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THE CHINA BUSINESS REVIEW

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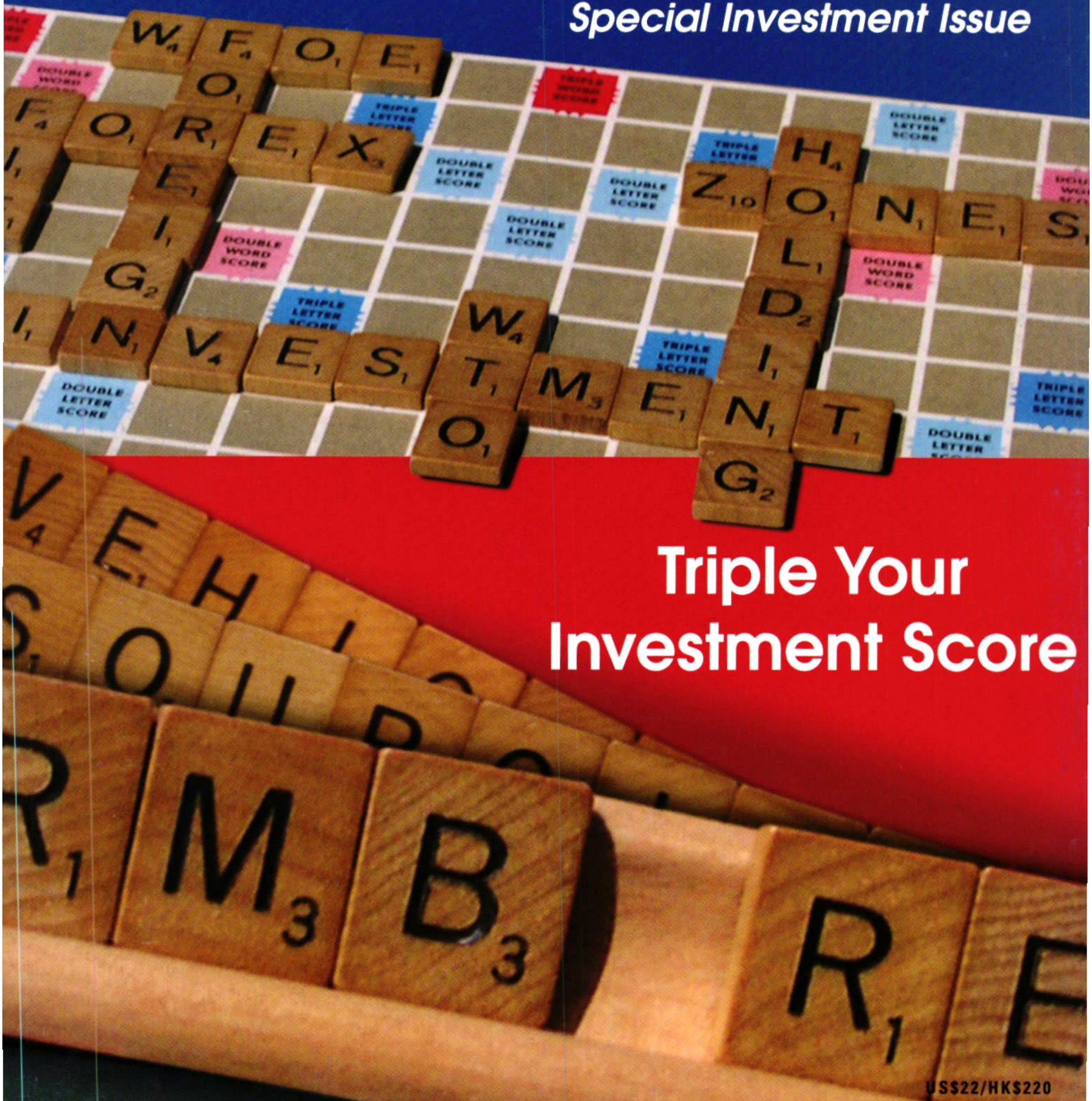
Special Investment Issue



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SPECIAL ISSUE: INVESTMENT

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Short Takes

And the Poor Get Poorer...

China has recorded its first rise in poverty since economic reforms began in 1978—the number of farmers in poverty increased by 800,000 last year. According to the PRC government's poverty task force, more than one in 11 rural residents now lives on less than ¥637 ($76.93) per year. Beijing blamed the increase on the emergence of severe acute respiratory syndrome and natural disasters, citing droughts and flooding in Anhui, Heilongjiang, Henan, Shaanxi, and Sichuan provinces.

China's economic inequality has moved to the top of the political agenda in recent years. According to a Chinese Academy of Social Sciences report released earlier this year, the average urban dweller earns 3.1 times more than his rural counterpart and, accounting for the difference in education and health benefits, the income gap between China's urban and rural residents is among the worst in the world. China's Gini coefficient, a standard measure of general economic inequality, shows China's income distribution to be as unequal as that of the United States—and more unequal than two-thirds of all countries.

China Starts "Two-Girl" Policy

China has started awarding bonus pensions to parents of two girls to correct the skewed gender ratio, which shows 117 boys born for every 100 girls nationwide. Zhao Baige, a vice minister of the State Population and Family Planning Commission, announced in August a 15-province pilot program in which rural parents of two girls, as well as parents with only one child or parents with a disabled child, would be given at least ¥600 annually after turning 60 years old. (Rural parents whose first child is a girl are allowed to have a second child; parents of minority ethnic groups are also allowed to have multiple children.)

According to the Xinhua News Agency, President Hu Jintao said earlier this year that bringing China's newborn sex ratio back to parity by 2010 is one of the country's priorities.

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THE US-CHINA BUSINESS COUNCIL

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BULLETIN

EVENT WRAP-UP

Washington

July

Quarterly World Trade Organization (WTO) Working Group Meeting Featured Charles Freeman, assistant US Trade Representative for the People's Republic of China, Taiwan, Hong Kong, Macao, and Mongolia, and his colleagues for an informal, off-the-record discussion on the current status of China's WTO commitments.

Meeting with Mark Cohen, Intellectual Property Rights (IPR) Attaché Designate Cohen discussed company concerns and US government initiatives on China's IPR regulatory framework and enforcement efforts, and his newly created IPR attaché post at the US Embassy in Beijing.

Beijing

July

Reception and Dinner with US Congressional Staff Delegation Co-hosted by the US-China Business Council (USCBC) and the American Chamber of Commerce in China, the dinner reception featured a US congressional staff delegation led by Matthew Szymanski, chief of staff and staff director for the House Small Business Committee and chief counsel to Rep. Donald Manzullo (R-IL).

August

Lunch with US Congressional Delegation Headed by Rep. Tom Davis (R-VA, chair of the House Government Reform Committee), the US congressional delegation was joined by staff members from the House Government Reform Committee.

Governor's Forum Luncheon on Anhui Province USCBC's second program in the Governor's Forum series featured Anhui Governor Wang Jinshan and Vice Governor Wen Haiying, accompanied by key provincial officials. Co-hosted with the China Council for the Promotion of International Trade.

UPCOMING EVENTS

Issues Luncheons, Washington, DC
September 16, 2004
October 21, 2004
November 18, 2004

China Operations Conference, Shanghai
October 21, 2004
For more information, see below

Save the Date!

Forecast 2005

Evening Reception: February 2, 2005
Conference: February 3, 2005
The St. Regis, Washington, DC

Plan Your Travel to China around the US-China Business Council's

China Operations 2004 Conference

Thursday, October 21, 2004
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The Westin, Shanghai

The full-day conference will present discussions on

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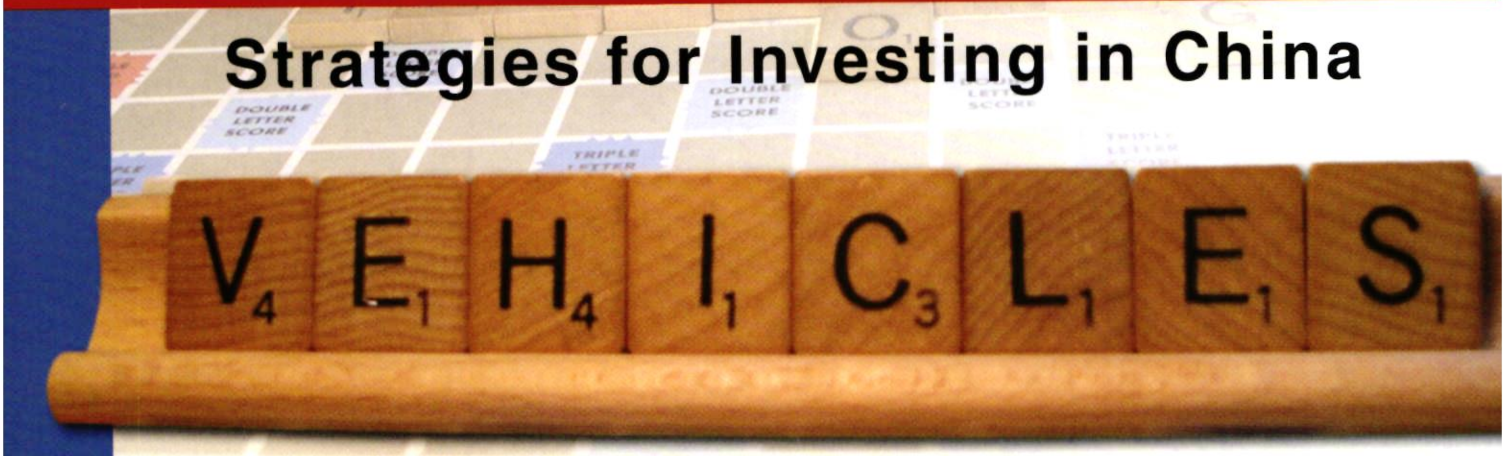
Service Centers—Establishing shared service centers in China
China's Economy and Financial Services—A look at soft landings and hard credit
Luncheon Keynote: Trading and Distribution Rights—What happens next?
Antitrust and Antidumping—What to expect from the "Two Antis"

For more information or to register, see www.uschina.org

China Operations is a USCBC members-only event.

Strategies for Investing in China



Traditional WFOEs and JVs compete with newer FISCs and R&D centers as foreign investment options

R. Mark Mechem

Since China's entry into the World Trade Organization (WTO) foreign investor interest and participation in the country's economy has grown to unprecedented levels. China now rivals the United States as the world's number one destination for foreign direct investment (FDI). China's implementation of its WTO commitments has significantly expanded foreign investors' ability to participate in the country's economy.

Moreover, recent years have seen a marked evolution in the way companies view their China-based operations in the context of their global business development strategies. Companies no longer view their China operations as a special case, somewhat removed and isolated from the rest of a company's international operations. Rather, China-based businesses are increasingly integral parts of global business plans.

Combined with the new opportunities emerging as China's WTO commitments kick in, this shift in viewpoint is leading foreign investors to approach the question of how to structure operations in the country in a fundamentally new way. Of course, which of the country's limited (if proliferating) number of investment vehicles to choose is still one of the most crucial decisions a foreign investor must make in China. But where regulatory prohibitions—especially those found in the Catalogue Guiding Foreign Investment in Industry—once all but dictated how foreign companies could structure their China investments, strategic and commercial considerations are rapidly becoming the most salient deciding factors in choosing an investment vehicle. Is your company's goal to tap into China's rapidly expanding domestic market or to establish a manufacturing base for exports or some combination of both depending on your investment timeframe? Indeed, the regularization of China's market for FDI in recent years has now reached a point where such considerations are no longer the exclusive purview of multinational corporations. Many small and medium-sized foreign companies can now reasonably begin to consider a "China play" in their own growth and development plans.

The representative office—traditional first step

Though technically not an investment vehicle, the representative office (*daibiaochu*) is usually the quickest and least expensive way to establish a presence in China (see p.28). Opening a representative office enables a company to learn about the market through market research, build reputation and brand awareness, and foster important and necessary relationships with actual or potential customers, regulators, and possible partners for future investment. A representative office is an attractive option for a company that wishes to establish a reputation and build capacity while it waits for further market openings, a strategy that has been popular in many service industries including telecom. In other service sectors, such as the law, the representative office remains essentially the only option.

The chief constraint of the representative office is that it cannot engage in "direct profit-making" activities. Nevertheless, many representative offices operate as sales offices and are empowered to negotiate virtually all aspects of a deal. But when it comes to actually signing a contract and taking payment, it is the parent company, not the representative, that must conclude the deal.

Another constraint of the representative office is the fact that it must be sponsored by a Chinese company or organization that is recognized by the Ministry of Commerce (MOFCOM) as having an interest in the proposed business of the office. As representative offices

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are licensed for only three years, sponsorship must be renewed each time the office reregisters, a situation that can lead to bureaucratic fatigue and headaches when dealing with one's sponsor.

Similarly, PRC citizens employed by representative offices are technically not employees of the parent company, but of a Chinese labor organization such as the Foreign Enterprise Service Corp. (FESCO). FESCO and its competitors theoretically provide Chinese employees of representative offices with pension, health, and other benefits based on contributions from the representative office itself. Many companies have found that these benefits, though often exceeding standards in most Chinese companies, often fall short of international corporate standards, meaning that companies must provide supplementary coverage to their Chinese employees that they would not have to offer in other structures.

For some industries, representative offices are an attractive way to expand into new geographic markets. Functionally, this might best be thought of as branching. But the Chinese FDI regime treats representative offices and branches quite differently in several important respects that often determine which vehicle a given company decides to pursue. Though the laws and regulations governing the establishment and operation of representative offices are well established, branch offices remain poorly defined in Chinese law, especially outside of financial services. To the extent that branch offices are defined, it is important to note that they do not hold legal person status, as representative offices do. The parent company bears all liability for the actions of a branch office. Taxation is another important consideration. Branch offices are taxed on actual profits, whereas a representative office may be taxed on deemed profits. Consequently, the tax burden associated with a representative office may actually be higher than would otherwise be justified.

Straight to the chase: The WFOE

The wholly foreign-owned enterprise (*waishang duzi qiye* or WFOE) has become the dominant form of foreign-invested enterprise (FIE) over the past decade, a trend that has only accelerated following China's 2001 WTO entry. WFOEs constitute nearly 70 percent of new FDI projects approved in the first half of 2004, and 75 percent of investment dollars.

WFOEs have always been popular vehicles for foreign investors. The earlier dominance of the joint venture (JV) was primarily due to the fact that the Catalogue Guiding Foreign Investment in Industry previously forbade WFOEs in many sectors of the Chinese economy.

Simplicity and control are the principal attractions of the WFOE. WFOEs can often be established and begin operations much more quickly than JVs, as there is no need to engage in protracted negotiations with prospective partners. Not only are WFOEs immune to pressure from Chinese partners to transfer sensitive technologies, but they are also better able to protect proprietary industrial processes than most JVs. Similarly, a WFOE's expansion plans remain subject solely to the foreign investor's capabilities.

The persistence of the JV must be attributed to its unique commercial advantages.

The Chinese government has traditionally offered only lukewarm support to WFOEs. Although China's WTO entry agreement mandates national treatment, WFOEs may still find it difficult to compete for contracts in sectors where there are strong or influential domestic competitors.

Joint ventures: Holding their own

JVs may have declined in relative terms as a percentage of China's FDI, but they continue to multiply in absolute terms. This is notable because the number of sectors in which foreign investors may only participate through JVs continues to shrink. The persistence of the JV, then, must be attributed to its unique commercial advantages.

Forming a JV with one or more Chinese partners often enables a foreign investor to tap valuable resources and mitigate exposure to risk. JV partners can help lower start-up costs, especially in capital-intensive industries. Many Chinese JV partners can contribute good site locations and serviceable infrastructure. A properly chosen JV partner may also bring a trained work force and strong sourcing, distribution, marketing, and after-sales networks to the enterprise. It is worth noting that, though some early foreign investors have sought to break away from or buy out their JV partners, others have built such strong and mutually beneficial relationships that they now prefer to expand their businesses in China in concert with their JV partners—even though the law no longer requires them to do so.

Continued on page 34

At Your Service

Foreign service providers are starting to make inroads in the China market—with some exceptions

Julie Walton

Before China joined the World Trade Organization (WTO) in 2001, the few foreign service providers operating in China did so under a highly restrictive framework that dictated their choices of partner, location, and business scope. China's WTO commitments on services lift most of these restrictions, allowing foreign investors in China to operate as they do in other economies around the globe. Of course, this does not mean that foreign service providers are gaining completely unfettered access to each service sector in China. Foreign firms in many sectors may only form joint ventures and often are restricted to minority stakes.

But in some services, such as publications distribution, the central government has not only fully met the letter and spirit of its WTO services commitments, but exceeded them. In others, such as construction, the reverse has happened. Sectors once fairly open to foreign investment now appear more restricted. In many other sectors, companies that were initially discouraged by restrictions in place even after WTO entry have, through quiet advocacy or creativity in choice of joint venture partner, advanced their cause.

A review of the most notable advances—and of backsliding, as the PRC government tries to strengthen domestic companies so that they can hold their own against foreign behemoths—makes abundantly clear that China's changing regulatory and economic landscape since WTO entry has kept even the most seasoned foreign investors on their toes.

Distribution

China's prohibitions on foreign control of distribution channels have long frustrated investors. Wholesaling, retailing, and other distribution services have slowly opened to foreign investors since China joined the WTO, and restrictions on geographic location, equity participation, and form of incorporation will be lifted December 11, 2004 (see the *CBR*, September–October 2003, p.14). Initially, the central government's implementation record in this sector was poor, despite its own clearly defined time frames. Yet, as more significant commitments approached, implementation sped up. For example, the General Administration of Press and Publication (GAPP) and the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC) published a rule in 2003 that permitted wholly foreign-owned retail outlets for books, magazines, and newspapers about 18 months ahead of schedule. The rule also allowed foreign investment in online publication sales, chain stores, and reader's clubs, as well as in existing publication distributors, including state-owned enterprises. The same rule will allow wholly foreign-owned wholesale companies for books, magazines, and newspapers in December 2004.

Germany's Bertelsmann AG was the first to take advantage of this new opening. The company bought a 40 percent stake in Beijing 21st Century Book Chain in December 2003, subsequently forming the first national joint venture retail bookstore chain. This deal reflected GAPP's recognition that it must upgrade and modernize the country's print media distribution sector and that inviting foreign investment is one way to stimulate change in the industry.

Another notable area of progress has been in gasoline retailing. Both Royal Dutch/Shell Group and BP plc are vigorously pursuing gas station ventures with Sinopec and PetroChina, respectively. Of China's 80,000 gasoline stations, only 300 are foreign-invested. Given the huge increase in auto purchases in China, the demand

Julie Walton
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M&A Laws Push Sector Openings

Many of the investments that foreign companies have made in sectors liberalized since China entered the World Trade Organization could not have been made were it not for substantial changes in the laws governing mergers and acquisitions. Both the Notice on Strengthening the Administration of Examination, Approval, Registration, Foreign Exchange Issues, and Taxation of Foreign Invested Enterprises and the Provisional Regulation on the Acquisition of Domestic Enterprises by Foreign Investors simplify the process by which foreign companies can acquire domestic Chinese firms.

Under the new system, foreign investors may now purchase assets in existing domestic companies without creating new joint ventures. They may also invest directly in domestic companies via an asset purchase or the transfer of shareholder rights. Furthermore, the restriction that companies must take a minimum 10 percent equity stake was removed, although in most cases companies are looking to take much larger stakes. With expanded options for mergers and acquisitions, foreign companies are now less restricted in their investment options.

—Julie Walton

for gasoline is sure to rise steadily in coming years. The Shell and BP joint ventures are the first large-scale forays for foreign companies into the retail oil business as allowed under China's WTO commitments.

The companies will be limited to joint ventures for the foreseeable future: though most distribution-related restrictions will be lifted December 11, 2004, foreign companies cannot have controlling stakes in chain store operations with more than 30 outlets, a restriction with no deadline for removal. As each company's joint venture plans to establish 500 outlets initially, the two oil giants are limited to minority shares.

Logistics

China made no overarching commitment to open its logistics sector. Distribution, transportation, freight forwarding, and shipping are all addressed separately within China's WTO commitments, causing confusion and frustration among foreign investors because of overlapping business license and registration procedures. This fragmentation reflects the greatest challenge facing foreign investors in logistics: China's lack of infrastructure, both physical and regulatory.

To be sure, this fragmentation of the logistics sector has prevented smaller foreign logistics companies from operating in China. Currently, international giants Dutch-based Maersk Logistics, US-based APL Logistics, and UK-based P&O Nedlloyd are the only firms allowed to operate nationwide as wholly foreign-owned logistics companies. But the central government is aware that a fractured and inefficient logistics framework hinders the growth of Chinese companies as well as foreign ones.

Indeed, most of the challenges to foreign participation in this sector are unrelated to China's WTO commitments. Ministerial infighting prevents the railway, aviation, customs, and communications and transport authorities from creating a comprehensive regulatory process for companies that want to provide fully integrated, nationwide logistics services. At the local level, the need to protect jobs pushes local officials to discourage outside trucking companies from providing services, though recent pressure from the central government to eliminate local protectionism may reduce this sort of barrier over the next few years. Finally, overcrowded highways on the eastern seaboard, mountainous terrain in the west, and poor refrigeration technology present significant obstacles to anyone transporting fragile or perishable goods.

Compounding these difficulties, central government regulators have a mixed record in opening the logistics sector to foreign participation. The Ministry of Railways released rules governing foreign participation in the rail sector right before China joined the WTO, making good on its promise to open rail freight forwarding to foreign joint ventures upon WTO entry (see the *CBR*, March–April 2004, p.24). Railroads are particularly important to foreign investors because most of the country's freight travels by rail. Wholly foreign-owned rail freight companies will be permitted in 2007. On the other hand, road transportation was liberalized initially in 2002, but foreign stakes were capped at 75 percent—considered by many in the foreign business community as contrary to the spirit of China's WTO commitments. According to these commitments, wholly foreign-owned enterprises (WFOEs) are allowed in road transport by December 11, 2004. Regulations allowing foreign majority investment in freight forwarding companies were released on time in 2002; companies will have to wait until 2005 to establish WFOEs.

Fortunately, many of the WTO trade, distribution, and freight-forwarding commitments are to be phased in this year, so foreign investors might soon have an easier time navigating the system. For instance, the new foreign commercial enterprise regulations governing distribution should make it easier for companies to streamline their operations (see p.14).

Insurance

By the end of May 2004, 38 foreign insurance companies were operating in China in both life and nonlife areas. Though this may sound impressive compared to the handful that had set up before WTO entry, foreign life insurance companies are restricted to joint ventures with a maximum foreign stake of 50 percent. (The exception is American International Group, Inc. [AIG], whose wholly foreign-owned branches in China were permitted to remain so after China entered the WTO. AIG was also allowed to establish four more wholly foreign-owned branches in Beijing; Dongguan and Jiangmen, Guangdong; and Suzhou, Jiangsu. Any future branches will have to be joint ventures with a 50 percent maximum stake.)

Insurance licensing remains an opaque process, with high capital requirements for

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setting up branches. Furthermore, though nonlife insurers may set up WFOEs, they may not set up a branch without first establishing a subsidiary in China. Consequently, foreign insurers account for only about five percent of China's insurance market, although in Shanghai, which has been open longer to foreign investment, foreign companies have about 10 percent of the market.

Companies are moving quickly to take advantage of new opportunities as more cities open and as foreign insurers gain permission to provide a broader array of services.

Companies have accepted the long approval process and high capital requirements to obtain access to China's potentially lucrative insurance market. Yet these obstacles and the limits on foreign stakes in life insurance have prompted some companies to reach out to nontraditional partners, hoping to tap into nationwide distribution networks and new population segments, or gain strong political backing. For instance, New York Life International, LLC partnered with Haier Investment Development Co. in a 50-50 joint venture to sell life insurance in Shanghai. And UK-based insurer Aviva plc partnered with China National Cereals, Oils, and Foodstuffs Import & Export Co. to sell life insurance in Guangzhou.

Travelers Insurance Co., part of Citigroup Inc., received preliminary approval in June 2004 to begin setting up a life insurance joint venture with Shanghai Alliance Investment Ltd., an investment arm of the Shanghai branch of the State Asset Supervision and Administration Commission. It took the China Insurance Regulatory Commission a year to approve Travelers's initial application to begin establishing an insurance joint venture. The two sides now have about six months within which they must formally start operations.

Companies are moving quickly to take advantage of new opportunities as more cities open and as foreign insurers gain permission to provide a broader array of services. Aviva recently won approval to open branches selling life insurance in Beijing and in Chengdu, Sichuan, two cities that were opened at the end of 2003, and expects to offer health insurance products after December 11, 2004.

Alternatively, some companies have chosen to wait until China has phased in more of its geographic or business scope commitments. Liberty International Holdings, Inc. waited until China's WTO commitments allowing WFOEs in nonlife insurance took effect before setting up its WFOE in Chongqing to offer property and casualty products.

The June release of the Implementing Rules of the Regulations on the Administration of Foreign-Invested Insurance Companies should speed up the liberalization process. The capital outlay required to open a new branch was lowered to ¥20 million ($2.42 million), and the stake that foreign companies may buy in Chinese insurers was doubled to 20 percent. When AIG purchased a 9.9 percent stake in People's Insurance Co. of China in November 2003, AIG indicated it might raise its stake when regulations permitted it do so—which they now do.

Banking

Foreign bankers in China have faced many of the same problems plaguing foreign insurers: high capitalization requirements, lengthy licensing processes, and limitations on business scope. Despite these difficulties, most foreign banks committed to China are finding ways to conduct business profitably. Banks from more than 60 countries and regions had received approval to set up operations by the end of March 2004. This included 195 businesses and 213 representative offices.

US-based Citibank, UK-based HSBC, Japan-based Mizuho Bank, and Hong Kong-based Bank of East Asia were first to receive permission to handle renminbi-denominated business for domestic Chinese companies after this liberalization took effect (on time) in December 2003.

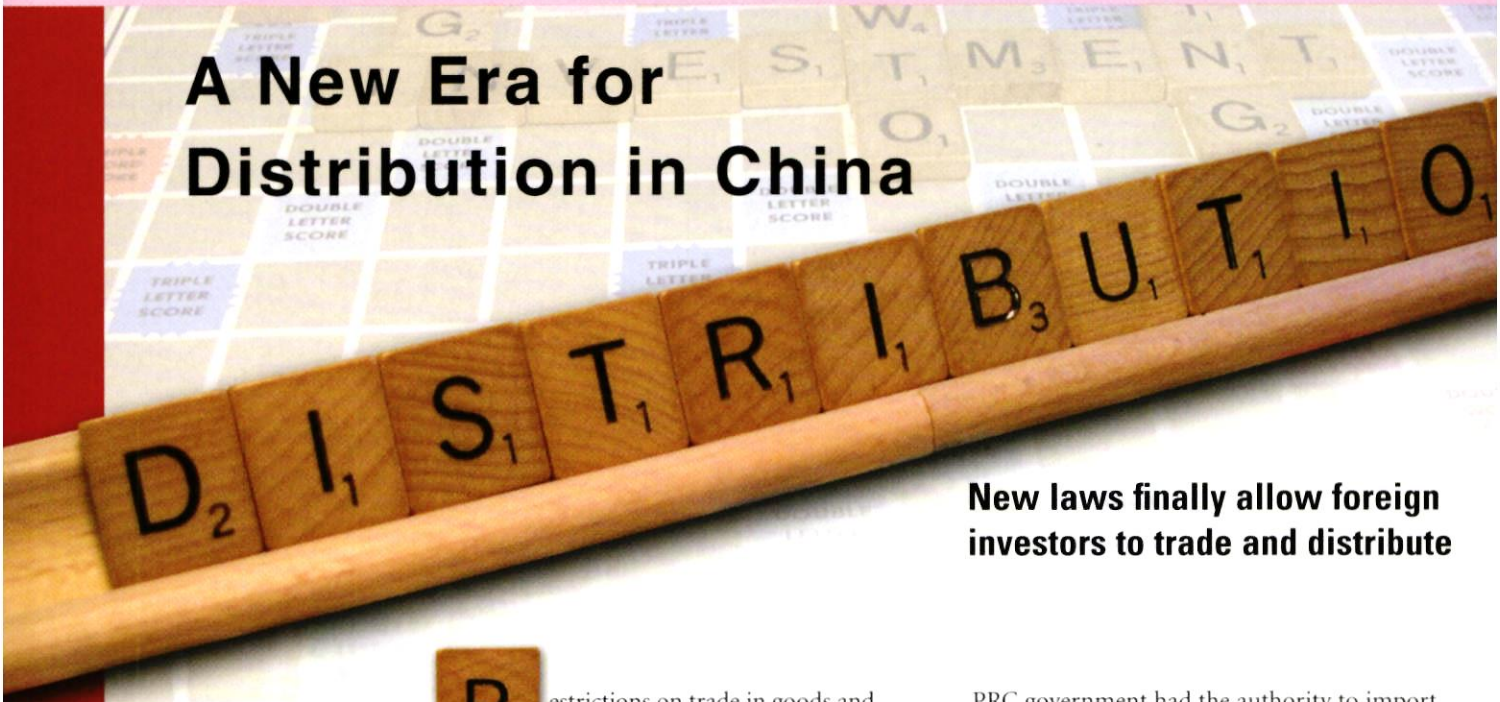
In early 2004, HSBC joined with Bank of Shanghai, and Citibank partnered with Shanghai Pudong Development Bank, to launch dual-currency credit card services for Chinese individuals. Though foreign firms may not issue their own local credit cards until 2007 at the earliest, the tie-ups present a unique investment opportunity for the two foreign companies to gain strategic market know-how prior to venturing out on their own. In this case, outright prohibition on offering one type of financial service has not prevented foreign players from finding legitimate ways to operate in the market.

Media and entertainment

The central government has long restricted foreign investment in the content and management of China's media and entertainment offerings. But rising levels of disposable income and greater access to diverse media and entertainment sources have created significant demand for new products, especially among the urban population. This demand, combined with the rapid development of the industry and China's WTO commitments, has pushed liberalization.

Continued on page 37

A New Era for Distribution in China



New laws finally allow foreign investors to trade and distribute

Sara Yang Bosco

Restrictions on trade in goods and services across geographic boundaries and within China have long been some of the biggest obstacles to foreign investors' success in the country. China's commitments as part of its 2001 World Trade Organization (WTO) entry package included pledges to open these activities to foreign firms. But only this year has that promise become reality, as a result of two significant developments. On April 6, the Standing Committee of the National People's Congress enacted amendments to the PRC Foreign Trade Law. Just 10 days later, the Ministry of Commerce (MOFCOM) followed by issuing the Measures for the Administration of Foreign Investment in the Commercial Sector (Commercial Sector Investment Measures). The Commercial Sector Investment Measures and the amendments to the Foreign Trade Law took effect June 1 and July 1, respectively, and herald the start of a new era for foreign companies doing business in and with China.

Amendments to the Foreign Trade Law

China's Foreign Trade Law, originally passed in 1994, applies to foreign trade, or the import and export of goods and technology, and international services trade. The most recent changes to the law eliminate the foreign trade authority system, under which the state designated which companies had rights to trade with foreign parties. The law also protects intellectual property, a major concern for foreign companies. Finally, the law announces that a catalogue for international services trade is forthcoming and outlines MOFCOM's powers.

- **Breaking the state monopoly**

Before the amended Foreign Trade Law took effect, only certain companies licensed by the PRC government had the authority to import and export all goods, technologies, and services. Since most companies did not have foreign trade authority, foreign suppliers were forced to enter into contracts with these specially licensed companies, thus driving up costs and forcing contractual relationships between parties without common commercial interests.

As part of its WTO entry agreement, China pledged to eliminate this system and allow all enterprises in China the right to engage in foreign trade by December 11, 2004. Indeed, China met this deadline about five months early. Chinese entities or individuals that wish to import or export goods and technologies for their own use may now do so by registering as a "foreign trade operator," a process that should be more administrative than substantive. This also means that foreign companies can deal directly with their Chinese counterparts.

Though the law defines a foreign trade operator as "a legal person, other organization, or individual engaged in foreign trade business activities...after completing industry and commerce formalities...in accordance with the law," it is not clear whether a foreign-invested enterprise (FIE) must register as a foreign trade operator to import and export goods and services. Since FIEs have always had the authority to import goods and technology for their own use and to export goods and technologies they have manufactured or developed themselves, this authority will likely continue. More important for foreign companies is the fact that the Commercial Sector Investment Measures permit FIEs to import goods for resale or export goods they have not made or developed (see below).

- **Intellectual property protection**

The protection of intellectual property in international trade is enshrined in a new chapter of the Foreign Trade Law. The law states the

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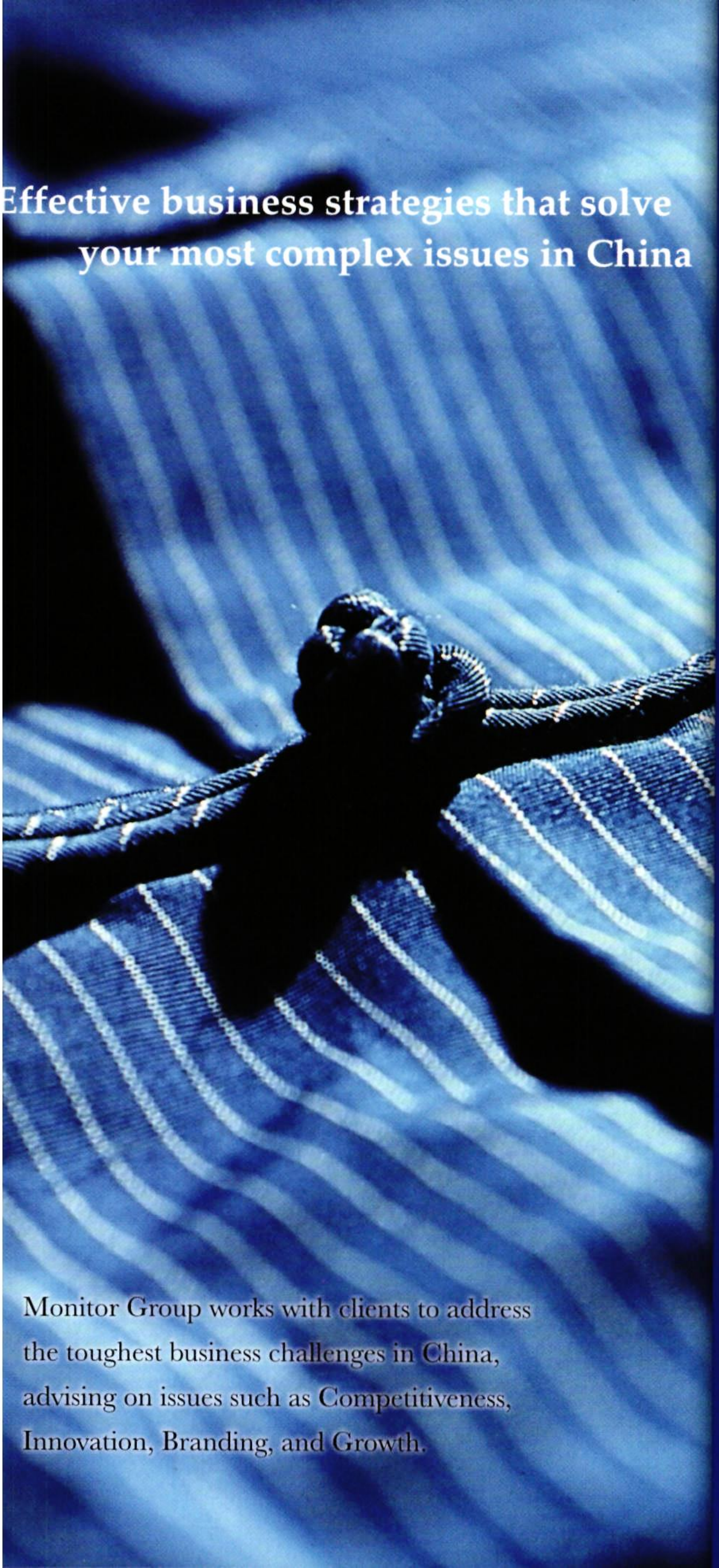
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basic principle that "the state shall protect intellectual property rights in foreign trade in accordance with relevant laws and administrative regulations" and authorizes MOFCOM to prohibit, for a defined period of time, production and sales in China by those who import goods that infringe intellectual property rights. The new chapter also protects the licensees of imported technology in China against the imposition of mandatory license of unrelated technology, exclusive grant-back

The opening of this sector should bring radical changes to the way foreign companies sell goods and provide services in China.

licenses (where the licensee makes an improvement on the original technology, and the original licensor obtains grant-back rights of the improvements), and other practices that jeopardize the notion of fair competition in trade activities. It also allows the Chinese government to adopt retaliatory trade measures against other countries that fail to protect the intellectual property rights of PRC entities and individuals adequately.

- **International services trade**

With regard to "international services trade," which refers to cross-border services to and from China but does not include foreign investment in the service sector, the new law states that MOFCOM, in conjunction with other government agencies under the State Council, will issue a catalogue on market access. The use of a catalogue to regulate access follows a pattern in other areas, such as technology transfer and foreign investment, but interested parties will want to monitor the forthcoming catalogue for compliance with China's WTO commitments.

- **Scope of MOFCOM powers**

Under the amended Foreign Trade Law, the state still retains a vague and arguably broad mandate to restrict the ability of firms to import and export goods and services. For example, the state can impose quotas, tariff-quotas, and licenses, but the law is silent about how this can be done. The law also grants the State Council department in charge of foreign trade (currently MOFCOM) the authority to investigate the competitiveness of domestic industries in light of import and export of goods and services, trade barriers, the need to take antidumping measures, matters in foreign trade concerning national security and state secrets, and other matters that influence order in foreign trade activities and require investigation. The law does not address how the investigations are to be carried out, procedural rights of entities affected by such investigations, or enforcement actions.

Foreign investment in the commercial sector

Of all of the commitments China made when it became a WTO member, the commitment to open the distribution industry to foreign companies was one of the most eagerly anticipated. The Commercial Sector Investment Measures essentially permit subsidiaries of foreign companies in China to engage in wholesaling, retailing, and franchising, as well as distribution support services such as warehousing, inventory management, delivery, after-sales services, and repair and maintenance. The measures allow majority foreign ownership of most types of distribution businesses and will allow 100 percent foreign ownership on December 11, 2004. Existing limits on geographic location and numbers of foreign-invested distribution enterprises will also be lifted at the end of the year.

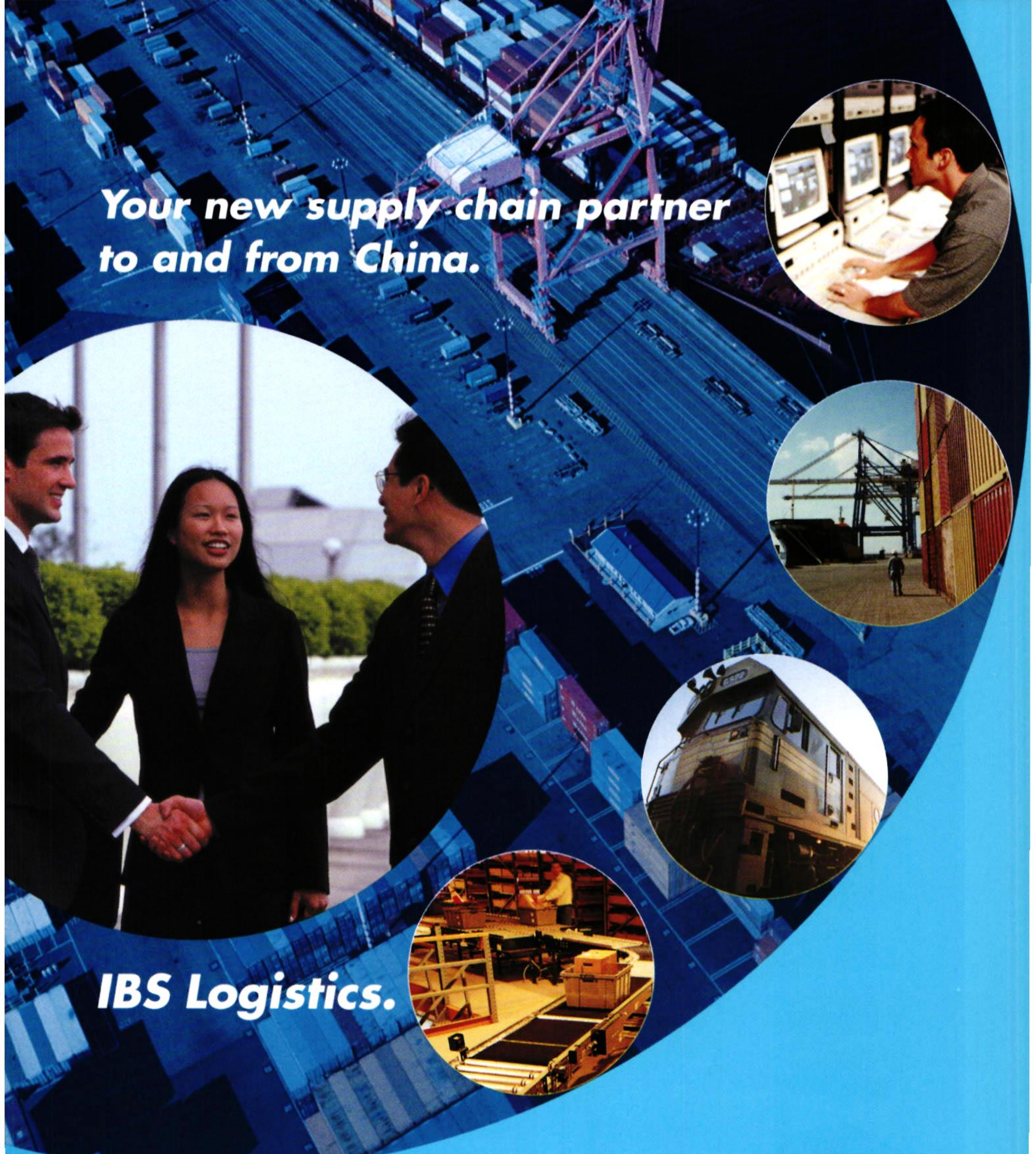
The threshold requirements for entering the distribution sector are low. Under the Commercial Sector Investment Measures, an FIE may apply to the provincial-level MOFCOM where it is located to expand its scope of business to include distribution—thus becoming a foreign-invested commercial enterprise (see p.28). Hence the opening of this sector should bring radical changes to the way that foreign companies sell goods and provide services in China.

Foreign investors will be permitted to set up companies in China for the sole purpose of wholesale or retail trade. Providers of systems integration, after-sales, and many other types of services will be able to sell parts, components, and other products together with their services. A joint venture or wholly foreign-owned subsidiary manufacturing in China will now be able to sell product lines that include the products of its parent, other affiliates, and unrelated companies, whether foreign or domestic.

Specifically, the new measures cover the following activities:

- Commission agency services, or the sale of the goods of others, pursuant to a contract, and for a fee, by sales agents, brokers, auctioneers, or other wholesalers;
- Wholesale services, or sale of goods to retailers, industrial, commercial and institutional users, and other wholesalers;
- Retail services, or the sale of goods for individual or collective consumption from a fixed location or via television, telephone, mail order, Internet, or vending machine;
- Franchise services, or the grant of authority pursuant to contract for the use of a trademark, trade name, business method, etc., in exchange for remuneration or franchising fees.

Continued on page 40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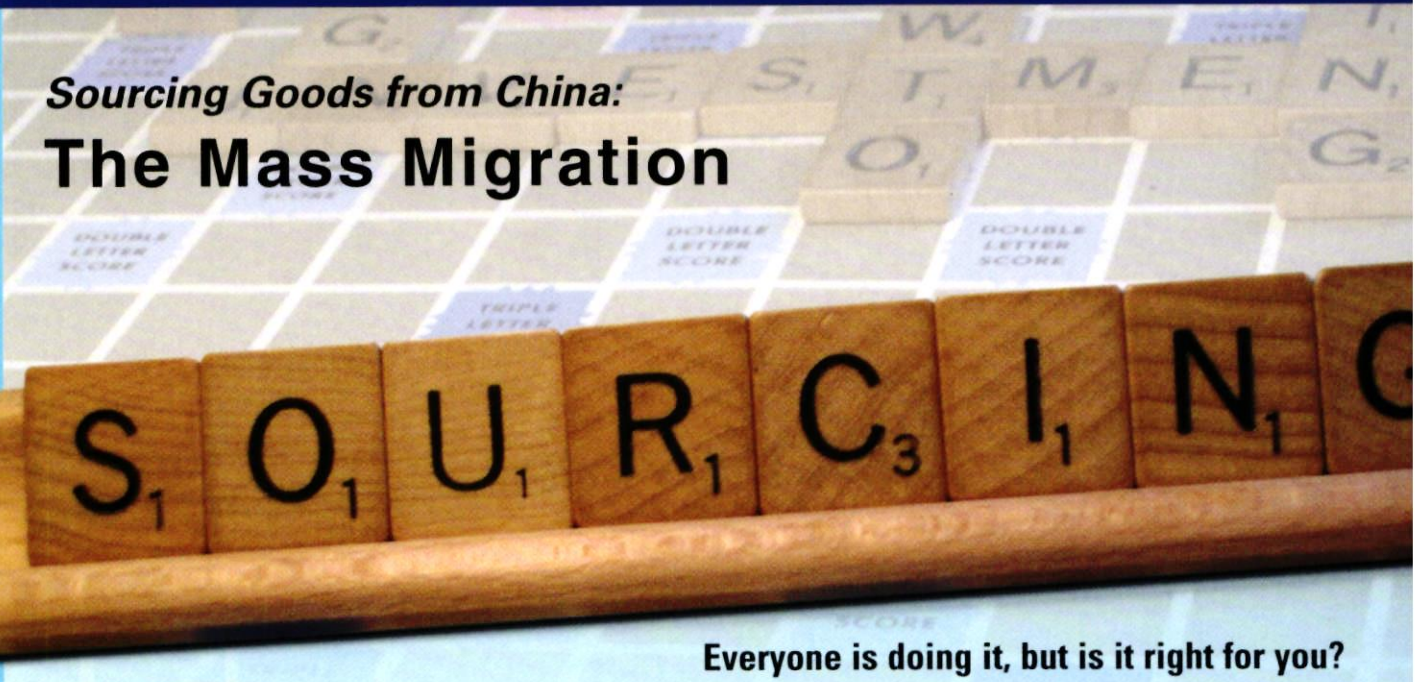

Sourcing Goods from China:

The Mass Migration

Everyone is doing it, but is it right for you?

Isaac Cheng

IF you work for a manufacturing or retail company and have not yet moved operations beyond domestic borders, someone in your boardroom has likely asked in the past year, Should we source from China?

Most larger US companies, which profit more from cost-cutting moves because of their scale, have already made the move, with many giants such as Wal-Mart Stores, Inc. and General Electric Co. setting up purchasing centers in China to feed their global supply chains. Even companies that have decided that their existing manufacturing operations are best left untouched for now are reexamining their upstream supply chains and confronting their suppliers with price quotes from Chinese producers. If your company has never looked at the option before, now may be the time to look. And if you have looked before, it may be time to look again, since the manufacturing dynamics in China change quickly.

The big question

The first question for the uninitiated, of course, is: Should we go to China? The answer depends in part on your company's products (see p.21). Most analysts note that China excels at sourcing components or goods made on templates, such as furniture, toys, and consumer electronics and appliances. Telecom, biotechology, and electronics are also emerging new strengths, and General Electric Co., Microsoft Corp., and Motorola, Inc., among others, have set up global research and development centers in China to capitalize on them.

The answer also depends on the level of PRC exposure your company seeks. For companies entering China only for procurement, cost advantage is still China's primary draw, but companies considering more permanent stakes may find better product quality and manufacturing flexibility, as well as growing domestic demand, to be more important. Depending on these factors, here's what sourcing from China can offer your company:

- **Lower labor costs**

According to a Boston Consulting Group (BCG) outsourcing report, the average hourly pay (including benefits) of production workers in China is \$0.80 versus \$21.86 in the United States; given the same equipment, American workers need to be 25 times more productive than their Chinese counterparts to remain competitive. Furthermore, if PRC government reforms on labor mobility succeed, huge labor surpluses in the rural areas and underemployed workers at state-owned enterprises waiting in the wings may keep manufacturing wages competitive for some time.

- **Long-term flexibility in production**

Companies often overlook the fact that, once Chinese workers have been well trained, substituting human hands for expensive, specialized machines can actually improve the flexibility of production lines.

- **Proximity to downstream manufacturers**

For companies that churn out intermediate goods such as auto parts, refined chemicals, and machine tools, customers—other factories—are increasingly located in China. Paradoxically, moving operations to China nowadays can lower shipping costs in addition to lowering labor costs.

- **Familiarity with the PRC operating environment**

Companies with longer-term plans to supply the

Isaac Cheng
is junior editor of the *CBR*.

Chinese market can start with a sourcing operation, which enables them to explore their options and lay the groundwork for a move toward local production.

1. Pick product to source
2. Define supplier and product criteria
3. Search for suppliers
4. Research supplier qualifications
5. Evaluate samples
6. Audit factories
7. Test order
8. Choose supplier
9. Establish reliable quality control
10. Establish communications
11. Establish supply chains
12. Monitor patent protection
13. Enforce long-term cost reductions
14. Repeat as needed

● **Lower capital costs**
For companies that plan to set up PRC manufacturing operations, land and setup costs can be a fraction of US costs, at least in the interior provinces and outside of major cities. Companies also find that using local components often minimizes input costs.

As more foreign companies move to China, they are creating nuclei of high-quality production and are challenging local factories to compete not only on price but on quality and service.

● **Favorable tax structures**
Foreign-invested manufacturers enjoy a tax rate of 15 percent, as opposed to 33 percent for domestic enterprises, and the government rebates up to 15 percent of value-added taxes (VAT) on exports (see the *CBR*, January–February 2004, p.32). Though the government has plans to unify the business tax structure and phase out some of these incentives, localities are likely to continue to offer incentives to lure investors.

China is equally well known as a tough environment for logistics and intellectual property rights (IPR) protection and as a lackluster enforcer of legal contracts. Specific difficulties in sourcing include:

● **Initial start-up time**
Getting a sourcing operation up and running may take longer than you anticipate, depending on the complexity of your product and your supplier's abilities. Finding a new supplier almost always requires new molds or new lines and plenty of quality control.

● **A weak intellectual property regime**
Foreign companies will find IPR protection a major concern for the foreseeable future, despite promising Chinese commitments on IPR made at April's Joint Commission on Commerce and Trade meeting between senior US and PRC trade officials.

● **Increased management complexity**
Adding an overseas branch or supply relationship requires stronger communication, stringent quality control monitoring, and a redesign of operations to adjust for different comparative advantages. The sheer geographical and cultural distance between the United States and China causes some small US companies to hesitate; even the 12-to 15-hour time difference can make teleconferencing a headache.

● **Longer and more complex supply chains**
Delayed delivery of consumer goods to US and European consumers is a risk unless companies manage their supply chains properly.

● **Energy shortages and other operational hiccups**
This summer, factories across China were crippled by power shortages, which are likely to persist through 2005. PRC producers have borne the brunt of the power outages; some have been forced to operate only on the graveyard shift.

● **Decommissioning of local assets**
Companies may find that closing US factories and laying off workers at home are necessary if sourcing adds excess capacity and returns to local assets are low. The penalties are unique to individual companies but usually entail financial, social, and sometimes political costs.

Other trends have added to the appeal of China as a sourcing destination. First, as more foreign companies move to China, they are creating nuclei of high-quality production and are challenging local factories to compete not only on price but on quality and service. Second, as the Chinese consumer market grows enough to support major industries, companies are establishing their presence in hitherto unexplored categories, not only across product lines but also vertically along the supply chain. Retailers and product assemblers are joining component makers in China, meaning that, for some companies, all their partners have already made the move. Finally, the PRC government seems to have convinced the business community that it is serious about building an investment-friendly institutional regime. For instance, the new PRC Administrative Licensing Law greatly increases transparency in licensing and registration. And China's strenuous efforts to be recognized as a market economy, and the Chinese Communist

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—Sean Maloney
Executive Vice President
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—Vaughn Koshkarian
President, Ford Asia Pacific Operations and Vice President
Ford Motor Company

Should My Product Go?

A check-heavy left side argues against sourcing from China; more checks on the right signal a move may be appropriate.

LABOR CONTENT		
❑ Blend of automation and highly skilled labor	❑ Automated processes	❑ Labor-intensive manufacture
IPR DANGER		
❑ Intellectual property integral to product	❑ Proprietary parts easily segregated	❑ Public domain
CHINA MARKET POTENTIAL		
❑ No perceived PRC demand	❑ PRC demand is rising but not yet robust	❑ China is the main growth market
PRC SUPPLIER ENVIRONMENT		
❑ No PRC producers	❑ Some PRC producers	❑ PRC is leading global producer
LOGISTICS CONSTRAINTS		
❑ Customized orders for time-sensitive clients	❑ Faraway clients but uniform shipments	❑ Strong international distribution chains
DEMAND STRUCTURE		
❑ Unpredictable fluctuations	❑ Predictable fluctuations	❑ Stable
STANDARDIZATION OF GOODS		
❑ Customized	❑ Partially customized	❑ Standardized

Party's new embrace of private entrepreneurs, offer some comfort for foreign investors uncertain of China's long-term commitment to a more open economy.

Assessing the costs

Each company must make its own decision to move to China, and a careful cost analysis is a critical part of this decision. A China-based competitor's price, adjusted for quality and market position differentials, can serve as an initial guide. Total cost analysis will incorporate cost savings (the largest portion of which is usually cheaper labor and components) and additional costs incurred, such as the initial setup costs and higher freight costs and duty payments. A more complex model will include sensitivity analysis to anticipate different scenarios, such as a government-forced slowdown or widespread power shortages.

Choosing the right path

Perhaps the easiest way for a company to source in China is to link up with an existing supplier's operations there or to encourage an existing supplier to also make the move. This allows for Chinese production prices at a familiar level of quality control and delivery.

Five Options

Think strategically and consider long-term plans before you pick your path.

Structure	Pros & Cons
1. Source selective components using sourcing agent	PROS: Easy to set up CONS: Low cost savings; little awareness of China markets
2. Source products through representative office in China	PROS: Hands-on approach and development of local expertise lets you sleep easier at night CONS: Increased management demands
3. Establish global procurement center	PROS: Maximize savings internationally; build deep relationships with PRC suppliers CONS: Requires good enterprise and communication systems within the company
4. Set up joint venture or wholly foreign-owned manufacturing enterprise in China	PROS: Production with rapid response; better positioned to capitalize on growing PRC strengths CONS: Large fixed investment
5. Create full manufacturing, distribution, and sales network	PROS: In some industries, China is the major growth market CONS: CEO or board decision; must have long-term investment and exit plans

Sourcing Help

Companies that otherwise would go to China often delay because of the initial capital and management outlay required, and the complex operational and regulatory environment in China. One solution to these problems is to retain a sourcing firm.

Some firms cover the entire process, from finding suppliers to transferring design specifications to setting up the supply chain and conducting quality control. This is a good choice for small companies or companies with limited management resources; all communication is with the US-based office of the sourcing firm. These firms generally charge between 3 and 12 percent commission on invoiced goods, depending on the complexity of the process and the scale of the order. Examples include ThreeSixty Sourcing Inc. and International Smart Sourcing Inc.

Other sourcing agents operate more as matchmakers. One example, Shanghaimart, gathers providers of high-value manufactures in a trade center in Shanghai according to client specifications and offers order coordination, trade financing, and limited delivery services. Such firms should be used if companies are comfortable handling their own supply management and are willing to take a more hands-on approach.

For companies that plan on setting up their own sourcing operations but need advice on PRC regulations and commercial realities, a consultant expert in Chinese commercial law can be invaluable. These consultants, which include China-focused consultants like NCO Ltd. in Shanghai or China branches of international firms such as Accenture Ltd. and Monitor Group, offer advice on corporate structures and different partners and locations to consider.

Regardless of specialty and size, the most important qualification of a sourcing firm is operational experience and a strong presence in China, preferably in more than one location. Sourcing agents should be able to present their search process and their track record in your industry up front and, ideally, come with referrals from your partners. Before entering the relationship, your company should be clear on how the sourcing agent matches suppliers and clients and should define the degree of involvement that will be required of your company.

—Isaac Cheng

Another way to find partners is through industry trade fairs in China; referrals from officials in the relevant ministry or local government; discussions with the American Chamber of Commerce, the US-China Business Council (publisher of this magazine), the US Commercial Service, or other trade organizations. Firms can also ask existing Chinese partners about potential partners or suppliers in other product areas, keeping in mind possible biases they may have.

Companies that are understaffed or on a tight budget can turn to sourcing agents (see above). Outside help on sourcing ranges from matchmaking to consulting on logistics and quality control. According to *McKinsey Quarterly*, procurement agents' fees range from 3 to 12 percent of the purchase price, depending on the level of service. Of course, careful vetting of sourcing firms is crucial.

Do due diligence

The next step is to conduct due diligence on PRC factories—examine their financial health, production capacity, quality of goods, client references, export history, IPR performance, and level of experience with Western or US companies. It is important to compile as broad a list of potential factories as possible. According to BCG's report, Carrier Corp., an air-conditioner manufacturing subsidiary of United Technologies Corp., obtained 1,600 quotes before making its first order. Product samples are the first bar—shoddy quality or unreliable delivery should eliminate candidates.

After narrowing down the field to three to five suppliers that look good on paper and produce good-quality products at a satisfactory price, a detailed factory audit in China should follow. During the inspection, it is important to bring a good translator and to take the time to understand each candidate's production process and ensure that it meets international product and labor standards.

US companies will want to ask questions such as: Does the Chinese vendor run its own compliance checks on quality control and have sufficient oversight? Is the PRC supplier likely to outsource the order? Second-degree outsourcing makes it more difficult for companies to monitor supplier quality and ensure that there are no environmental, health, safety, or child labor violations in the manufacture of its goods.

The next step is for your company to make a detailed, second-level assessment that integrates buyer requirements into the evaluation; this process usually rates the candidate as a whole, including all business practices, with a specific grading scale for each set of criteria. Your company can then either choose one candidate or start a bidding process between the potential suppliers on your shortlist.

It's all about execution

Once your company finds a Chinese partner, how do you structure the relationship? Some companies make frequent buying and audit trips to China or use a full-service sourcing agent.

Though this is an easy way to test the waters, it fails to capture many of the long-term advantages of sourcing from China. Setting up a PRC representative office to manage sourcing operations may be a better choice (see p.28). The representative office is relatively simple to establish, although it cannot export goods on its own account. Another similar option is to set up a sourcing coordination center in Hong Kong, which allows control of shipping and more security over transactions (at the expense of higher operating costs and greater distance from the manufacturing plant). Companies with longer planning horizons, more management heft, and a commitment to the Chinese market may choose to set up a wholly foreign-owned enterprise (WFOE), a more popular means of entry than the joint venture (see p.6). Some companies acquire a PRC firm to jumpstart their WFOE formation.

No matter what route you take, maintaining high product quality will be challenging. For critical components with a low tolerance for error, having an employee on the ground to monitor the manufacturing process is indispensable. For other goods, regular onsite inspections, random product sampling, and periodic holistic evaluation of supplier operations generally suffice. One US company holds monthly online performance reviews with each vendor. These reviews are public to competing suppliers, creating a unique info-sharing and peer pressure environment. The company also conducts direct performance reviews two to four times per year, depending on the sensitivity of the product. Quality maintenance, delivery performance, inventory, and cost savings should all be reviewed, with the supplier submitting specific evidence to show that it is verifying process control and implementing agreed-upon standards (local and otherwise). If there are breaches, the PRC supplier must have a non-negotiable timeline for returning to the standards.

The rules for quality control hold equally true for social responsibility standards. In many cases, the PRC vendor is aware of the local environmental, health, and safety standards but is uncertain what action to take to meet these requirements. If forced by local content requirements to choose vendors less savvy about regulatory compliance, a company may need to invest resources to educate and upgrade the supplier. One of the benefits of this approach is the usually favorable relationship that develops between the vendor and the buyer.

Strong communications systems are critical to supply chain management. According to sourcing firms, the order-to-delivery lag can be as short as 12 days but can run up to 8 weeks. If demand changes unpredictably or there is no capacity for excess inventory, good communication between China suppliers and US clients becomes crucial. One US company uses an online supplier databank to allow Chinese suppliers to submit all documents, including invoices, online and also to enable buyers to track purchase orders.

Strong communications systems are critical to supply chain management. According to sourcing firms, the order-to-delivery lag can be as short as 12 days but can run up to 8 weeks.

Communication is also necessary between the head office and the office responsible for China management. For multinationals or companies with multiple business lines, good online technology also encourages local operations to coordinate buying efforts and thus maximize the cost savings that Chinese procurement brings.

Don't rest on your laurels (or your cost savings)

Finally, companies already in China cannot afford to be complacent. It is no secret that the PRC manufacturing environment is changing quickly, especially in terms of diversification. Companies should plan annual or biannual reviews of their product lines to see if sourcing or logistics operations need to be modified. Sourcing consultant ThreeSixty Sourcing Inc. estimates that even their clients with operations already in China often achieve cost savings of 25 percent. Other sourcing firms cite inability to keep track of regulatory and operational developments as a primary reason that companies retain them.

The standing lesson from the failed wave of foreign investment in China in the 1990s is that companies that refuse to adjust to changing local conditions put themselves at a disadvantage. As the Chinese say, "it is the flowing water that stays fresh" (*liushui bu fu*). This is true not only in the PRC consumer market, but also in the manufactures market. 完

When Joint Ventures Go Bad

After resolving a nearly eight-year dispute with its China partner, BorgWarner Inc. shares its cautionary tale

Stephanie Bransfield and Donald Schlueter

BorgWarner South Asia Inc. (BorgWarner) and the Shiyan Automotive Transmission Factory (SATF), a unit of the Shiyan city government, Hubei, signed an agreement on June 2, 2004 that ended their longstanding, bitter dispute over the joint venture (JV) Huazhong Warner Transmission Co., Ltd. (Huazhong). The agreement called for SATF to return BorgWarner's technology and to pay BorgWarner a cash settlement in US dollars, and provided for termination of the JV without any further liability to, or legal action by, either party.

Stephanie Bransfield is a corporate counsel at BorgWarner Inc. and had corporate responsibility for the resolution of the Huazhong Warner dispute.

Donald Schlueter has worked for 10 years with greenfield joint ventures in western China and is currently an independent consultant. He was general manager of the Huazhong Warner Transmission Co., Ltd. joint venture.

BorgWarner established its first Chinese joint venture in Beijing in 1992 and currently has successful JVs in Beijing and Ningbo, Zhejiang. It continues to actively pursue automotive business opportunities throughout China.

The agreement overturned the result of a trial and subsequent ruling of which BorgWarner had had no notice. The ruling had not only awarded all of Huazhong's assets to SATF, but also effectively stripped BorgWarner of its investment and technology.

The June agreement came only with the leadership of the Hubei Provincial People's Procuratorate and the US Commercial Service in Beijing and with the support and assistance of the Shiyan city and Hubei provincial people's governments. Credit also is due to the US Commercial Service and the US Department of Commerce, which, from the beginning, worked with the various PRC ministries and government departments to develop an environment for settlement, principles of transparency, and rule of law for the resolution of this matter.

BorgWarner's experiences are a must-read for foreign investors interested in the difficulties of resolving problems with Sino-foreign joint ventures that go awry.

Huazhong's rocky startup

The saga began when the JV was formed in 1995 between BorgWarner and SATF, which held 60 and 40 percent of equity, respectively, to manufacture five-speed manual transmissions for 1.5-ton light trucks to be produced by a Chinese truck manufacturer for the Chinese market. This was a greenfield JV, and each party committed to undertake certain responsibilities and follow a schedule for completing these activities. Otherwise, either party was entitled unilaterally to apply directly to the Hubei Commission on Foreign Trade and Economic Cooperation (COFTEC) for liquidation and termination. Hubei COFTEC approved the JV contract without any amendments.

BorgWarner supplied technology, a completed transmission design, and a completed prototype transmission within the time frames called for in the JV contract. SATF was to secure and improve a site for the manufacturing facility; secure a facility lessor to finance, build, and lease back the facility to the JV; and assist the JV in obtaining a supply agreement with the potential customer. But SATF fulfilled none of these commitments.

Huazhong's sole responsibility under the site lease was to make the specified site lease payments. All other costs to prepare the site, including the cost of connecting the utilities to the site, were to be SATF's responsibility. SATF was repeatedly informed of its duties under the site lease, but never made any attempt to comply, nor did it acknowledge any responsibility to fulfill them.

As mentioned above, SATF was to obtain a facility lessor to finance, build, and lease back the manufacturing facility to Huazhong. But SATF identified only one company, a unit under the Shiyan city government, as having any interest in being the facility lessor. The JV contract specified a cost plus 3 percent construction contract. The potential facility lessor presented a formula that, as best could be determined, was cost plus 400 percent. Huazhong rejected the proposal and the facility lessor countered with a proposal that was even more expensive. In short, SATF never made a realistic effort to secure a viable facility lessor.

After its formation, Huazhong held a series of meetings with its potential customer, a Chinese truck manufacturer. In each of the meetings, a price was discussed in general terms, and the customer made clear that it had thoroughly tested and evaluated the BorgWarner-based prototype and found it to be the best one tested. Despite this, the customer was not prepared to sign a supply agreement. The impasse arose because the prices that the potential customer sought were roughly 30 percent below those specified in the feasibility study for the JV that the customer had itself prepared; the customer would offer no explanation for the disparity. It rapidly became clear that, pricing aside, the parties would be unable to reach a supply agreement in the time specified in the JV contract; the customer wanted Huazhong to complete the facility and begin production before the customer would even consider signing a supply agreement. Huazhong later discovered, from the minutes of a separate meeting between SATF and the customer, that the customer would be unable to pay the feasibility study prices and would only be able to take roughly 30 percent of the feasibility study volumes.

Bringing in the board

By April 1996, BorgWarner's senior management in the United States was concerned with the status reports coming from Huazhong and requested a board of directors meeting. Donald Schlueter, Huazhong's general manager, reported that the JV had missed all of the SATF-supported deadlines to date. The SATF-appointed directors insisted that there was no problem and thus would not give any assurances that things would improve. BorgWarner suggested that the parties agree to a mutual termination of Huazhong as permitted in the JV contract. SATF rejected this suggestion. The parties agreed to meet again in June. BorgWarner informed SATF that BorgWarner was prepared to suspend its performance under the JV contract because of SATF's nonperformance, but gave SATF an opportunity to comply with its responsibilities.

By the next board of directors meeting, the situation had only gotten worse. Supply agreement talks had come to a standstill, the parties disagreed bitterly over who was to pay the fees for connecting electricity to the site (in spite of the clear language in the site lease placing this obligation on SATF), and SATF could not find a facility lessor that was interested in the terms and conditions specified in the JV contract. The differences between the parties were so great that the directors could not even agree to approve the minutes of the meeting.

BorgWarner suggested that the parties agree to a mutual termination of Huazhong as permitted in the JV contract. SATF rejected this suggestion.

From bad to worse

After the board meetings, Huazhong proposed termination of the site lease because of SATF's nonperformance. The majority of the board members (that is, those appointed by BorgWarner) approved the termination. In August 1996, BorgWarner terminated its technology transfer agreement with Huazhong because of the JV's nonpayment of fees.

The site lease specified that the China International Economic Trade Arbitration Commission (CIETAC) would provide the forum to settle disputes. In September, ignoring certain preliminary requirements in the site lease, SATF submitted a claim against Huazhong to CIETAC based upon the JV's termination of the site lease. The individual who submitted the claim on behalf of SATF was not only an SATF director but also the SATF-appointed chair of Huazhong. SATF then successfully influenced the Shiyan branch of China Construction Bank to prevent Huazhong from using its own funds to defend itself before CIETAC and also tried to prevent Schlueter from retaining legal counsel to defend the JV. BorgWarner was forced to front the funds for the JV's defense.

The JV then decided to audit its books and arranged for the JV's external auditor to travel to Shiyan. After the auditor had been at work for a short period, the SATF-appointed JV chair denied the auditor access to Huazhong's offices and would not allow him to complete his work. The auditor was nonetheless able to find one occasion on which the JV chair made

The differences between the parties were so great that the directors could not even agree to approve the minutes of the meeting.

an unauthorized and secret withdrawal of ¥710,000 ($85,749).

Based upon its earlier termination of its technology transfer agreement with Huazhong, BorgWarner terminated its name license agreement with the JV in October 1996 and its trademark license agreement with the JV in November. It again requested the return of its technology. SATF removed the technology covered by the terminated technology transfer agreement from the potential customer's site and refused to release the technology to Schlueter so that it could be returned to BorgWarner. At the same time, SATF withdrew all of its technical personnel from Huazhong to work on SATF's own competing transmission project for the JV's would-be customer. To comply with the termination of the name license agreement, Huazhong tried to register a new name that did not include the word "Warner," but found that it was unable to do so without SATF's concurrence.

At this point, Schlueter solicited assistance from the Shiyan mayor, Hubei provincial government, and Hubei COFTEC. The Shiyan mayor never responded to the numerous requests for assistance. Hubei COFTEC and the provincial government both indicated that they would investigate.

By November 1996, Huazhong submitted to CIETAC its statement of defense and its counterclaims against SATF regarding the site lease. Because Huazhong's counterclaims were so compelling, SATF immediately petitioned CIETAC to withdraw its claim against the JV and claimed that CIETAC did not have legal jurisdiction to hear the matter. CIETAC sought briefs from both parties on the issue.

Huazhong later learned, from minutes it uncovered of a meeting between SATF and the Shiyan city government, that the city was willing to finance legal actions to take the JV's assets. SATF assured the city that they would prevail.

By the end of 1996, the BorgWarner-led board of directors formally approved a resolution to close Huazhong's offices, return all employees to SATF, and secure all company records. The external auditor was scheduled to conduct the annual audit, make copies of all records for each party, and secure the originals with the JV. Once again, the JV chair prevented this from happening. BorgWarner applied to Hubei COFTEC to unilaterally terminate the JV, as was its right under the government-approved JV contract.

1997: Complete legal meltdown

In early January 1997, Schlueter was on annual leave, and CIETAC was still considering the site lease arbitration. On January 2, according to the court docket number, SATF sued Huazhong in local court based on the JV's alleged breach of the site lease. Huazhong's chair, who had previously submitted a claim on SATF's behalf against Huazhong with CIETAC, now appeared on Huazhong's behalf in local court on the same matter even though the JV contract did not permit him to do so. Another SATF-appointed Huazhong board member represented SATF against the JV. Unsurprisingly, SATF won the case. Besides the obvious conflicts of interest of the individuals appearing on both sides of the case, numerous Chinese procedural laws were broken during the trial. SATF both sued and represented the JV and sealed all of the trial records, keeping them from BorgWarner and Huazhong's general manager. The court decision was handed down on Saturday, January 18, a legal holiday for the court. To this day it is not clear if a trial actually took place.

Upon returning to China, and still unaware of the court proceedings the previous month, Schlueter met with representatives of Hubei COFTEC and a vice governor in mid-February. Hubei COFTEC told him that it would need about a month to complete formalities for the termination. The vice governor said he would investigate, do what the findings dictated, and get back to the JV with a report. This never happened.

On March 7, 1997, Schlueter and BorgWarner first learned of the court decision when Huazhong received a fax from its SATF-appoint-

Hoping to Avoid Joint Venture Problems?

Follow these practical tips:

1. Conduct comprehensive, independent due diligence on
   - the history and reputation not only of the prospective joint venture (JV) partner, but also of its principal officers and the individuals proposed as directors and officers of the JV
   - the history and reputation of the local government
   - all assumptions on which the feasibility study is based
2. Ensure sufficient control of the JV's board to be able to bring critical actions to pass
3. Establish a strong relationship with the local government as early as possible in the JV creation process
4. Realize that no matter how just your cause, no one within the various levels and departments of government will cause another person or department to lose face
5. Explore as many avenues as possible for resolving a dispute or bringing pressure to bear on officials
6. Be persistent and patient, and things will come your way eventually

—Stephanie Bransfield and Donald Schlueter

ed chair informing it of the suit in Shiyan Court. The chair went on to say that he had represented Huazhong against SATF and lost, and claimed that the parties would need to contribute additional funds to cover the shortfall between the court's award to SATF and the funds that had already been seized from Huazhong's accounts. By the day that Huazhong received the fax, the time had run out for an appeal.

A few days later, Huazhong received another fax, this one from Hubei COFTEC, rejecting the application for termination because it had not been approved by both parties' JV board members. Hubei COFTEC disallowed the unilateral termination provisions of the JV contract that it had originally approved. Although it arrived in March, the rejection notice was dated and stamped on Sunday, January 19, 1997—the day after the court decision. Huazhong then received notice that CIETAC agreed with SATF's position that, because both parties to the arbitration were Chinese legal persons, it did not have legal jurisdiction despite the arbitration provisions of the site lease.

Huazhong and BorgWarner, with the assistance of the US Commercial Service in Beijing and US Ambassador to China James R. Sasser, petitioned numerous PRC ministries and leaders, including the Supreme People's Court and the Hubei governor, with no visible results. With the assistance of Alan Turley and Bob Bannerman of the US Commercial Service, a number of meetings were arranged with the Ministry of Foreign Affairs and the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC). Huazhong was told that, because it had by this time petitioned the Supreme People's Court, the matter was now in the hands of the courts, and MOFTEC could do nothing until the courts took action. At the same time, BorgWarner contacted numerous nongovernmental organizations, including the US-China Business Council (publisher of the *CBR*), to discuss this matter and get their support to petition government officials. (And many consultants eagerly offered their services, but of course would not give assurances as to any results.)

In February 1998, BorgWarner petitioned the Supreme People's Procuratorate and forwarded the petition to the Hubei Provincial People's Procuratorate (HPPP). The HPPP heard Huazhong's testimony and decided to accept the case. The HPPP conducted a thorough investigation and in July 1999 issued its report, which upheld Huazhong's and BorgWarner's position and instructed the Hubei Provincial High Court to either overturn the erroneous court decision and return the funds to the JV or to conduct a retrial. Although by law the Hubei High Court was required to follow the HPPP recommendation, there were no time limits in the relevant statutes by which the court had to respond. The result was no action.

New Hubei and Shiyan leaders save the day

The HPPP, under the leadership of Xu Hanming, Ma Weimin, and Xiang Jinqiao, continued to press the Hubei High Court and the Shiyan city government to take action and correct this matter, with few, if any, visible results. With the continued efforts of Schlueter and the Beacon Law Firm of Beijing, the HPPP recommendation gradually gained support over the next several years from the Hubei government and Provincial Communist Party Secretary Yu Zhengsheng. At the same time, the US secretaries of Commerce continually raised the Huazhong Warner issue: William M. Daley at the US-China Joint Commission on Commerce and Trade meetings and later Donald L. Evans with PRC State Councilor Wu Yi. Assistant Secretary of Commerce William H. Lash raised the issue whenever he met with PRC counterparts.

Over the past year, Minister Counselor for Commerce Affairs Craig Allen and HPPP Vice President Xu Hanming's strong support and assistance were key to resolving this dispute. But the final boost needed to reach the settlement came from the new leadership in Shiyan—Mayor Zhao Bin and Party Secretary Chen Tianhui—who led Shiyan in a positive new direction.

This settlement does not fully uphold the rule of law or the JV contract, but considering the circumstances surrounding the dispute, the settlement is a major step toward ensuring that foreign investments will be protected under PRC law and that approved contracts will be upheld in Shiyan and in Hubei. BorgWarner and the US Commercial Service are satisfied with the settlement and are pleased that, after nearly eight years, the dispute is finally resolved. 完

The Representative Office Option

Though setting up a wholly foreign-owned enterprise is increasingly easy—and common—representative offices still offer advantages

Laura Dodge

As China allows foreign investors in more and more industries to set up wholly foreign-owned enterprises (WFOEs), which offer considerable control over operations, some are asking what will happen to the old standby, the representative office (RO). The answer is that the RO is not dead yet. In fact, the representative office offers distinct advantages for some types of firms. A look at these advantages—and disadvantages—along with current regulatory conditions and an outline of how to establish an office, can help your firm decide whether to go the RO route.

Why set up an RO?

Representative offices, which cannot conduct business or trade directly, serve as intermediaries between a company headquartered abroad and its Chinese customers. The RO best serves foreign firms that seek to manage goods or services in China, that need a conduit for sourcing, or that engage in sales and marketing activities. For example, if a small tool company in Kansas sources materials from Chongqing, it might set up an RO to handle the sourcing. ROs are also appropriate for businesses that conduct research, consulting, or quality control.

Recently, some US software firms have been establishing ROs in China to identify potential clients and partners. For these kinds of projects, which do not involve manufacturing or significant purchases, the RO can be an ideal vehicle. And for some types of businesses, such as legal services, the representative office is still the only way to enter China. In other industries, such as insurance, companies must operate an RO in China for two years before applying for a joint venture or a WFOE. Representative offices often serve smaller firms well, while WFOEs offer distinct advantages for firms with large-scale business operations or those expecting dramatic growth.

Since there is no capital registration requirement to set up a representative office, ROs are typically cheaper to establish than WFOEs. Start-up costs (including rent, sponsor fees, and accountants) should not exceed \$10,000, roughly one-tenth the average capital needed for a WFOE (depending on the industry) or a joint venture. The low cost makes an RO a good way for companies to get their feet wet in China.

But ROs have some distinct disadvantages in China. ROs cannot invoice clients directly. Rather, the home-country office must manage all payments. ROs also encounter restrictions on revenue-earning capacity. Depending on the scale of profits the home office earns in China, RO costs can often outweigh revenues. In most cases, China taxes ROs based on the actual revenues their home office earns in China. When an overseas parent invoices Chinese companies directly, its representative office may be liable for withholding tax of up to 20 percent. These disadvantages make it likely that WFOEs will eventually replace representative offices in most sectors where they are permitted.

New tax rules make RO life easier

The State Administration of Taxation (SAT) issued rules in 2003 that simplify the tax status of ROs. In the past, representative offices were responsible for paying both foreign enterprise business tax and income tax in China following government-determined methods. The rules provide new categories under which ROs can classify their China operations for tax purposes. According to the guidelines, companies—instead of government tax bureaus, as in the past—determine their own tax category. The rules offer

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relief from the previous double taxation problem by offering tax exemption for ROs that do not earn revenue in China.

SAT clarified the 2003 rules in May 2004 and again in June 2004. The most welcome clarification was a reinstatement of the tax-exempt status of ROs that are principal suppliers. In other words, ROs that trade in China on behalf of their foreign manufacturing headquarters can apply for tax-exempt status. Tax-exempt status is also possible for ROs of foreign governmental, international nonprofit, and nongovernmental organizations, provided they can prove the nature of their activities.

Other kinds of representative offices, including those engaged in commercial, consulting, or agency-based activities (such as travel and advertising) and trade, are subject to a business tax of 5 percent on gross income, and an enterprise income tax of 33 percent of net income, providing, of course, that there is income. (This tax is reduced to 15 percent in some special economic zones). ROs that do not fall under the nonprofit or nongovernmental categories above are taxed along the following guidelines:

- ROs in law, accounting, auditing, or consulting are taxed on the basis of actual revenues.
- ROs in trade or agency activities are taxed on a cost-plus basis, that is, taxed on income, which is calculated based on expenditures.
- ROs that provide preparatory and auxiliary services to companies within a wider group will be taxed on an actual basis when revenue is generated by the RO and collected at the company's headquarters (including banking and insurance companies that do not earn revenue in China).

How to set up an RO

Once a foreign company has decided to establish an RO, it can begin the potentially dizzying process of applying for approvals and registration. Fortunately, in an attempt to streamline the application process, the Ministry of Commerce (MOFCOM) has cut the amount of red tape involved.

In June 2004, MOFCOM's Department of Foreign Trade began to consider eliminating one of the most cumbersome steps in the application process: obtaining approval from a local MOFCOM office. Generally, companies setting up an RO in a Chinese city have to obtain approval from a local MOFCOM office before obtaining a registration certificate from the State Administration of Industry and Commerce (SAIC). But as of this writing, the RO approval process has been suspended in some cities, including Beijing. Until MOFCOM makes a decision and restarts the RO application process, the following information can be used as a general RO start-up guide.

RO Application Procedures in Limbo

Though the Ministry of Commerce (MOFCOM) may soon eliminate the need to apply to local MOFCOM departments for representative office (RO) approval, the ministry's approval process has been as follows:

Documents required for application

The PRC sponsoring organization must submit the following documents to MOFCOM on the applying companies behalf.

1 A historical background of the company, with preferably two years or more but no less than one year of business, that states the purpose of the China RO and its business scope;

2 A statement of intended location and operation term (ROs are approved for three years initially and can be extended). In order to provide these documents, a company must find a suitable office location and have its landlord provide proof that the office is available for commercial use. A signed lease agreement is also required.

3 Certificate of authorization from headquarters to the representative accredited to the office. Representatives can be foreigners, Hong Kong or Macao residents, or Chinese nationals. The latter must gain approval from the Foreign Enterprise Service Corp. or other agencies that serve as an employment intermediary between foreign employers and Chinese employees.

4 Though not officially required, tax consultants recommend showing more than $10,000 in paid-up capital in documents certifying—in English and Chinese—incorporation, the tax registration certificate, register of directors, memorandum of organization and/or incorporation, and articles of association.

5 A letter requesting permission to establish the RO and a board resolution supporting this, on company letterhead;

6 A letter appointing a chief representative to the RO, also on company letterhead;

7 An original bank reference, translated into Chinese and submitted in triplicate, in the company name.

After applying to MOFCOM (if the process doesn't change), a firm has 30 days to register with the State Administration of Industry and Commerce (SAIC) or its designated local bureau. Registration involves paying legal service fees, rent, and the sponsor fee. SAIC has 30 days to approve the registration, although typically it takes between one and two weeks. Upon obtaining a certificate of registration, the RO then proceeds to establish a foreign exchange bank account, which is only necessary after registration, and to handle relations with customs, tax authorities, and the Public Security Bureau. Companies may also wish to up their Internet sites.

—Laura Dodge

1 Obtain a sponsor

To set up a representative office, a foreign company must first find a Chinese sponsor to help it obtain approval and registration. Generally, this can be done through MOFCOM, which typically matches the company to a sponsor engaged in a similar type of business. Sponsors charge a one-time fee for their services, usually between $800 and $1,000. According to the Beijing MOFCOM office, the ministry expects this fee to fall in 2005.

To see its application process through, the company must establish a relationship with its sponsor. Sponsors submit the foreign company's documents to the local authorities and alert the company to relevant deadlines and procedures.

2 Find an office

For most companies, the need to sign a lease agreement before obtaining approval for a representative office may seem impractical. Why sign a lease before you know whether your RO will be approved? Yet the lease agreement is one of the requisite documents for RO applications. Fortunately, finding office space in China has become easier in recent years. Representative offices are required to find grade "A" office space, but they are no longer restricted to foreign-only office space or residential property. In fact, in some cities the over-supply of office space means that companies can locate space and negotiate reasonable rents within a few weeks.

Most RO or WFOE companies sign a lease for at least two years. If a company is planning a long-term investment, it may wish to consider a longer lease term and to negotiate a lower rent. In negotiations, many companies ask for certain lease perks, such as two or three rent-free months. Also, companies should consider electric power supply, Internet hook-up, plumbing, transportation, and other facilities when searching for the best location.

3 Apply

After obtaining a sponsor and a lease agreement, the foreign company then embarks on the task of obtaining the necessary approvals. The approval authority depends on the company's particular line of business, but falls under MOFCOM's scope. If, as mentioned above, MOFCOM revises or removes the approval step of the application process, an RO would simply register with the SAIC department in its relevant sector. Given the number of procedures required for application to MOFCOM, this would be welcome news (see p.29).

4 Hire staff

To hire local staff, the RO must go through a human resource intermediary, such as the local-government-run Foreign Enterprise Service Corp. or a few nonstate firms. It is important not to bypass this step; if authorities discover a firm is employing staff direct-

Commercial Enterprises Have an Alternative—the FICE

Companies engaged in wholesale or retail activity may now forego the representative office altogether and consider a new alternative: the foreign-invested commercial enterprise (FICE).

As of June 1, 2004, the Regulations on Management of Foreign Investment in the Commercial Sector allow majority foreign-owned firms to establish retailing, wholesaling, franchising, and distribution services in China. Retail firms will be limited to certain cities and provinces until December 11, 2004, when all geographic restrictions will be lifted. Wholly foreign-owned firms will also gain the right to set up FICEs in December.

Foreign firms were previously allowed to set up equity or cooperative joint venture commercial enterprises in provincial capitals, major cities, and special economic zones. These FICEs faced strict requirements, however, including a high minimum registered capital in China and $200 million in assets.

The new measures significantly lower barriers of entry. Whereas under the previous system, a wholesaler needed at least ¥50 million ($6.04 million) to register, the new registration requirements are ¥500,000 ($60,386) for wholesalers and ¥300,000 ($36,231) for retailers.

What's more, the new rules governing FICEs enable companies, including manufacturers, to expand their business scopes. The scope for wholesale firms includes commission agency and import and export, in addition to wholesale activities; retail firms can import merchandise on their own accounts, procure domestic goods for export, and operate retail stores.

Some kinks need to be ironed out before the process of establishing a FICE becomes as straight forward as that of a representative office. First, although the lower registration requirements mean that smaller FICEs can set up shop in China, in practice they may be unwelcome. One consultant suggested that local governments may be less enthusiastic about welcoming smaller retail and wholesale firms, since they will bring less revenue to town. Even large FICEs may be unappealing to local government hosts, given the low minimum registration requirements. Foreign manufacturers with existing companies in China may wish to think twice about setting up a FICE—manufacturing firms generally receive larger tax breaks than companies involved in the commercial sector.

Complicating matters further, the sheer volume of applications for the preferred wholly foreign-owned FICE, which will be possible beginning this December, is likely to cause a bureaucratic log jam at the Ministry of Commerce (MOFCOM). Currently, most FICE applications come from Hong Kong and Macao firms since, under the free-trade Closer Economic Partnership Arrangement between Hong Kong and mainland China, these firms can take advantage of the new rules early. Consumers can expect to see a lot more car, clothes, and cosmetic outlets in China next year.

Restrictions apply to other products, such as periodicals, fertilizers, and pharmaceuticals. Specifically, FICEs that deal in media content (such as books and periodicals), gas, and motor vehicles face restrictions specific to those industries. Trading and wholesaling in pharmaceuticals and pesticides is prohibited until December 11, 2004; trading in chemical fertilizers is forbidden until December 11, 2006.

Companies interested in establishing a FICE should apply to the MOFCOM office in the province where they want to locate their business. The provincial branch will submit the application to the central MOFCOM office within a month of receipt. MOFCOM then has three months to approve the business or delegate that authority to the provincial branch.

—Laura Dodge

ly, they have the authority to close down the office. Another thing to keep in mind: China's human resource agencies often require wages and benefits that, though higher than Chinese standards, are still generally well below international standards. Demands for severance pay and wages, negotiated with the agency, may well exceed the amount required by PRC law. Although they serve as middlemen, human resource agencies may cut down the time and effort it takes to find qualified staff.

You're good to go

Setting up a representative office in China is a lot easier than it used to be. Approval times are generally short, procedures are relatively clear, and there is a solid institutional infrastructure to guide foreign companies. In fact, the whole process of establishing an RO, if it encounters no hurdles, should take six weeks. One more important thing to remember, however, is that if a company fails to register its RO, authorities will likely levy a ¥10,000 ($1,208) fine. 完

Bringing the Profits Home

Basic steps ensure smooth transfer of profits from China operations

Adam Ross

The need to learn about profit repatriation is, by most measures, a sign of success for a foreign-invested enterprise (FIE) in China. Yet because of China's currency exchange restrictions and its cumbersome finance and tax bureaucracies, the profit repatriation process is elaborate and labor intensive. As with most aspects of doing business in China, experience and a commitment to good government relations helps immensely.

This article, based on discussions with FIE financial managers and foreign exchange (forex) banking personnel, provides an introduction to the profit repatriation system and its difficulties. Of course, much of the detailed work these procedures encompass is best performed by China-based accountants and lawyers—but basic awareness of the potential pitfalls is important for those managing a business in China.

Requirements

China's forex regime dictates that banks require certain documentation before converting renminbi (RMB) profits to foreign currency. This paperwork includes tax certification, board of directors' approval, registered capital verification, and official forex registration.

The most important item is the tax certificate. To receive it, companies must first undergo a certified accounting audit. Large FIEs in China often employ one of the big four international accounting firms (Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers) although smaller companies often use smaller international accounting companies. The annual audit is a mandatory procedure which, by law, must be completed by the end of April each year. Unlisted companies should note that because

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US-listed public companies schedule their audits in January and February to meet US listing requirements, unlisted companies may have trouble scheduling audits until March or April.

Companies must then file the audit and complementary documents with the local State Administration of Taxation (SAT) office, and after several weeks, will receive tax certification. SAT will conduct its own audit if it suspects accounting irregularities or illegal tax avoidance strategies, in which case tax certification may be significantly delayed.

Once all taxes are paid, a percentage of profits is designated for government-mandated company funds, including a reserve fund (to ensure against a venture's future losses), an enterprise expansion fund, and a staff bonus and welfare fund. (These contributions, which can run as low as 3 percent of gross profits, should be negotiated with local authorities during an FIE's initial setup.) FIEs must also meet relevant registered capital requirements before profits can be converted. In addition, a company must obtain its board of directors' approval for profit repatriation and submit that approval to the local tax bureau.

The bank serves mostly as a final checkpoint to ensure that documents are in order. All banks with forex services can do the job through a company's forex account; the process is simple and entails minimal transaction fees.

Strategies and pitfalls

Though repatriation procedures are clear and usually predictable, the sheer number of required documents can lead to delays. The year-end audit and capitalization checks mandate a full review of an enterprise's business, which involves multiple government departments, including SAT, the Ministry of Commerce (MOFCOM), the State Administration of Foreign Exchange (SAFE), and the General Administration of Customs. Disputes with any of these government bodies over items such as tax rebate eligibility, customs records, or fees paid to foreign consultants, can delay the audit and approval processes.

This is when good government relations reap rewards. Companies that meet regularly with local Customs and MOFCOM officials, maintaining an open line of communication and information exchange, are less likely to run into year-end documentation delays. Foreign companies consistently report that vague areas in commercial laws, as well as varying regional enforcement practices for tax and audit requirements, sometimes pose problems that can best be cleared up with reliable government contacts. In addition, government contacts can offer warnings of upcoming politically influenced "campaigns" that could disrupt business, such as the investigations into excessive investment in the steel and cement industries and the increased number of associated tax audits earlier this year.

As suggested above, companies must plan ahead when establishing their China tax obligations. Certain charges owed to the parent company, such as royalty charges for parent-owned intellectual property or intra-company consulting, can be properly charged against the China venture to reduce a firm's China tax obligations. Companies should seek out good tax planning advice from accounting firms or lawyers to utilize such transfers legally.

FIEs must carefully account for all intra-company transactions, including imports and exports of equipment and service fees. SAT auditors are increasingly homing in on FIEs with frequent intra-company dealings, in an effort to discourage exaggerated transfers purposely designed to avoid PRC business taxes. In June, SAT released Circular 70, which directs local tax bureaus to scrutinize companies with extended periods of losses, companies that expand despite low profits, and companies with fluctuating profit numbers. Companies should seek professional advice on transfers, tailoring their approaches to the known enforcement practices of local Customs and tax officials. Foreign firms note that accounting for expensive, non-physical product imports such as software is particularly difficult, requiring extra accounting attention.

Basic Profit Repatriation Checklist

Establish the enterprise

- Verify legitimacy of all local government tax incentives
- Specify percentage of profits for mandatory social development fund contributions

Stay alert

- Maintain regular consultation with tax lawyers or tax consultants to keep abreast of tax law changes and to adjust financial relationship with parent firm if needed
- Establish close working relationship with local customs, commerce, and tax officials

Repatriation

- Schedule your annual audit far in advance and make sure papers are in order
- Make certain all registered capital is complete and foreign exchange registration secured
- File audit papers and other documentation with local tax bureau, obtain tax certification, pay taxes, and contribute to mandatory funds
- Obtain board of directors' approval for dividend transfer and submit it to the local tax bureau
- Repatriate profits through the foreign exchange department of your China-based bank

—Adam Ross

Profits roll into the future

Industry insiders report that forex procedures today are looser than they were a few years ago. The change is due to the present surplus of foreign currency in the PRC financial system, as well as to the success companies have had in demanding speedy forex services from banks and PRC authorities. The Chinese government is also beginning to loosen capital outflows in some circumstances for domestic firms, which could pave the way for broader relaxation of controls.

The profit repatriation processes outlined here are unlikely to undergo significant change anytime soon. Though burdensome documentation requirements, vague rules, and related ambiguities add costs, delays, and risks to the profit equation, the system serves an important monitoring function for a Chinese government keen to preserve central-government control over foreign investment and foreign exchange. The most important change on the horizon is a new unified tax law, which China's government is expected to roll out by 2006. The new system will phase out tax breaks for foreign-invested companies, and introduce industry-specific tax advantages instead. Companies looking to invest now should clarify whether and how these upcoming structural changes will affect their ongoing investment arrangements. 完

Strategies for Investing in China

Continued from page 7

Some early investors that initially entered the Chinese market via a JV have reported considerable difficulty in negotiating such issues as technology transfer, human resource allocation, intellectual property rights, and expansion plans with their partners. These difficulties have been exacerbated by the fact that China's laws and regulations concerning corporate governance often convey disproportionate power to minority partners in a JV (see p.24). Most significant decisions in a JV require unanimous board approval.

Some foreign investors have been frustrated by the unwillingness or inability of JV partners to pursue expansion plans, a situation that has become more pronounced with tightening credit markets. This reluctance is of particular concern to multinationals, which are increasingly making efforts to integrate their China-based operations with the rest of their global supply chains.

- **The equity joint venture: Beijing's favorite**

The equity joint venture (*hezi qiye* or EJV) is the main form of JV in China and was once the country's most common investment vehicle. EJVs accounted for 27 percent of the new FDI approved in China during the first half of this year and nearly 90 percent of all JVs. PRC leaders traditionally preferred the EJV because they believed that it facilitated greater transfer of needed technologies and know-how.

An EJV is a separate legal person established by one or more foreign and Chinese investors. Ownership and the share of profits and losses incurred by the partners are determined by their respective contributions to the JV's registered capital. To take advantage of tax incentives offered to FIEs, the foreign parties' investment must exceed 25 percent.

The EJV may represent an attractive option to foreign investors interested in selling to the Chinese domestic market. Although China must open distribution-related services to WFOEs by the end of 2004 under its WTO entry agreement, access to a Chinese partner's existing channels may offer a quicker, more economical way to learn about the market and establish a presence than would building a new network. A Chinese JV partner may be able and eager to leverage its existing commercial and government relationships to assure the success of the venture, which can also enhance the attractiveness of the EJV over the WFOE for some companies.

- **The cooperative joint venture: Special purpose vehicle**

The cooperative (or contractual) joint venture (*hezuo qiye* or CJV) differs from the EJV in two fundamental ways. First, the CJV need not be a distinct legal person. If the CJV is not incorporated as a limited liability company in its own right, the parties to the JV retain their independent legal status. Second, and perhaps more important, ownership and profits are shared in a CJV not on the basis of each party's equity contributions to registered capital but rather on the basis of their contractual agreements. Thus, the establishment of a CJV can prove both time consuming and expensive, as virtually all aspects of the proposed investment structure and business operation must be hammered out in negotiations.

Nevertheless, the CJV offers a unique set of possible commercial advantages. As the regulatory constraints on direct foreign participation in many sectors of the Chinese economy have relaxed in recent years, use of the CJV structure has increasingly converged with international norms. The CJV has become the standard form in certain industries, such as construction, where several contractors join forces to bid on a project. In other industries, the CJV may be preferable to the EJV in situations where parties to the JV wish to contribute difficult-to-value assets, such as property, plant and equipment, or proprietary designs and other intellectual property. CJVs also allow for the variable distribution of profits, which is impossible in an EJV, where profits are apportioned according to equity stake. This can be particularly advantageous when the foreign investor must contribute substantial upfront capital or technology to develop the venture. A CJV can then be structured with an accelerated return schedule enabling the foreign party to recoup its investment more quickly than in an EJV.

New options for demanding investors

The WFOE, JV, and representative office served the needs of both China and its foreign investors for many years. But as the economy and FDI inflows grew, some larger investors found themselves straining against the confines of these investment vehicles. Many larger investors had established numerous business units in China. To respond to the needs of these investors as well as to meet its WTO commitments, the Chinese government is expanding the scope of permitted activities for its older investment vehicles and has introduced newer investment vehicles such as holding companies, the foreign-invested company limited by shares, and research and development centers.

- **Pulling it all together: The holding company**

The holding company (*konggu gongsi*) structure offers distinct advantages for foreign investors looking to coordinate and consolidate functions across multiple business units in China. Holding companies may take the form of a WFOE or EJV, but WFOEs dominate. At present, the holding company structure is only open to a limited cross-section of major foreign investors. Although the minimum paid-in registered capital requirement ($30 million) is not excessively restrictive, the additional requirement that the foreign investor have at least 10 FIEs in the country effectively shuts the door to this vehicle for most companies. Nevertheless, holding company approvals continue to rise as more and more investors meet these minimum requirements.

Initially, the chief attraction of the holding company structure was the ability to establish an entity within the holding group to engage in distribution and after-sales services rather than needing to rely on JV partners or third parties on an investment-by-investment basis. These rights extend to providing such services for the holding company's foreign parent as well.

Holding companies enable foreign investors to integrate other business functions—such as procurement, importation, sales and marketing, and training—to achieve economies of scale. Research and development are often centralized under a holding company as well. Holding companies can also provide support services, such as consulting and equipment leasing, directly to their invested companies.

But the promise of the holding company structure in other areas has yet to be fully realized. This is particularly true of intra-group finances. While holding companies can provide loan guarantees for their invested companies or even extend credit to companies within the group, they cannot distribute profits and losses across business units. Foreign exchange balancing, one of the potential attractions of the holding company structure, remains underutilized as transactions are subject to State Administration of Foreign Exchange (SAFE) approvals individually rather than collectively. Tax and personnel functions remain decentralized for similar reasons.

Though holding companies will still be attractive because they enable economies of scale, the present popularity of this structure—there were more than 300 in early 2003—may fade as trading and distribution rights are extended to all FIEs later this year (see p.14). The Chinese government, in that case, may either lower the bar for establishing a holding company or extend additional special rights, such as streamlined foreign exchange balancing and centralized tax and human resource functions, to maintain the holding company as a suitably attractive investment vehicle.

- **Companies limited by shares**

The foreign-invested company limited by shares or foreign-invested share company (FISC) resembles an EJV in many respects. Although considerably more expensive and complex to establish, the FISC offers a number of decided advantages to companies heavily invested in China. The FISC is China's first investment vehicle to allow for an indefinite lifespan. FISCs are eligible for preferential treatment, such as tax holidays, accorded to foreign-invested enterprises in certain sectors and regions provided that the foreign equity stake is at least 25 percent of the registered capital. At the same time, FISCs also maintain their status as domestic Chinese companies even when the foreign investors hold a controlling stake. A minimum of five promoters are required to form a FISC, one of which must be foreign and at least half of which must be PRC residents.

Though many early R&D centers originally appeared as black holes on the balance sheet, they have undergone a marked transformation.

More important, however, FISCs can integrate many management functions across business units—most notably human resources, marketing, and tax. In contrast to China's other investment vehicles, FISCs may distribute tax burdens equitably by jurisdiction.

Exercising managerial control and exiting the investment are theoretically easier in a FISC than in a JV. The veto power exercised by minority partners in a traditional JV is greatly reduced in a FISC as only a two-thirds majority is required. FISCs can also sell both A and B shares on China's domestic stock exchanges. The first FISC to list B shares was a Taiwan-invested appliance-maker, Can Kun, in 1993. The first to list A shares was a Taiwan-invested company called Zhejiang King Refrigeration in December 2003. Investors may exit by transferring shareholdings, even to offshore interests, without the approval of other shareholders, provided that the post-transfer ownership structure does not violate applicable Chinese law.

Research & development: Joining the global mainstream

China had more than 120 foreign-invested research and development (R&D) centers in February 2003, and these R&D centers have undergone considerable repositioning in terms of corporate strategies in recent years. Some early R&D centers were established more as deal-sweeteners to smooth bureaucratic approval of other investment projects—they were a way to demonstrate a company's commitment to the Chinese market. They also proved useful for some investors as vehicles to identify and recruit highly skilled potential employees from partner institutions. Others were established to focus on issues unique to the Chinese market, such as language and interface localization of software products.

Notably, though many early R&D centers originally appeared as black holes on the balance sheet, they have undergone a marked transformation. Foreign investors have quickly learned how to turn their R&D centers into value-generating operations. Most China-based R&D centers continue to focus on product development for the domestic or regional markets, but basic research appears to be on the rise. Not only does the Chinese government continue to offer investment incentives in this direction, but some companies have also realized cost savings approaching 90 percent by conducting research in China. These savings, combined with growing interest in and increased access to China's domestic market, are contributing to a closer integration of China-based R&D centers with many companies' global R&D and manufacturing operations.

Expanding via M&A often promises the ability to establish a mature footprint in the domestic market quickly.

Mergers & acquisitions

As China continues to relax its regulatory regime for FDI and as an increasing number of foreign investors begin to integrate China-based operations more closely into the rest of their global supply chains, a shift is taking place in expansion strategies. In many industries, expanding in China used to entail a proliferation of JVs. Nowadays, however, mergers and acquisitions (M&A) are increasingly attractive alternatives, as in other markets. This is not confined to buying out JV partners, as discussed earlier, but extends to the acquisition of entirely different Chinese firms. As elsewhere, expanding via M&A often promises the ability to establish a mature footprint in the domestic market quickly. At the very least, companies can gain ready access to an experienced work force and some potentially valuable assets through M&A.

Here again, the difficulties associated with M&A in China may foreshadow further revisions to the country's regulatory regime to address the needs and concerns of foreign investors. Valuation of assets, never an easy proposition, remains more difficult in China than elsewhere. Human resource concerns are arguably even more difficult, especially in terms of potential work force reductions and benefit liabilities.

Winds of change

Foreign direct investment in China continues to grow in both volume and complexity. Chinese authorities have demonstrated flexibility and pragmatism in adjusting the country's investment regime to meet the evolving needs of its foreign investors over the past 20-odd years. Although foreign investors increasingly find themselves straining against the limits of China's existing FDI structures, change will almost certainly continue to follow established patterns: Progressive regional governments and companies are designated as test cases for proposed liberalizations, and once a pilot program shows promising results, the government extends the newly modified investment rule or structure to the rest of the country and other companies.

Shanghai is the clear nexus for such activity now. The city has encouraged the establishment of new variants on China's traditional investment vehicles. Export procurement centers (EPCs) serve as a case in point. Before the implementation of China's amended Foreign Trade Law, which confers trading rights on all FIEs in keeping with the country's WTO entry commitments, Shanghai extended trading rights to EPCs, a new class of FIE.

Similarly, the Shanghai government has spent considerable effort to entice multinational corporations to move their Greater China or even Asia-Pacific regional headquarters to Shanghai. More than 60 regional headquarters have now located in the city. It is worth noting, however, that certain critical functions of these headquarters remain offshore. China's closed capital market and its restrictive and cumbersome regulatory regime continue to dissuade most foreign investors from centralizing regional financial operations in the country. Most of those financial operations remain in Hong Kong, Singapore, and Japan. This fact has not been lost on Shanghai's municipal authorities, who are exploring options to accommodate foreign investor needs in such critical areas. Yet their eagerness to accommodate foreign investors' needs is probably the most promising trend as foreign companies look at China as a long-term destination for their businesses; China's FDI regulatory regime will continue to converge with established international norms as foreign investors integrate their China operations with the rest of their global operations. 完

At Your Service

Continued from page 12

On the management side, Warner Brothers International Theaters, Inc. has been actively forging partnerships with Chinese media or real estate companies to build and operate theaters across the country. Although China only committed to allow foreign minority shares for cinema management, Warner Brothers's October 2003 deal—in which it took a 51 percent stake in a new joint venture with the Shanghai Cinema Group—effectively opened the door to foreign majority ownership in theater management in accordance with the WTO's Most Favored Nation principle. Warner Brothers has not stopped there, reaching out to the Wanda Group real estate company to build 30 multiplex cinemas in North China and the Guangzhou Jinyi Film and Television Investment Co. Ltd. to build at least 10 more in South China. With only a little more than 1,200 cinemas nationwide, compared with 30,000 in the United States, China seems to have ample room for growth in this sector.

Authorities have also lifted the ban on foreign investment in film and television content production companies (see the *CBR*, November–December 2003, p.42). The State Administration of Radio, Film, and Television (SARFT) issued a regulation in October 2003 that permits foreign investment in film production and film technology companies beginning December 1, 2003. Foreign investors may hold majority shares in film technology ventures in certain provinces and cities, and foreign partners may take stakes of up to 49 percent in film production companies. International media giant Viacom became the first foreign company to take advantage of this liberalization when it announced in March 2004 a joint venture with Shanghai Media Group (SMG) to produce Chinese-language children's programming for distribution on SMG's channels. In July, SARFT issued another rule that allowed Sino-foreign co-production of films.

Advertising

The regulatory environment surrounding advertising and foreign participation in the sector has long been restrictive and haphazard. For instance, one locality may place restrictions on how long an ad may be displayed while another may regulate the size of the ad. Minority foreign ownership was permitted upon WTO entry, with majority foreign ownership to be allowed by December 2003. But because there were no new approval procedures, older rules remained in place that effectively barred foreign majority stakes in advertising joint ventures despite the commitments. In March 2004, the State Administration of Industry and Commerce and Ministry of Commerce (MOFCOM) finally released provisions that permitted foreign majority ownership of up to 70 percent and established a legal framework under which new players can enter the market and existing advertisers can gain greater control over their China operations through branching or acquisition. Although WFOEs will be permitted on December 11, 2005, Star TV, the Hong Kong-based broadcast company, received approval from MOFCOM in July 2004 to establish a wholly foreign-owned advertising company. Star TV qualified to establish the WFOE early through the Hong Kong-PRC Closer Economic Partnership Arrangement.

China accelerated compliance with its WTO commitments in the tourism industry by two years when it issued regulations in June 2003 that permit wholly foreign-owned travel agencies to operate in China.

Telecom

China's WTO commitments have not provided the access that foreign telecom service providers had hoped for. Since China's WTO entry in 2001, AT&T has been the only service provider approved (for data communications, virtual private networks, remote access, and Internet) but the joint venture is restricted to operating in Pudong and most of the deal was hashed out over several years prior to China's accession. The Ministry of Information Industry (MII) has failed to approve new entrants or lift geographic restrictions and has defined its WTO commitments narrowly. China's 2004 commitments include raising the ceiling on foreign joint venture participation in mobile voice and data basic telecom services to 49 percent and opening fixed-line basic telecom services among Beijing, Guangzhou, and Shanghai to joint ventures in which foreign investors may hold up to a 25 percent stake. But MII's revised Catalogue on Telecommunications Services Classification, issued in March 2003, remains an obstacle to foreign investment because it does not define which items within the revised value-added telecom services (VATS) section are open to foreign investment. MII officials have maintained that the VATS operations listed in China's WTO commitments are exhaustive and that not all VATS operations are open to foreign investment.

Foreign companies are gaining access to China's service market, and their aggressive and creative business models sometimes push PRC regulatory authorities to a broader understanding of what China's WTO commitments mean in practice.

Additional regulatory hurdles, such as the absence of the much-anticipated telecom law, also inhibit market access. It appears that a final law will not be issued until 2005 at the earliest. This law is particularly important because it will likely outline a framework for network consolidation, interconnection, and universal service provisions, and establish a regulatory authority, which would lower some of the barriers foreign investors face in this sector.

Other openings

Several other services have opened in notable ways:

- **Auto finance**

In 2003, the China Banking Regulatory Commission (CBRC) issued rules governing auto-financing activities by nonbank financial institutions. Though consistent with China's WTO pledges, the implementing rules were not only two years late, but impose practical limitations, such as high capital requirements and caps on total lending. Nevertheless, foreign companies have made strides in accessing the market. In 2003, CBRC approved General Motors Corp., Volkswagen AG, and Toyota Motor Corp. to offer auto-financing services. Ford Motor Co. received initial approval this year.

- **Leasing**

China has yet to issue established, comprehensive, WTO-compliant approval processes for leasing. Yet despite this obstacle, Caterpillar China Financial Leasing Co. received approval in April to establish a wholly foreign-owned leasing company. It will be able to serve its customers after December 11, 2004, when China's WTO commitments take effect. In early 2004, MOFCOM's foreign investment department announced that it was amending the rules that govern foreign-invested leasing operations, with the goal of having new rules in place by the end of the year. At that time, MOFCOM had already received 10 applications from foreign firms to set up leasing businesses. MOFCOM said it would be unlikely to approve all applications, but it would probably select one or two to conduct trial operations of wholly foreign-owned leasing companies.

- **Convention services**

According to China's WTO commitments, joint ventures with foreign majority ownership in convention and exhibition services were permitted upon accession in 2001. China made no other commitments in this area, but in February 2004, MOFCOM issued rules allowing the establishment of WFOEs, thus exceeding China's WTO commitments. Foreign partners in existing JV companies may choose to buy out their partners, which often happens when complete foreign ownership is allowed in a particular sector.

- **Tourism**

China accelerated compliance with its WTO commitments in the tourism industry by two years when it issued regulations in June 2003 that permit wholly foreign-owned travel agencies to operate in China. The regulation covers only foreign-majority joint venture and wholly foreign-owned travel agencies established before December 11, 2007, when all geographic, registered capital, and branch restrictions are due to be lifted. JAL International Travel Service of Japan became the first WFOE travel agency shortly after the release of the regulations, while German-based Touristik Union International became the first foreign company to have a controlling stake (75 percent) in a Sino-foreign travel joint venture.

Tourism ventures are also riding the coattails of the central government's Great Western Development Strategy, launched in 1998 to attract investment to central and western China (see the *CBR*, March–April 2004, p.8). Though infrastructure development and manufacturing were the primary targets of the plan, service industries, especially tourism, are finding new areas for investment. For instance, the Sichuan branch of China International Travel Service established a joint venture with American Express Travel in mid-2004 to promote Sichuan and western China. Other companies are setting up small eco-tourism ventures.

- **Education**

Exploding demand for college-level services has already led to the establishment of joint venture courses or degree programs among a wide range of foreign universities and Chinese institutes of higher education. China's WTO commitments also permitted majority foreign ownership in primary and secondary noncompulsory education services in 2001. As a result, the Ministry of Education has had to revise many rules to offer various types of private, for-profit schools, a significant shift that seems to acknowledge demand for alternative education.

Construction

With much of China's outdated urban infrastructure straining to provide for ever-larger populations, foreign companies operating in the construction, urban planning, and utilities sectors have long considered China's market ripe for their services. Prior to China's WTO entry, numerous factors, including restrictive PRC regulations and differing local investment procedures, limited broad foreign investment in these sectors. Although new regulations ostensibly opened these sectors to foreign investment, companies still face many hurdles if they want to participate.

The former MOFTEC and the Ministry of Construction issued regulations in 2003 that fulfill China's WTO commitment to open the urban planning sector, but the rules include several provisions that have made actual foreign participation difficult. The Regulation on Management of Foreign-Invested Urban Planning Service Enterprises allows joint venture and wholly foreign-owned investment in urban planning, but prohibits foreign investment in comprehensive urban planning, thus limiting foreign investment to "micro-level urban planning." The regulation does not define "micro-level urban planning" or explain how it may differ from engineering or construction consulting services.

Foreign construction and engineering companies have also faced numerous difficulties simply maintaining the access they had before China joined the WTO, let alone trying to secure the greater access China's WTO commitments promise. Although regulations technically opened China's construction and engineering sector to WFOEs in November 2002, well ahead of the 2004 deadline, significant implementation problems emerged in 2003 that rendered the liberalization virtually meaningless. High capitalization requirements, the repeal of laws that qualify foreign engineering and construction companies, and other measures, such as the requirement that PRC certification be based on experience in the PRC only, rather than on the company's experience globally, have stalled sector liberalization. Previously, most foreign engineering and design companies operated quite well on a project-by-project approval basis. Their hopes for the construction and engineering sector after China's WTO entry centered on being able to expand as WFOEs. In the current situation, however, companies face more restrictions than ever.

One potential bright spot might be in the provision of urban utility services. In 2002, officials at the Ministry of Construction and the former State Development Planning Commission began to comment publicly on the need to open the urban utility sector to foreign investment to alleviate the shortfall of government funds available to maintain the system. The Ministry of Construction allowed several cities to experiment with pilot projects allowing foreign investment in public utilities; Beijing formally opened its utility sector in January 2003. In April 2004, the Ministry of Construction issued rules opening the sector nationwide to foreign-invested enterprises with majority Chinese ownership. The rules guide local governments on how to franchise local public utility supply services in water, natural gas, public transportation, and sewage and solid waste treatment to business entities. It remains to be seen how these new rules will affect foreign investment in the utility sector. Price controls on water or gas, inefficient distribution methods, and lack of comprehensive credit and payment systems still discourage full foreign participation.

Serving the people

Foreign companies are gaining access to China's service market, and their aggressive and creative business models sometimes push PRC regulatory authorities to a broader understanding of what China's WTO commitments mean in practice. At the same time, powerful government and industry forces actively protect—and in some cases prop up—certain sectors, regardless of the international agreements the government has made. But it is important to understand China's WTO service sector commitments in the context of China's overall economic development. For example, without a modern framework governing mergers and acquisitions, foreign companies would have a harder time breaking into the banking sector (see p.10). And WTO commitments cannot translate into market access if other non-WTO related barriers such as inefficient distribution systems and price controls exist. In short, a combination of factors has propelled or limited foreign companies' access to China's service market, and thus, a combination of investment policies, market developments, regulatory reforms, and yes, China's commitment to fulfill its promises, will drive liberalization in the future.

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A New Era for Distribution in China

Continued from page 16

Foreign-invested commercial enterprises engaged in commission agency, wholesale, and retail services can also provide related subordinated services. The measures do not define "subordinated services," but the services listed as subordinated services in the distribution sector in the WTO Protocol may be instructive. These services include 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; and sales promotion, marketing, advertising, installation, and after-sales services including maintenance, repair, and training services.

The Commercial Sector Investment Measures allow retail enterprises to import merchandise for their own sales and procure domestic products for export. Wholesalers may import and export merchandise.

Most significant, the Commercial Sector Investment Measures specifically state that the business scope of retailing enterprises includes the import of merchandise for the enterprise's own sales and procurement of domestic products for export, and that the business scope of wholesalers includes the import and export of merchandise. Thus, FIEs may import and resell goods specified in their business scope and procure such goods for export. Moreover, FIEs continue to have foreign trade authority and now are granted distribution rights for sales within China proper. Precise requirements to obtain approval to engage in these distribution activities have yet to be defined clearly, as the *CBR* goes to press.

Impact on foreign companies and investors

The amended Foreign Trade Law and the Commercial Sector Investment Measures will change China's business environment in several important ways.

- **Greater access to markets**

The amendments to the Foreign Trade Law make it possible for foreign companies to deal directly with their Chinese counterparts, leading to transactions that are more commercially driven and transparent. These attributes of an open market will make outcomes more predictable and thus encourage more such transactions. Presumably, import-export companies and companies in China's bonded zones that have sold into China via the bonded zone markets can also deal directly with Chinese customers. This will save on transaction costs.

Chinese subsidiaries of foreign companies will now have a far greater range of activities available to them. Under the Commercial Sector Investment Measures, foreign companies can establish trading companies without geographic restrictions. Previously, the only option available to foreign companies wishing to set up a trading company in China was to set up in a bonded zone. This is no longer necessary. With MOFCOM approval of the goods to be distributed, foreign companies can immediately set up joint ventures anywhere in China to engage solely in trading and will be able to set up wholly foreign-owned trading companies after December 11, 2004. Because such trading companies need not be located in bonded zones, companies will have greater access to customers and markets than ever before. Foreign investors setting up shop in China proper will eventually supplant the traditional role played by FIEs in bonded zones: to sell products in China quickly. Existing manufacturing FIEs will be able to offer a complete range of products—not only what they produce—to their customers by adding appropriate language to their business scopes.

- **Better infrastructure for doing business with China**

More flexible foreign exchange rules

To date, PRC domestic companies' access to foreign exchange has generally been limited to specially licensed companies with foreign trade authority, though China has been easing restrictions over the last year. Bonded-zone companies have had to rely on the specially licensed companies to exchange their renminbi revenues for foreign exchange to remit such funds out of China, as have Chinese buyers of imported goods and services. Both should now have greater access to foreign exchange, and Chinese companies should be able to deal directly with foreign suppliers. One question that remains to be answered is whether companies must file their foreign trade operator registration with the state foreign exchange authorities and the foreign trade operator's bank, a process that could create barriers for companies that want to engage in foreign trade activities.

Legislative improvements

Other legislative developments that are necessary for foreign companies to realize the full benefits of openings in the distribution sector have taken place. For example, China issued new rules for foreign investment in the provision of logistics services in 2003 and foreign investment in freight forwarding services in 2004. Amendments to the Foreign Trade Law also include provisions relating to antitrust and unfair competition, in that companies engaged in foreign trade activities will not be allowed to engage in such activities if antitrust and unfair competition rules and principles might be violated.

Enforcement

How, exactly, enforcement of the Foreign Trade Law will develop is unclear. This law grants to MOFCOM general and vague powers to prohibit monopolistic, anti-competitive activities. It also empowers MOFCOM to investigate the impact of trade in goods on domestic industries and trade-related matters concerning national security or state interests and other matters that influence the order of foreign trade. MOFCOM may also publicly announce investigations, hold hearings, and impose trade remedial or anti-dumping actions. But the law is silent on standards of behavior and procedural rules to be followed in enforcement actions. Further, the Foreign Trade Law grants MOFCOM powers in areas that are also monitored and regulated by other government departments. Indeed, MOFCOM may investigate and take action against activities that harm "the foreign trade order...in accordance with other relevant laws and regulations." This could give rise to disputes between MOFCOM and other government departments such as the State Administration of Industry and Commerce, and perhaps worse, subject FIEs to multiple investigations.

Foreign companies can now establish trading companies without geographic restrictions.

New competition

One of the consequences of WTO entry that China had always feared was competition. As access to China's market expands, local businesses and industry are forced to become more commercially competitive. What was perhaps less expected is the speed with which Chinese companies are emerging as formidable competition for foreign firms in nearly every sector.

Spotted on the horizon: The elusive level playing field

At the time of this writing, the legislative changes discussed here allow foreign businesses to enter into more rational, commercially driven transactions and offer a high degree of certainty that US companies will be able to engage in a far greater range of activities than ever before. In the coming months, foreign companies may see some indication of how these legislative changes will affect their business transactions in the PRC. The ultimate goal of China's WTO membership, at least from the US point of view, is to create a level playing field for foreign and Chinese firms. The Foreign Trade Law and Commercial Sector Investment Measures bring China one step closer to achieving this goal. 完

NEWS OF CHINA-RELATED EDUCATIONAL, CULTURAL, AND CHARITABLE PROJECTS

Opportunities introduces significant charitable, cultural, and educational projects that seek American business support and aims to assist companies in identifying programs meriting their assistance. The materials contained in *Opportunities* are boiled down; our goal is to provide contact information and only the most skeletal description of each organization's interests. I strongly encourage interested companies to make direct contact with the programs contained here, so that each firm can review for itself the more-detailed materials that individual organizations can provide.

The importance of American corporate participation in programs that bring benefit to the people of China and strengthen the bonds of US-China friendship beyond the commercial realm cannot be overstated. We congratulate the many American firms that support a wide range of important and positive efforts in China and hope that *Opportunities* will help companies to explore new ways of making a difference.

Robert A. Kapp
President, The US-China Business Council

(Note: The purpose of *Opportunities* is to facilitate direct contact between interested companies and project developers. The US-China Business Council is not a sponsor of any project listed in *Opportunities* and makes no recommendation with regard to corporate assistance to any specific project.)

US Institutions: **AFS Intercultural Programs, Inc. - AFS USA**
Chinese Institution: **China Education Association for International Exchange (CEAIE)**
Project Description: **Bilateral educational exchange programs for secondary school teachers and students between China, the United States, and a range of other countries. Most programs are for the academic year.**

With the endorsement of the PRC Ministry of Education, AFS has cooperated with CEAIE for more than 20 years in facilitating exchanges at the secondary school level for teachers and students from almost every province in China. Since 2001, high school students from other countries have been able to spend a year in China. All participants are hosted in families and attend local schools.

To further build capacity in China and to ensure that students from rural and remote areas are able to take part, AFS seeks corporate sponsorship. Companies may also offer AFS scholarships to the children of their employees as a direct employee benefit.

AFS (formerly American Field Service) is an international, nonprofit, educational organization, exchanging more than 10,000 students, young adults, and teachers among more than 50 countries each year. Since 1947, more than 300,000 individuals and an equal number of host families have had an AFS experience.

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US Institution: **Fauna and Flora International, Inc. (FFI)**
Chinese Institution: **State Environmental Protection Administration (SEPA)**
Project Description: **Capacity building for ecological impact assessment in China**

FFI, the world's oldest conservation organization dedicated to saving threatened species and ecosystems, has been asked by China's SEPA to help build capacity to incorporate considerations of biodiversity in the environmental impact assessment (EIA) process. The EIA process in China has recently been strengthened by a new national law. Since the Great Western Development Strategy was launched in 1999, the need for safeguards to protect China's rare and endangered species and fragile ecosystems has become acute, as new infrastructure projects and extractive industries have opened up once-remote regions and damaged nature reserves. In planning for sustainable development, China can benefit from international experience in biological surveys and ecological assessment. With support from Shell-China, FFI is leading the way by designing training for the Chinese teams that carry out field-level surveys and analysis for EIAs.

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US Institution: **Fauna and Flora International, Inc.**
Chinese Institution: **Upper Yangzi Organization and the Three Great Rivers Source Nature Reserve**
Project Description: **Environmental protection on the Tibetan Plateau**

Since 1999, FFI has been working together with local nongovernmental organizations (NGOs) in Qinghai Province to protect the wildlife of the Tibetan Plateau. The Upper Yangzi Organization was founded by Tibetan nomadic herders to promote environmental protection and conservation in their grassland home in Suojia, near the source of the Yangzi River. In 2003, this area was included in the new Three Great Rivers Source National Nature Reserve. The project is currently focusing on putting protection in place for the snow leopard and Tibetan antelope through two community-managed local protected areas. Other projects include plans for environmental education and research on environmentally sustainable means to improve the living standards of the nomads. FFI is also working to help other Tibetan NGOs build their capacity for this kind of work.

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US Institution: **HuskyTV and American Public Television (APT)**
Chinese Institution: **China National Tourist Office**
Project Description: **Wanderlust: Asia Revealed—A new series for US public television stations devoted exclusively to the Asia-Pacific region**

This 10-part television series seeks to illuminate a continent about which many Americans know little. "Wanderlust: Asia Revealed" is a fascinating journey through the following nine countries: China (2 episodes), Cambodia, India, Malaysia, Mongolia, Sri Lanka, Thailand, Vietnam, and Japan. The goal of the series is to increase viewers' understanding of the diverse history and culture of the region, as well as its growing importance to the world economy. The series will be produced by HuskyTV LLC, which has produced numerous television programs from a variety of locations in Asia. APT, a 501(c)(3) organization and a major distributor of programming to Public Broadcasting Service (PBS) stations, will oversee production of this series. APT anticipates strong demand for "Wanderlust" from PBS stations because it will be the first series airing in the United States devoted exclusively to Asia. The producers are seeking funding of the series through corporate sponsorships.

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US Institution: **International Consortium for the CURE of Childhood Cancer in China (CURE)**
Chinese Institution: **Soong Ching Ling Foundation (SCLF) of Shanghai and Beijing**
Project Description: **Develop in China a national health care program for diagnosis, research, and treatment of serious childhood diseases, especially cancer**

Cancer causes more deaths of Chinese children than any other illness. CURE has partnered with the SCLF of Shanghai and Beijing to provide the initial funding for a program to increase the cancer cure rates among Chinese children. CURE is a nonprofit organization that consists of world-class volunteer experts in childhood diseases, along with representatives of the

US government and businesses. The PRC Minister of Health supports the CURE vision and concept for developing nation-wide network of "Centers of Excellence" for this important first national childhood health care initiative. The SCLF is hosting major fundraising galas on November 10, 2004 in Beijing and on November 12 in Shanghai, and sponsorship from US and Chinese businesses is critical to their success. Annual corporate memberships in CURE are also available.

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US Institution: **Kham Aid Foundation**
Chinese Institution: **Ganzi Prefecture Women's Federation and Ganzi Prefecture Disabled Persons Federation**
Project Description: **Health care for impoverished communities in western Sichuan**

Kham Aid Foundation works with communities in Ganzi Tibetan Autonomous Prefecture, providing grassroots assistance in the areas of health, education, and economic development. We are especially seeking sponsors for our midwife training program, which provides health care to women in remote rural communities where there are no doctors and infant mortality is historically very high. We are also seeking a corporate partner for our wheelchair program, which provides free wheelchairs to 80–100 needy disabled people in Sichuan each year and helps their families better care for them. Both programs receive significant publicity in China and abroad; Kham Aid hopes to receive donations of between $10,000 and $20,000.

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US Institution: **PlaNet Finance Corp.**
Chinese Institution: **PlaNet Finance China (Pei Feng Zhong Guo)**
Project Description: **Matching information technology and microfinance to reduce poverty and promote entrepreneurship among low-income Chinese people**

Microloans, used to start small businesses such as selling chicken eggs or repairing bicycles, have allowed many poor people to work their way out of poverty; the power of information technology (computers, the Internet, and telecoms) can help small village banks manage loan portfolios, connect clients to timely market information, and network across vast distances. A combination of entrepreneurship and technology could help in China's quest to close the gap between rich and poor.

PlaNet Finance China is a nonprofit organization that works to reduce poverty by supporting the microfinance sector in China particularly through the effective use of information and communication technology (ICT). PlaNet Finance has provided skills training to "barefoot bankers" in rural and urban areas throughout China since 2002, including Guangxi, Jilin, and Shaanxi. Working together with local partners, such as the All-China Women's Federation and the China Foundation for Poverty Alleviation, PlaNet Finance China serves more than 30,000 low-income entrepreneurs all over the country. PlaNet Finance seeks corporate and individual partners to support the program with equipment, human resources, or financial support. All potential partners from outside or within China are encouraged to get involved.

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International Institutions: **United Nations Foundation; UN Department of Economic and Social Affairs**
Chinese Institutions: **State Economic and Trade Commission; Ministry of Construction; China Architecture Design & Research Institute; Center for Renewable Energy Development; China Renewable Energy Industry Association**
Project Description: **To expand the use of solar energy for water heating in China by integrating high-quality solar technology into attractive and cost-effective building designs**

China has a well-established commercial solar thermal industry with more than 1,000 factories that manufacture and sell solar hot water collecting systems. Most of these collectors are used to heat water and are sold without subsidies. But poor and inconsistent product quality and the fragmented nature of the solar industry in China prevent market penetration and long-term market growth. In addition, many communities dislike the appearance of current solar technology and resist large-scale dissemination efforts.

This project promotes solar thermal technology as an alternative to coal for heating water for residential use, by integrating high-quality solar technology into attractive and cost-effective building designs. The project focuses on strengthening capacity within the building industry to integrate solar water heating technology into new residences. It also conducts consumer outreach on the benefits of solar technology and explores opportunities for creating financial incentives for real estate developers and home buyers to use solar systems. Since this program began, it has constructed three times as many demonstration projects as originally planned and has influenced policy in ways that will contribute to solar water heating beyond the pilot projects.

UNF seeks sponsors who could make a tax-deductible contribution to support the development of solar water heating systems. Such assistance could lead to interesting opportunities to engage directly in the project, either through participation in the demonstration projects or through the development of joint ventures or other relationships with participating Chinese contractors.

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International Institutions: **United Nations Foundation (UNF), UN Department of Economic and Social Affairs; UN Development Program**
Chinese Institutions: **National Development and Reform Commission; economic and trade commissions in Shanghai and in Ji'nan and Yantai, Shandong**
Project Description: **To establish energy service companies that provide boiler and maintenance services to industrial plants and institutions**

Poor operational energy efficiency is a chronic problem with small and medium-scale coal-fired boilers in China; they alone account for a quarter of China's annual carbon dioxide emissions. This pollution contributes to climate change and the growing number of related health problems in China. Studies have identified three key contributing factors—poor operations, lack of maintenance, and variable fuel quality—that together combine to reduce the average operational efficiency of boilers by 10 to 20 percent.

In partnership with the Italian Ministry of Environment, UNF supports this project to promote market-based mechanisms to improve the energy efficiency of small coal-fired boilers in China to reduce pollution and protect the environment. The project will establish energy service companies to provide boiler and maintenance services to industrial plants and institutions in three pilot cities and to generate coal and cost savings for boiler owners as well as environmental benefits. Because of the relatively low economic cost of using coal and the PRC government's concern about national energy security, coal is likely to remain a main fuel source for space heating and industrial boilers for the next 20 years. The project activities are crucial to realizing significant energy savings, preventing efficiency deterioration of new boilers, and reducing China's carbon dioxide emissions.

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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 & Public Relations

INVESTMENTS IN CHINA

Aegis Group plc (UK)
Bought China-based World Wide Web Integrated Net Solutions to expand its digital marketing reach. $3.6 million. 07/04.

Ogilvy & Mather Asia Pacific, a unit of Ogilvy & Mather Worldwide, part of the WPP Group plc (UK)
Purchased 51% stake in Fuzhou-based Fujian Effort Advertising Co., which will be renamed Ogilvy Effort. 07/04.

Star Group Ltd., a subsidiary of the News Corp. Ltd. (Australia)
Will set up wholly foreign-owned advertising agency, Star Group (China) Corp. Ltd., in Shanghai. 07/04.

Architecture, Construction & Engineering

CHINA'S EXPORTS

Zhenhua Port and Machinery Co. (Shanghai)
Won contract to provide cranes for Singapore state-owned port operator, PSA Corp. Ltd. $70 million. 05/04.

CHINA'S IMPORTS

Yang Molen (US)
Won contract to design Shanghai Pudong International Airport's new terminal. 07/04.

Ove Arup & Partners (UK)
Won design contract from Xiamen's Road and Bridge Construction Investment Corp. for Xiamen East tunnel in Xiamen, Fujian. 06/04.

CHINA'S INVESTMENTS ABROAD

NORINCO (Hebei)
Set up joint venture with Teheran Urban & Suburban Co. to engineer, produce parts for, and build metro line in Teheran. (Iran 51%-PRC 49%). $836 million. 05/04.

Automotive

CHINA'S IMPORTS

ION Ltd. (Australia)
Secured five-year contract to provide automatic transmissions to Shenzhen Minghe Trading Co. 07/04.

DaimlerChrysler AG (Germany)
Won contract from PRC Ministry of Science and Technology to provide three hydrogen-powered Mercedes-Benz Citaro fuel-cell buses to the city of Beijing in 2005. 05/04.

INVESTMENTS IN CHINA

Volkswagen AG (Germany)/First Automotive Works (Jilin)
Formed joint venture, Volkswagen FAW Platform Co. Ltd., to build auto parts facility in Changchun, Jilin. (Germany:60%-PRC:40%). $170 million. 07/04.

Metaldyne Corp. (US)/Dongfeng Motor Co. Ltd. (Hubei)
Signed MOU to create a joint venture to produce and sell powder metal-based products. 06/04.

Renault SA (France)/Dongfeng Motor Co. Ltd. (Hubei)
Set up joint venture to produce Renault car models in China with an annual capacity of 300,000 automobiles. 06/04.

DaimlerChrysler AG (Germany), China Motor Corp. (Taiwan)/Fujian Motor Industry Corp.
Created joint venture to produce Mercedes-Benz Sprinter, Vito, and Viano van models in Fuzhou, Fujian. $235 million. 05/04.

OTHER

General Motors Corp. (US)
Will move Asia-Pacific regional headquarters from Singapore to Shanghai by January 2005. 06/04.

MG Rover (UK)/Shanghai Automotive Industry Corp.
Signed alliance to design and produce new line of Rover models for Chinese domestic use and export. 06/04.

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; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum & Gas Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: Digital Subscriber Line; ETDZ: economic and technological development zone; GSM: Global System for Mobile Communication; ICBC: Industrial and Commercial Bank of China; IT: information technology; LNG: liquified natural gas; MII: Ministry of Information Industry; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; SARFT: State Administration of Radio, Film, and Television; SEZ: special economic zone; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; WFOE: wholly foreign-owned enterprise

Aviation/Aerospace

CHINA'S IMPORTS

Airbus SAS (France)
Received order from China Eastern Airlines Corp. for 10 SAS A330 jetliners. $2 billion. 06/04.

Metrologic Instruments Inc. (US)
Signed agreement with CAAC's Second Research Institute to provide 4 baggage-tunnel scanning systems to airports servicing Chongqing and Chengdu, Sichuan. 06/04.

GE Aircraft Engines, a unit of General Electric Co. (US)
Won 10-year maintenance contract for Shenzhen Airlines's CFM56-3C1 engines. $40 million. 05/04.

INVESTMENTS IN CHINA

AVIC I
Won contract from Airbus SAS to make panels and landing gear for A380 jumbo jets. $100 million. 06/04.

AVIC I, AVIC II
Won contracts from Boeing Co. to produce 7E7 jetliner rudders and composite parts and assemblies. 06/04.

Aeromot Aeronaves e Motores SA (Brazil)/Guizhou Aircraft Industrial Co.
Formed joint venture to produce two lines of civil aviation training aircraft. (Brazil:25%-PRC:75%). 05/04.

Deutsche Lufthansa AG (Germany)/Shenzhen Airport Co. Ltd.
Set up air freight terminal joint venture in Shenzhen. (Germany:50%-PRC:50%). 05/04.

Viação Aérea Rio-Grandense, SA (Brazil)/Air China (Beijing)
Established joint venture to set up air travel routes between Beijing and Brazil. 05/04.

OTHER

Korean Air (South Korea)/China Southern Airlines Co. Ltd. (Guangdong)
Signed code share agreement for service between Incheon, South Korea, and Shenyang, Liaoning. 06/04.

Banking & Finance

INVESTMENTS IN CHINA

Morgan Stanley (US)/Gemdale Corp. (Shanghai), Shengrong Investment Co. Ltd. (Shanghai)
Formed asset management joint venture to dispose of $344 million of bad assets purchased from China Construction Bank. (US:55%-PRC:45%). 06/04.

American Growth Fund (Canada)/Jiangnan Securities Co. Ltd. (Shenzhen)
Set up fund management joint venture. (Canada:33%-PRC:67%). 05/04.

OTHER

Ernst & Young LLP (US)
Opened its sixth China office in Dalian, Liaoning. 07/04.

JCB International Co. (Japan)
Will license its brand to Bank of China, which will issue and manage JCB brand credit cards. 07/04.

Standard Chartered plc (UK), Citibank (US), Bank of Tokyo-Mitsubishi (Japan)/ Nanyang Commercial Bank, a unit of Bank of China
Received licenses from CBRC to provide financial derivatives transaction services for Chinese corporations and individuals. 06/04.

JP Morgan Fleming Asset Management, a unit of JP Morgan Chase & Co. (US)/Shanghai International Trust & Investment Co.
Received approval to operate asset management joint venture, the Shangtou JP Morgan Fleming Fund Management Co. (US:33%-PRC:67%). 05/04.

London Metal Exchange (UK)/Shanghai Futures Exchange
Signed MOU to cooperate in future product development, mutual sharing of information, and assistance with the understanding of market regulation and compliance issues. 05/04.

Chemicals, Petrochemicals & Related Equipment

CHINA'S IMPORTS

Lurgi AG (Germany)
Won contract to build methanol unit in Hainan for the CNOOC-Kingboard Chemical joint venture. $90 million. 05/04.

Saipem SpA, Tecnimont SpA (Italy), Sofregaz (France)
Won approval for contract to engineer and construct LNG reception facilities for Guangdong Dapeng LNG. $240 million. 05/04.

UOP LLC, a joint venture between Honeywell International Inc. and Union Carbide Corp. (US)
Won contract to provide PetroChina with technology for a hydrocracking unit at Dalian Petrochemical Co. 05/04.

INVESTMENTS IN CHINA

Nuplex Industries Ltd. (New Zealand)
Purchased Guangdong-based resins producer Foshan Veeya Chemical Co. 07/04.

Ningbo PTA Investment Co. Ltd., a joint venture of Mitsubishi Chemical Corp., ITOCHU Corp., and Mitsubishi Corp. (Japan)/CITIC Group
Formed joint venture, Ningbo Mitsubishi Chemical Corp., to produce 600,000 tons per year of purified terephthalic acid in Zhejiang. (Japan:90%-PRC:10%). $108 million. 06/04.

Bayer Material Science AG (Germany)
Signed agreement with Shanghai Chemical Industry Park Corp. to build hexamethylene diisocyanate plant. $100 million. 05/04.

Mun Siong Group (Singapore)/Daqing Oilfield Engineering (Heilongjiang)
Set up joint venture, Mun Siong Engineering Design & Construction. (Singapore:51%-PRC:49%). 05/04.

Consulting

INVESTMENTS IN CHINA

Capgemini (France)
Purchased China-based Bexcel Management Consultants to expand its presence in Beijing, Shanghai, Shenzhen, and Hong Kong. 06/04.

Education

CHINA'S IMPORTS

Cisco Systems, Inc. (US)
Signed MOU with China's Ministry of Education to provide its Cisco Networking Academy Program to 35 national Model Software Colleges. $37.7 million. 07/04.

Electronics, Hardware & Software

CHINA'S IMPORTS

Intel Corp. (US)
Signed deal to license CMOS process technology to Nanotech Corp. 06/04.

Magic Software Enterprises Ltd. (Israel)
Will supply Shanghai Pudong International Airport Cargo Terminal Co. Ltd. with its HERMES Air Cargo Handling application. $600,000. 06/04.

SBS Technologies Inc. (US)
Won contract to provide China Electronics Technology Group Corp. with processor boards for inclusion in electronics production equipment. 06/04.

INVESTMENTS IN CHINA

EPCOS AG (Germany)/Jiangsu Baotong Electronic & Technology Co. Ltd.
Set up joint venture, Baoke Electronic Co. Ltd., to produce surface acoustic wave filters for use in television sets. (Germany:51%-PRC:49%). 07/04.

SANYO Electric Co. (Japan), GP Batteries International Ltd. (Singapore)
Set up joint venture in Ningbo, Zhejiang, to produce lithium batteries. (Japan:51%-Singapore:49%). 07/04.

Schneider Electric SA (France), Fuji Electric Holdings (Japan)
Set up joint venture, Schneider Fuji Breakers Dalian, to produce low-voltage circuit breakers. (France:60%-Japan:40%). 07/04.

Payton Technology Corp., Sun Shenzhen LLC, Tu ShenZhen LLC (US)/Shenzhen Kaifa Technology Co.
Set up semiconductor production joint venture, Shenzhen Payton Technology Co. Ltd. (US:60%-PRC:40%). $280 million. 06/04.

Matsushita Electric Industrial Co. (Japan)/Zhejiang Wolong Hi-Tech Co.
Formed joint venture, Zhejiang Wolong Household Electric Appliance Motor Co., Ltd. to conduct R&D, production, and sales of household electric appliance motors. (Japan:40%-PRC:60%). $14 million. 06/04.

Warburg Pincus LLC (US)/Datang Telecom Technology Co. Ltd. (Hebei)
Signed investment agreement to develop Datang Microelectronics' production of integrated circuits. (US:30%-PRC:70%). $70 million. 06/04.

NEC Corp. (Japan), IFS AB (Sweden)
Will set up a test center in Shanghai to showcase IFS's enterprise applications for automotive producers. 05/04.

OTHER

China Electronics Corp. (Hebei)
Will cooperate with France-based Groupe Ingenico, a producer of secure electronic payment and transaction systems, to distribute and manufacture terminals in China. 06/04.

Hitachi Global Storage Technologies (Japan)
Signed MOU to build hard disk drive factory in Shenzhen. $500 million. 06/04.

Intel Corp. (US)/Shanda Interactive Entertainment Ltd. (Shanghai)
Will cooperate to develop online interactive entertainment for computers, televisions, and mobile phones. 06/04.

NEC Information Systems Ltd., a subsidiary of NEC Corp. (Japan)/Digital China Ltd. (Beijing)
Will cooperate to sell NEC computers and servers through Digital China's distribution network in mainland China. 06/04.

Beijing Jade Bird Commerce Technology Ltd.
Signed two-year distributor agreement for MapInfo Corp. software in China. 05/04.

Siemens AG (Germany)/Ningbo Bird Co. Ltd. (Zhejiang)
Signed MOU to jointly develop mobile phones to be sold under the Bird brand and to market and sell Siemens mobile handsets through Bird's sales outlets. 05/04.

Energy & Electric Power

CHINA'S IMPORTS

Hitachi Ltd., ITOCHU Corp. (Japan)/Dongfang Electric Corp. (Sichuan)
Won an order to supply and install two boilers, turbines, and power generators at the Zouxian Power Plant in Shandong. $91.7 million. 07/04.

ABB Ltd. (Switzerland)
Sold five transformers to Qianxi Substation in Hebei and Laoshan Substation in Qingdao, Shandong. $4.8 million. 06/04.

General Electric Co. (US)
Signed contract to sell two 500-kV compensation systems to China's Southern Power Grid. 06/04.

United Solar Ovonic Corp. (US)
Signed contract to supply the Beijing New Capital Museum Project with a 300-kW solar photovoltaic system. 06/04.

INVESTMENTS IN CHINA

Ferroli Group (Italy)
Purchased Chinese electrical boiler maker, Bealich. 06/04.

Global Power Equipment Group Inc. (US)
Purchased 90% stake in Jiangsu-based Nanjing Boiler Works. 06/04.

Companhia Vale do Rio Doce (Brazil)/Shanghai Baosteel Group Corp., Yongcheng Coal & Electricity Group Co. Ltd. (Henan)
Set up coal processing joint venture, Henan Longyu Energy Co. Ltd. (Brazil:25%-PRC:75%). $241 million. 05/04.

Siemens AG (Germany)/XJ Electric Co. Ltd. (Beijing)
Set up joint venture, Siemens Power Transmission Solutions Co. Ltd., to design, produce, and sell high-voltage direct current power transmission equipment. (Germany:50%-PRC:50%). 05/04.

Environmental Equipment & Technology

INVESTMENTS IN CHINA

Eco Water Ltd. (Singapore)/China Yunnan Lanping TL Hydraulic Power Co.
Set up wastewater treatment joint venture, Yunnan Tian Long Eco Water Hydro Investment Co. (Singapore:50%-PRC:50%). 06/04.

Salcon Bhd (Malaysia)/Jin Ying Group, Linyi Municipality Water Supply Co. (Shandong)
Created 30 year build-operate-transfer joint venture to supply Linyi City with drinking water. (Malaysia:40%-PRC:60%). $71 million. 06/04.

Keppel Corp. Ltd. (Singapore)/China Cheng Tong Resources Recycling Development Corp. (Beijing)
Set up Beijing-based joint venture, Dayu Shidai Technologies, to pursue water treatment contracts. (Singapore:49%-PRC:51%). 05/04.

Veolia Water (France)
Won contracts to construct and operate a water treatment plant in Bei Yuan for the Olympic Village as well as the refurbishment and operation of two drinking water production plants in Zunyi, Guizhou. $251.4 million. 05/04.

Food & Food Processing

INVESTMENTS IN CHINA

Del Monte Pacific Ltd. (Singapore)
Purchased 89% stake in Tianjin-based Great Lakes Fresh Foods & Juice Co. Ltd., a subsidiary of US-based Great Lakes Co. $6.3 million. 07/04.

Tesco PLC (UK)
Purchased 50% stake of Shanghai-based Hymall hypermarket business from Ting Cao, a unit of Taiwan-based Ting Hsin International Group. (UK:50%-Taiwan:50%). $254.4 million. 07/04.

Anheuser-Busch Companies Inc. (US)
Increased ownership of Harbin Brewery Group Ltd. to 99.6%. $720 million. 06/04.

Corn Products International Inc. (US)/Golden Corn Development Co. (Shandong), Shandong Juneng Electric Power Group
Set up joint venture, Golden Far East Modified Starch Co., to produce corn starches. 06/04.

Interbrew SA (Belgium)
Acquired 70% stake in Zhejiang Shiliang Brewery Co. Ltd. $53.2 million. 06/04.

McCain Foods Ltd. (Canada)
Will construct a French fry processing plant in Harbin, Heilongjiang. $32.9 million. 06/04.

PepsiCo Inc. (US)/Unilever China Ltd. (Hong Kong)
Created joint venture to produce Lipton's Iced Tea for the Chinese market. (US:50%-HK:50%). 05/04.

SABMiller plc(UK)
Acquired 90% stake in two brewing plants from Anhui Longjin Group. $33.8 million. 05/04.

OTHER

Shanghai Deep Sea Fisheries
Signed contract to fish Cook Islands' territorial waters and process fish at a plant owned by Cook Islands Fish Exports. 06/04.

Forestry, Timber & Paper

CHINA'S IMPORTS

Metso Corp. (Finland)
Received order from Shandong Huatai Paper Co. Ltd. for a bleached chemi-thermomechanical pulp line, a bale pulping line, and a rolling finishing line. 06/04.

INVESTMENTS IN CHINA

Asia Pacific Resources International Holdings Ltd. (Singapore)
Purchased 90% stake in state-owned Shandong Rizhao SSYMB Pulp and Paper. 05/04.

Human Resources & Labor

INVESTMENTS IN CHINA

Adecco SA (Switzerland)
Signed contract with state-owned Shanghai Foreign Services Co. Ltd. to develop temporary staffing assignments in Shanghai. 07/04.

Internet/E-Commerce

CHINA'S IMPORTS

SINA Corp. (Shanghai)
Entered agreement to purchase Davidhill Capital Inc. and its instant messaging technology. $15 million. 07/04.

Verity Inc. (US)
Received order to provide K2 Enterprise search and classification software to China's Ministry of Agriculture for use on its International Trade Promotion Council's website. 07/04.

INVESTMENTS IN CHINA

Google Inc. (US)
Purchased minority stake in Chinese Internet search engine Baidu.com Inc. $10 million. 06/04.

OTHER

Cyber Village Holdings Ltd. (Singapore)
Signed MOU to develop Internet television for China Netcom Corp. Ltd. 05/04.

Media, Publishing & Entertainment

INVESTMENTS IN CHINA

Wolters Kluwer NV (the Netherlands)
Will help BMJ Publishing Group provide clinical information to 20 Chinese research institutions. 06/04.

Panpac Media Group Ltd. (Singapore)
Purchased publishing firm Observer Star Group Holdings. $4.4 million. 05/04.

Medical Equipment & Devices

CHINA'S IMPORTS

Thermogenesis Corp. (US)
Received order for two stem-cell processing and preservation systems from Zhejiang Provincial Blood Center in Hangzhou, Zhejiang. 06/04.

INVESTMENTS IN CHINA

Philips Medical Systems, a subsidiary of Royal Philips Electronics NV (the Netherlands)/Neusoft Group Ltd. (Liaoning)
Formed joint venture, Philips and Neusoft Medical Systems Co. Ltd., in Shenyang, Liaoning, to conduct research and development and to manufacture and sell mid-range to economy-class medical equipment to developing countries. (the Netherlands:51%-PRC:49%). $29.6 million. 06/04.

Metals, Minerals & Mining

CHINA'S IMPORTS

Andritz AG (Austria)
Received order for annealing and pickling line with capacity of 500,000 tons per year for cold-rolled strip from Taiyuan Iron and Steel Co. Ltd. in Shanxi. 07/04.

BHP Billiton Ltd. (Australia)
Won seven-year contract to supply Handan Iron and Steel Group of Hebei with 2 million tons of ore per year. 07/04.

Jindal Stainless Ltd. (India)
Won contract to supply 50,000 tons of steel to China Minmetals Group. $60 million. 05/04.

CHINA'S INVESTMENTS ABROAD

International Ferro Metals Co. (South Africa)/Jiuquan Iron and Steel Group Co. Ltd. (Gansu)
Set up joint venture to develop a 240,000 tons-per-year ferrochrome project in South Africa. $157 million. 07/04.

INVESTMENTS IN CHINA

Companhia Vale do Rio Doce (Brazil), Itochu Corp. (Japan)/Yankuang Group Co. (Shandong)
Set up joint venture, Shandong Yankuang International Coking Co., to transfer coke-making facilities from Germany to Shandong. (Brazil:25%-Japan:5%- PRC:70%). $102 million. 07/04.

LNM Group (the Netherlands)
Will build steel production plant in Yinkou, Liaoning. 07/04.

NGM Resources Ltd. (Australia), Placer Dome Inc. (Canada)/China Gold Guangxi Co.
Created joint venture to explore gold deposits in Guangxi. 06/04.

Luna Gold Corp. (Canada)/Yunnan Nonferrous Mining and Geology Ltd.
Set up joint venture, Xinlong Mineral Resources Co. Ltd., to explore and mine the Gongguo area of Yunnan. (Canada:80%-PRC:20%). 05/04.

Minco Mining & Metals Corp. (Canada)/Guangdong Geological Exploration and Development Corp.
Created joint venture for the exploration and development of the Fuwan silver property in Guangdong. (Canada:70%-PRC:30%). $3.6 million. 05/04.

Miscellaneous

INVESTMENTS IN CHINA

Schieder Moebel Holding GmbH (Germany)/Chinese Red Star Furniture Group Co. Ltd.
Set up joint venture to construct upholstered furniture factory near Shanghai. (Germany:60%-PRC:40%). $8 million. 07/04.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

L'Air Liquide SA (France)
Won 15-year oxygen, nitrogen, and argon gas supply contract with Zhangjiagang Pohang Stainless Steel Co., a joint venture between South Korea's Pohang Iron and Steel Co. and China's Shagang Group. 06/04.

Larsen & Toubro Ltd. (India)
Won coal gasification equipment supply contract for the Zhong Yuan Project in Henan. $20.5 million. 06/04.

CHINA'S INVESTMENTS ABROAD

Middle East Petrol Farm FZE (United Arab Emirates), State Oil Company of the Azerbaijan Republic/SINOPEC
Signed 25-year contract for the development of Azerbaijani Garachukhur oil field. (Azerbaijan:25%-United Arab Emirates:37.5%-PRC:37.5%). $220 million. 06/04.

INVESTMENTS IN CHINA

Fortune Oil PLC (UK)/Beijing Fortune Huiyuan Gas Co. Ltd., Fortune Gas Development (Hebei), Qufu Gas Co. (Shandong)
Created joint venture to reticulate natural gas in Shandong and Hebei. (UK:25%-PRC:75%). 06/04.

UMW Ace Ltd. (Malaysia)/Baoji Petroleum Steel Pipe Co. (Shanxi)
Set up joint venture, Shanghai BSW Petropipe Co., to build oil and gas piping in Shanghai. (Malaysia:49%-PRC:51%). 05/04.

OTHER

CNPC/KazMunaiGaz (Kazakhstan)
Signed agreement to complete 1,240 mile-long oil pipeline from Atasu, Kazakhstan, to the border of Xinjiang. 05/04.

PETROBRAS (Brazil)/SINOPEC
Signed agreement for international oil exploration and refining. 05/04.

Pharmaceuticals

INVESTMENTS IN CHINA

The Goldman Sachs Group Inc. (US)
Invested $40 million in Shenzhen Neptunus Pharmaceutical Co. Ltd. 07/04.

Ports & Shipping

INVESTMENTS IN CHINA

Odfjell ASA (Norway)/Garson Group (Jiangsu)
Created joint venture to develop a shipping-tanker terminal in Jiangyin, Jiangsu. (Norway:55%-PRC:45%). 06/04.

Rail

CHINA'S EXPORTS

Zhuzhou Times New Materials Technology Co. (Hunan)
Signed five-year contract to supply Bombardier Transportation with metal-rubber complex products. 06/04.

Telecommunications

CHINA'S EXPORTS

Huawei Technologies Co. Ltd. (Guangdong)
Won contract to supply network equipment and routers to Brazil's Embratel. $5.4 million. 07/04.

Huawei Technologies Co. Ltd. (Guangdong)
Won contract to help build GPRS network for Thuraya Satellite Telecom in the United Arab Emirates. 07/04.

Huawei Technologies Co. (Shenzhen)
Won contract from Russia's OAO Mobile TeleSystems to provide equipment for its GSM cellular system in Siberia and the Russian Far East. $27 million. 07/04.

Zhongxing Telecom Equipment Ltd. (Guangdong)
Signed deal to provide the Tunisian Ministry of Transportation with equipment for third-generation networks. 06/04.

CHINA'S IMPORTS

LM Ericsson AB (Sweden)
Won contract from Hubei Mobile Communications Co. Ltd. to provide equipment and services for the expansion of a GSM network in Hubei. $27 million. 07/04.

Siemens AG (Germany)
Won order to develop mobile telecom network infrastructure for China Mobile in Anhui. $41 million. 07/04.

Alcatel Shanghai Bell
Won contract to provide Jiangsu Telecom with a service router to develop an IP network in Jiangsu. 06/04.

CIENA Corp. (US)
Won contract to provide Zhejiang Unicom with a storage area network for its data center. 06/04.

Green Packet Inc. (US)
Won contract from China Telecom for software that integrates wireless wide data networks with wireless local networks. $20 million. 06/04.

Superscape Group PLC (UK)
Won contract to provide mobile phone games to KongZhong Corp., a Beijing-based company that supplies games to China Mobile. 06/04.

Beijing Watchdata System Co. Ltd.
Won bid to become the primary supplier of SIM cards for Thai company DTAC. 05/04.

LM Ericsson AB (Sweden)
Won contract from Jiangsu Mobile to provide equipment and services for network expansion. $58 million. 05/04.

Lucent Technologies (US)
Won contract to supply optical networking equipment to develop Jiangsu Telecom's optical transmission network. 05/04.

Lucent Technologies (US)
Won contracts to provide equipment, software, and services to China Unicom for expanding CDMA networks in Hubei, Inner Mongolia, Shaanxi, and Shandong. $120 million. 05/04.

INVESTMENTS IN CHINA

France Telecom SA/China Telecom
Signed agreement to open a joint research and development center in China. 06/04.

Sony Ericsson Mobile Communications AB (UK)
Increased investment to 51% stake in Beijing Ericsson Putian Mobile Communications, a phone manufacturing joint venture. $15 million. 06/04.

OTHER

Cirmaker Technology Corp. (Taiwan)
Received three licenses from MII to produce set-top boxes for satellite and cable television to convert analog to digital signals. 07/04.

NetScout Systems Inc. (US)/Shanghai Posts & Telecommunications Equipment Co. Ltd.
Entered partnership to resell NetScout's nGenius IT products in China. 06/04.

Textiles & Apparel

INVESTMENTS IN CHINA

E.I. du Pont de Nemours & Co. (US)/Wuxi Xingda Nylon Co. Ltd. (Jiangsu)
Set up joint venture to produce and distribute nylon filaments for brushes. (US:70%-PRC:30%). 06/04.

INVISTA (US)
Will build spandex plant in Foshan, Guangdong. $100 million. 06/04.

Kuraray Co. Ltd. (Japan)/Zhejiang Hexin Industry Co.
Set up joint venture, Hexin Kuraray Micro Fiber Leather, to manufacture synthetic leather. (Japan:33.3%-PRC:66.7%) $14.3 million. 05/04.

Tourism & Hotels

INVESTMENTS IN CHINA

American Express Travel, a unit of American Express Co. (US)/China International Travel Service Ltd. (Beijing)
Created joint venture, the Sichuan CITS Express Service Center, to develop tourism in western China. 06/04.

China Southern Airlines Co. Ltd. (Guangdong)
Formed partnership with Best Western International to develop a frequent flyer program between China Southern's Sky Pearl Club and Best Western's Gold Crown Club International. 06/04.

Starwood Hotels & Resorts Worldwide, Inc. (US)
Signed agreement with Xiamen Fuchun Orient Hotel Co. Ltd. to manage the Sheraton Xiamen Hotel. 06/04.

NEWS OF CHINA-RELATED EDUCATIONAL, CULTURAL, AND CHARITABLE PROJECTS

Continued from page 45

UNF seeks sponsors who could make a tax-deductible contribution to support the establishment of energy service companies which provide boiler and maintenance services to industrial plants and institutions. Such assistance supports the improvement of energy-efficient, small, coal-fired boilers, which generates savings for boiler owners and helps to reduce China's carbon dioxide emissions.

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Other Notices

The US-China Legal Cooperation Fund Invites Grant Proposals

The US-China Legal Cooperation Fund, established in June 1998, is a program of the China Business Forum, charitable education and research arm of the US-China Business Council. The Fund offers grants to Chinese and American cooperating partners for worthy projects in a wide range of areas of Chinese legal development.

The Fund welcomes proposals for financial support. To date, the Fund has supported more than 50 projects, through 11 semiannual grant rounds.

All information about the Fund, including eligibility and application guidelines, may be found at the Fund's website, www.uschinalegalcoop.org. The application process is simple, but applicants must follow the instructions on the website exactly if their applications are to be given full consideration.

The next deadline for applications is October 1, 2004.

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COMMENTARY

Common Culture, Different Styles

Photograph: Catherine Gelb

Min Chen

China is an ethnically and culturally diverse country. Its dominant cultural tradition has been heavily influenced by Confucianism and Taoism, but within that tradition are many different subcultures. The spoken language also varies greatly from region to region. Without special study of Cantonese, for example, someone from Beijing cannot understand residents of Guangdong or neighboring Hong Kong. Other regional languages and subcultures are also quite distinct. A Shanghainese, for instance, will likely encounter difficulties doing business with someone from the Northeast, if he or she has not prepared for different business practices in that part of China.

Min Chen, a professor of International Business at Thunderbird, Garvin School of International Management in Glendale, Arizona, is currently working as a senior vice president of business development for a US multinational corporation in China.

Similar cultural tradition, varied business practices

Most Chinese people attach great importance to cultivating, maintaining, and developing connections (*guanxi*) and are highly sensitive to face (*mianzi*) and *renqing*. (*Renqing* can be translated literally as "human feeling" but more often means a favor that involves obligation to reciprocate, usually with a sentimental element.) These social values, which are the keys for understanding Chinese social behavioral patterns and their business dynamics, are shared by Chinese living not only in the PRC but also by those living in Taiwan, Hong Kong, and in overseas Chinese societies all over the world (see the *CBR*, May–June 2004, p.48). Nevertheless, China's regional subcultures give these common values different weights in their daily interactions—including their business dealings.

Throughout history, Chinese businesspeople from different regions have exhibited distinct

Beijing is China's political capital, and many Chinese say that Beijingers are pure "political animals."

characteristics. More recently, these distinctions have reemerged or evolved into features that have differentiated one region's businesspeople from another's and even contributed to the formation of unique competitive advantages.

This article is intended to describe, in general terms, the different styles of businesspeople from a few key areas of China. Of course, generalizations of this kind risk oversimplifying the situation and tend to highlight the more extreme stereotypes of a given group. Also, China's big cities, like commercial and political capitals around the world, attract people from all over the country, so the people one meets in Shanghai, for example, may not, in fact, be from the area. Nevertheless, in the same way that native Californians are considered easy-going and New Yorkers known as loud, aggressive, and business-savvy, natives of Chinese regions share characteristics—of which many foreigners may be unaware—that affect how they do business.

Beijingers

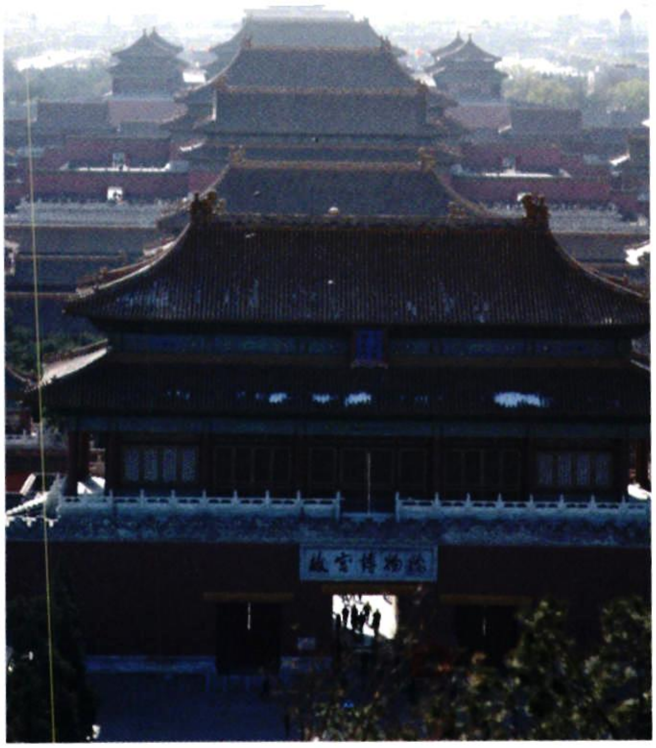
Beijing is China's political capital, and many Chinese say that Beijingers are pure "political animals." Beijingers from all social strata and professions share this political zeal. Politics is the salt in Beijing life, goes a common saying—without this salt, Beijing life is tasteless. Most Beijingers are up-to-date on the latest political news; people joke that in the streets of Beijing, random passers-by will know more about politics than many politicians outside Beijing.

Related to this love of politics is an emphasis on family status, background, and social position. Thus, Beijing businesspeople may automatically treat seriously and with great respect someone whose business card displays the title of board chair or president, especially of a big corporation. And big companies, large business groups, and well-known brands tend to have a much easier time breaking into the Beijing market. On the negative side, Beijingers' preoccupation with politics has been criticized as resulting in a weaker market consciousness and slower reaction to market changes. Thus, Beijingers' business behavior often changes with official policy shifts, responding more to the needs of government than the market.

Also related to Beijingers' love of politics is their love of *kandashan*, literally "hacking the big mountains" but meaning "eloquently talking about a wide variety of unrelated topics," such as the Great Wall, Mars exploration, former US President Bill Clinton's sex scandals, Iraq prisoner abuse, and the Taiwan elections. Foreign businesspeople may discover one manifestation of this tendency when negotiating across from a Beijing company: often they may find a "talking grandfather" (*kanye*) in the room to sing the praises of the foreign partners to create an atmosphere conducive to negotiation.

Beijingers are also especially sensitive to face, thus they pay special attention to formalities. Nevertheless, Beijingers are well known for their love of humor, often used to lighten up otherwise formal proceedings.

Given these characteristics, foreign businesspeople conducting business in the PRC capital should be prepared to *kandashan* and play "political cards" by cultivating connections with leading politicians. Companies with good political skills and connections are regarded as more desirable business partners in the capital. Finally, foreign businesspeople who can emulate the style of Confucian businesspeople and comport themselves elegantly—exhibiting broad knowledge, deep scholarship, and artistic cultivation—can also gain admiration and respect.



Photograph: Dennis Chen

Most people agree that the rule of law is stronger in Shanghai than in most other parts of China.

Shanghainese

Situated in the middle of China's eastern coastline, Shanghai sits at the mouth of the Yangzi River at the heart of the Yangzi River Delta. Shanghai is China's economic center, an important industrial base as well as its largest port. Finance, insurance, domestic and international trade, and other services are concentrated here. Various businesses are well-developed, and competition is stiff.

Because of Shanghai's history as an immigrant city with strong foreign influence, it has developed a unique culture that combines West with East. This mix has given Shanghainese certain tendencies and characteristics, often called *haipai*, or Shanghai style.

Because they are more familiar with Westerners than Chinese in other parts of China, Shanghainese tend to treat Westerners more equally, thus allowing Western businesspeople to cooperate more easily with Shanghainese. Shanghainese also tend to adopt Western ways of business and conform to international standards.

For instance, most people agree that the rule of law is stronger in Shanghai than in most other parts of China (see the *CBR*, May–June 2004, p.44). As, historically, most residents were immigrants and could not rely on traditional social structures for support, everyone had to follow common rules to make a living. Thus, contracts tend to be honored more often in Shanghai than in other parts of China.

Because of Shanghai's comparatively mobile population, Shanghainese are inclined to maintain good relationships with social contacts over the short term and keep the level of socialization relatively shallow. Unlike Beijingers, who tend to forge friendships with business partners and sometimes take risks for their friends, Shanghainese seldom mix emotions with business. Shanghainese tend to accept *renqing* reluctantly, return *renqing* quickly, and exchange favors of equal value.

Shanghainese also tend to focus on economic interests, value individualism, and emphasize practicality by ignoring politics and showing concern for individual interests. In Shanghai, as long as money can be made, strangers can quickly form bonds.

Finally, Shanghainese have a reputation for knowing how to obtain and protect personal rights and interests. In Shanghai markets, it is not unusual to see a well-dressed gentleman arguing with a vegetable seller for a few cents. In business negotiations, Shanghainese are generally professional, discreet, and attentive to minute details. Therefore, negotiations with Shanghainese over even minor issues may be lengthy. Canny Shanghai businesspeople tend to avoid taking big risks and prefer steady and stable business.

Cantonese businesspeople are usually welcoming to outsiders.

Cantonese

Guangdong's geography and weather have contributed to the cultural differences that have evolved in this southern province. In ancient times, large areas of Guangdong were swampy, and typhoons often wreaked havoc along Guangdong's coast. Difficult living conditions led Cantonese to emphasize practicality in order to survive. As a result, Cantonese, like Shanghainese, were also less interested in politics and officialdom than Beijingers.

Mountainous terrain separated Guangdong into various small, independent units and prevented much exchange with the culture and social systems of central China. Traditional Chinese culture, particularly Confucian ideals and the philosophy of moderation, weakened as they passed through Hunan, Jiangsu, and Zhejiang and reached Guangdong in a modified form. Distance from mainstream Chinese culture has also led to a greater belief in local superstitious practices, such as face reading, *fengshui* (an ancient Chinese practice that configures work or home environments in ways that promote health, happiness, and prosperity), and belief in fate.

Guangdong's location between mountains and seas contributed to the open and free cultural tradition of the Cantonese. Well-developed agriculture, and convenient sea and river transportation, provided excellent conditions for commercial activities. Guangdong businesspeople have long traveled overseas for business; during the Qing Dynasty (1644–1911), Guangdong was the only official Chinese trade port until the advent of treaty ports in the 1840s.

Cantonese businesspeople are also usually more welcoming to outsiders, whether Chinese or foreign, and have also introduced foreign ideas to China. For instance, Kang Youwei, a Guangdong native and the grandfather of Chinese modern reform, introduced Western political systems. Dr. Sun Yat Sen, the founder of the Republic of China, led China's republican revolution in 1911. In business, Cantonese prefer to take advantage of new opportunities, because it is, in their view, rel-

Photograph: Catherine Gelb

atively easy to get monopoly profits from new business. In this sense, Cantonese are risk takers.

But Guangdong's long business experience has led to some negative traits as well. Having benefited from earlier opening to the outside and from their business acumen, many Cantonese tend to take advantage of green hands from other parts of China. And though many Cantonese make legitimate profits by following good business practices, others have taken to counterfeiting and smuggling. Numerous underground workshops produce counterfeit branded products from daily necessities to electronics, from labor intensive to technology intensive products. In one investigation, more than 30 companies in Guangdong alone were discovered to be counterfeiting compact discs.

Northeasterners have a reputation for a "tiger-like spirit."

Northeasterners

Northeasterners are well known for their ebullience, sincerity, and friendliness in business. In the Northeast—Heilongjiang, Jilin, and Liaoning—the following saying is popular: "If emotions are deep, finish the drink with one gulp; if emotions are shallow, only lick the glass." Perhaps taking the saying a bit too literally, Northeastern men have been known to drink themselves under the table to show their sincerity. This generosity of spirit sometimes extends to the wallet—when Northeasterners are in good a mood, they do not hesitate to shell out large sums of money, whether in business or service.

Northeasterners also have a reputation for a "tiger-like spirit" (*dongbeihu*), which predisposes many to feats of daring, such as swimming in sub-zero temperatures—and to short fuses. In a few unfortunate cases, business negotiations have degenerated into shouting matches, replete with curses and the occasional fistfight or worse. This short fuse may explain why Northeasterners have a reputation for rarely spending much time bargaining over minute details in small business deals and may also explain their propensity for big and quick deals.

All the Chinese share a common trait, "*ai mianzi*" or "sensitivity to face." But native Northeasterners may be more sensitive about *mianzi* than Chinese from other regions. Therefore, experienced businesspeople say that to do business with Northeasterners requires a greater investment in emotions and attention to issues of face. Done well, such investment can bring excellent results.

Nevertheless, outsiders should be wary. Like the Cantonese, Northeasterners are known for misleading outsiders. Chinese say that Northeastern swindlers are known for their courage and skill in pulling off spectacular scams. One of the highest-profile Chinese business scandals in recent history was that of Northeasterner Shen Taifu who, while he was the chair of the board and president of the Beijing Great Wall Machining and Electronic Co. in the late 1980s and early 1990s, cheated his company out of more than ¥1 billion ($120.7 million). Shen was convicted of bribery and corruption and executed in 1994.

Sichuanese are known for their honesty and sincerity.

Sichuanese

The Sichuan basin is crisscrossed by rivers and covered with fertile land, resulting in a warm climate and an economy and history of self-reliance. Rich natural conditions have bestowed a relatively high level of wealth and stability on generation after generation of Sichuanese, while geographical isolation has fostered conservative attitudes and relative complacency. As an old Sichuan saying goes, "Business life lasts 60 years [one generation], but cultivating land can generate money over 10,000 years." As a result, Sichuanese were traditionally uninterested in business and tended to lack commercial drive, at least compared with people in other parts of China.

After the opening and reform of China began, Sichuanese began to leave the basin for new opportunities, with some of them becoming businesspeople and entrepreneurs. Only a small minority wanted to take the risk of leaving their homeland, however. Most Sichuanese who have left Sichuan have ended up as hired hands; relatively few are bosses.

Yet this is not to say that Sichuan's human capital is inferior to that found in other parts of China—far from it. Sichuan is home to many of the firms that make up China's military-industrial complex, because both the Nationalist and Communist governments considered Sichuan a safe base, far from foreign threats. Sichuan ranked first in scientific and technological talent in several national statistical surveys conducted during the 1990s. For many years, Sichuan has been among the top regions in terms of scientific and technological innovation, but many of Sichuan's innovations have been capitalized on by rich companies from coastal regions. For example, a Sichuan technician invented a multipurpose wrench. The technician initially priced the wrench at ¥30,000 ($3,629), but nobody was interested. Later on, it was sold to a company from the coast, which produced it successfully for export.

Sichuanese, who believe that "one cannot be successful without credibility," (*min wuxin buli*) are known for their honesty and sincerity. Once they have made a promise, they will do all they can to realize it. Thus, borrowing and lending money

among Sichuanese was traditionally done orally, without contracts. This emphasis on credibility spills over into business—in one 1995 national survey of counterfeited goods conducted by the China Association of Quality 10,000 Miles Promotion (*Zhongguo Zhiliang Wanlixing Cujinhui*), Sichuan was listed as the least-counterfeiting province.

Sichuan has long been a center of Taoism and has been subject to strong Confucian influence. Thus, Sichuanese tend to emphasize harmony and moderation in their daily interactions. They tend to believe in the tenet of forgiveness whenever possible. Even when they are right, they believe that they should not gloat. Sichuan's traditional tea houses were sites not only for relaxation and entertainment, but also for conflict mediation and resolution.

Sichuanese are known to emphasize practicality and have little vanity. Sichuan native Deng Xiaoping's reform slogan that "a good cat, whether black or white, is one that can catch mice," came originally from a popular Sichuan saying. Sichuanese are also known for their hard work and tenacity. A typical example is mountainous Chongqing's "pole army" (*bangbang jun*), porters who eke out a living by carrying heavy bags suspended from poles on their shoulders for little compensation. For foreign businesspeople, the Sichuanese work ethic means that as long as business terms are reasonable and negotiated in good faith, Sichuanese are easy to work with.

Wenzhounese are known for their business acumen.

Zhejiangese

Situated on the east coast, Zhejiang has a long commercial and seafaring history. Over time, Zhejiangese have become known for their creativity, path-breaking spirit, free-thinking tradition, and matter-of-fact attitudes.

More than 2,000 years ago, an official from Zhejiang named Fan Ni gave up his office and became a successful businessman. During the Tang Dynasty (618–907 AD), Ningbo and Wenzhou were famous trade ports, and Zhejiang businesspeople regularly traveled from Ningbo to Japan for business. After the Opium War in 1840, Ningbo and Wenzhou were opened as international trade ports and became early bases of modern Chinese industry. Ningbo gave rise to one of the most powerful business groups in Shanghai in the early twentieth century. Since reforms began in 1978, Zhejiang township enterprises have developed rapidly, and the city of Wenzhou has become famous for its thriving private sector.

Zhejiang people use their sophisticated social skills to their advantage in business. During negotiations, for instance, Zhejiangese tend to say little about themselves, letting their prospective business partners speak first and thus feel more knowledgeable and authoritative. In handling relationships, Zhejiangese excel in adjusting their tactics to the social status, position, purpose, and perspectives of their counterparts.

There are basically two prominent groups of Zhejiang businesspeople: those from Ningbo and those from Wenzhou. Ningbo businesspeople have a reputation for leaving home to seek their fortunes. Shanghai was traditionally the main base for Ningbo natives starting businesses in China, while Hong Kong was the main base for overseas Ningbo businesspeople. The only two world-class Chinese shipping tycoons were Ningbonese: C. Y. Tung (the father of Hong Kong's current chief executive, Tung Chee-Hwa) and Yue Kong Pao. Like the Shanghainese, Ningbo businesspeople are familiar with both Western and Eastern cultures (Ningbo was one of the treaty ports opened to foreign trade in the late Qing Dynasty) and thus are considered sincere and generally enjoy a good reputation among their clients.

Coastal Wenzhou is surrounded by mountains and open seas. Since ancient times, Wenzhounese have taken pride in running businesses. Today they are not only known for their intelligence, but also for their business acumen. Wenzhounese are well known for their "thick face"—for not fearing rejection and for selling their products throughout the country with smiling faces, endless persuasion, and worn-out shoes. Wenzhou businesspeople have spread out all over China and the world during the reform period.

People from Wenzhou are not picky about how they make their fortune. They will deal in low-end items that others disdain, like buttons and cigarette lighters, and earn riches quietly. Most of them also like being their own boss and are willing to take risks to do so. One interesting example is the story of young entrepreneur Wang Yao, who since 1991 has audaciously negotiated with six airlines to open more than 50 domestic charter lines.

The Chinese melting pot

This article has attempted to cover business subcultures only of areas of mainland China where economic activity has been among the most dynamic in the past few decades. It has not included discussions on business subcultures beyond mainland China, such as Hong Kong, Taiwan, and Southeast Asia, where ethnic Chinese dominate business scenes. Noticeable differences in business practices do exist among the Chinese living in those areas, however, and treating all Chinese the same way would be a gross—and costly—mistake. To be successful in dealing with Chinese, it is important for Western businesspeople to understand differences in business practices among the Chinese from different parts of China.

Nevertheless, one should also avoid going to the other extreme of only paying attention to differences without taking advantage of cultural similarities. With China's continued opening and reform, exchanges among Chinese from different regions have become ever more frequent. Some business practices that used to be particular to one area are spreading across the country. For example, practices like *fengshui* and numerology used to be concentrated in Guangdong and Hong Kong, but have spread all over China since the early 1980s. Even the Chinese dialects have become less powerful, as people need to use standard Mandarin to communicate with each other.

Chinese economic integration has played a key role in breaking down differences while building up commonalities among the Chinese. When foreigners deal with Chinese businesspeople, therefore, they would do well to remember both the similarities and differences among their Chinese business counterparts. 完

Wahaha's exhibition hall at its corporate headquarters in Hangzhou, Zhejiang.
Photographs: Paula M. Miller

Wahaha

The Chinese beverage company's expansion is no laughing matter

Paula M. Miller

If you've traveled in China, chances are you drank at least one bottle of Wahaha brand water, or perhaps the company's iced tea, fruit drinks, or its Future Cola. Once you returned to the United States, you may even have come across Future Cola in New York or Los Angeles, because the company that first set up shop in an elementary school in Hangzhou, Zhejiang, is going global.

Paula M. Miller is assistant editor of the *CBR*.

Wahaha's Hangzhou Xiasha Economic and Technological Development Zone Facility.

The company's founder and two retired schoolteachers initially sold milk products and popsicles out of a school store.

From Hangzhou to huge

The Hangzhou Wahaha Group Co., Ltd., China's leading domestic beverage producer, didn't achieve success overnight. The company's predecessor, the Hangzhou Shangcheng District School-Run Enterprise Sales Department, funded its start-up operations in 1987 with a government loan. Zong Qinghou, the company's founder, and two retired schoolteachers initially sold milk products and popsicles out of a school store, but to benefit the students' health the group soon began producing and selling nutritional drinks. The company's success selling nutrition products in school shops led to its first big expansion: with Hangzhou government support, the company acquired a large, 30-year-old state-owned enterprise, the Hangzhou Canned Food Product Co., in 1991. The company then changed its name to the Hangzhou Wahaha Group Co. (The word "Wahaha" is meant to mimic the sound of a baby laughing and is taken from a children's folk song.)

Wahaha's second large-scale expansion occurred in 1994 when the company merged with three insolvent companies in Fuling, Sichuan, to set up its first factory in Chongqing. Establishing a factory in Chongqing helped the company in two ways. The location provided Wahaha with a manufacturing base in western China, enabling the company to reduce distribution costs. And the merger occurred when the central government was providing coastal companies incentives to invest in the west.

In 1996, Wahaha joined with Groupe Danone SA to form five new subsidiaries, of which Danone owns 51 percent and Wahaha the remainder; Danone now owns 30 percent of the whole company. With Danone's assistance, the company was able to invest in advanced production lines and improve efficiency. Thanks to the mergers and joint ventures, Wahaha's production doubled from 1996 to 1997.

Today, Wahaha's corporate headquarters are still in Hangzhou, and the company has roughly 70 subsidiary companies and 40 manufacturing bases scattered throughout China. Wahaha employs about 10,000 staff and its sales networks cover every county in China. One-third of the company's production occurs at its largest facility—in Hangzhou's Xiasha Economic and Technological Development Zone.

Despite production difficulties because of severe acute respiratory syndrome, energy supply shortages, and raw material price increases in 2003, the company surpassed its sales target of ¥10 billion last year ($1.21 billion). In 2003 its total beverage production reached 3.7 million tons, up 14.6 percent over 2002. Wahaha accounted for 15.6 percent of China's total beverage production. Last year marked the company's sixth consecutive year as China's number one domestic, nonalcoholic beverage producer in production volume, assets, sales revenue, tax, and profit. Its 2003 income from all products totaled ¥10.23 billion ($1.24 billion), of which ¥8.43 billion ($1.02 billion) was sales revenue and ¥1.37 billion was profit ($165.46 million). The company's assets total ¥4.4 billion ($531.4 million).

Although the state owns a majority share, the company is also foreign- and group-invested. Perhaps because it is often said that the state holds a "passive stake" in Wahaha and because Zong—the company's founder, chair, and general manager, who was sent to labor in the countryside for years during the Cultural Revolution and thus received only a junior-high-school education—has played such a large role in the company's development, Wahaha is often regarded as a private enterprise.

Wahaha is now carefully expanding beyond the mainland. It works with a trading and distribution company in Taiwan and in July completed a factory for its cola products in Indonesia. Wahaha products are on sale in France, Germany, Hong Kong, Italy, Japan, Malaysia, the Netherlands, Spain, Taiwan, Thailand, and the United States. But Shan Qining, Wahaha's Foreign Liaison Office vice director notes, "The hardest part of going global is handling new markets. For example, it would be easier for Wahaha to sell products in Southeast Asia than in the West. The move is less risky because many Chinese are already in Southeast Asia. To target US customers, we will likely need to alter products to suit their tastes."

From milk to Future Cola

Wahaha currently produces 30 varieties of milk and yogurt drink, purified and mineral water, carbonated soft drink, fruit and vegetable juice, sports drink, and tea, as well as congee (rice porridge), canned food, and health products, such as children's vitamins. In 2002, the company further diversified into children's clothing. It may soon develop personal care products, including shampoo and toothpaste.

According to Shan, the company's hottest-selling products in China are bottled water and vitamin-enhanced milk drinks (the state has approved the sale of Wahaha's vitamin-enhanced milk in schools nationwide). He elaborated, "Wahaha's milk products and bottled water are strong sellers—our main challenge is to increase our cola sales. Chinese consumers are gradually accepting colas, but which cola brand will they select?"

Wahaha started making its own cola in 1998. Feichang Kele (translated as Extreme Cola or, more commonly, Future Cola, for its sound) tastes like a cross between Coca-Cola and Pepsi, but bears a red and white label that strongly resembles the Coca-Cola Co.'s world-famous one.

After selling milk products successfully in the United States in 2003, Wahaha, inspired by a US-based request, decided to try its luck in the US cola market this spring. In late April, Wahaha shipped 170,400 bottles of Future Cola to its US distributor, the Manpolo International Trading Corp., a small import-export company located in New York's Chinatown. In June, Manpolo distributed the entire first Future Cola shipment to the small Chinese-American grocery store chain Hong Kong Supermarket, Inc., which has stores in New York and Los Angeles—the first time a mainland Chinese cola had hit US stores. Wahaha's goal is to have Future Cola sit on the same shelves as Coca-Cola and Pepsi and sell for roughly the same price. But given its limited initial distribution, it looks like American Future Cola fans will have to wait a while before they will find it stocked at local convenience stores.

The company's hottest-selling products in China are bottled water and vitamin-enhanced milk drinks.

Competition

Wahaha considers its top cola competitors the Coca-Cola Co. and PepsiCo, Inc. followed by the Taiwan-founded companies Uni-President Enterprise Corp. and Tingyi (Cayman Islands) Holding Corp. Coca-Cola dominates the mainland's soda market. According to PRC government statistics, it held a 24 percent market share in 2003 compared to Future Cola's 7 percent share.

According to Shan, "Seven years ago, when Wahaha was preparing to launch Future Cola, people laughed because previously several Chinese companies had tried to sell cola, failed, and either went bankrupt or were bought out by Coca-Cola or PepsiCo." But in 2003, he claims, Wahaha's total beverage production [3.75 million tons] exceeded that of Coca-Cola in China.

Wahaha does not worry too much about domestic competition. It has had to battle imitations, however. Shan explained the company's strategy. "The best way to fight counterfeit products is to lower your own prices. This pricing strategy will make fake-product makers drop out. Wahaha also reports intellectual property problems to local police." According to Shan, Wahaha is able to keep costs low because the company produces its own bottles and caps.

After selling milk products successfully in the United States in 2003, Wahaha, inspired by a US-based request, decided to try its luck in the US cola market this spring.

Marketing a "patriotic" brand

Wahaha has employed three main marketing techniques. First, its advertisements, especially for Future Cola, promote its products as patriotic brands. Advertisements promote Future Cola as China's own cola (never mind the foreign investment) and encourage consumers to support the nation, by selecting Wahaha over foreign competitors.

Second, Wahaha carefully chooses which regions it will target for each product. Shan explained, "Some products, such as our water, sell better in the city and some products, like our cola, do better in the countryside. Consumers in all areas will choose Wahaha water, but consumers in large cities are unlikely to choose Future Cola.... Wahaha's focus on rural areas for Future Cola does not mean it has given up on cities—but city grocery stores have very high entry fees. For practical reasons, we wanted to introduce the product with lower costs."

Because Coca-Cola and Pepsi were already strong in China's cities, where fashion-conscious consumers have more to spend on food and drink, Wahaha launched Future Cola in the countryside in 1998. The relatively small price difference between Future Cola and the US brands makes a difference to many rural consumers (in China, Future Cola sells for about ¥2 [$0.24] per bottle—about 6 cents less than its US rivals), which is one reason that Future Cola has sold well in the countryside.

Third, the company frequently uses celebrities to promote its products. Hong Kong actor and comedian Stephen Chow promoted a series of Wahaha tea drinks, Chinese-American pop singer Wang Lihong promoted bottled water, and Taiwan's Yu Chengqing (Harlem Yu) helped launch Future Cola. Wahaha runs frequent TV commercials that, according to Shan, mainly run on China Central Television Channel 1 around news time.

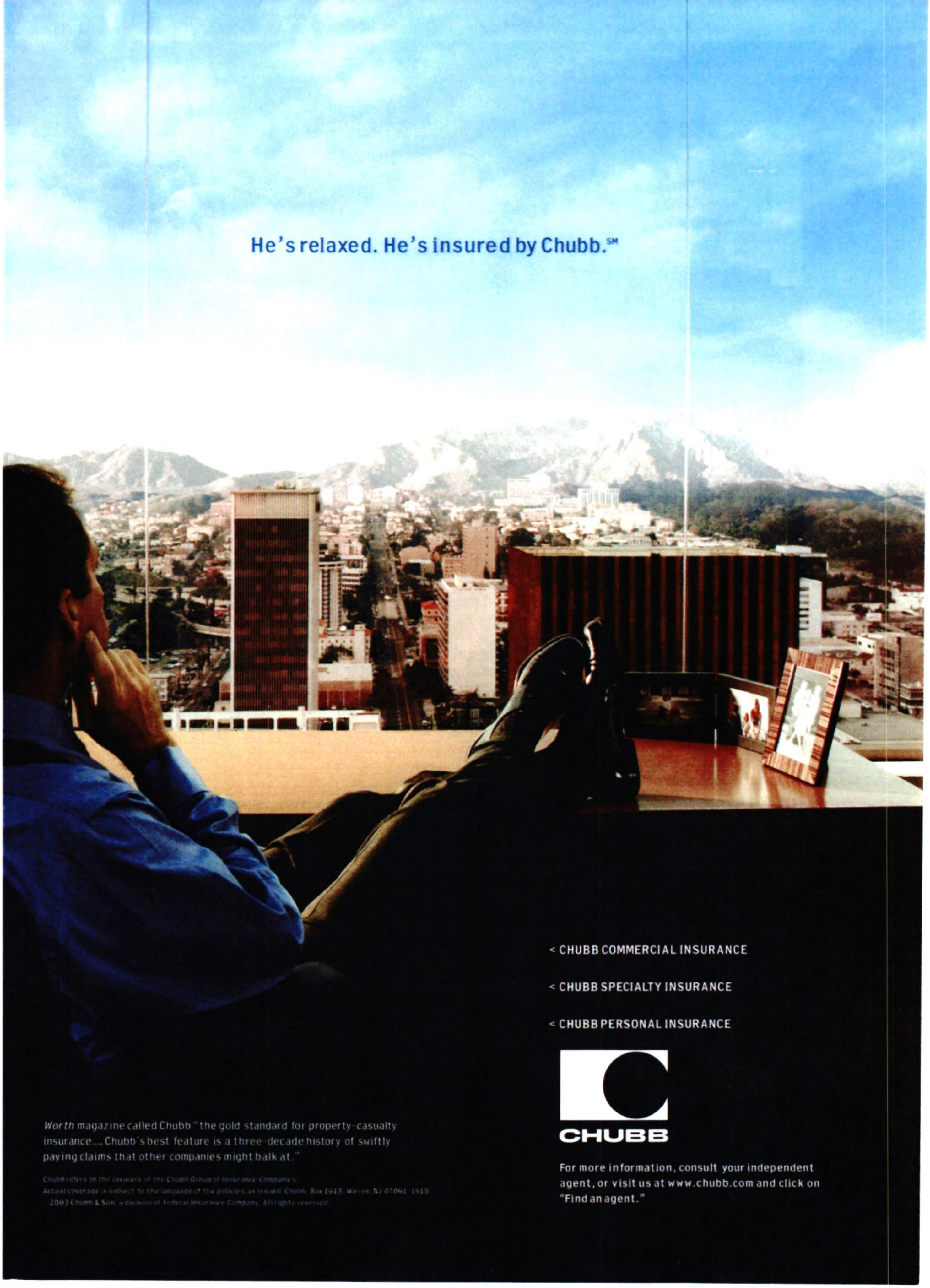
Distribution

Wahaha's distributors in China are responsible for capital, storage, and delivery—but Wahaha dealers help them with management and marketing. The company maintains two grades of distributors: more than 1,500 first-level dealers that need to meet distribution targets and manage large networks and capital; and 12,000 second-level dealers that deal at smaller levels. The company has 35 provincial sales offices, 2,500 sales team employees, and more than 2 million sales outlets across China.

A bubbly future?

When asked about Wahaha's future, Shan replied, "Our general manager doesn't like five-year plans because the market changes so quickly. But the company hopes to increase this year's sales revenue by 10 percent over last year."

Though it seems certain that Wahaha will continue to grow in China, it will likely take a while for Wahaha products to develop a stronghold overseas. And if the company truly wants Future Cola to compete in the US cola wars, it may wish to adjust its US market-entry strategy. It is logical to launch Future Cola in Chinese-American grocery stores. Yet without expanding its distribution, the cola will remain unknown to many American consumers. Why not repackage the product as an alternative, "Indie" cola that the nontraditional-cola drinking crowd will enjoy? That, or price Future Cola below major US competitors. Or, because extreme sports are ever-more popular for young American athletes and fans, Feichang Kele's translation "Extreme Cola" could entice a new generation of American youth looking for the latest trendy soft drink. 完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CRITICAL EYE ON HANGZHOU

An ancient capital is poised to make a high-tech leap

A New CBR Department Focuses on Regional Investment Locations

Over the next year, the *CBR* will be profiling investment environments around China. We begin within the Yangzi River Delta (YRD), the east coast region surrounding and including Shanghai. Following recent rapid development, each large city in the region boasts at least two national-level development zones, many medium sized cities have one, and these days, it seems just about every place on the map is actively promoting foreign investment in a designated local industrial district.

While the variety of locations can be daunting, the situation is a boon for foreign companies, which can freely pick their destination and can bargain to secure favorable prices and service contracts. Though development zones are all extensions of the central government, they are promoted and managed at the local level, which breeds dynamic competition among cities to attract individual investments.

These reports will be based on information from site visits to industrial zones, interviews with foreign companies, and information from local infrastructure and development plans. The reports will focus on the overall investment, operational, and logistical environments of each city. The goal of the reports is to paint a clearer picture of growth trends in the many promising investment locations across China.

Adam Ross
and Vivien Fang

Hangzhou is an ancient city, a former imperial stronghold known for its natural beauty. The capital of wealthy Zhejiang Province, Hangzhou lies 120 km south of Shanghai and is most famous for its West Lake, an inspiration for artists and leaders throughout the ages.

While Hangzhou remains a major tourist spot, it has also developed into Zhejiang's leading economic engine, accounting for 22 percent of the province's GDP, nearly 30 percent of its imports, and 17 percent of foreign direct investment. Foreign firms are attracted to Hangzhou by steady infrastructure improvements, a highly educated work force, a strong spirit of private enterprise, and access to Zhejiang's local markets. At the same time, high property costs and a shortage of qualified managers are concerns for many of Hangzhou's foreign-invested companies.

Local officials view the eastern Jiangsu city of Suzhou as Hangzhou's main competitor for foreign investment. Suzhou is the region's second-highest recipient of foreign investment after Shanghai, benefiting from proximity to Shanghai's top-notch support services for foreign companies, and from efficient logistics links. But Suzhou is currently suffering from problems related to overinvestment: widespread human resource shortages, rising raw material costs, severe power shortages, and congested transportation routes. Hangzhou is in a good position to narrow the Suzhou gap, simply because it is less heavily invested and has more room to grow.

Strengths: Infrastructure and technical talent

The Hangzhou city and Zhejiang provincial governments are modernizing transportation, shipping, and logistics networks. Of this work, the most crucial is the expansion of road links to Shanghai, a route on which many Hangzhou companies depend to move goods out of the country and connect to distribution centers across China. Two extra lanes are currently being added to the 102 km Hang-Pu Expressway between the two cities, which is supposed to be completed by 2007. Traffic problems will ease further after completion of the Hangzhou Bay Bridge, targeted for 2008, which will allow Ningbo-Shanghai road traffic to bypass Hangzhou.

Adam Ross and Vivien Fang are research associates at the US-China Business Council in Shanghai.

In addition, the new Xiaoshan International Airport, opened in 2000 with direct flights to Hong Kong, Japan, Singapore, and South Korea, means that Hangzhou-based businesspeople no longer have to fly out of Shanghai for their international travel.

Hangzhou has a deep pool of talented workers, with 35 colleges and universities that produce tens of thousands of graduates each year. Zhejiang University is one of the country's top institutions of higher learning and supports research centers in biotechnology, software development, and engineering. This educational base complements Zhejiang's traditional strength in promoting private industry and entrepreneurial activity.

Property, people, and power shortages

All of the foreign company managers interviewed for this article were concerned with the high costs of residential property in Hangzhou, which rival those of Shanghai. This is a significant issue because it raises fixed costs; most companies consider moving to Hangzhou because they hope it will help lower expenses relative to Shanghai.

A related problem is the dearth of trained managers. Second-tier cities throughout China are experiencing a brain drain to Beijing, Shanghai, and abroad, and Hangzhou is no exception. Foreign companies have trouble finding local talent to fill demanding managerial-level positions. This problem is exacerbated by high housing prices, which discourage potential candidates from elsewhere who would need to rent living space in Hangzhou.

Like most other Chinese cities, Hangzhou faced power shortages this summer and will continue to do so through 2005. Companies in Hangzhou's development zones express concern about the shortages, but note that advance warning systems for power shutdowns have improved from years past. In addition, a new natural gas line for Hangzhou, scheduled to begin operating by summer 2006, is expected to supply enough power to meet demand. The power situation remains very much in flux, however, with plans and target dates subject to change. In the meantime, most foreign manufacturers are purchasing diesel generators, with rebate subsidies available from Hangzhou's development zones.

Riding the YRD investment wave

The strong foreign investment tide washing over the YRD is providing a short-term boost to all regional industrial centers, including Hangzhou. The city's solid infrastructure and educational foundation should support growth over the long term, especially in comparison to other nearby investment locations.

As Hangzhou manages future expansion, a key question will be how the city integrates higher education resources into the local economy. A potentially dynamic system of education-industrial partnerships has been slow to take off; in the meantime, talented students are lured by opportunities elsewhere. But educational strengths may become more apparent if Hangzhou can attract higher-value investments. Hangzhou indeed has the potential to base its economy on high-value research, development, and engineering projects—which would improve the city's chances for long-term success. 完

Hangzhou, 2003

Population: 6.43 million
Per capita GDP: $3,930
Average per capita urban disposable income: $1,558 (+9.5%)
Average per capita rural net income: $693 (+9.5%)
Average per capita urban spending: $1,202 (+8%)
Average per capita rural spending: $553 (+15.7%)
Mobile phone use: 61.4% of city population

Hangzhou Accounts for
0.50% of China's total population
1.48% of China's total GDP
1.74% of China's total contracted FDI
2.50% of China's exports
1.76% of China's imports

13.74% of Zhejiang's total population
22.73% of Zhejiang's total GDP
16.60% of Zhejiang's total contracted FDI
26.40% of Zhejiang's exports
36.77% of Zhejiang's imports

Economy
GDP: $25.26 billion (+15%)
Fixed-asset investment: $12.15 billion (+30.7%)
Value-added industrial output: $11.29 billion (+19.9%)
Retail sales: $7.09 billion (+12.4%)
Consumer price index: -0.5%

Foreign Direct Investment
Number of contracts: 869 (+48%)
Amount contracted: $2 billion (+107%)
Amount utilized: $1.01 billion (+93.3%)
Top five investors (amount contracted)

1. Hong Kong	$812.3 million
2. British Virgin Islands	$189.2 million
3. United States	$181.9 million
4. Japan	$124.2 million
5. Taiwan	$122.7 million

Hangzhou Foreign Trade
Total trade: $18.23 billion (+39.2%)
Exports: $10.95 billion (+29.2%)
Imports: $7.28 billion (+57.5%)
Top trade partners
1. United States
2. Japan
3. European Union
4. Hong Kong

Source: Hangzhou Statistics Bureau
Note: All growth rates are compared to the same period in 2002 except where indicated.

Foreign Direct Investment in Hangzhou National-Level Development Zones 2003

Zone	Website	Contracted Amount ($ million)	% of Hangzhou	Utilized Amount ($ million)	% of Hangzhou
Hangzhou Economic & Technological Development Zone	www.hetz.gov.cn	402.2	20.10%	193.9	19.23%
Hangzhou High-Technology Industry Development Zone	www.hhtz.gov.cn	220.6	11.02%	150.9	14.96%
Xiaoshan Economic & Technical Development Zone	www.xetdz.com	211.5	10.57%	126.0	12.49%
Hangzhou Zhijiang National Tourist Holiday Resort	www.hz-zj.com	37.8	0.19%	29.7	0.29%

Source: Hangzhou Municipal Foreign Trade and Economic Cooperation Bureau

INTERVIEW WITH DINESH PALIWAL

Dinesh Paliwal is group executive vice president of ABB Ltd. and member of the Executive Committee and chair of ABB Inc. An 18-year veteran of ABB, he has global responsibility for ABB's automation business and is in charge of the company's North America region operations. CBR Editor Catherine Gelb recently spoke with Paliwal about ABB's operations and goals in China.

Q: What are ABB's main lines of business in China today?

A: ABB employs 7,000 in China, and an additional 2,000-3,000 are employed on a contract basis. This year our revenue base in China will reach $2 billion. ABB has 17 production and manufacturing facilities throughout eastern China that produce motors, drives, electrical switchgears, and high-power transformers, among other products. The company provides such products for power infrastructure development, automation, and controls.

ABB has invested $600 million over 10 years. The company started operations along China's eastern coast. Six years ago we opened our first facility in Chongqing; we are now moving into Chengdu. In part, this is because the Chinese government wants us to begin drawing more western resources. But we are also attracted to the labor pool in western China.

Our philosophy is to establish only joint ventures [JVs] in which we have majority stakes, or wholly foreign-owned enterprises [WFOEs]. We don't find a significant difference in control between a JV in which we have 80 to 90 percent equity and a WFOE. Our holding company in Beijing acts as our headquarters for China and Hong Kong. We've had our headquarters in China since 1994.

Q: What are the company's plans for future expansion in China?

A: In 1994, our revenue base in China was $500 million. After a wonderful 10 years, we are looking at revenues of $2 billion. Our internal goal is to double revenues by 2008, to $4 billion. This is feasible—with our recent growth rates of 30 to 40 percent we would reach this goal by 2008.

Our mission in China—like our mission in the United States—is to develop strong management for our indigenous operations. For this reason, another goal by 2008 is to have entirely local management. At first, we employed large numbers of expatriates in China. We are now undertaking a significant degree of mentoring and training of Chinese managers.

We have also announced plans for a research and development [R&D] center geared toward Chinese needs. One difference between China and other countries in terms of technology is the willingness at times to employ very advanced technology without having any prior, indigenous experience [with that technology] within the country. Elsewhere in the world, countries prefer to go with proven, if less advanced, technologies and tweak the technologies locally.

Because Chinese standards differ, and because there is pressure in all industries to use local suppliers and contractors, R&D can bring these suppliers up to standard. This year, we are starting up the research center with only about 20 or 30 people, though eventually we will reach 50 or 100. The center is headed by one of our top scientists, Dr. Gan, who happens to be Chinese, and is now working for us in the United States. He was recently appointed "fellow" of our research and development program, a very high honor within ABB.

People generalize too readily about China's move up the technology ladder. Both India and China are picking up relatively easy-access technologies. There is a big gap between these countries and the West in the medical field, in large power transformers, and in HVDC [high voltage direct current], gas chromatography, pollution analysis and control, and process control and facility optimization technologies.

Q: How does China fit into ABB's global strategy?

A: For ABB, two regions are most important strategically: North America and China. We have a five-year strategic plan for the two regions. The respective plans aim to exploit China's growth and to take advantage of the $50 billion North American market.

Q: I understand that you are currently serving as one of a group of economic advisors to the governor of Guangdong Province. What does this role entail? What kinds of issues have you been called on to address?

A: We are generally called on to give macroeconomic views. We meet with 12 well-qualified departmental governors and conduct, in effect, business workshops. They are eager to learn from an experienced company like ABB.

The Chinese are already thinking about 2010, 2015, 2020. Guangdong is very good at exporting and manufacturing. We have discussed how to take advantage of the full value chain, beginning with R&D and product design. We challenged the officials to think about the education front—an inherent strength in China—and to ask themselves what sorts of scientists they should cultivate.

Q: Recently the PRC government has undertaken some measures to cool down its overheated economy. What economic trends do you see as most important to your company's future growth and stability in China?

A: The overheating has to be handled carefully. Loan approvals have slowed, showing that the government's strategies—such as going after the construction industry on the coast—are working. Also, China has been slowing investment in its aging steel industry, known for its poor quality steel and pollution of the environment, and construction of multiple shipyards.

One area they are not slowing is the power sector—they realize they're vulnerable to shortages and that they need reliable power sources. They are spending $10 billion per year now on developing their grid, compared with $2 to $2.5 billion that the United States spends on its grid. The Three Gorges Dam will eventually produce 1,000 MW, which will help industrial users nationwide. Recently ABB won a $390 million order from China for a third HVDC power line supplying power generated by the dam to Shanghai.

Of course, they are also still putting money into high-quality steel. ABB is actively supplying equipment to top steel and cement producers, and is cooperating on the gas pipeline that will supply gas from Urumqi in remote western China to its eastern industrial development base.

Q: What are the main challenges for ABB in China? How is the company going about meeting those challenges?

A: Our number one challenge is finding the right people: trained engineers who don't make mistakes. We have no error margin. Today, as soon as we train people we lose them to new competitors. Thus, we have to be a better employer than our competitors.

Our second major challenge is resource availability for production of transformers, motors, and machines. However, this is becoming increasingly less of a problem.

Intellectual property protection is also a big concern—of course the United States has a big role in working with the Chinese to improve this situation.

Q: Based on your experience, what are the main challenges for China in terms of its future growth and stability and, in particular, its increasingly important role in the global economy?

A: Political turbulence—from Taiwan or terrorism, potentially aimed at power or other infrastructure—would have an adverse effect on China's progress.

Infrastructure weaknesses in general are a major concern—for example, 24 of China's 30 provinces lack good, reliable, power sources. If for some reason the government failed to continue its power development plans, growth would suffer. And foreign investment will depend on steady progress in infrastructure. Intellectual property rights improvements, and opening of markets, are also key for foreign companies. Most foreign companies in China are taking the long view, yet China must address these issues in the next five years.

ABB high voltage in China.
Photographs: ABB

Photograph: Dennis Chen

With Visa in Hand, United States or Bust

A business trip tests the new US visa application system and reveals some unexpected facets of America

DENNIS CHEN

As part of my preparation to attend the US-China Business Council's (USCBC) June 2004 Biennial Gala and Annual Meeting in Washington, DC, I went to the US Embassy in Beijing in April to apply for my visa. I would be applying for a US visa for the first time since the US government had put in place new visa security requirements, which include fingerprinting, and opened its new visa call center in China. (For security reasons, the United States began requiring fingerprinting for citizens of countries that need visas to enter the United States beginning March 2004; citizens of other countries will be fingerprinted for entry to the United States beginning this fall.)

Navigating the new visa application system

To schedule a visa interview in China, applicants must first phone the call center's hotline, which involves buying a ¥54 ($6.52) prepaid phone card from CITIC Industrial Bank (applicants must also pay the ¥830 [$100] application fee to the bank). The card allows applicants to call the visa hotline (4008-872-333) to schedule their visa interview with the US Embassy and its consulates in China. When making my appointment, the hotline operator asked for basic information, such as my name, passport number, approximate arrival date in the United States, and type of visa I was applying for; she then scheduled the time for my interview with a visa officer. Luckily, my appointment at the US Embassy was set for only three business days later.

My appointment was at 2:00 pm on a beautiful April day—which is unusual for Beijing. When I arrived at the embassy on the day of my appointment, I checked my cell phone and briefcase, which are banned from the visa section for security reasons, at one of the private stalls outside the embassy. I then got in line with the other applicants and, after about 20 minutes, entered the building, passed through the security gate, and entered the waiting room, where each service window was staffed by a visa officer. First, I had to stand in line to turn in my application materials; then I had to wait for a visa officer to call me for fingerprinting. Some people, including many Chinese officials, view the fingerprinting requirement as an unacceptable humiliation. I don't feel strongly about the fingerprinting requirement, but I do hope the system will make travel safer.

Once I was fingerprinted, I waited in line for my interview. During my interview, the visa officer asked me simple questions, such as the USCBC's location in the United States, how long I have been working at USCBC, and the purpose of my visit to the States.

My visa was issued roughly 20 minutes after my interview; it took me about two and a half hours to complete the visa process that day. Some applicants were not so lucky—several people with public service passports were rejected.

Impressions of America

Visa in hand, and fingerprints verified by the US immigration authorities at Chicago O'Hare

DENNIS CHEN
is government affairs manager at the US-China Business Council in Beijing.

International Airport, I finally stepped onto American soil on May 29, two days before Memorial Day. My first stop was Washington, DC, where I attended the USCBC's gala and annual meeting and worked several days at our headquarters. It was my second visit to the area, having first visited the United States and Washington in 2002.

Although Washington is not like Beijing, where you notice many new buildings and roads even after a short absence, I did see something new and interesting in Washington, DC—statues of panda bears on many street corners. Each panda bear, part of the DC Commission on the Arts and Humanities PandaMania public art project, is unique. I even saw a bear on Connecticut Avenue that was dressed as a Chinese terracotta warrior.

One morning I set out from my hotel on 17th Street for a walk and saw a building with a large banner that read "America Needs Good Jobs." I realized I was in front of the AFL-CIO headquarters. I became familiar with the organization in March, when it petitioned the US Trade Representative (USTR) to investigate China's labor practices, which the AFL-CIO argued constitute an unfair barrier to trade and thus cost the United States jobs. It is true that China has become one of the largest foreign investment recipients in the world and that foreign investment brings millions of jobs to China, but most of those jobs are low-skilled positions in light industries. It is hard to say they are especially "good" jobs.

After walking past the AFL-CIO building, I neared the north gate of the White House. In Lafayette Square, just north of the White House, I spotted a white tent with many anti-war slogans. An expressionless old man was sitting by the tent. I wondered who he was—and if he was homeless—so I approached him and asked where he was from. He shook his head and looked like he didn't know how to answer my question. He then explained that he has been protesting against war for 23 years in this tiny tent! I had to remind myself that I was in America where people can do almost anything they want—including protesting in front of the president.

After my work obligations were complete, I traveled to New York City—my dream to visit the Big Apple was about to come true. Obviously security has been tightened significantly since September 11, 2001. When I took the ferry to visit the Statue of Liberty, I went through a security check that was as strict as those in US airports. Passengers were even required to take off their waist belts in the security check before boarding the ferry.

It was immediately clear to me, walking through the city, that New York is a melting pot of different races and cultures. But I didn't really appreciate how true this was until I found myself on a subway platform waiting for a train, and heard a familiar melody played from a subway loudspeaker. I immediately recognized it as the classical Chinese lute song, "Spring, River, Flower, Moon, Night." Maybe Americans don't find it very unusual to hear US music in China, but it was overwhelming for me to hear this classical Chinese music in a public place in a foreign country.

In the end, my two-week trip to the States provided rewarding and eye-opening work and life experiences. I look forward to my next visit to America—or *Meiguo*, the "beautiful country." 完

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