of the country. Furthermore, some MNCs have been ineffective in educating customers about the value of their advanced products.

The success of domestic firms in the home appliance industry is probably more a result of normal market competition than of distortions caused by government protection.

5 Exports MNCs can use exports to increase volume and generate greater revenue. They may also use export profits to subsidize low-price strategies within China. It is not always easy to boost exports, however, as this requires other (sibling) subsidiaries to cede markets to Chinese subsidiaries.

Be ready to compete

The PRC government may provide protection and support to some domestic firms in China's home appliance industry. For example, many Chinese firms have gained easy access to low- or even no-cost loans from state-owned banks. Theoretically, these loans can support domestic companies engaged in low-price competition and may even allow companies to oversupply markets, lowering export prices. But the competition in China's home appliance sector is generally transparent, and government protection appears lighter than in many other industries. The success of domestic firms in the home appliance industry is probably more a result of normal market competition than of distortions caused by government protection.

This conclusion has important implications for understanding China's current market. Many people anticipated that China's WTO entry would enable MNCs to gain advantages in many industries as market barriers weakened. But the aggressive price behavior of PRC home appliance companies suggests that local firms can gain competitive strength and even surpass MNCs in China without significant government protections.

Chinese firms in many other industries also use low-price strategies to compete with MNCs. Lessons from the home appliance industry are thus crucial to MNCs in other industries—particularly those such as software and electronics—in which consolidation among domestic firms and the emergence of domestic market leaders are not yet apparent. The relatively undeveloped state of these markets means that MNCs still have time to take preemptive actions to gain a strong position in China's market. 完

China's Domestic PC Industry Heats Up

In 2002, China passed Japan to become the world's second-largest personal computer (PC) market. Interfax Information Services reported that China sold 10.1 million PCs in 2002, most of which were domestic brands. Hong Kong-listed Legend Group Ltd. controls 30 percent of the market; other strong domestic performers include Great Wall Computer Co. Ltd. and Founder Technology Corp. Dell Computer Corp. is the leading foreign player in China, with an estimated 400,000 PCs sold in 2002, or about 5 percent of the market. Other foreign competitors include IBM Corp., Hewlett-Packard Co., Toshiba Corp., and Acer Group.

In the face of strong domestic PC sales growth in 2002, stiff competition tended to reduce profit margins. To gain market share, foreign companies Dell and Toshiba initiated price reductions that were matched by Chinese competitors.

Manufacturing capacity has expanded significantly over the past few years, with most production staying close to China's largest cities, including several provincial capitals along the east coast. The availability of parts and equipment in Dongguan, Guangdong, which has strong investment in computer parts led by Hong Kong and Taiwan companies, is the basis of dynamic computer manufacturing in South China. Shanghai's Yangzi River delta region is fast acquiring the same kind of critical density of supporting products and services. Logistics and supply chain inadequacies in China's less-developed regions raise manufacturing costs to uncompetitive levels, even though labor is generally less expensive.

Legend manufactures out of Beijing, Shanghai, and Huiyang, Guangdong, while Founder Technology and Great Wall Computer operate in Guangdong's Shenzhen-Dongguan corridor. As for foreign companies, Dell's manufacturing facility is located in Xiamen, Fuijian; Toshiba is currently building a large laptop manufacturing center in Hangzhou, Zhejiang; and South Korea's TriGem Computer Inc. is manufacturing more than one million computers annually for export at its factory in Shenyang, Liaoning.

Manufacturers are optimistic about the Chinese market's room for growth. Deutsche Bank estimates that only 15 to 20 percent of China's current PC sales are for replacements, far below Japan's 30 to 35 percent, a level that signals further growth potential. At the same time, analysts warn about the potential waning of the "PC era" in the near future. This message may be especially pertinent for China, where a wireless revolution is in full swing, with cell-phone-based Internet services emerging as an alternative to PCs.

—The US-China Business Council

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

BULLETIN

UPCOMING EVENTS

The Trade and Investment Climate in Sichuan and Chongqing

Washington, DC
September 2, 2003
Featuring incoming Consul General Jeffrey Moon, US Consulate General, Chengdu, Sichuan.

September Issues Luncheon

Washington, DC
September 18, 2003

Meeting with Tianjin Mayor Dai Xianglong and Other Tianjin Leaders

New York, NY
September 24, 2003

Forecast 2004

Washington, DC
Evening Reception: January 28, 2004
Conference: January 29, 2004
For more information, see p.41

USCBC President Robert Kapp introducing the Council's WTO implementation survey during the July Issues Luncheon.

EVENT WRAP-UP

Washington

July

China and SARS: The Crisis and Its Effect on Politics and the Economy
Featured Richard Bush, senior fellow and director, Center for Northeast Asian Policy Studies, The Brookings Institution; Laurie Garrett, medical and science writer for *Newsday*; Robert Kapp, president, The US-China Business Council; and Minxin Pei and Michael D. Swaine, senior associates and co-directors of the China Program, Carnegie Endowment for International Peace. Co-sponsored by the Carnegie Endowment for International Peace, The US-China Business Council, The Brookings Institution, and the Atlantic Council of the United States. USCBC members may view the transcript at *www.uschina.org/members/documents/2003/07/02-sarschinatranscript.pdf*.

Issues Luncheon Featured Matthew Goodman, director for Asian Economic Affairs, National Security Council

Seattle

Protecting Your Intellectual Property in China: A Discussion of Best Practices and Effective Strategies
Featured Iain McDaniels, deputy director, China Operations, The US-China Business Council. USCBC members may view the presentation at *www.uschina.org/members/documents/2003/07/iprspeech.pdf*.

Beijing

US Companies' Assessments of China's World Trade Organization (WTO) Progress
Featured Robert Kapp, president, The US-China Business Council

Shanghai

US Companies' Assessments of China's WTO Progress
Featured Robert Kapp

Hong Kong

The Mainland and Hong Kong Closer Economic Partnership Arrangement and Its Implications
Featured Robert Kapp

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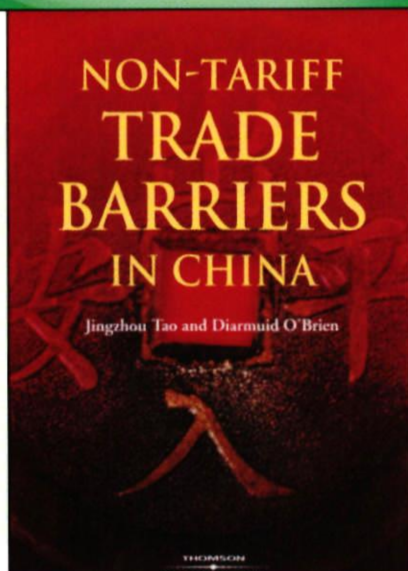


Non-Tariff Trade Barriers in China

by Jingzhou Tao and Diarmuid O'Brien.
Hong Kong: Sweet & Maxwell Asia, 2003. 357 pp. $63 softcover.

Though doing business in China has no doubt become easier during the reform period, it has not become less complex. As this new book by lawyers in the Beijing office of Coudert Brothers point out, China's investment regime and international trade system are "embedded" within a web of restrictions. China's commitments to the World Trade Organization (WTO) go a long way toward bringing China's trade and investment regimes into line with international norms, yet nontariff trade barriers persist, making this book timely.

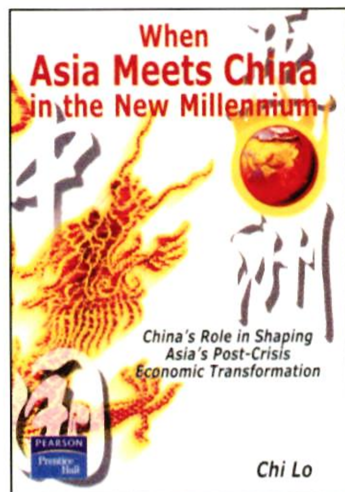
The authors have undertaken a grand task, namely to identify the many "difficulties" of trading with or investing in the country. They succeed admirably in covering a broad range of topics—from foreign exchange management to intellectual property rights (IPR) issues to standards and trading rights—with a detailed examination of the development of regulatory and administrative barriers up to the present day.

The book offers concise analysis of China's existing legal framework along with interesting anecdotes and case histories of the rules in actual implementation. It is divided into six chapters, the first five of which address foreign exchange, IPR protection, distribution, trading, and standards. Each chapter summarizes the recent history of an issue, providing coherent context to the description of the key regulatory requirements as they exist today and moving forward through China's implementation of its WTO commitments. Tables and flow charts are included to help summarize the often-complicated procedures. The final chapter addresses China's WTO service schedule commitments for specific industries and moves beyond a simple recitation of the market access phase-ins by linking the regulatory environment to actual investments made in the sectors and the complications that have arisen.

This book is a solid reference for any manager or service provider working on China who seeks explanations of China's broad regulatory regime. The book is not meant to be a manual for specific procedures; managers will need to consult professional service providers for the latest developments in tax, foreign exchange, and investment guidelines in China's rapidly changing regulatory landscape. Yet the book has prolonged its shelf life by providing the history and context of the many barriers foreign companies will continue to face in China.

—*Brian L. Goldstein*

Brian L. Goldstein is former research manager in the Beijing office of The US-China Business Council.

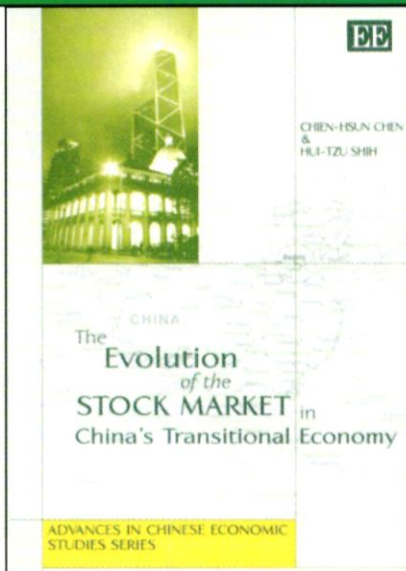


When Asia Meets China in the New Millennium

by Chi Lo. Singapore: Pearson Prentice Hall, 2003. 190pp. $23.50 softcover.

Hong Kong-based economist Chi Lo takes an unsentimental look at the ways that Asia must to adapt to compete with China's already formidable economic strength in *When Asia Meets China in the New Millennium*. Brushing aside the doomsayers—those who argue that the rest of Asia has no chance against a rising China—Lo marshals basic macroeconomic theory and recent history to argue that China can be a catalyst for reform and healthy competition in Asia in the future.

Lo surveys the causes and effects of the Asian financial crisis; the decline of Japan as an economic powerhouse in Asia; and the recent growth and remaining challenges facing China's developing economy. In the process, he makes some assertions that should reassure Asian economies looking at China's rise with



The Evolution of the Stock Market in China's Transitional Economy

by Chien-Hsun Chen and Hui-Tzu Shih.
Northhampton, MA: Edward Elgar Publishing, 2002. 187 pp. $80 hardcover.

The collapse of Enron was not only a clarion call to America's financial institutions and stock market watchdogs, but a loud warning to nascent capital markets around the world—including China's—about the need for regulation and abundant oversight. Whether China can transcend the growing pains often associated with emerging markets is critical to China's economic growth. But as China lists more state-owned enterprises, it runs the risk of continued stock price volatility, fraud, and stock manipulation (known in China as "stir-frying stocks"). These issues are troubling enough to command the attention of China's top policymakers.

In *The Evolution of the Stock Market in China's Transitional Economy*, Chien-Hsun Chen and Hui-Tzu Shih, both at the Chung-Hua Institution for Economic Research in Taiwan, have produced an informative and insightful study of China's stock market development. They firmly place the growth of China's capital market in the context of China's shift from a centrally planned to a market-oriented economy. In doing so, the authors develop several intriguing propositions to explain the inefficiency of the Chinese stock market. For instance, the authors cite the lack of true competition among companies and the inconsistent quality of publicly traded firms as the fundamental reasons why China needs a robust regulator and more regulations. But many Chinese regulations have the unintended consequence of serving as bureaucratic impediments rather than as liberalizing forces. The more informed prescription might not be more regulations, but better enforcement.

Perhaps, as the authors contend, the lack of proper legal institutions in China contributes to the flagrant disregard of regulations by public companies and individuals in their quest for profit. "Violations of trading rules, a phenomenon that tends to accompany institutional transformation," the authors write, "occurs frequently in China's stock market; since 1993, there have been more than 100 cases of listed companies and an equal number of cases of financial institutions and securities firms having had penalties imposed upon them by the CSRC [China Securities Regulatory Commission] or other relevant agencies." But trading violations are not a phenomenon restricted to transitional economies.

The better question would be, Why have there only been 200 recorded violations over a 10-year period? On any given day, the US Securities and Exchange Commission sanctions by administrative proceeding or initiates a federal court action against a dozen corporations, brokerages, and individuals.

To the authors' credit, they provide empirical data of the performance of several listed companies based upon variables such as profitability, liquidity, stability, management performance, and growth. Their analyses showed that all of these variables markedly improved after a company listed. Furthermore, in purely quantitative terms, the data also demonstrated that, on the whole, Shanghai-listed companies perform better than Shenzhen-listed stocks.

In *The Evolution of the Stock Market in China's Transitional Economy*, the reader will find a straightforward account of the development of China's stock markets that further clarifies the role China's capital markets will play in the country's financial future.

—*Mark T. Fung*

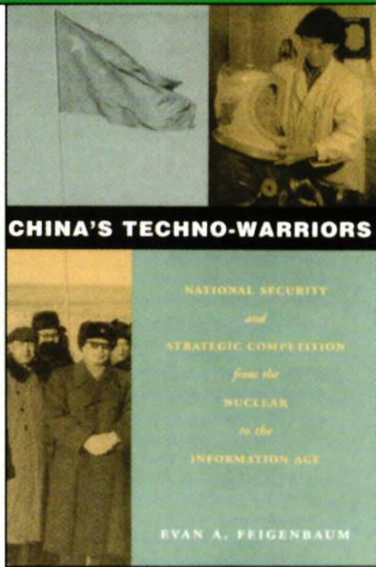
Mark T. Fung is a PhD candidate in China Studies at the Johns Hopkins School of Advanced International Studies and on the Term Member Advisory Committee at the Council on Foreign Relations in Washington, DC.

something close to dread. In particular, Lo argues that China will not be first in every industry, and thus economies that find their true comparative advantages will be able to thrive.

Specifically, he delves into the China-Hong Kong, China-Taiwan, and China-Japan relationships in separate chapters to suggest ways that the three economic powerhouses can adapt to China's emerging role as an economic center of East Asia. He also notes the roles of the US and European economies in influencing global supply and demand for Asian goods and services.

Written before the recent high-profile attacks by critics in Europe, Japan, and the United States on China's economic success (which they attribute to an artificially undervalued currency and other unfair trade practices), *When Asia Meets China*'s brisk analysis of recent economic history offers some useful context to business readers looking for an antidote to these shrill headlines. —*Catherine Gelb*

Catherine Gelb is editor of *The CBR*.



China's Techno-Warriors: National Security and Strategic Competition from the Nuclear to the Information Age

by Evan A. Feigenbaum.
Stanford, CA: Stanford University Press, 2003, 360pp. $55 hardcover.

China's Techno-Warriors is an exceptionally well written volume, whose lively literacy helps turn a doctoral dissertation into an informative and meaningful interpretation of the broad course of China's pursuit of high-technology development from the early years of the People's Republic to the present. In tracing this evolution, Evan Feigenbaum, a member of the policy planning staff at the US Department of State, with responsibility for Chinese, Japanese, Korean, and Southeast Asian affairs, as well as Asia-Pacific strategic issues, touches upon the psychological and even emotional roots of China's long-standing pursuit of national technological prowess and the poignant contradictions that beset the traditional technology-acquisition strategy in an era of increasing Chinese integration with world markets and economic systems.

Along the way, business readers with interests in China's technology development policy—and in issues relating to US-China high-technology trade—will recognize some familiar agencies and actors, but will meet others for the first time. The mosaic of military, industrial, and political forces that have formed China's strategic approach to the development of advanced technology has changed over time, but an understanding of the continuum that has led to present-day approaches can only be helpful to businesspeople today. China has not changed so much that the facts and the personalities of 30 and 40 years ago are now unrecognized and forgotten.

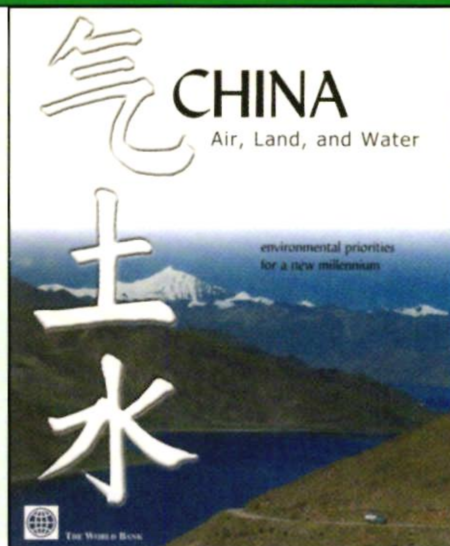
Feigenbaum starts from the moment in the mid-1950s when Mao Zedong accepted the argument, advanced principally by Marshal Nie Rongzhen (one of China's top revolutionary military leaders), that the PRC needed to aim for the top in strategic weapons development. Nie wanted China to build its own atomic devices and delivery systems because in a world of ubiquitous foreign threats it could not afford to allow its defense systems to remain permanently backward, and because strategic weapons development held the key to the successful pursuit of comprehensive technological modernization in the Chinese economy.

Once Mao bought in to this formula, Nie built a strategic weapons sector that, as Feigenbaum artfully reveals, displayed many of the intellectual and professional characteristics of sophisticated, modern high-tech sectors in advanced industrial nations: creativity, horizontal linkages among agencies, peer review, and so on. This tight-knit, flexible, often-brilliant band of scientists and military people survived most of the political bloodlettings of the late 1950s, 1960s, and 1970s largely unscathed.

Feigenbaum moves his story forward into the post-1978 reform period, dwelling at length on the regime's attempts, especially in the "863 Program" begun in 1986, to provide resources and strategic guidance to cream-of-the-crop technology development, even as the thrust of China's overall strategy increasingly emphasized civilian production, economic integration with the "outside world," and indeed the market economy itself. By the end of the book, Feigenbaum's study suggests that while the legacy of China's approach to strategic military technology development had produced brilliant achievements and virtually defined China's national approach to advanced technology into the 1990s, changes in global technology and in China's own economic systems by the turn of the new century were so great that the state-driven, sometimes almost isolationist, approach to high-tech development had become a drag on future development. His concluding reflections on this dilemma make a compelling close to a thoughtful study.

—*Robert A. Kapp*

Robert A. Kapp is president of The US-China Business Council.



China: Air, Land, and Water—Environmental Priorities for a New Millennium

Robert T. Livernash, ed. Washington: The World Bank, 2001. 174 pp. $30 softcover (including CD-ROM).

In this report, the World Bank presents environmental strategies to improve the management of China's natural resources, focusing on land, water, and air policies in the decade ahead. *China: Air, Land, and Water* was published shortly after China entered the World Trade Organization and just as China's State Environmental Protection Administration (SEPA) confirmed its 10th Five-Year Plan (2001-05).

China's size and diversity complicates environmental policymaking, which severely limits SEPA's ability, let alone that of the World Bank, to monitor developments. Most of the data and background for this report came from a dozen or more Chinese research institutes, many affiliated with the Chinese Academy of Sciences. The result of this collective effort will appeal to those interested in Chinese environmental administration and natural resources issues at large in Asia.

The book begins by asserting that economic growth in the past two decades reduced Chinese poverty and improved environmental protection, but acknowledges that this growth created new pressures on natural resources. In the cities, home to about 30 percent of the population, air pollution is severe and on the rise. In the countryside, land degradation is a serious environmental issue. In industry, pollution from the town and village industrial enterprises, the pride of Chinese economic reform, has forced the government to attempt to impose regulatory discipline. The authors criticize the government's strategy to boost economic growth at almost any cost and instead call for "sustainable management and development."

From these beginnings, the World Bank addresses specific pollution management issues. The authors isolate desertification and salinization as serious problems in western China, and deforestation in northern China. Pollution resulting from industrial and urban growth plagues coastal seas. And despite considerable progress in addressing environmental issues, the government has failed to address basic domestic environmental problems, such as the widespread use of solid fuel—including coal—for cooking and heating. To alleviate this last problem, the authors call for reduced dependency on coal.

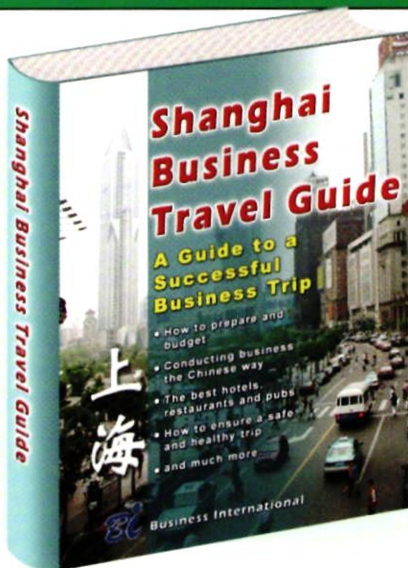
The final third of this study analyzes the government's national environmental priorities, while outlining the World Bank's current and planned environmental strategies in China. The authors recommend management through what they term "institutions, instruments, and investments." The authors advocate better coordination among government agencies to implement legal and economic reforms, alongside vaguely identified targeted investments.

The report's main weakness is its inability to spell out a specific environmental strategy for China and define what sustainable development actually means in China. In the world's largest country, sustainable development is bound to mean different things to a Chinese peasant from Anhui, a government official in Xinjiang, a foreign investor, or a Beijing-based official at the World Bank. The report leaves the reader to guess whether China should follow development models of its own, or those borrowed from abroad.

Impeccably organized and rich in data, this report nevertheless suffers from insufficient attention to local detail and realities on the ground. Little is written about the role of China's many environmental nongovernmental organizations, or of local education in protecting natural resources. Perspectives on major environmental problems from Chinese state researchers and a World Wide Fund for Nature analyst are available as background papers in an attached CD-ROM, which helps broaden the book's scope.

—*Victor Zatsepine*

Victor Zatsepine, who lived in China for nearly 10 years, is a PhD candidate at the University of British Columbia in Vancouver, British Columbia, Canada.



Shanghai Business Travel Guide

by Lawrence DeAngelo.
Business International, 2002. 69 pp. $14.50 Adobe PDF format.

Shanghai Business Travel Guide is an e-book for businesspeople with little or no experience doing business in China, and for this audience the book will be very useful. The format is a 69-page multimedia Adobe Acrobat document, available for purchase online (*http://www.buymyebook.com/buy/authorinfo.asp?id=854X1056Y3*) and delivered by e-mail. Content includes condensed travel and cultural information, links to extensive Internet resources, and embedded voice selections in Mandarin. The author, an American who has lived and worked in Asia for almost 20 years, compiled this guide with the help of Shanghai-based businesspeople.

The *Travel Guide* is a worthwhile resource for both planning and executing a Shanghai business trip. The first section deals with pre-travel requirements and concerns—the PRC visa application process, potential health issues, hotel reservations, and cost estimates useful for developing a travel budget. Next, the focus shifts to travel considerations specific to China, and Shanghai in particular. Topics include weather patterns, local customs, restaurant recommendations, and nightlife spots. The third section outlines the standard knowledge required for business meetings, including greetings and farewells, conduct expected at Chinese-style business meals, and the acceptance and refusal of gifts.

An especially useful feature of this e-book is its multimedia audio component. The guide features six pages of common Chinese words and phrases, written in *pinyin* and embedded as audio files that link with your computer's RealAudio player. This provides an excellent opportunity for travelers to hear Mandarin for the first time, or to revive those dormant language skills, while passing time on the cross-Pacific flight or in a hotel room. The technology is easy to use and requires no downloads beyond the free RealAudio player. In fact, this function makes the book a useful purchase for any laptop-carrying traveler, with business objectives or otherwise, who wants to gain a basic Mandarin Chinese vocabulary.

The book includes accurate contact listings for 23 top-quality hotels, as well as informative introductions to tourism and entertainment areas and restaurant recommendations for many types of international and Chinese cuisine. And most important, as foreigners living and doing business in Shanghai, we can attest that the book gives sound advice and recommendations on where to go for good lodging, food, and entertainment.

The section on business etiquette is a great first introduction to what is and is not expected of you in China. It lays out a few simple rules that should help you through those first nervous encounters. The good news is that Chinese hosts will be impressed that a China neophyte makes the effort to do things the Chinese way and are not likely to walk from the negotiating table for minor transgressions. But travelers ignore the brief mentions of the importance of "face" at their peril. Mistakes in this area can break deals.

The book also informs the novice China business traveler about initial problems and "culture clashes" that Westerners commonly experience in China, both in business and in everyday life. The guide provides useful recommendations on table manners at a business dinner, whether or not to tip the bellhop, and even how to deal with locals' curious stares. Though most of this information is worthwhile and quite informative, the author's advice about bargaining customs is somewhat misleading. The book says, only somewhat facetiously, that business travelers should ask for a discount when buying anything in Shanghai and should start by asking for 50 percent off. In reality, this advice only applies to open air markets, which are becoming less common in this, China's most modern city. Most stores now adhere to sticker prices, and visitors who try to bargain in these places may end up embarrassing themselves.

Finally, though most of the information is accurate, we discovered a few minor errors. For instance, the lobby bar in the Hyatt is on the 54th floor, not the 47th, and some of the *pinyin* romanizations of Chinese words are incorrect. And, as with any travel guide, the information in *Shanghai Business Travel Guide* may soon become dated. Shanghai is a dynamic city, with restaurants and other venues frequently opening, closing, and switching locations. Similarly, links to independent websites inserted throughout the book may also change. Nevertheless, *Shanghai Business Travel Guide* remains a good introduction for the novice business traveler to Shanghai.

—Adam Ross and Iain K. McDaniels

Adam Ross and Iain K. McDaniels are research associate and deputy director of China operations, respectively, at The US-China Business Council in Shanghai.

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Sourcing in China

Continued from page 32

communication, from sending requests for quotation to issuing purchase orders and confirmations, took place by fax. In the last few years, e-mail has dramatically improved communication and many China-based suppliers have established online ordering or enterprise resource planning systems that can link up with the systems of their customers.

Nevertheless, managing numerous customers and thousands of stock-keeping units by fax or e-mail is inefficient, and importers and suppliers need state-of-the-art systems to achieve the best results. ThreeSixty Sourcing works with customers to establish Internet-based planning systems that permit these customers to access all phases of the planning and production cycle over a secure Internet connection. These customers can then view their order and shipment status or project tracking information any time of day from anywhere in the world.

China's new factories, high-tech offices, and production lines enable Chinese suppliers to crank out any orders placed in front of them at the right time—and at the right price and quality, says ThreeSixty's Albucher. And supporting infrastructure such as highways and deep-water ports is also improving. Goods used to linger in Chinese ports for weeks; ships now sail five days a week, Albucher adds.

WTO opens doors

China's World Trade Organization (WTO) entry has been providing greater market access and trading rights for foreign companies in China, if slowly. Such openings are prompting companies in a wider range of industries to reevaluate the Chinese sourcing model. One example is the luggage industry. High-quality nylon luggage products that used to be made in the Philippines and Thailand are now produced in China.

With lower costs for products and labor in China and an ever-growing selection of more sophisticated logistics services, American SMEs may find that the time is right to explore sourcing in China. In fact, they may find they cannot afford to pass up the opportunity. 完

Zoning In

Continued from page 29

one technology firm was considering investing in China in 1997, Shanghai's Waigaoqiao was the only viable option. Although the firm has been pleased with the zone's facilities and infrastructure, as the firm expands its China operations it is seriously considering moving into other FTZs or EPZs that could better meet its needs.

The future of the zones

One question that has yet to be resolved is what impact implementation of China's World Trade Organization (WTO) commitments will have on the future of its free-trade and export-processing zones. Under its WTO entry agreement, China must give trading rights (import and export rights) to all enterprises by December 11, 2004. Some trade analysts think most FTZs will either die out or be scaled back after full trading and distribution rights are implemented because so much of their current attraction stems from the trading rights they offer.

Another issue to watch is how the zones fare once China merges FIE and domestic company tax rates and incentives in the next three to five years. Though FTZs and EPZs will probably manage better than the other zones because companies do not invest in them simply for tax breaks, a unified tax policy, unless augmented by other incentives, could spell the demise of many development zones. Even FTZs will need to specialize and develop additional incentives to remain competitive. Officials in Tianjin FTZ and Waigaoqiao point to their niche markets, autos and information technology, respectively, as indicators that they are well positioned to survive. They also cite the expertise they have developed in catering to the needs of foreign investors as a key advantage that will make them attractive investment options even after FIEs get trading and distribution rights and tax incentives are phased out.

Some investors believe that EPZs will overtake FTZs in popularity, as processing trade will remain an integral part of China's economic machine for several years to come. The customs clearance policies and rebate incentives that EPZs offer export-oriented firms are here to stay, and will deepen the advantage that EPZs have over FTZs. While EPZ commissioners in TEDA, Jinqiao, and Longgang said that they were not concerned that their operations would be shut down as WTO commitments take effect, they also admitted that they will have to specialize in a particular sector or industrial segment to compete.

One place to look for clues about the zones' future is in PRC government policy. Most of the 38 new EPZs the State Council approved in 2003 are located in central and western China. In China's drive to develop its hinterlands, EPZs could draw foreign investment to the interior, particularly if the cost of manufacturing continues to rise along the coast. This movement would fit into China's overall policy of promoting exports and trying to create jobs in second- and third-tier cities to absorb ever-rising numbers of rural migrants. But expanding EPZs to the interior will only work if the infrastructure, technical know-how, and local government sensitivity to the needs of foreign investment are fully developed. 完

The Value of the Renminbi

Continued from page 5

deflation because less RMB would be needed to buy things in dollars—the price of the dollar (and dollar-denominated goods) would have fallen.

Thus, allowing the RMB to rise against the dollar would hurt important sectors of the PRC economy *unless* the PRC government somehow eases the upward pressure by printing more RMB, to satisfy the demand—and maintain its current exchange rate. The money supply has indeed grown by as much as 20 percent this year. Bank lending has also surged (thanks to low interest rates among other policies in place to cure deflation), fueling a worrisome rise in property investment. Another downside of this monetary expansion is that excessive growth in the money supply can turn a borderline deflationary environment into an inflationary one.

In fully flexible exchange rate regimes, the value of a currency against others adjusts until the supply-demand equilibrium is re-established. Calls are increasing for China to move to a more flexible exchange rate regime. According to Jun Ma of Deutsche Bank, PRC officials are aware of the advantages of a more flexible system, in the form of an easing of inflationary pressure and a possible fall in excessive bank lending—and of its disadvantages. Without a healthy financial system, moving from a fixed to a fully floating exchange rate system can be destabilizing because a floating currency is exposed to international currency fluctuations. China's banks are weak and the country's legal and regulatory systems are arguably too immature to police and defend the financial markets adequately.

China already allows free conversion for current account (trade) transactions. A fully floating exchange rate, analysts point out, can exist even if China maintains controls on the inflow and outflow of (non-trade, i.e. financial) capital. But the currency will still react to global supply and demand—and be a potential target of speculation.

Economists have studied the effectiveness of capital controls in countries like Chile that maintained both capital controls and a floating exchange rate during the Asian financial crisis and its aftermath. The jury is out on whether such controls are sustainable over the long term.

Misplaced blame

Meanwhile, it is hard to argue that the RMB's recent decline against other currencies is the primary reason that the world is buying Chinese-made goods, for several reasons:

- China's trade balance is moderating in 2003, even as the currency falls, which supports the possibility that the value of the RMB is neither the sole reason for China's trade surplus nor the sole reason for the US trade deficit with China.

- Companies are setting up factories in China because of the country's large and inexpensive labor pool, its continual improvements in infrastructure and support services for business, and its emerging consumer base.

- China's exports were strong even in the months after the Asian financial crisis in the late 1990s, when the RMB strengthened against many currencies that depreciated during the crisis.

China's middle road

There has been no indication that the Chinese government intends to move to a new, fully flexible exchange rate regime anytime soon. The Chinese learned the lesson of the Asian crisis—that flexible exchange rates in economies with weak financial sectors and inadequate legal regimes leave economies exposed to international financial meltdowns.

China may seek a middle road to soak up the excess RMB that is, as of August 2003, already flooding the economy and risking turning deflation into inflation. The alternatives facing China that are mentioned often in the press are to widen the band around which the RMB fluctuates and to let it settle within a slightly higher range, or to undertake a one-time revaluation and then proceed as before. The consensus among analysts seems to be that despite pro forma public statements by the PRC premier and the heads of the People's Bank of China and Ministry of Finance that the Chinese government has no intention of altering the exchange rate regime, these same PRC officials will allow the band around which the RMB fluctuates to widen.

Of course, PRC officials have been promising greater flexibility for years. What may be different this time is the realization that more flexibility might actually help the government manage monetary policy while answering overseas critics.

The government is also reportedly considering allowing PRC banks to issue bonds denominated in dollars and to permit PRC companies to hold and transact business in foreign currency. The government may also establish a qualified domestic institutional investor system to encourage investment in financial markets. If China decides to widen the RMB trading band, at least one estimate put the end rate at ¥8.15 to $1. As others have pointed out, such a cautious move to widen the band slightly—or undertake a one-time revaluation—may not be enough to head off the calls for protection in the United States and elsewhere from manufacturing firms facing the intractable structural problems that prevent them from competing against Chinese goods.

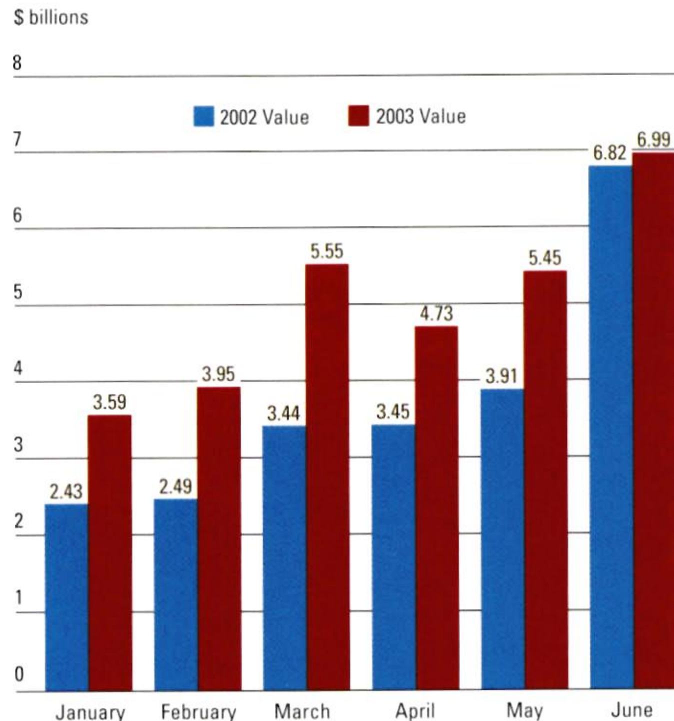
—*Catherine Gelb*

Catherine Gelb is editor of *The CBR*.

A Story in Numbers: Foreign

Foreign direct investment (FDI) in the first half of 2003 showed strong growth despite the effects of SARS.

Figure 1: Utilized FDI by Month, January–June



SOURCE: PRC Ministry of Commerce (MOFCOM)
NOTE: Revised 2002 statistics

But is this comparing apples to oranges? The PRC recently revised early 2002 FDI statistics downward.

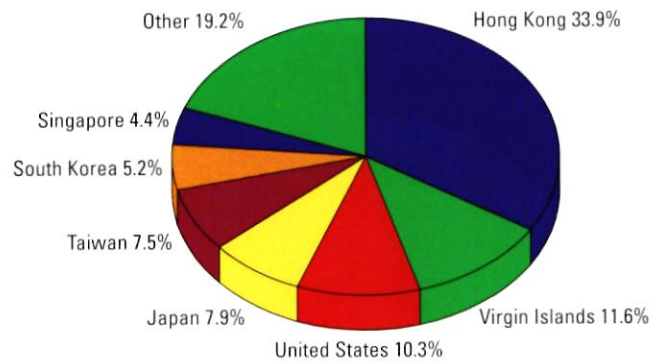
Table 1: Revisions to 2002 Utilized FDI Statistics

Period	Original Value ($ billions)	Revised Value ($ billions)
January 2002	2.97	2.43
February 2002	2.91	2.49
March 2002	4.24	3.44
April 2002	4.03	3.45
May 2002	2.72	3.91
June 2002	7.66	6.82
Year 2002	52.74	50.68

SOURCE: MOFCOM, Xinhua News Agency
NOTE: MOFCOM has only released revisions of total monthly figures through June 2002.

The usual suspects remained the top sources of FDI in 2002.

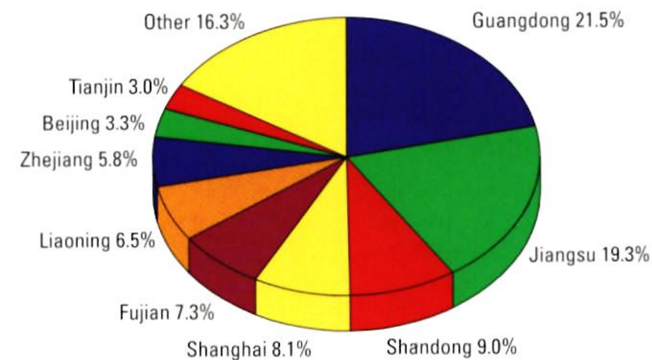
Figure 2: Top Territories Investing in China, January–December 2002



SOURCE: MOFCOM; National Bureau of Statistics (NBS), *China Statistical Yearbook 2002*
NOTE: Unrevised 2002 statistics

And the top provincial recipients of 2002 FDI likewise did not change.

Figure 3: Top Provincial Recipients of Utilized FDI, January–December 2002



SOURCE: MOFCOM; NBS *China Statistical Yearbook 2002*
NOTE: Unrevised 2002 statistics

Direct Investment in China

2002 FDI figures show the popularity of 100% foreign ownership...

Table 2: Utilized FDI by Vehicle, January-December 2002

Vehicle	Value ($ billions)	Change over Previous Year (%)	Share of Total (%)
Equity Joint Ventures (JVs)	14.99	-4.7	28.4
Contractual JVs	5.06	-18.6	9.6
Wholly Foreign-Owned Enterprises	31.73	32.9	60.2
Foreign-Invested Shareholding Ventures	0.70	32.1	1.3
Joint Resource Exploration	0.27	-46.8	0.5
Total FDI	**52.74**	**12.5**	**100.0**

SOURCE: MOFCOM (http://www.fdi.gov.cn/common/info.jsp?id=ABC00000000000004551)
NOTE: Unrevised 2002 statistics

...And of the finance and insurance sector.

Table 3: Utilized FDI by Industry, January-December 2002

Industry/Sector	Value ($ millions)	Change over Previous Year (%)	Share of Total (%)
Agriculture, Forestry, Animal Husbandry, and Fishing	1,027.64	14.4	2.0
Mining	581.06	-28.4	1.1
Manufacturing	36,799.98	19.1	69.8
Textiles	2,278.78	18.8	4.3
Raw Chemicals	2,449.39	11.4	4.6
Medical/Pharmaceutical	683.57	9.9	1.3
Ordinary Machinery	1,289.28	-2.9	2.4
Electronic/Telecom Equipment	8,135.54	14.7	15.4
Power, Gas, and Water Generation and Supply	1,375.08	-39.5	2.6
Construction	708.77	-12.1	1.3
Geological Prospecting and Water Conservation	6.96	-33.7	0.01
Transport, Storage, Post, and Telecom Services	913.46	0.5	1.7
Wholesale and Retail	932.64	-20.2	1.8
Finance and Insurance	106.65	202.1	0.2
Real Estate	5,662.77	10.2	10.7
Social Services	2,943.45	13.4	5.6
Healthcare, Sports, and Welfare	128.07	8.0	0.2
Education, Culture, and Broadcasting	37.79	5.0	0.1
R&D and Related Services	197.52	64.0	0.4
Other	1,321.02	25.7	2.5
Total	**52,742.86**	**12.5**	**100.0**

SOURCES: MOFCOM; NBS, *China Statistical Yearbook 2002*
NOTE: Unrevised 2002 statistics. Figures may not add to total because of rounding.

Sales and Investment

MAY 16–JULY 15, 2003

Compiled by Isaac Cheng

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.

Advertising, Marketing, & PR

OTHER

Adidas-Salomon AG (Germany)
Signed six-year sponsorship agreement with the China Football Association. 06/03.

Agriculture

INVESTMENTS IN CHINA

Canada IND Modern Cow Industry Development Group Co., Ltd./Xinjiang Delong Aide Biological Engineering Co., Ltd.
Will form joint venture, Xinjiang Delong Aide Biological Engineering Co., Ltd., to transplant cow embryos. 06/03.

Architecture, Construction, & Engineering

OTHER

McGraw-Hill Construction, a unit of The McGraw-Hill Companies (US)
Signed agreement with the China International Contractors Association to coordinate communications between North American and Chinese design and construction companies. 06/03.

Automotive

CHINA'S IMPORTS

Daewoo International Corp., Daewoo Precision Industrial Ltd. (South Korea)
Won 10-year car-parts supply contract from Torch Investment Co. Ltd. in Hunan for shock absorbers. $34.2 million. 06/03.

TDS Automotive (Canada)
Won five-year complete knockdown export packing contract from Bayerische Motoren Werke AG and Brilliance China Automotive Holdings Ltd.'s joint venture in Shenyang, Liaoning. 05/03.

INVESTMENTS IN CHINA

Nissan Motor Co. (Japan)/China Dongfeng Motor Corp. (Hubei)
Formed joint venture, Dongfeng Motor Co., to produce passenger vehicles in Wuhan, Hubei. (Japan:50%-PRC:50%). $2 billion. 07/03.

Volvo Trucks, a unit of Volvo AB (Sweden)/China National Heavy Truck Corp. (Shandong)
Formed joint venture, Ji'nan Huawo Truck Co., Ltd., to produce heavy-duty trucks in Ji'nan, Shandong. (Sweden:50%-PRC:50%). $72.6 million. 06/03.

OTHER

Shanghai Baosteel Group Corp.
Was selected by Shanghai Volkswagen Co., a joint venture of Volkswagen AG and the Shanghai Automotive Industry Corp., to supply automobile steel plates for the Passat B5. 07/03.

Aviation/Aerospace

CHINA'S IMPORTS

Hamilton Sundstrand (US)
Won contract from AVIC I to supply electric power systems for the ARJ21 regional jet. 06/03.

Banking & Finance

INVESTMENTS IN CHINA

United Overseas Bank (Singapore)/Beijing Securities Co.
Signed agreement to form a fund management joint venture. (Singapore:33%-PRC:67%). $12.1 million. 05/03.

OTHER

Daiwa Securities Group (Japan)/Shanghai International Group
Will form brokerage joint venture subject to CSRC approval. (Japan:33%-PRC:67%). $63.2 million. 07/03.

Morgan Stanley (US)
Formed partnership with CCB to dispose of $524 million in CCB nonperforming loans. 07/03.

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: General Administration of Civil Aviation of China; CATV: cable television; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: Digital Subscriber Line; ETDZ: economic and technological development zone; GSM: Global System for Mobile Communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquified natural gas; MII: Ministry of Information Industry; MOFTEC: Ministry of Foreign Trade and Economic Cooperation; MOU: memorandum of understanding; NA: not available; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; SARFT: State Administration of Radio, Film, and Television; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

UBS AG (Switzerland)

Completed first foreign purchase of A shares on the Chinese stock market. 07/03.

Goldman Sachs Group Inc. (US)

Signed MOU with ICBC to form a joint venture to dispose of up to $1.2 billion in ICBC nonperforming loans. 06/03.

Chemicals, Petrochemicals, & Related Equipment

CHINA'S IMPORTS

Bechtel Petroleum & Chemical (US), Foster Wheeler Energy Ltd. (UK), SINOPEC Engineering Inc.

Jointly won contract from CSPC Nanhai Petrochemicals Project, a joint venture between CNOOC and Royal Dutch/Shell Group, to implement a $4.3 billion petrochemical complex in Guangdong. 05/03.

Technip-Coflexip (France), SINOPEC

Won contract from Shanghai SECCO Petrochemical Co., Ltd., a joint venture of BP Plc, SINOPEC, and Shanghai Petrochemical Corp., for construction of two ethylene plants. $205 million. 05/03.

Shanghai Chemical Industry Park Industrial Gases Co., a joint venture of Air Liquide (France) and Praxair, Inc. (US)

Won contracts from BASF Chemical Co. Ltd. and Shanghai SECCO Petrochemical Co., Ltd. to provide industrial gases. 05/03.

INVESTMENTS IN CHINA

San-Dia Polymers, Ltd. (Japan)

Created subsidiary San-Dia Polymers (Nantong) Co. to produce super absorbent polymers. $20 million. 07/03.

Lonza Group Ltd. (Switzerland)

Will build niacinamide plant in Guangzhou. $30 million. 06/03.

Nippon Shokubai Co. Ltd. (Japan)

Will build superabsorbents plant in Zhangjiagang, Jiangsu. $40 million. 06/03.

Yushiro Chemical Industry Co. (Japan)

Will build metalworking fluid plant in Shanghai. $1 million. 06/03.

Eliokem Inc. (US)

Will build wingstay antioxidant plant in Ningbo, Jiangsu. 05/03.

Stella Chemifa Corp. (Japan)/Zhejiang Central Fluor Industrial Co.

Formed joint venture to produce hydrofluoric acid. (Japan:55%-PRC:45%). $2.6 million. 05/03.

Sumitomo Chemical Co. (Japan)

Will form agricultural chemicals joint venture with local chemical firm in Dalian, Liaoning, to produce chemical ingredients for export. (Japan:60%-PRC:40%). $3.9 million. 05/03.

Distribution, Logistics, & Related Services

INVESTMENTS IN CHINA

Hoyer GmbH (Germany)/Shanghai JY (Group) Co.

Formed bulk transportation joint venture, Shanghai Hoyer Sinobulk Transport. 07/03.

Zuellig Pharma Holdings Ltd. (the Philippines)/China Xinxing Medicine Corp.

Formed pharmaceutical distribution joint venture, Zuellig Xinxing Pharmaceutical Co. (the Philippines:49%-PRC:51%). $14.5 million. 06/03.

OTHER

DHL Express (Germany)

Signed contract with Hong Kong Dragon Airlines (Dragonair) for air cargo capacity on flights to Shanghai. 05/03.

Electronics, Hardware, & Software

CHINA'S IMPORTS

ASML Holding NV (the Netherlands)

Won order from Advanced Semiconductor Manufacturing Corp. in Shanghai for three imaging systems for chip production. 06/03.

Diebold, Inc. (US)

Won order from Bank of Communications in Shanghai for automated teller machines and bulk cash recycling machines. $8.5 million. 06/03.

NCR Corp. (US)

Won orders from Bank of Communications and Agricultural Credit Union Bank for automated teller machines in Shanghai and Guangdong, respectively. $6.7 million. 05/03.

CHINA'S INVESTMENTS ABROAD

Beijing E-World Technology Co.

Signed agreement to license US-based On2 Technologies' video-compression technology and purchase a 3% stake. $1.7 million. 06/03.

INVESTMENTS IN CHINA

Autoplus International Group (Malaysia)/Xiamen Overseas Chinese Electronic Co.

Will form a joint venture, XOCECO-Ace, to produce computers and peripherals. (Malaysia:70%-PRC:30%). $516,000. 06/03.

International Finance Corp., a private subsidiary of the World Bank, DEG (Germany), OCBC Bank (Singapore)

Jointly purchased a 31% stake in Beijing Gaoweida Technology Development Ltd. $6.5 million. 06/03.

Sony China, a subsidiary of Sony Corp. (Japan)

Acquired a majority stake in Sobey Digital Technology Co. Ltd. in Chengdu, Sichuan. 06/03.

Widax (Asia) Ltd., a unit of Terabit Access Technology International Ltd. (Hong Kong)

Agreed to purchase majority stake in Ruian Weiye Technology (Shenzhen) Ltd. from Welback Enterprises. $1.26 million. 06/03.

Energy & Electric Power

CHINA'S EXPORTS

Harbin Power Station Engineering Co. Ltd. (Heilongjiang)
Won contract from Bangladesh Power Development Board to supply turnkey power plant. $38 million. 06/03.

CHINA'S IMPORTS

ABB Ltd. (Switzerland)
Won contract from East China Electrical Power Group Corp. for integrated IT for first regional power trading system. $6 million. 06/03.

Babcock Borsig Espana (Spain)
Won contract from Yueyang Sinopec & Shell Coal Gasification Co., a joint venture of SINOPEC and Shell China, for equipment to build its coal gasification plant. 06/03.

Shanghai Hydro-Power Equipment Co. Ltd., a joint venture of Voith Siemens Hydro Power Generation (Germany) and Shanghai Electric Corp.
Won contract from Longtan Hydro Power Development Co. Ltd. to design and produce turbines for power generators in Guangxi. $39.8 million. 06/03.

CHINA'S INVESTMENTS ABROAD

Chengda Engineering Corp. (Sichuan)/PT Geo Dipa Energi, PT Sumber Energi Sakti Prima (Indonesia)
Formed consortium to build power plant in Cilacap, Central Java, for state-owned electric company PT Perusahaan Listrik Negara. (PRC:70%-Indonesia:30%). $510 million. 06/03.

INVESTMENTS IN CHINA

Asia Power Corp. Ltd. (Singapore)/Changzhou Changxin Electric Power Co. Ltd. (Jiangsu), Yangzhou Suyuan Group Co. Ltd., Jiangsu Electric Power Development Co. Ltd., China Huadian Group Co. Ltd.
Formed joint venture, Changzhou Huayuan Electric Power Co. Ltd., to develop, manage, and operate a new power plant in Jiangsu. (Singapore:25%-PRC:75%). $66 million. 06/03.

Kyocera Corp. (Japan)/Tianjin Yiqing Group (Holding Share) Co.
Formed joint venture, Kyocera (Tianjin) Solar Energy Co., to manufacture and develop solar cell modules and systems. (Japan:90%-PRC:10%). $1.5 million. 06/03.

Environmental Equipment & Technology

CHINA'S IMPORTS

Shenfei Dayen, a joint venture of Dayen Environmental Ltd. (Singapore) and SAC General Products Industry, a unit of Shenyang Aircraft Corp. Group
Signed agreement with the Beijing government to build and operate a water and wastewater treatment facility for the Beijing Jufuyuan Industrial Area. 07/03.

INVESTMENTS IN CHINA

Pinang Water Ltd., a unit of PBA Holdings Bhd (Malaysia)/Government of Yi Chun, Jiangxi
Signed joint venture agreement to construct a water treatment plant. (Malaysia:29%-PRC:71%). 07/03.

Food & Food Processing

INVESTMENTS IN CHINA

Starbucks Coffee International, a subsidiary of Starbucks Coffee Co. (US)
Purchased equity from President Chain Store Co. and Uni-President Enterprises Corp. of Taiwan, increasing its stake in its own Shanghai and Taiwan operations from 5% to 50%. 07/03.

Amway Corp. (US)
Signed an agreement with Guangzhou Economic and Technological Development Zone to increase registered capital and expand production of health products and protein drinks. $120 million. 06/03.

Anheuser-Busch Companies, Inc. (US)
Converted its bond with Tsingtao Brewery Co. Ltd. to 60 million shares, bringing its 4.5% stake to 9.9%. $280.9 million. 06/03.

Cargill Inc. (US), Uni-President Enterprises (Taiwan)
Will form joint venture to build a soybean oil crusher in Jiangsu. (US:50%-Taiwan:50%). $50 million. 06/03.

Carlsberg Asia, a unit of Carlsberg A/S (Denmark)
Acquired the largest brewery in Yunnan, Dali Beer (Group) Co. Ltd. 06/03.

Gardwell Ltd., a subsidiary of SABMiller PLC (UK)
Purchased 280 million shares of China's fourth-largest brewer, Harbin Brewery Group Ltd., giving it a controlling stake of 29.64%. $86.7 million. 06/03.

Forestry, Timber, & Paper

INVESTMENTS IN CHINA

Oji Paper Co. Ltd. (Japan)
Will build coated-paper plant in Nantong, Jiangsu. $507.6 million. 06/03.

UPM-Kymmene Corp. (Finland)/China Fuxing Pulp and Paper Co. Ltd., Guangdong Finance Investment (Holding) Corp. Ltd.
Will form joint venture for exploration of wood supplies in Zhanjiang, Guangdong. (Finland:45%-PRC:55%). $44 million. 05/03.

Insurance

INVESTMENTS IN CHINA

Standard Life Assurance Co. Ltd. (UK)/TEDA Investment Holding
Will form life insurance joint venture, Heng An Standard Life Insurance Co. in Tianjin (UK:50%-PRC:50%). $157.2 million. 07/03.

Tokio Marine & Fire Insurance and Millea Asia, subsidiaries of Millea Holdings (Japan)
Purchased a 24.9% stake in Shanghai-based Sino Life Insurance. $127.5 million. 06/03.

OTHER

Groupama SA (France)
Received CIRC approval to operate in Chengdu, Sichuan. 06/03.

Internet/E-Commerce

INVESTMENTS IN CHINA

eBay Inc. (US)
Purchased remaining 67% stake in US-based EachNet Inc., giving it a controlling stake in its subsidiary, Shanghai-based EachNet Inc. $150 million. 06/03.

Light Industry and Manufacturing

INVESTMENTS IN CHINA

ElcoBrandt SA, a unit of Elco Holdings (Israel)
Signed MOU to purchase 75% stake in Anhui-based Rongshida Group, including Maytag Corp.'s 50.5% stake. $25 million. 06/03.

Israeli FTI/Beijing Guoqiao Co.
Formed an air conditioner joint venture, Beijing Teddy More Air-conditioner Co. Ltd. (Israel:51%-PRC:49%). $5.2 million. 05/03.

Machinery & Machine Tools

CHINA'S IMPORTS

SMS Demag AG (Germany)
Won contract from Inner Mongolia Baotou Steel Union Co. Ltd. to supply equipment for cold-rolled steel sheet production. $61.9 million. 07/03.

Andritz AG (Austria)
Won contract from Ningbo Baoxin Stainless for a stainless steel rolling mill and other equipment. $57.5 million. 06/03.

INVESTMENTS IN CHINA

Chino Corp. (Japan)/Shanghai Automation Instrumentation Co.
Will set up joint venture, Chino Instrumentation (Kunshan) Co., to manufacture and market measuring and control equipment. (Japan:80%-PRC:20%). $1.6 million. 07/03.

Herrenknecht AG (Germany)/ Guangzhou Guangzhong Enterprise Group Corp.
Signed contract to set up joint venture Herrenknecht (Guangzhou) Tunnel Machinery Co. Ltd. (Germany:65%-PRC:35%). $2 million. 05/03.

Media, Publishing, & Entertainment

INVESTMENTS IN CHINA

Tom.com (Hong Kong)
Purchased a 44% stake in Chinese Entertainment Television Broadcast from AOL Time Warner, giving it a controlling stake of 64%. $6.8 million. 07/03.

AOL Time Warner (US)
Purchased a 49% stake in a Shanghai multiplex from Shanghai Yongle Co. $1.7 million. 06/03.

Medical Equipment & Devices

OTHER

Quatro Air Technologies Inc. (Canada)/China Ruichang Technology Co.
Signed cooperation agreement to build a factory to produce 5,000 air purification units annually. $2.4 million. 06/03.

Petroleum, Natural Gas, & Related Equipment

CHINA'S IMPORTS

Saipem SpA, a unit of Eni SpA, and Technimont, a unit of Edison SpA (Italy)
Won contract from a consortium of CNOOC, BP Plc, and others to build a regasification LNG terminal in Guangdong. $240 million. 06/03.

INVESTMENTS IN CHINA

China Gas Holdings Ltd. (Hong Kong)/Wuhu Natural Gas (Anhui)
Will form natural gas joint venture to provide services to Wuhu, Anhui. (HK:90%-PRC:10%). $12.8 million. 06/03.

Langfang Xinao Investment Ltd., a unit of Xinao Gas Holdings Ltd. (Hong Kong)/Dongguan Xinfeng Piped Gas Co. Ltd. (Guangdong)
Will form piped gas joint venture, Dongguan Xinao Gas Co. Ltd., in Guangdong. (HK:49%-PRC:51%). $18 million. 06/03.

Xinao Hunan Investment Ltd., a unit of Xinao Gas Holdings Ltd. (Hong Kong)/Xiangtan Coal Gas Co. Ltd. (Hunan)
Formed piped gas joint venture, Xiangtan Xinao Coal Gas Co. Ltd., in Xiangtan, Hunan. (HK:85%-PRC:15%). $12.8 million. 06/03.

OTHER

CNOOC
Purchased a 5.3% stake in Australia's largest oil and gas venture, the North West Shelf project. $348 million. 05/03.

Kerr-McGee China Petroleum Ltd., an affiliate of Kerr-McGee Corp. (US)/CNOOC
Signed production-sharing contract for oil exploration in part of Bohai Bay. 06/03.

OAO Yukos (Russia)
Signed two long-term agreements to supply oil by pipeline to China. 05/03.

Pharmaceuticals

INVESTMENTS IN CHINA

Cathay International Holdings Plc (UK)/Jilin University
Formed biotechnology and pharmaceutical joint venture, Changchun Botai Medicine and Biological Technology Co. Ltd. (UK:71%-PRC:29%). $3.7 million. 06/03.

OTHER

Eli Lilly and Co. (US)
Will transfer staff and technology to Zhejiang Hisun Pharmaceutical Co. Ltd. in cooperative effort to produce an antibiotic to treat multi-drug-resistant tuberculosis. 06/03.

Ports & Shipping

CHINA'S EXPORTS

Nantong Cosco KHI Ship Engineering, a joint venture of Kawasaki Shipbuilding Corp. (Japan) and COSCO
Won contract from K Line (Japan) Ltd. for three car carriers. 05/03.

Rail

CHINA'S IMPORTS

Alcatel (France)
Won contract from Guangzhou Metro Corp. to provide train control systems for Guangzhou's metro system. $40 million. 05/03.

Raw Materials

INVESTMENTS IN CHINA

Asia Aluminum Holdings Ltd. (Hong Kong)
Will build an aluminum panel plant in Guangdong. $384 million. 07/03.

LG Chem, Ltd. (South Korea)
Will build computer monitor coating plant in Nanjing, Jiangsu. $15 million. 07/03.

Sumitomo Corp. (Japan)/Shanghai Baosteel Group Corp., First Automotive Works
Will form joint venture to process and distribute steel for vehicles. $21.3 million. 07/03.

Taiwan Cement Corp. International Holdings
Will build a cement plant in Yingde, Guangdong. $301.9 million. 06/03.

Fushan Holdings Ltd. (Hong Kong)/Shanxi Jin Ye Coal and Coking Group Co., Golden Oak Development Ltd.
Will form coking coal joint venture. (HK:45%-PRC:55%). $13.77 million. 05/03.

Real Estate & Land

INVESTMENTS IN CHINA

Morgan Stanley (US)
Will build luxury residential and retail space in Shanghai. $90 million. 07/03.

OTHER

HSBC Holdings Plc (UK)/DTZ Debenham Tie Leung (SEA) Pte. Ltd. (Singapore)
Will cooperate to offer comprehensive real estate services to overseas investors in Chinese real estate. 06/03.

Telecommunications

CHINA'S EXPORTS

ZTE Corp.
Won contract from POSTelecom in Romania to supply equipment. $100 million. 07/03.

Huawei Technologies Co., Ltd.
Signed five-year agreement with PT Excelcomindo Pratama in Indonesia to supply mobile systems and solutions. 06/03.

Huawei Technologies
Won contract from MegaFon in Russia to build a dual-band mobile network in Siberia and the Russian Far East. $60 million. 06/03.

ZTE Corp.
Won contract from PAKTEL in Pakistan to provide GSM mobile systems. 05/03.

CHINA'S IMPORTS

Alcatel SA (France)
Signed multimillion-dollar contract with Nanjing Toptry China-Spacenet Co. Ltd. for delivery of a satellite Internet network management platform. 07/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contract from China Netcom to introduce DSL service in Lhasa, Tibet. 07/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contract from China Telecom to provide 920,000 DSL lines in 18 provinces. 07/03.

LM Ericsson AB (Sweden)
Won contract from China Unicom Ltd. to expand its CDMA network in Jiangsu and Liaoning. $57 million. 07/03.

LM Ericsson AB (Sweden)
Won contract from Guangxi Mobile, a subsidiary of China Mobile, for expansion of its GSM/GPRS network in Guangxi. $30 million. 07/03.

Lucent Technologies (US)
Won contract from Hunan Unicom, a subsidiary of China Unicom, to build the provincial optical backbone network for Hunan. 07/03.

Motorola Inc. (US)
Won contract from China Unicom Ltd. to expand its CDMA network in Jiangsu. $80 million. 07/03.

Nortel Networks Ltd. (Canada)
Won contract from China Railway Communications Co. Ltd. to be the exclusive supplier of packet voice (VoIP) equipment for Chongqing. 07/03.

UT Starcom, Inc. (US)
Won contract from China Telecom to provide 200,000 DSL lines in eight provinces. 07/03.

UT Starcom, Inc. (US)
Won contract from China Netcom to expand PAS service in Henan. $28.7 million. 07/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contracts from Zhejiang Mobile Communication Co. Ltd. to expand and upgrade its mobile network to 16 million subscriber lines. $30 million. 06/03.

LM Ericsson AB (Sweden)
Won contracts from China Mobile to expand its GSM/GPRS networks in Hebei and Liaoning. $76.3 million. 06/03.

Gemplus International SA (Luxembourg)
Was selected by China Unicom to provide more than 10 million subscriber cards for GSM mobile phones. 06/03.

Lucent Technologies (US)
Won contract from Beijing Communication Corp., a subsidiary of China Netcom, to build an advanced optical network in Beijing's suburbs. 06/03.

Lucent Technologies (US)
Won contract from Guangzhou Unicom and Tianjin Netcom to provide technical support and management training. 06/03.

UT Starcom, Inc. (US)
Won contract from China Netcom to expand its PAS system in suburban cities near Tianjin. $27.7 million. 06/03.

UT Starcom, Inc. (US)
Won contract from China Netcom to deploy PAS systems in several cities in Heilongjiang. $43 million. 06/03.

Alcatel Shanghai Bell, a joint venture of Alcatel (France) and MII
Won contracts from China Telecom to provide 90,000 DSL lines to Zhejiang and 200,000 DSL lines to Shanghai. 05/03.

Nortel Networks Ltd. (Canada)
Won contract from Shandong Unicom to provide a provincial optical backbone network. 05/03.

Siemens AG (Germany)
Won contract from China Mobile to expand its GSM network in Shanghai and Anhui. $36 million. 05/03.

Siemens AG (Germany)
Won contract from China Unicom to supply technology for expansion of its optical network. $10 million. 05/03.

UT Starcom, Inc. (US)
Won contract from Jiangsu Telecom, a subsidiary of China Telecom, to expand its PAS network in Suzhou. $20 million. 05/03.

INVESTMENTS IN CHINA

Lucent Technologies (US)
Will build dedicated research center in China. $50 million. 06/03.

SKT China, a unit of SK Telecom Co. (South Korea)/Eastern Communications Co. (Shanghai)
Will form wireless phone marketing joint venture, FaceOne, in Shanghai. (South Korea:35%-PRC:65%). $8.6 million. 06/03.

OTHER

Avici Systems Inc. (US)/Huawei Technologies
Formed partnership to package Avici routing solutions with Huawei products. 06/03.

Nokia Corp. (Japan)
Received license to manufacture and sell CDMA handsets. 06/03.

Tourism & Hotels

INVESTMENTS IN CHINA

Landmark Entertainment Group
Created subsidiary, Wuxi Hollywood Film & Entertainment Co. Ltd., to create "Oriental Hollywood" in Wuxi, Jiangsu. $10 million. 06/03.

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