September–October 2007

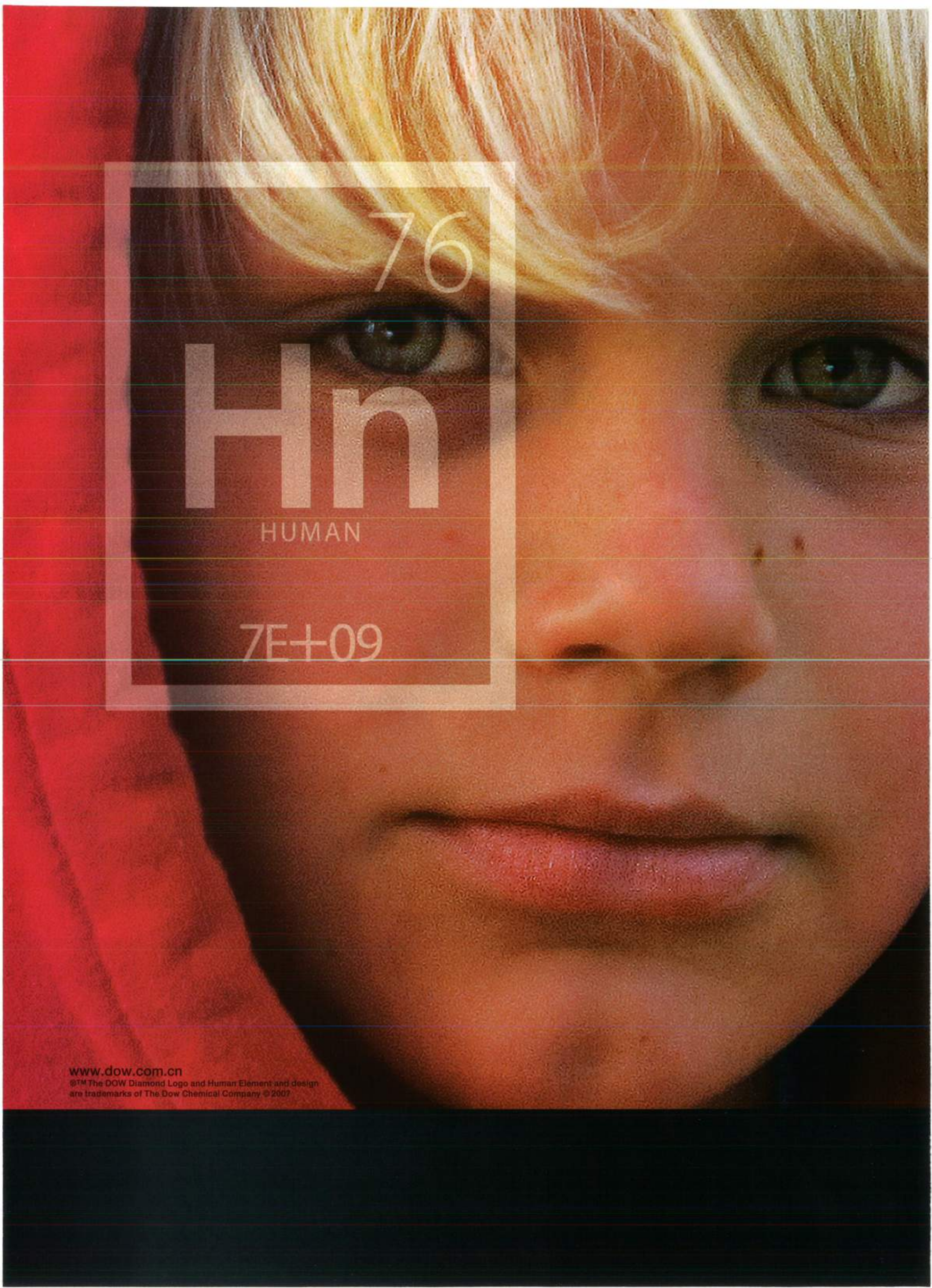
The China Business Review

USCBC
THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL

ankruptcy Law
risis Planning
henyang
I&A

Reaching China's Interior

US$22/HK$220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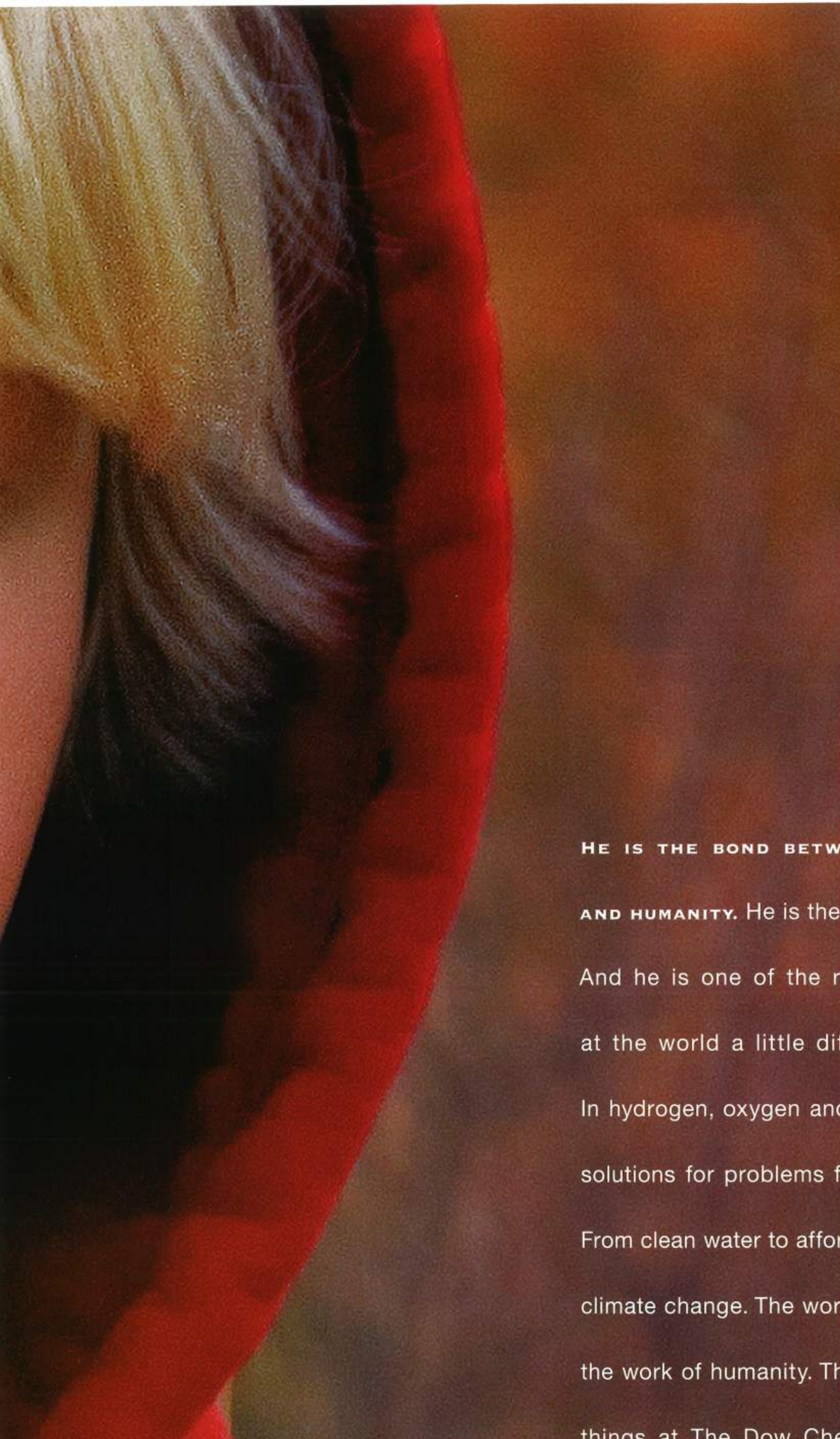

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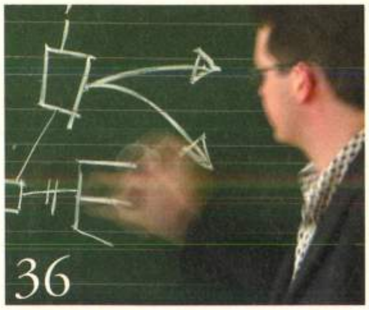
September–October 2007 Volume 34 Number 5

China Foto Press

The China Business Review

USCBC THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

Focus: Reaching the Interior



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Features

Departments

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Online-Only Content at Chinabusinessreview.com

- Consumer Attitudes Across China
- Shenyang Development Zones

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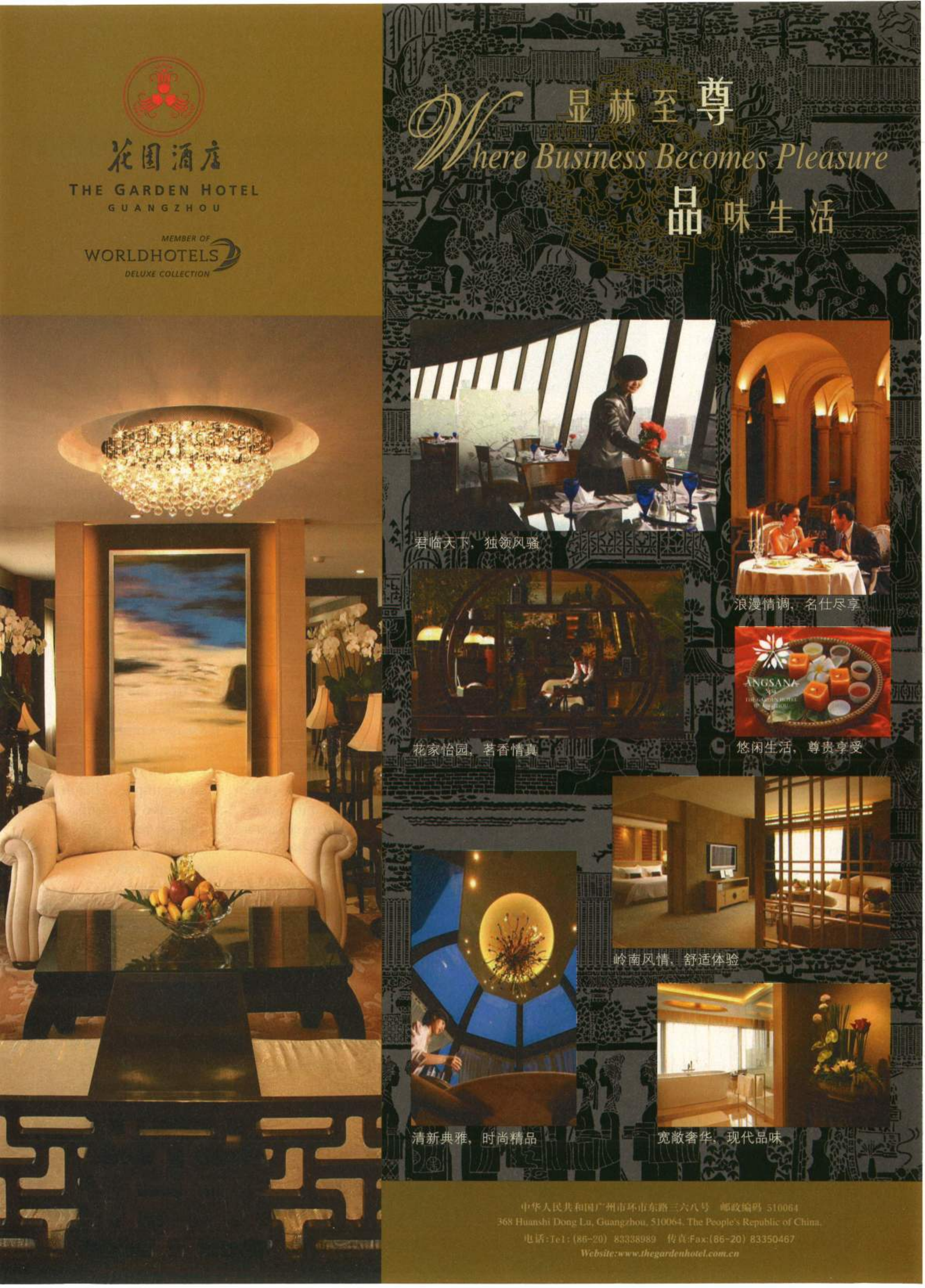
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Intellectual Property Rights

Entertainment-Base of China (5fad) is suing Baidu.com, Inc., the parent company of China's top Internet search engine, for providing illegal links to more than 1,000 copyrighted songs through its website. Compensation claims total ¥100 million ($13.2 million), making this the largest copyright case in China, according to a 5fad press release.

E.I. duPont de Nemours and Co. settled a case against Nanjing-based Trustchem Co., Ltd. for selling agricultural products

that contain rimsulfuron, a DuPont herbicide that is patent-protected in China. Trustchem will issue a formal apology to DuPont for its losses and pay an undisclosed amount of monetary compensation.

Environment

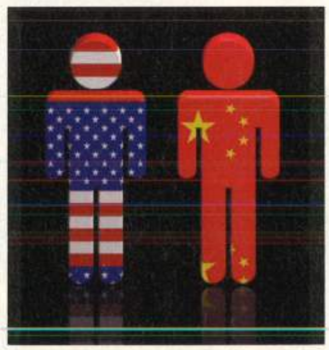
The PRC State Environmental Protection Administration (SEPA), People's Bank of China, and China Banking Regulatory Commission are urging commercial banks to use environmental compliance as a key factor in pre-loan risk assessments. This move is meant to provide enterprises with economic incentives to obey environmental rules. SEPA has already listed 30 domestic firms that have violated environmental standards.

The Organization for Economic Cooperation and Development (OECD) released an environmental performance review of China in July. The report makes 51 recommendations under three broad categories: closing the gap between implementation and policy, improving integration with

economic policies, and reinforcing support for international environmental cooperation. According to OECD, China has accepted these recommendations and plans to implement them.

US-China Relations

In preparation for the upcoming Joint Commission on Commerce and Trade (JCCT) and Strategic Economic Dialogue (SED) meetings in December, US Treasury Secretary Henry Paulson visited China for the fourth time since assuming his post. Paulson met President Hu Jintao, Vice Premier Wu Yi, and other top PRC officials. The third session of the SED



will focus on currency, product safety, energy, and the environment. In addition, this October's US-China Joint Economic Commission meeting in Washington, DC, will cover global imbalances, currency and financial sector reforms, and open investment policies.

Economy

China's economy grew at the fastest rate in 12 years, expanding 11.9 percent in the second quarter. Meanwhile, July inflation hit 5.6 percent, mainly because of a jump in food prices. The value of the renminbi rose to a high of 7.56 against the dollar in late July.

China's trade surplus hit a record $112.5 billion in the first half of 2007, up 84 percent from the first half of 2006. In response, some US lawmakers pushed harder for currency reform and introduced bills that would limit Chinese imports. Beijing also reacted by cutting value-added tax rebates on exports and placing restrictions on processing trade.

Product Safety

Both China and the United States have created new bodies to coordinate efforts on product and food safety. The Bush administration established the US Import Safety Working Group, while the PRC State Council formed a leading group on food and product safety. According to a new regulation, PRC officials will be allowed to conduct onsite examinations of manufacturing and sales facilities; consult, copy, and suspend trade-related contracts; confiscate illegal products; and suspend manufacturing and sales facilities that potentially threaten lives.

Over the last few months, US companies have recalled several products imported from China—from lead-tainted toys and toothpastes that contain diethylene glycol to poisonous pet food and substandard tires. Two-thirds of respondents in an NBC/*Wall Street Journal* poll have little or no confidence in Chinese food products. The American Importers Association notes that liability insurance will be critical for Chinese products exported to the United States.

中國進出口商品交易會

CHINA IMPORT AND EXPORT FAIR

A Road to Friendship & A Bridge to Trade

The 102 nd Session of China Import and Export Fair

October 15-20 & 25-30, 2007

Guangzhou • China

China Import and Export Fair (originally named Chinese Export Commodities Fair), also renowned as the Canton Fair, has been held for 101 sessions successfully since its inauguration in 1957. The Canton Fair is held in every spring and autumn in Guangzhou with a gross exhibition space of 630,000 m^2. Every session it attracts more than 16,000 reliable exhibitors who represent the advanced level and have premium quality products and around 200,000 buyers from over 210 countries and regions. Since its 101st session in April of 2007, the Canton Fair has ***set up the International Pavilion*** to overseas exhibitors, making the fair from a one-way marketplace that promotes China's export to a two-way dynamic trade platform that brings trade balance between China and the world. The change will certainly provide the overseas exporters with opportunities to get a profound understanding of the Chinese market and meet potential partners from different industries. Either for your sourcing or demonstrating your business via exhibition, the Canton Fair is ready to create a convenient and effective place for all professionals from industrial, commercial and trading communities around the world.

Time: October 15-20 & 25-30, 2007

Venues: Pazhou Complex & Liuhua Complex of China Import and Export Fair

Exhibits: Industrial Products, Textiles and Garments, Medicines and Health Products, Consumer Goods, Gifts

International Pavilion: **Time:** Oct. 15-20, 2007 **Venue:** Hall 21.2 & Hall 22.2, Pazhou Complex

Exhibit: (10 subsections are set up in accordance with exhibit category) Machinery and Equipment; Small Vehicles and Spare Parts; Electronics, IT Products and Household Electrical Appliances; Hardware and Tools; Building Materials and Kitchen and Sanitary Equipment; Raw Materials; Consumer Goods; Decorations and Gifts; Jewelry; Foodstuffs and Agricultural Products.

Space: 20,000 sqm ***Overseas exhibitors are welcome to participate.***

For more details, please refer to: ***www.cantonfair.org.cn***

The 103rd session of China Import and Export Fair will be held from April 15-20 & 25-30, 2008 in Guangzhou, China.

Hosts: Ministry of Commerce, PRC
People's Government of Guangdong Province
Organizer: China Foreign Trade Centre
(www.cftc.org.cn)
E-mail: info@cantonfair.org.cn
Tel: 86-20-26089999 Fax: 86-20-83335880

USCBC Hosts Annual Membership Meeting in Washington

The US-China Business Council (USCBC) held its 34th Annual Membership Meeting in Washington, DC, on June 5. Donald Hanna, managing director and head of Emerging Market Economic and Market Analysis, Citi, opened the conference with an update on China's economy. Alan Wm. Wolff, managing partner, Washington, DC, Office, Dewey Ballantine LLP, followed with a discussion on China's innovation drive and implications for US Companies. Next, Jill Malila, Client Management director, Mercer Human Resource Consulting, spoke on hiring, compensation, and retention trends and strategies. Godfrey Firth, chief representative, Shanghai, USCBC, discussed new challenges that face US companies expanding in China. Grant Aldonas, Scholl Chair in International Business, Center for Strategic and International Studies, and principal managing director, Split Rock International, Inc., spoke on bilateral commercial issues such as the Strategic Economic Dialogue, Congress, and future developments. Former Secretary of State and of the Treasury James A. Baker III, senior partner, Baker Botts LLP, delivered the luncheon keynote address on the future of US-China relations.

sardari.com

USCBC President John Frisbie (right) and Annual Meeting speaker Donald Hanna, director and global head of the Emerging Markets team in the Economic and Market Analysis Department at Citigroup Global Markets

Jill Malila, a principal and director of Client Management-China for Mercer Human Resource Consulting

USCBC Shanghai Chief Representative Godfrey Firth

Grant Aldonas, founder and principal managing director of Split Rock Consulting Inc.

James A. Baker III, former secretary of State and of the Treasury

Nearly 150 guests attended the Annual Meeting conference and luncheon

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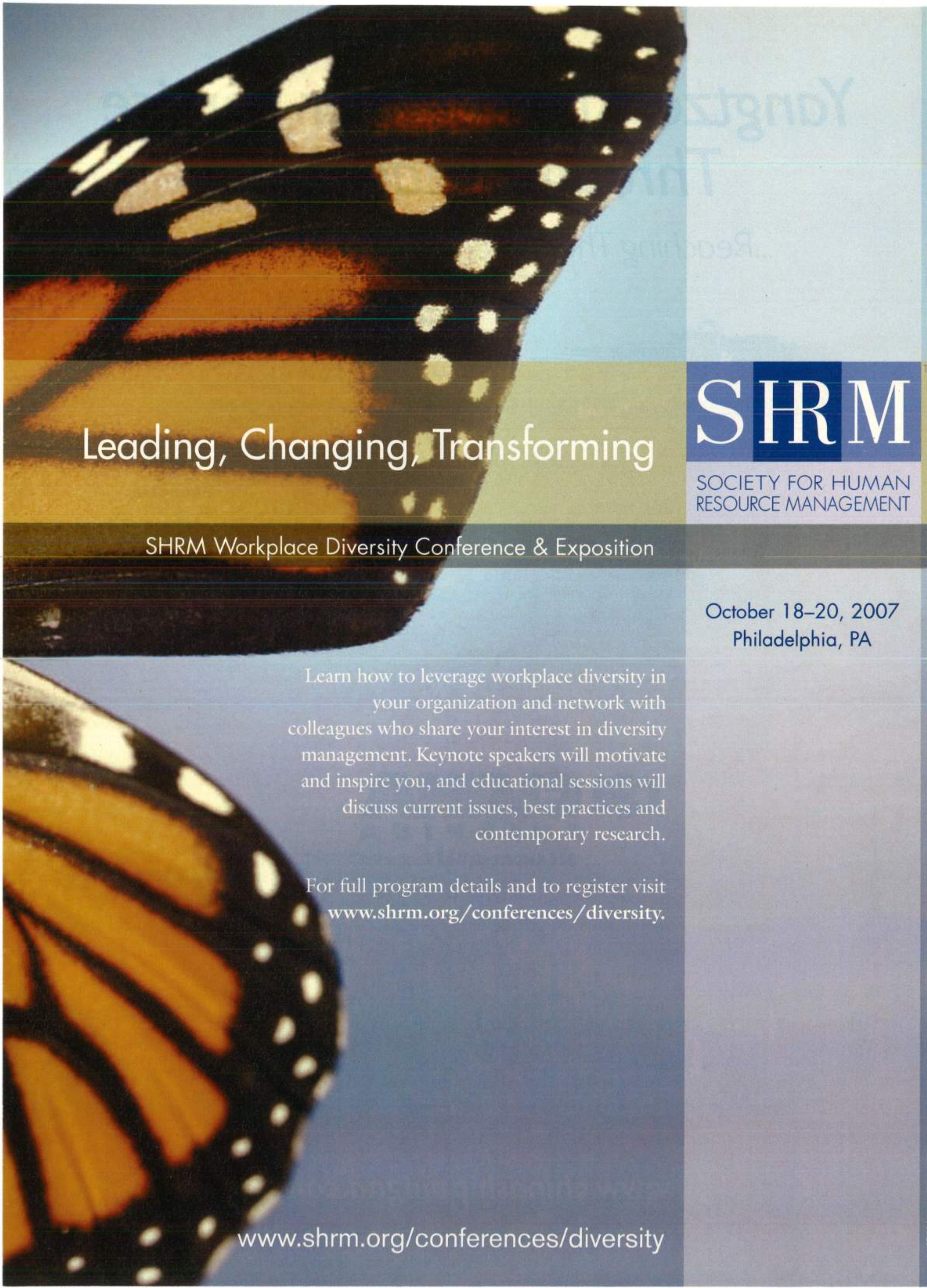
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Learn how to leverage workplace diversity in your organization and network with colleagues who share your interest in diversity management. Keynote speakers will motivate and inspire you, and educational sessions will discuss current issues, best practices and contemporary research.
For full program details and to register visit www.shrm.org/conferences/diversity.
www.shrm.org/conferences/diversity

Event Wrap Up

WASHINGTON

July

Issues Luncheon: US-China Joint Commission on Commerce and Trade (JCCT) Outlook

Featured Ira Kasoff, deputy assistant secretary for Asia, US Department of Commerce; and Tim Stratford, assistant US trade representative for China, Office of the US Trade Representative.

Briefing with Shanghai US Consul General Kenneth Jarrett

Featured Jarrett, who shared his perspective on the current business climate and US-China trade relations.

BEIJING

July

Reception with US-China Business Council (USCBC) President John Frisbie

Frisbie and USCBC Vice President of China Operations Bob Poole met with USCBC members to learn more about their views on policy and operating issues and to provide an update on the current political environment regarding China in Washington, DC.

August

Government Affairs Workshop and Luncheon

Featured discussions on recent developments in managing government affairs in China, including interacting with Chinese trade associations, integrating the China government affairs component into a global government affairs strategy, and structuring government affairs operations in China to complement a growing corporate China presence.

SHANGHAI

July

Luncheon: Labor Contract Law Provisions and Implementation

Featured Ma Jianjun, partner, Jun He Law Offices; and Susan Munro, counsel, O'Melveny & Myers LLP.

Reception with USCBC President Frisbie

Featured Frisbie and Poole.

HONG KONG

August

Issues Luncheon with USCBC President Frisbie

Featured Frisbie, who presented his and USCBC views on developments in Washington, bilateral initiatives including the Strategic Economic Dialogue and the JCCT, and current activity in Congress that could affect the trade relationship. The luncheon was cohosted by USCBC, AmCham Hong Kong, and AmCham China Business Committee leaders.

Upcoming Events

WASHINGTON

Issues Luncheons

September 20, 2007

October 18, 2007

November 15, 2007

Gala 2007

December 5, 2007

For more information, see p.55

Forecast 2008 Reception and Conference

January 30–31, 2008

For more information, see p.53

SHANGHAI

China Operations Conference

November 2, 2007

For more information, see p.39

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

USCBC President Visits China

USCBC President John Frisbie visited Beijing, Shanghai, and Hong Kong during the last two weeks of July to meet with senior PRC government officials and advocate USCBC positions. Frisbie also met with member company representatives to learn about their key operating and policy concerns.

In Beijing, Frisbie met with vice- and assistant-minister level officials at the ministries of Commerce, Finance, and Foreign Affairs, the three key PRC agencies coordinating the Joint Commission on Commerce and Trade (JCCT) and Strategic Economic Dialogue (SED). He underscored that the JCCT and SED dialogues are the best way to achieve progress on US companies' operating challenges and to undercut pressures for anti-China legislation. Frisbie also raised several specific market access issues as well as product safety and worrisome protectionist trends in trade and investment policies in the United States and China.

In a meeting with a vice governor of the People's Bank of China, Frisbie noted that the exchange rate continues to be of symbolic importance to many in the United States, even though its actual impact on the US trade deficit is likely overstated. Frisbie emphasized that USCBC believes the ultimate solution to this issue is for China to move toward a market-driven exchange rate and thus supports more financial sector reforms and market openings.

In Shanghai, Frisbie met with Shanghai Mayor Han Zheng and discussed the city's plans to develop its services sector. Frisbie gave Han the USCBC-commissioned report *The Prospects for US-China Services Trade and Investment*, which highlights the benefits to both economies of further opening China's services sector to foreign participation.

In addition to government meetings, Frisbie met with more than 100 USCBC member company representatives in the three cities and briefed them on his PRC government meetings and Washington trade politics. He also heard executives' detailed views on the operating environment in China. In Hong Kong, Frisbie spoke about the current state of US-China trade relations at a luncheon cosponsored by USCBC, AmCham Hong Kong, and AmCham China Business Committee leaders.

Get Ready for a Busy Fall

Erin Ennis

Before Congress adjourned for the month of August, it took more action on China-related issues and legislation. Here is a recap of what happened and what we think will—and will not—happen this fall.

Development

The Senate Banking and Finance committees each passed bills that address China's currency, both passing with sizeable majorities. Both measures have provisions that may be inconsistent with the United States' World Trade Organization (WTO) obligations. The US-China Business Council (USCBC) has weighed in against these provisions.

Next Steps

The Senate Banking and Finance committees will try to work out the differences in their competing currency bills in September. Senate Majority Leader Harry Reid (D-NV) has said only one currency bill will come before the Senate floor in the fall. It remains to be seen whether they can agree on a compromise approach or will choose one bill over the other. Even so, the Senate may not return to China legislation any time soon—this fall, it is slated to consider appropriations, an Iraq resolution, and a small measure called the Farm Bill. Nevertheless, floor time can always be found when the Senate really wants to take up an issue. That will be the case on currency legislation if a deal can be reached that garners support from both the Banking and Finance committees.

Development

The House Ways and Means Committee held its third China hearing of the year just before heading into its summer break. The hearing covered familiar ground, with many members voicing concern over China's exchange rate, government subsidies, and the safety of imported products. USCBC submitted testimony that urged members to avoid legislation that does not comply with WTO rules and that undermines US credibility.

Next Steps

Trade Subcommittee Chair Sander Levin (D-MI) said the purpose of the hearing was to set the stage for legislation that he is drafting. The Ways and Means committee staff worked on the measure in August, but it is not clear when it will be completed and ready for introduction. The bill will certainly address currency, but may also include provisions on alleged PRC subsidies and possibly intellectual property rights protection and import safety.

Trade enforcement legislation

In addition to these bills, Finance Committee Chair Max Baucus (D-MT) and Sen. Orin Hatch (R-UT) introduced legislation on trade enforcement that may be considered this fall. The bill would, among other things, limit the president's discretion in China-specific safeguard cases under Section 421 of the Trade Act of 1974. (Section 421 safeguards are China-specific limits on imports that cause or threaten to cause market disruption in the United States.) The broad measure also

- Grants the Senate Finance and House Ways and Means committees the authority to require the US Trade Representative (USTR) to identify specific market access barriers in its annual report;
- Creates a Senate-confirmed chief enforcement officer at USTR and forms an interagency trade enforcement working group; and
- Establishes a commission to review WTO dispute settlement rulings and prohibits legal changes in accordance with the ruling until Congress receives the commission's report.

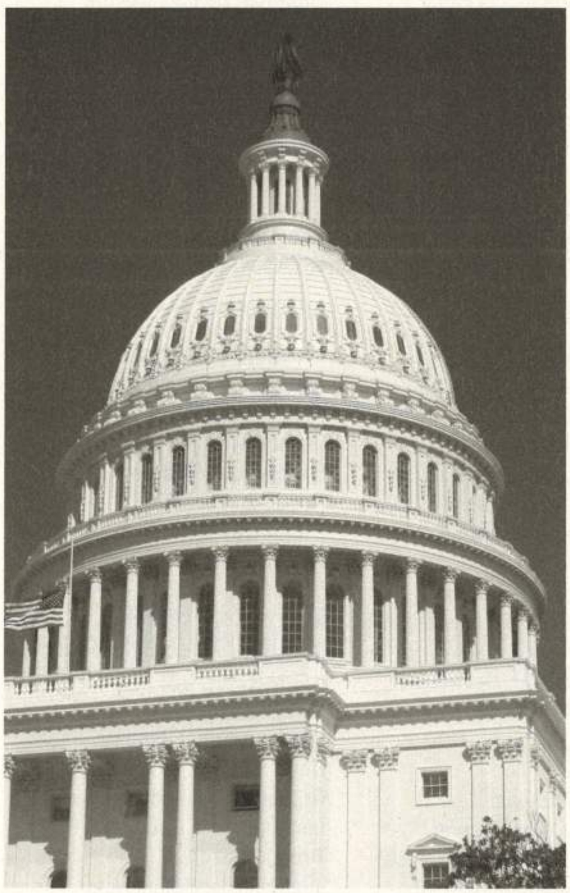
Regarding Section 421, the bill makes three changes. Under existing law, the president can waive the imposition of International Trade Commission-recommended trade restrictions on imports from China if he or she determines that such restrictions are not in the national economic interest of the United States or would cause serious harm to national security. The new bill requires extraordinary circumstances for both national security and economic waivers and stipulates that a waiver can be invoked only if the harm to national or economic security "clearly and significantly" outweighs the benefits of implementing the restrictions. Finally, the bill gives Congress the ability to

We should be ready to stand up and ensure that any bill that might move ahead is not detrimental to the bilateral trade relationship.

overturn a presidential waiver by passing a disapproval resolution in both chambers. The threat of legislation passing this year is high, but it is possible that in 2007 neither chamber will reach a consensus that leads to a bill being presented to the president for signature (or veto). In that case, efforts to pass a bill will certainly continue in 2008—which is of course an election year in the United States. Legislative chaos may ensue.

USCBC action

USCBC has been toiling away on all of these issues and working on its submission for USTR's October interagency hearing on China's WTO compliance. In addition to the usual engagement with Capitol Hill offices, USCBC released the full analysis of US exports to China by congressional district. The analysis, undertaken by the Trade Partnership, quantifies US exports to China from 2000—the year before China joined the WTO—through 2006 from all 435 congressional districts in the 110th Congress.



The report, which is available at www.uschina.org/public/exports and has been frequently cited in national and local press, is meant to better inform the debate about China trade as our legislators consider actions.

Readers should keep one more item in mind for the fall: USCBC, other associations, and individual companies will likely be asked to weigh in publicly on specific legislative proposals. We should be ready to stand up and ensure that any bill that might move ahead is not detrimental to the bilateral trade relationship. USCBC is looking forward to the opportunity to do so, and we hope US companies will as well. 完

Erin Ennis is vice president of the US-China Business Council in Washington, DC.

The China Business Review

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China Conference Calendar

China-related events near you

September–December 2007

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

China International Fair for Investment & Trade

SEPTEMBER 8–11

Location: Xiamen, Fujian: International Conference and Exhibition Center
Organizers: PRC Ministry of Commerce (MOFCOM); Provincial Government of Fujian; Municipal Government of Xiamen
Contact: Liaison Department of the Organizing Committee
Tel: 86-592-266-9825
cifit@chinafair.org.cn
www.chinafair.org.cn

Drug Development in China

SEPTEMBER 10–11

Location: Philadelphia, PA: Park Hyatt
Organizer: Cambridge Healthtech Institute
Contact: Jim Prudhomme
Tel: 1-781-972-5486
chi@healthtech.com
www.healthtech.com

Green Building and Energy Conservation: The Talk, Practice, and Performance

SEPTEMBER 13–14

Location: Hangzhou, Zhejiang: Hyatt Regency
Organizer: McGraw-Hill Construction
Contact: Cristina Hoepker
Tel: 1-866-727-3820
cristina_hoepker@mcgrawhill.com
www.construction.com/event

China International Small and Medium Enterprises (SME) Fair

SEPTEMBER 15–18

Location: Guangzhou International Exhibition Center
Organizers: National Development and Reform Commission (NDRC), SME Department; PRC Ministry of Finance, Enterprise Department; MOFCOM, Trade Development Bureau
Contact: Luo Kui
Tel: 86-20-8319-8921
cismef@sme.gov.cn
www.csmef.com.cn

China Summit: A Focus on Free and Fair Trade

SEPTEMBER 16–18

Location: Arlington, VA: Ritz-Carlton Pentagon City
Organizer: American Metal Market
Contact: Viviana Matasaru
Tel: 1-646-274-6214
vmatasaru@amm.com
http://amm.com/events/2007/china

China International Meat Industry Exhibition

SEPTEMBER 17–19

Location: Nanjing, Jiangsu: Nanjing International Exhibition Center
Organizers: China Meat Association; Beijing Zhongyue-Onis Exposition Co., Ltd.
Contact: Bian Zenglin
Tel: 86-10-6609-5157
chinameat@sina.com
www.cimie.com

Bridging the Cultural Divide: Strategies and Tactics for Sino-American Business Relationships

SEPTEMBER 19–21

Location: Traverse City, MI: Grand Traverse Resort
Organizer: Butzel Long; Michigan State Law College; National Center for Dispute Settlement
Contact: Edward F. Hartfield
Tel: 1-586-741-0870
ehartfield@ncdsusa.org
www.law.msu.edu/bridging

China Northeast Asia (Shenyang) Commodities Fair

SEPTEMBER 20–23

Location: Shenyang, Liaoning: Liaoning Industrial Exhibition Hall
Organizers: China Council for the Promotion of International Trade (CCPIT); Shenyang Municipal Government
Contact: Justin Zhang
Tel: 86-24-2272-9952
ccpitlei@hotmail.com
www.northeastasiafair.cn

Chengdu Motor Show

SEPTEMBER 22–28

Location: Chengdu, Sichuan: New International Convention and Exposition Center
Organizer: Hannover Fairs China Ltd.
Contact: Wang Fei
Tel: 86-21-5045-6700
cdms@hfchina.com
www.cd-motorshow.com

The Dragon and the Elephant: Developing Innovation Capacity in China and India

SEPTEMBER 24–25

Location: Washington, DC: The National Academies' Headquarters
Organizer: The National Academies, Board on Science, Technology, and Economic Policy
Contact: Mahendra Shunmoogam
Tel: 202-334-2823
mshunmoogam@nas.edu
www7.nationalacademies.org/step

CEBIT Satellite, Broadcast, Cable & Networks

OCTOBER 10–13

Location: Shanghai New International Expo Center
Organizers: CCPIT, Electronics and Information Industry Sub-Council; Hannover Fairs Shanghai, Ltd.
Contact: Judy Zhu
Tel: 86-21-5045-6700
cebit-asia@hfchina.com
www.cebit-asia.com

Power Transmission and Control Asia

OCTOBER 10–13

Location: Shanghai New International Expo Center
Organizers: Deutsche Messe AG; Hannover Fairs Shanghai Ltd.
Contact: Judy Zhu
Tel: 86-21-5045-6700
ptc-asia@hfchina.com
www.ptc-asia.com

China Magnetics 2007

OCTOBER 15–17

Location: Beijing: Novotel Xinqiao Hotel
Organizer: IntertechPira
Contact: Joshua Vermette
Tel: 207-781-9605
jvermette@intertechusa.com
www.intertechusa.com

The 102nd China Import & Export Fair, Phase I & II

OCTOBER 15–30

Location: Guangzhou: Pazhou and Liuhua Complexes; Phase I (Oct. 15–20) Phase II (Oct. 25–30)
Organizers: MOFCOM; China Foreign Trade Center
Tel: 86-20-2608-9999
webmaster@cantonfair.org.cn
www.cantonfair.org.cn

International Forum on China Trade Compliance

OCTOBER 16–17

Location: Omni San Francisco Hotel
Organizer: American Conference Institute
Tel: 212-352-3220
customercare@americanconference.com
http://americanconference.com

China Conference Calendar

Macao International Trade & Investment Fair

OCTOBER 18–21

Location: Venetian Macao Convention and Exhibition Center
Organizer: Macao Trade and Investment Promotion Institute
Tel: 853-2871-3913
ipim@ipim.gov.mo
www.mif.com.mo

Food Logistics & Supply Chain Management World China

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OCTOBER 31–NOVEMBER 2

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Contact: Carol Chen
Tel: 86-10-8451-1832
carol@ejkcn.com
http://ejkcn.com/energychinaexpo

Wind Power Shanghai

NOVEMBER 1–3

Locations: Shanghai International Exhibition Center; Sheraton Grand Taipingyang Hotel Shanghai
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Contact: Eelia Yao
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eelia@siec-ccpit.com
www.windpowershanghai.com

China International Travel Mart

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Location: Kunming, Yunnan: Kunming International Convention and Exhibition Center
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Location: Hong Kong: Grand Hyatt
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marianne.bunton@dowjones.com
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China Electronics Fair

NOVEMBER 14–17

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The Sales and Distribution Revolution

Companies in China must constantly reassess their sales and distribution models to keep up with a rapidly changing market

David C. Michael

Growth and more growth—this is the expectation that global executives place upon their China operations today. Yet for every company, sustaining growth in China is a formidable challenge. Opportunities shift rapidly, and the business model built for one stage of China market growth is often ill-equipped to capture the next stage. This is particularly true in sales and distribution. Companies that fail to significantly reinvent their China sales and distribution model every two to three years are almost certainly missing significant growth opportunities.

The changing shape of Chinese demand

In the consumer sector, demand is rising rapidly and spreading across broader geographic areas, as an increasing number of Chinese consumers have more spending power than ever before. Consumer demand, which was largely limited to China's biggest cities just a few years ago in many product categories, is now spread across hundreds of cities. According to Boston Consulting Group (BCG) analysis, more than half of affluent households (defined as urban households with an annual income greater than $4,300) will reside outside of the top 40 cities by 2008 (see Figure 1). Tier 3 cities will be home to 7 million affluent households, while Tier 4 cities will boast 10.6 million. (Tiers are defined by 2005 population and per capita income.) Reaching these new consumer segments is the key to sustained growth.

In the industrial sector, manufacturers, including a growing number of local private companies, are setting up shop and increasing their presence across China (see Figure 2). Reaching these new industrial customers requires extending the reach of sales and distribution networks.

Changing routes to the customer

As consumer demand changes in China, consumer interfaces are also evolving, particularly at the retail and distributor level. Large, nationwide mass market retail chains are rapidly modernizing and consolidating, and distribution channels are continually changing. For instance, one channel may grow and consolidate quickly, taking up a significant portion of the premium market volume. A good example of this is the emergence of electronics superstores throughout China. Until the early 2000s, the majority of consumer electronics were sold through state-owned department stores and independent "mom-and-pop" retailers. Few organized chain stores existed, and none were national or even regional in scope. Today, consumer electronics chain store groups, such as Guomei Electronic Appliance Co. Ltd. and Suning Appliance Co. Ltd., operate networks of hundreds of stores across China. The emergence of these chains creates an opportunity for foreign companies to work directly with retailers and avoid the use of distributors as intermediaries, which was previously the only viable way to reach thousands of mom-and-pop stores.

As these chains expand their reach to smaller cities, their foreign suppliers can move with them. On the other hand, the rapid rise of such chains also creates serious "channel conflict" dilemmas for the supplier—how to maintain business relationships with retailers that are in decline as new retailers rise, and to what extent to make decisions in areas such as pricing that end up accelerating the rise of such chains.

The Chinese grocery retailer Lianhua Supermarket Holdings Co. Ltd. has adapted its business to become a successful retail chain in the supermarket segment. Until a few years ago, most people did their grocery shopping in the local wet market, but shoppers have shifted toward supermarkets and hypermarkets. These new channels deliver a superior shopping experience, selection, and hygiene. Lianhua, initially a supermarket retailer, entered into a joint venture with a subsidiary of Carrefour Group and expanded its range of store formats to include hypermarkets. In part because of this pairing, Lianhua's revenue from hypermarkets has grown from ¥947,717 ($125,310) in 2002 to ¥8.6 million ($1.1 million) in 2006.

Another change in consumer interfaces is the development of modern distributors. Historically, many Chinese "distributors" were entrepreneurial traders (or even smugglers) who provided little transparency to the company and the end-consumer. A new set of distributors has emerged within the past four years, however. They are more professional and specialize in logistics and distribution services, such as inventory management, customer service, and delivery. Typically, these players focus on a limited set of provinces or market segments and make money based on fees for the distribution services they provide, rather than on price arbitrage of the goods that they buy and sell. These changes in distribution practices and organization have created new routes to market and new channel partners. But because identifying and cultivating such players may not be straightforward, foreign companies that do this well will have an advantage.

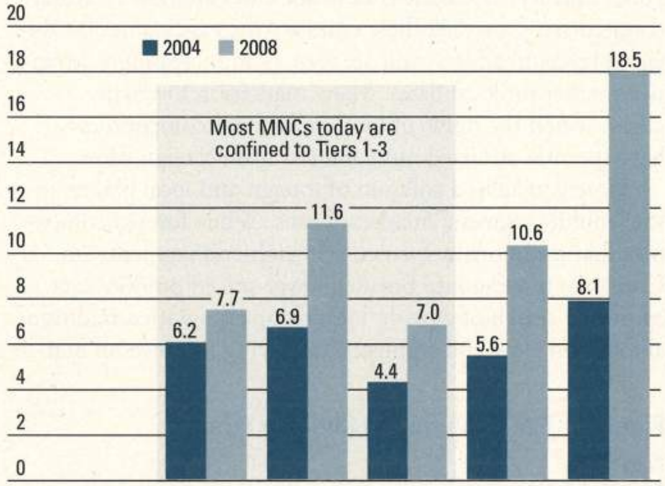
Diagnostic Questions

Companies are often unsure how to start adapting their sales and distribution models. Below is a list of questions to spur thinking on the subject:

- What sales and distribution models will your company need in China 24 months from now? How different are those models from your current models? Are you preparing for the change?
- Do you have a clear understanding of who your end-customers are, and of their needs? Or is your line of sight blocked by middlemen feeding you limited information?
- Do you know what your salespeople in China are doing today? Are you confident that they are being managed effectively? Are they really working in your company's best interests?
- Do you know what your competitors' sales and distribution models are? Are you confident that your models are better than theirs? If not, then how will you develop a better approach?
- Do you have the right balance of coverage, cost, and control in your China sales and distribution model? Where is the imbalance, and how will you fix it?
- What companies in other industries in China follow best practices in sales and distribution? What have you learned from them?

—*David C. Michael*

Figure 1: More than Half of Affluent Households will be Outside the Top 40 Cities by 2008



	Tier 1	Tier 2	Tier 3	Tier 4	Rest of China
Number of cities	3	15	22	70	500+
CAGR, 2004–08	5.4%	14.0%	12.1%	17.2%	22.8%

Notes: Households with income greater than ¥3,000/month. $1=¥7.6. CAGR=compound annual growth rate in the number of higher income households. MNC=multinational corporation.
Sources: Boston Consulting Group, PRC National Bureau of Statistics

Figure 2: Potential Customers in Mid- and Low-Level Industrial Segments

	Segment	Customer size	No. of potential industrial customers 2006		2008E
	A	> ¥750 million	10	~600 above Cutoff	15
	B	> ¥150 million	70		80
Cutoff ¥40 million	C	> ¥75 million	80		100
	D	> ¥15 million	540		670
	E	< ¥15 million	9,300		
		Market size	~¥40 billion		~¥50 billion

Note: An analysis for one industrial client revealed a vast potential market of small customers.
Source: Boston Consulting Group

David C. Michael is the Beijing-based managing director of the Boston Consulting Group's Greater China practice.

New competitive pressures

In most market segments, more foreign companies are entering China, and a growing number of cost-focused domestic companies are emerging (see Figure 3). Various battles loom as the competition intensifies. For example, many goods and services markets in major cities are now intensely competitive—after all, these cities are the easiest ones for foreign players to address and are seen as an increasingly attractive market for local firms. Many markets in lower-tier cities—often the home of local incumbent competitors—have recently attracted more interest from foreign firms.

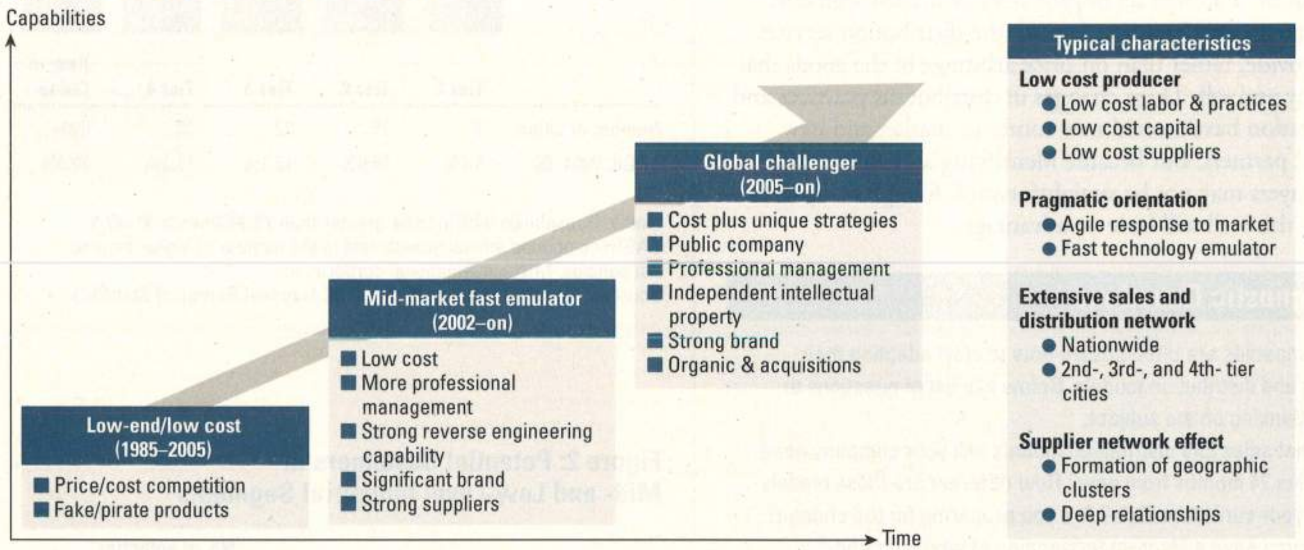
More generally, a collision of foreign and local players in the "middle segment" markets looms. While foreign companies that traditionally focused on "high-end segments" in China are moving into broader, lower-priced product categories in search of growth, local companies with a traditional focus on "low-end segments" are trying to move up market. In the past year, this phenomenon has occurred in many industrial product sectors in China, including motors, switching components, and construction equipment.

What it takes

A number of diverse issues confront companies in China: how to cover various geographic and customer segments; how to manage the end-customer relationship; how to structure the distributor and sales force; how to streamline processes and boost productivity; and how to manage the shift into broader market segments beyond the "high end." These issues put massive stress on existing sales and distribution models, which need to be reinvented frequently to ensure continued growth in China's changing business environment.

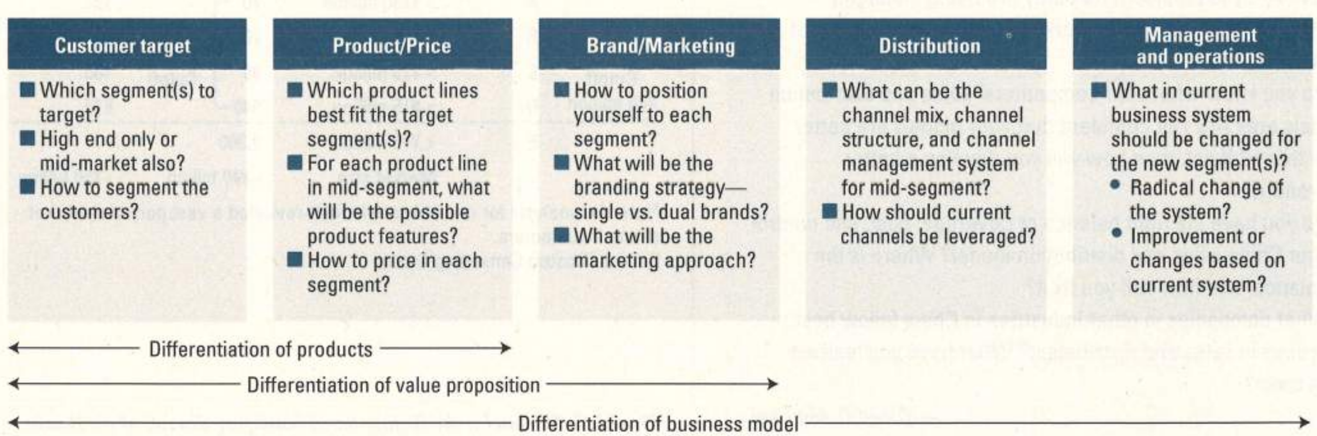
To respond effectively to competitive pressures in China today, companies need to operate multiple distri-

Figure 3: The Evolution of Chinese Firms



Source: Boston Consulting Group

Figure 4: Align Business Models to Capture Superior Growth



Source: Boston Consulting Group

bution models concurrently. Companies should tailor these models to each location and market segment. For example, in one market segment a company may need a sales force to interact directly with its customers, while in another market segment, multiple levels of distribution may be more cost-effective.

■ **Geographically specific solutions** China is a large country with many regional markets, each potentially requiring a different sales and distribution model.

■ **Re-evaluation of distribution structure** Increasingly, companies directly target end-customers (such as major corporate accounts) or retailers rather than relying on middlemen. Retail consolidation and the rise of large local corporate customers have made this a viable strategy in many situations.

■ **Regional management structure** To operate in local markets effectively and correctly gauge local market conditions, companies need a network of offices and organizations in different regions across China. Maintaining a single headquarters in Beijing or Shanghai, or a few regional offices, is no longer sufficient.

■ **Checks and balances** To manage a large and geographically dispersed organization successfully, companies must develop and continually improve tools for measuring and monitoring the performance of sales and distribution models.

■ **A dual timeframe approach to management** Companies must manage their existing sales and distribution model while developing a new one, recognizing that a new model may be required 12–24 months from now (see Figure 4).

Re-invent—or else

Consumer demand and market segments in China are continually evolving as they spread across a broader geographic area and consumer spending power increases significantly. New competitive pressures from small regional players are emerging, and traditional consumer interfaces are changing. As a result, companies must reevaluate—and change—their sales and distribution models to avoid stagnation and achieve sustained growth in China. 完

Case Studies: Sales and Distribution Strategies

The following cases detail examples of multinational corporations (MNCs) that have faced sales and distribution challenges in China and what they have done to address them.

Consumer electronics

A global consumer electronics company provides a successful example of the rapid evolution of a sales and distribution network in China over four years. In Years 1 and 2, the company started with a target market of Beijing, Guangzhou, Shanghai, Shenzhen, and Tianjin; distribution relationships with three national distributors and agents; a marketing focus on national-level brand marketing via TV; and a small company headquarters in China. In Year 3, it expanded its target market to include the top 50 cities, increased its distribution network to 65 provincial distributors, segmented its marketing focus, and set up five regional offices. In Year 4, the company's target market included more than 200 cities and neighboring countries, and its distribution network included 3,000 retail accounts, 65 distributors, and 400 wholesalers. It also shifted its marketing focus to heavily emphasize point-of-sale influence. Its corporate structure, based in five regions, included more than 8,000 employees. From Year 1 to Year 4, total sales in China more than quadrupled.

Industrial goods

In China's industrial goods sector, customer demand is shifting from high-end to mid-level markets. One global engineering company is a prime example of an MNC that is considering adapting its products and processes to accommodate this evolution. Traditionally, the company focused on high-end, high-margin products but noticed that its customer base is increasingly migrating to mid-level products, which are designed according to more basic specifications than high-end products. Its clients' purchase decisions are changing as local mid-market companies become more competitive throughout China. Customers are becoming more price sensitive as the decision power to purchase industrial products shifts from lower to higher levels of the organization. As a result, the company has begun to offer lower-priced products to compete with the growing number of mid-market local companies. The company also realized that its existing sales model was unsuitable for serving the more diverse and fragmented mid-market customer base and is therefore using a radically different sales model to serve this market. The new model involves using distributors different from those used in the old model to access new types of customers. Under the new model, levels of customer service and sales costs are lowered and products simplified. (Simplified products are marketed under a different brand to avoid undermining the top-end version.)

Apparel

Sales and distribution networks are also evolving in the apparel market, which is becoming more fragmented and growing quickly outside of first-tier cities. An apparel MNC needed to determine how to expand its business quickly through local franchises while developing a key brand in lower-tier cities to drive growth and stay competitive. In response to this growing demand, the company created a new, extensive franchise model and provided the tools and management support to help its franchisees reach these goals.

—David C. Michael

China's Investment Climate City by City

A recent World Bank report ranks the investment environment of 120 cities in China

William P. Mako

In terms of the investment climate for foreign firms, China's cities vary widely. According to a recent World Bank study of 12,400 foreign and domestic firms in 120 cities in China, the level of foreign investment in individual cities depends greatly on per capita income, transport costs, education, and skill levels; local government effectiveness, measured by tax burden, labor flexibility, and efficiency of importing and exporting; and quality of life, measured by environment, health, and education levels (see p.25).

City characteristics

Local market size and income, port access, supplier and service provider access, and human resources contribute heavily to the attractiveness of China's coastal cities as destinations for foreign investment. The World Bank study ranks China's "Mega Five" cities—Beijing, Tianjin, Shanghai, Guangzhou, and Shenzhen (in that order)—in the top quintile for overall investment climate and for urban quality of life. According to the study, however, only one-fifth of differences in the extent of foreign ownership in Chinese cities is associated with differences in city characteristics such as population size, economic growth, and transport costs, while one-quarter is associated with educational levels and other urban quality of life factors. The remaining differences are associated with effectiveness of local government.

Government efficiency indicators

To evaluate government efficiency, the survey measured taxes and fees, company expenditures on entertainment and travel, time spent on bureaucratic interactions, and import-export efficiency. The study finds that, in general, the investment climate of China's regions for foreign and domestic companies can be ranked from best to worst as follows:

1. Southeast: Fujian, Guangdong, Jiangsu, Shanghai, and Zhejiang;

2. Bohai Bay region: Beijing, Hebei, Shandong, and Tianjin;

3. Northeast: Heilongjiang, Jilin, and Liaoning;

4. Central China: Anhui, Henan, Hubei, Hunan, and Jiangxi;

5. Southwest: Chongqing, Guizhou, Guangxi, Hainan, Sichuan, and Yunnan; and

6. Northwest: Gansu, Inner Mongolia, Ningxia, Qinghai, Shaanxi, Shanxi, and Xinjiang (see Map).

The results of individual cities within each region vary, and domestic and foreign firms are often sensitive to somewhat different sets of investment climate issues, as detailed below.

Taxes

Taxes and fees average 3.1 percent of sales revenue in the top tenth percentile of cities, versus 6.9 percent in the bottom tenth percentile. In general, companies in the Southeast average the lowest taxes and administrative fees relative to sales, and companies in the Southwest average the highest (see Table 1). Southeast and Bohai Bay firms report a somewhat lower value-added tax (VAT) burden. This may reflect greater reliance on component purchases instead of in-house production, a higher number of VAT-advantaged high-tech firms, and higher export sales with VAT refunds. (The survey was conducted before recent adjustments to VAT rebates.) It may also indicate that city-specific administrative fees, such as those for construction, land use, enterprise registration, water, and road transport, may be lower in the wealthier coastal cities than in interior cities.

Overstaffing

Foreign and domestic firms indicate that overstaffing averages 2.5 percent or less of their total workforce in southeastern and Bohai Bay cities versus 3 to 4 percent elsewhere in China. This pattern may reflect higher demand for labor in China's booming coastal cities and less flexibility in regulating labor relations in other parts of the country.

Import-export efficiency

According to the survey, importing and exporting tends to be most efficient in Southeast and Bohai Bay cities; average import and export times are 70–130 percent longer in other regions. PRC authorities maintain that customs and inspection procedures are standardized nationwide. Further research is needed to confirm whether differences in import and export processing times reflect official procedures, efficiency of service providers, sophistication among local importers and exporters, or a combination of factors.

Bureaucracy

Coastal cities appear to be less bureaucratic than interior cities, even within regions. Asked how often they interact with four government agencies (local tax administration, public security, environmental protection, and labor and social security offices), firms surveyed in southeastern and central cities reported an average of 52 days per year. Averages range from 63 to 78 days for the other regions. Looking at survey results by type of firm, it appears that bureaucratic interactions are relatively high for producers of high-value goods or bulk goods and for state-owned enterprises (SOEs) but relatively low for producers of low-value goods and for foreign-invested enterprises (FIEs).

About the Survey

The findings of the World Bank report *Governance, Investment Climate, and Harmonious Society: Competitiveness Enhancements for 120 Cities in China* are based on a survey of 12,400 firms and data from 120 cities in 2005, administered and compiled by the Survey Service Center of the PRC National Bureau of Statistics, in cooperation with the State Information Center. Sixty-four percent of the firms interviewed were domestic private enterprises, 28 percent were foreign-invested enterprises, and 8 percent were majority state-owned enterprises. All interviewees were from manufacturing firms.

The report ranks the cities in terms of overall investment climate and government effectiveness, for both domestic and foreign firms. Rankings build on regression analyses of the relationship between a performance measure (such as percentage of firms with foreign ownership) and independent variables, which may include market, local government effectiveness, and urban quality of life indicators. For the full report, see www.worldbank.org/cn.

—*The World Bank*

Regions of Mainland China

Note: Tibet was not included in the survey.

Comparing cities within regions

Scores for each city within a region can vary widely. Investors that are interested in a particular region should study each city's investment climate before choosing where to invest.

Mega cities vs. smaller coastal cities

Given the many desirable characteristics of the Mega Five, such as relatively high income, good access to seaports, rich human resources, good urban infrastructure, and generally good quality of life, it is unsurprising that Shenzhen, Guangzhou, Shanghai, Tianjin, and Beijing rank in the top quintile of 120 cities in terms of overall investment climate (see Table 2). These mega cities do less well, however, when the ranking is based more narrowly on local government effectiveness for FIEs. For instance, when looking specifically at effectiveness for FIEs, Shanghai slips from seventeenth to twenty-sixth place, Tianjin from nineteenth to twenty-ninth, and Beijing from twenty-third to thirty-second. Why is this?

In many cases, it appears that China's smaller coastal cities are outperforming the Mega Five in terms of creating a business-friendly environment for foreign firms. For instance, firms in the five cities ranked highest in terms of local government effectiveness, or the "Top Five"—Huizhou, Dongguan, and Jiangmen, Guangdong; Qingdao, Shandong; and Shantou, Guangdong (in that order)—report that taxes

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and fees average 2.6 percent of sales revenue. (Shenzhen, which ranks third in terms of local government effectiveness for foreign firms, is included as one of the Mega Five.) This average is notably higher (4.6 percent) for the Mega Five (see Table 3). Overstaffing averages 0.7 percent of the workforce for surveyed firms in the Top Five, versus 2.2 percent in the Mega Five. Times to process imports or exports average 1.7 days for surveyed firms in the Top Five, versus 3.6 days in the Mega Five. Lastly, firms report that interactions with major local bureaucracies average 38 days a year in the Top Five versus 82 days in the Mega Five.

Table 1: Investment Climate Indicators: Regional Averages

Region	Taxes (% of sales)	Overstaffing (% of workforce)	Relative time to import/export (Southeast = 1)	Bureaucratic interaction (days/year)
Southeast	4.1	0.9	1.0 x	52
Bohai Bay	4.5	2.5	1.2 x	72
Northeast	5.4	3.7	1.7 x	63
Central	5.0	3.3	1.9 x	52
Southwest	6.3	3.2	1.9 x	66
Northwest	5.8	4.1	2.3 x	78

Table 2: Top 20 Cities for Foreign Firms

Overall investment climate for FIEs	Local government effectiveness for FIEs
1. Dongguan, Guangdong	1. Huizhou, Guangdong
2. Shenzhen, Guangdong	2. Dongguan, Guangdong
3. Suzhou, Jiangsu	3. Shenzhen, Guangdong
4. Zhuhai, Guangdong	4. Jiangmen, Guangdong
5. Huizhou, Guangdong	5. Qingdao, Shandong
6. Foshan, Guangdong	6. Shantou, Guangdong
7. Qingdao, Shandong	7. Zhuhai, Guangdong
8. Jiangmen, Guangdong	8. Suzhou, Jiangsu
9. Xiamen, Fujian	9. Shaoxing, Zhejiang
10. Guangzhou, Guangdong	10. Foshan, Guangdong
11. Dalian, Liaoning	11. Weihai, Shandong
12. Weihai, Shandong	12. Hangzhou, Zhejiang
13. Hangzhou, Zhejiang	13. Ganzhou, Jiangxi
14. Shantou, Guangdong	14. Guangzhou, Guangdong
15. Yantai, Shandong	15. Maoming, Guangdong
16. Shaoxing, Zhejiang	16. Xiamen, Fujian
17. Shanghai	17. Dalian, Liaoning
18. Ningbo, Zhejiang	18. Fuzhou, Fujian
19. Tianjin	19. Yantai, Shandong
20. Fuzhou, Fujian	20. Zhangzhou, Fujian

Note: FIEs = foreign-invested enterprises

Top- and bottom-ranked southeastern cities

Among the four southeastern cities ranked highest in terms of local government effectiveness for foreign investors—Huizhou, Dongguan, Shenzhen, and Jiangmen—taxes and fees average 1.1 to 2.8 percent of sales revenue (see Table 4). Taxes and fees average 5.3 percent in surveyed firms in the Southeast's four lowest-ranked cities. Import and export times are reported to be notably faster (40–50 percent of the regional average) for the top four cities relative to the four lowest-ranked cities. Overstaffing ranges from 0.1 to 0.7 percent of the workforce for surveyed firms in the top-ranked cities but is much higher in the bottom-ranked cities. In three of the top-ranked southeastern cities (Huizhou, Dongguan, and Jiangmen), firms report 31–48 days of interaction with major bureaucracies per year—versus 58 days for surveyed firms in the bottom-ranked cities.

Top- and bottom-ranked Bohai Bay cities

The Bohai Bay region presents a similar pattern. Among the three cities ranked highest for government effectiveness for foreign firms—Qingdao, Weihai, and Yantai, all in Shandong—taxes and fees average 3.1–3.9 percent of sales by surveyed firms, versus 4.6 percent for the region's bottom-ranked cities. Firms in Bohai's top-ranked cities report faster import and export times than those in the region's three bottom-ranked cities. Overstaffing ranges from 0.2 to 2.2 percent in Bohai's top three cities, versus 4.1 percent in the region's bottom three cities.

The Northeast

Among northeastern cities, survey data indicate that Dalian, Liaoning, is a clear investment climate leader—offering relatively low tax burdens (3.1 percent of sales), efficient import and export processing (6.7 days), and labor flexibility (1.2 percent). In contrast with the Southeast and Southwest, growth in the Northeast appears not to have strained the region's power and transportation infrastructure. Except for Dalian, however, northeastern cities must catch up in terms of offering a competitive investment climate.

Central China

Central cities lag behind southeastern cities in many measures of investment climate and local government effectiveness. Relative to other central cities, Nanchang and Ganzhou, Jiangxi; and Shangqiu, Zhoukou, and Xuchang, Henan, score reasonably well in one or two of the key measures of tax burden, export and import efficiency, and labor flexibility.

The Southwest

Among southwestern cities, survey data indicate that Deyang, Leshan, and Chengdu, Sichuan; Chongqing; and Guilin, Guangxi, offer some advantages, such as tax burdens below the regional average and—in Deyang and Guilin—less bureaucracy. According to survey data, however, none of

Table 3: Investment Climate Indicators: Top Five vs. Mega Five Cities

Group/city	Taxes (% of sales)	Overstaffing (% of workforce)	Import/export processing (days)	Bureaucratic interaction (days/year)
Top Five				
Huizhou	2.8	0.5	1.5	31
Dongguan	1.7	0.0	1.6	48
Jiangmen	1.1	0.7	1.7	43
Qingdao	3.5	1.4	2.1	36
Shantou	3.7	1.1	1.6	31
Average	**2.6**	**0.7**	**1.7**	**38**
Mega Five				
Beijing	5.1	2.6	4.3	82
Tianjin	6.3	4.7	4.1	93
Shanghai	5.3	1.6	4.4	60
Guangzhou	4.3	1.8	3.3	85
Shenzhen	2.0	0.1	2.0	90
Average	**4.6**	**2.2**	**3.6**	**82**

Note: Huizhou, Dongguan, Jiangmen, and Shantou are in Guangdong; Qingdao is in Shandong.

Table 4: Investment Climate Indicators: Southeast and Bohai Bay Regions

Region/city	Taxes (% of sales)	Import/export time vs. region's average	Overstaffing (% of workforce)	Bureaucratic interaction (days/year)
Southeast				
Top 4 cities				
Huizhou	2.8	0.4 x	0.5	31
Dongguan	1.7	0.4 x	0.0	48
Shenzhen	2.0	0.5 x	0.1	90
Jiangmen	1.1	0.5 x	0.7	43
Avg. of bottom 4 cities	5.3	1.9 x	1.5	58
Bohai Bay				
Top 3 cities				
Qingdao	3.5	0.5 x	1.4	36
Weihai	3.1	0.6 x	0.2	50
Yantai	3.9	0.8 x	2.2	61
Avg. of bottom 3 cities	4.6	1.6 x	4.1	90

Note: The top four southeastern cities are in Guangdong; the top three Bohai Bay cities are in Shandong.
Source for Tables 1-4: World Bank

these cities are consistently good performers in terms of local government effectiveness for foreign investors.

The Northwest

Among northwestern cities, surveyed firms report that taxes and fees average 3.6–5.3 percent of sales revenue in Wuzhong and Yinchuan, Ningxia; and in Urumqi, Xinjiang. For these three cities, firms report that interactions with major bureaucracies average 45–62 days per

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Reforming China's Investment Structure

The World Bank report suggests that, especially for less competitive cities, reforms could trigger significant gains in firm productivity and foreign investment. Local, provincial, and central governments would do well to

- Simplify licensing and other procedures required to start a business;
- Improve transparency and simplify approvals for urban land use;
- Eliminate many city-specific administrative fees and adopt objective measures for remaining fees;
- Maintain best-practice customs clearance procedures at inland customs posts and provide more public information on clearance procedures and requirements;
- Develop more consistent labor practices, by tightening enforcement where necessary to improve worker protection and loosening labor rules where possible to enhance labor flexibility;
- Privatize the remaining small and medium-sized state-owned enterprises (SOEs), liquidate nonviable SOEs, and improve corporate governance at large SOEs;
- Encourage foreign investment in local banks, such as city commercial banks;
- Provide additional legal and regulatory protection for lenders; encourage more widespread credit reporting; and make it easier for small and medium-sized enterprises (SMEs) to use assets other than real estate as collateral; and
- Encourage wider use, by local banks, of international best practices in SME lending.

The report also recommends sustained spending on education, health, and environmental protection, particularly in less-competitive cities; more investment in urban infrastructure and services; and further liberalization of China's transport and logistics sectors to reduce shipping costs for firms located in China's interior.

The World Bank Group continues to work with local partners, including the State Information Center, to refine its methodology and update data on city-level investment climate.

—The World Bank

The Challenge for Brands in the Other China

To tap the vast number of consumers in lower-tier cities in China, companies must better understand local consumer choices and employ effective branding strategies

Kunal Sinha

Beyond the megalopolises that attract the bulk of foreign investment in China—Beijing, Guangzhou, and Shanghai—much of the rest of China remains shrouded in mystery for many foreign investors. Few foreign companies know much about the lower-tier cities in China, and this lack of knowledge poses a challenge for most foreign marketers and communicators. As foreign businesses attempt to expand to all parts of China, they must make an effort to understand the hopes and aspirations of consumers in smaller Chinese cities.

Marketers have traditionally targeted affluent Chinese consumers, most of whom live in the large cities. In fact, until recently, China's wealth has been concentrated in the mammoth cities along the coast—an area that accounts for 51 percent of the total population and nearly two-thirds of GDP, according to the *2006 China Statistical Yearbook* (see Map).

There are signs of change, however. Currently, 70 percent of China's affluent households (those earning more than ¥80,000 [$10,576] per year) is concentrated in the top eight cities, but this figure is expected to decline sharply by 2012 to only 11 percent. The proportion of affluent households in smaller cities is expected to more than quadruple, according to a 2005 study by Asian Demographics Ltd. In addition, the PRC government's recent drive to develop western China has already put in place infrastructure, which will make it easier to transport new products to lower-tier cities where consumers previously had little or no exposure to foreign brands. Two-thirds of all retail sales in China already occur outside the 24 largest cities, according to an AccessAsia report.

A strong sense of community and increasing prosperity in the lower tiers provide foreign marketers new opportunities. Foreign companies may no longer need to convince an *individual* customer to buy a product, but rather target communities that share certain characteristics or opinion leaders and gatekeepers within the community.

To further understand consumers and marketing opportunities in China's interior, Ogilvy Discovery and Mindshare Insights in 2006 conducted the *Real China Revealed* study (see p.61). The results of this study offer a window into the attitudes and preferences of a vast ocean of consumers that remains largely untapped.

Shopping

Consumers in Tiers 1 and 2 shop more frequently—66 percent of the respondents said they shop at least once a week, including grocery shopping, compared to 52 percent in Tier 3. This is in part because more shops are close to residential areas in Tiers 1 and 2, while in Tier 3, shoppers within an area have access to only one or two markets. Another reason, however, could simply be that consumers in Tier 1 cities have more disposable income. In terms of shopping behavior, shoppers in lower tiers tend to set aside part of their budget to indulge in more impulse-shopping than consumers in Tier 1, who are more likely to optimize their time by sticking to the shopping list.

Discounts seem to have the greatest influence on impulse-shopping—58 percent of the respondents said they are lured by discounts—followed by free gifts (33 percent of the respondents). Shelf or aisle displays for specific brands, free gifts, and product samples are more effective in enticing shoppers in Tier 1, while radio advertisements and small countertop displays that optimize space work better in local stores in Tier 3 towns.

Ogilvy & Mather

Influences on purchasing decisions

Price remains the single most important factor in influencing consumer choices about stores and brands. Eighty-eight percent of all respondents said they were influenced by price, and 70 percent in Tiers 1 and 3 compared prices before making a choice. Brand is the second most important influence on purchase decisions, with 72 percent of respondents across the tiers stating that they are influenced by brand names.

Shoppers in Tier 1 seem to rely more on their own experiences in making purchasing choices, which may be a reflection of independent, confident shopping (see Figure 1, p.62). Shoppers in Tier 2 are more influenced by the opinions of others—likely those in their social groups and role models. Consumers in Tier 3, however, appear to put more stock in the shop owner's advice and product packaging, which assures the shopper of product quality in a market replete with counterfeits.

Children now have significant influence over the composition of the family shopping basket, and in Tier 1, they are often allowed to make their own product choices, especially in food and clothing. Even in the lower tiers, where children have less autonomy, more than two-thirds of respondents sought the opinion of the "little emperors" when doing family shopping. Parents are investing heavily in their children across the tiers, spending up to 40 percent of the monthly household income on children.

***Kunal Sinha**, executive director, Discovery, Ogilvy & Mather Greater China, oversees consumer insights and trends for Ogilvy.* *He wishes to thank Jane Ling and Kate Gong of Ogilvy Discovery; Michael Guo of Ogilvy RedForce; and Arjun Ghosh and Ina Zhao of Mindshare Insights for their research assistance.*

Eating out

More consumers in Tier 1 eat at branded fast food restaurants—such as KFC, Yoshinoya, and McDonalds—than those in Tier 3. Families in Tier 3 remain conservative in their food habits and prefer traditional Chinese meals. Much of the lower-tier food market is dominated by local food stalls and small restaurants, with food courts and street food especially popular. The relative dearth of Western restaurants in lower-tier cities—and the relatively high cost of Western food—may be other reasons that consumers eat Chinese food more often.

Nevertheless, foreign food brands can still stimulate demand by offering traditional cuisine in new and convenient formats such as microwavable dishes and takeout. In addition to localizing menus, as KFC has done successfully, foreign food chains can reassure consumers by adopting high hygiene and food-quality standards. Although lowering prices is another obvious strategy, these chains have yet to adopt differentiated pricing schemes for the various tiers.

Media and entertainment habits

Television remains a powerful medium, enjoying a penetration rate of 94 percent across tiers, though program preferences vary. Viewers in Tier 1 for whom TV is primarily an entertainment medium—prefer to watch sports, music, food, business, and nature and environmental programs. Viewers in Tier 2 enjoy local news, while those in Tier 3 prefer international news and education and career-oriented programs. This is in part because residents in lower tiers seek programs that keep them informed about the world or can help them advance their careers. National news and TV series, however, attract the highest viewership across the tiers (see Figure 2, p.62).

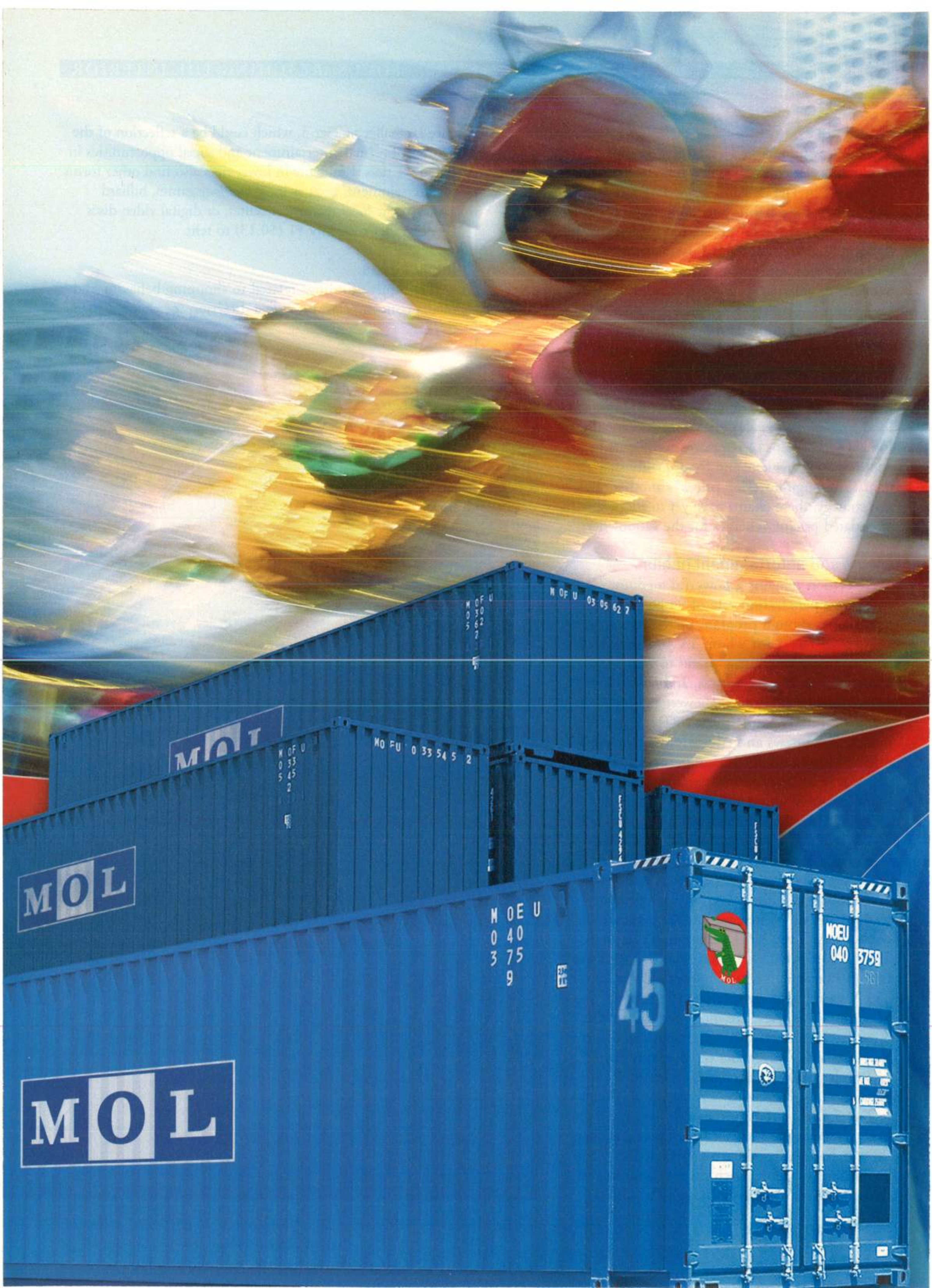
Newspapers and out-of-home (OOH) media, such as billboards, have average penetration rates of 64 percent and 60 percent, respectively. The OOH penetration rate in Tier 1 (73 percent) is higher than that of lower tiers (53 percent) because more residents in Tier 1 spend time outside of their homes. Magazines, however, are more popular in Tier 3, where 26.3 percent of the respondents said they had read a magazine the previous day.

Regular Internet access declines from 46.8 percent to 37.3 percent when comparing Tier 1 to Tier 3. Web surfers in the lower tiers are more likely to access the Internet from cybercafés than those in higher tiers. Internet users in Tier 1 and 2 cities spend half as much time web-surfing on weekends as on weekdays, though that difference is smaller in Tier 3, which could be a reflection of the paucity of formal entertainment and social opportunities in the lower tiers. Residents in lower tiers also find other forms of entertainment, such as long *mahjong* games, billiard games at the local recreation center, or digital video discs (DVDs) that cost only ¥1 ($0.13) to rent.

Implications

The study's findings related to shopping behavior and media consumption provide a direction for channel-plan-

Continued on page 60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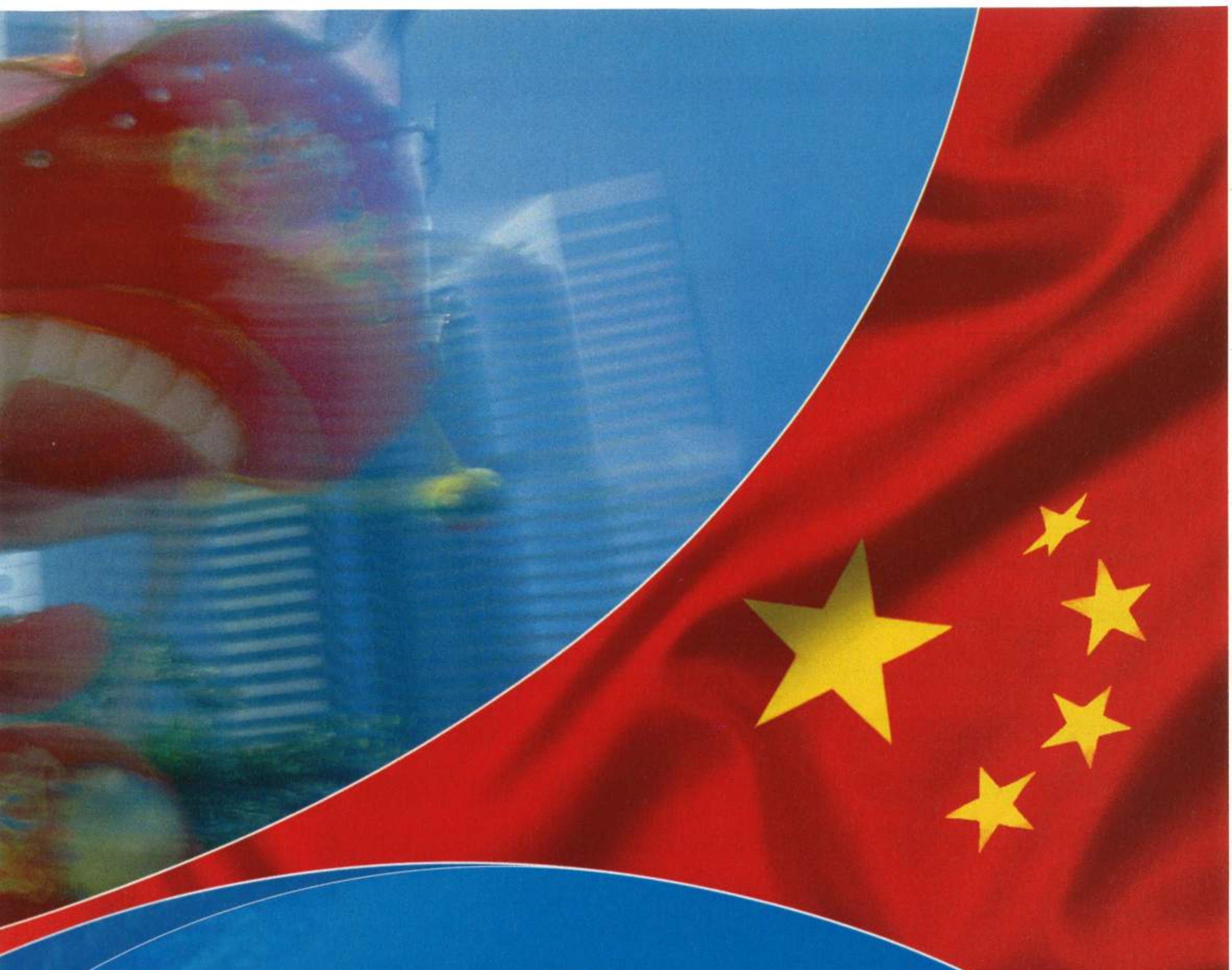


Income and Consu

Number of Durable Goods per 100 Households

Item	Eastern Region		Central Region		Western Region		Northeastern Region	
	Rural	Urban	Rural	Urban	Rural	Urban	Rural	Urban
Air conditioner	19	123	4	80	1	55	0	9
Automobile	NA	6	NA	1	NA	3	NA	1
Bicycle	146	149	96	114	58	94	82	98
Black and white television	17	NA	30	NA	22	NA	10	NA
Camera	7	60	2	37	2	41	4	39
Color television	107	147	81	129	78	131	99	120
Computer	6	57	1	33	0	32	1	29
Electric fan	213	205	171	208	89	143	33	64
Exhaust fan	15	82	2	54	1	56	5	78
Hi-fi stereo system	18	35	8	25	12	30	10	17
Mobile telephone	79	156	55	124	44	130	59	117
Motorcycle	65	38	37	22	33	17	40	10
Radio cassette player	12	NA	7	NA	13	NA	10	NA
Refrigerator	40	95	15	91	11	88	20	84
Tape recorder	NA	47	NA	32	NA	35	NA	39
Telephone set	86	NA	57	NA	46	NA	77	NA
Video recorder	6	NA	1	NA	2	NA	2	NA
Washing machine	56	96	36	97	32	96	63	91

Note: NA = not available

Rural and Urban Consumption, 2005 (¥)

Item	Low-income households (bottom quintile)		Lower-middle income households (second quintile)		Middle-income households (third quintile)		Upper-middle income households (fourth quintile)		High-income households (top quintile)	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Total Consumption	**3,703**	**1,548**	**5,574**	**1,913**	**7,308**	**2,328**	**9,411**	**2,879**	**15,628**	**4,593**
Food	1,701	796	2,336	950	2,839	1,121	3,426	1,297	4,759	1,808
Clothing	326	88	565	109	785	132	1,011	168	1,507	276
Residence	428	206	580	250	745	313	922	411	1,547	758
Household appliances and services	140	60	269	76	397	96	546	128	1,021	224
Transport and telecommunications	302	111	536	154	765	207	1,075	282	2,680	539
Education, culture and recreation, and services	441	155	720	209	986	262	1,337	345	2,304	571
Health care and medical services	270	106	408	129	562	148	765	184	1,143	305
Other goods and services	94	25	159	37	230	48	330	65	668	111

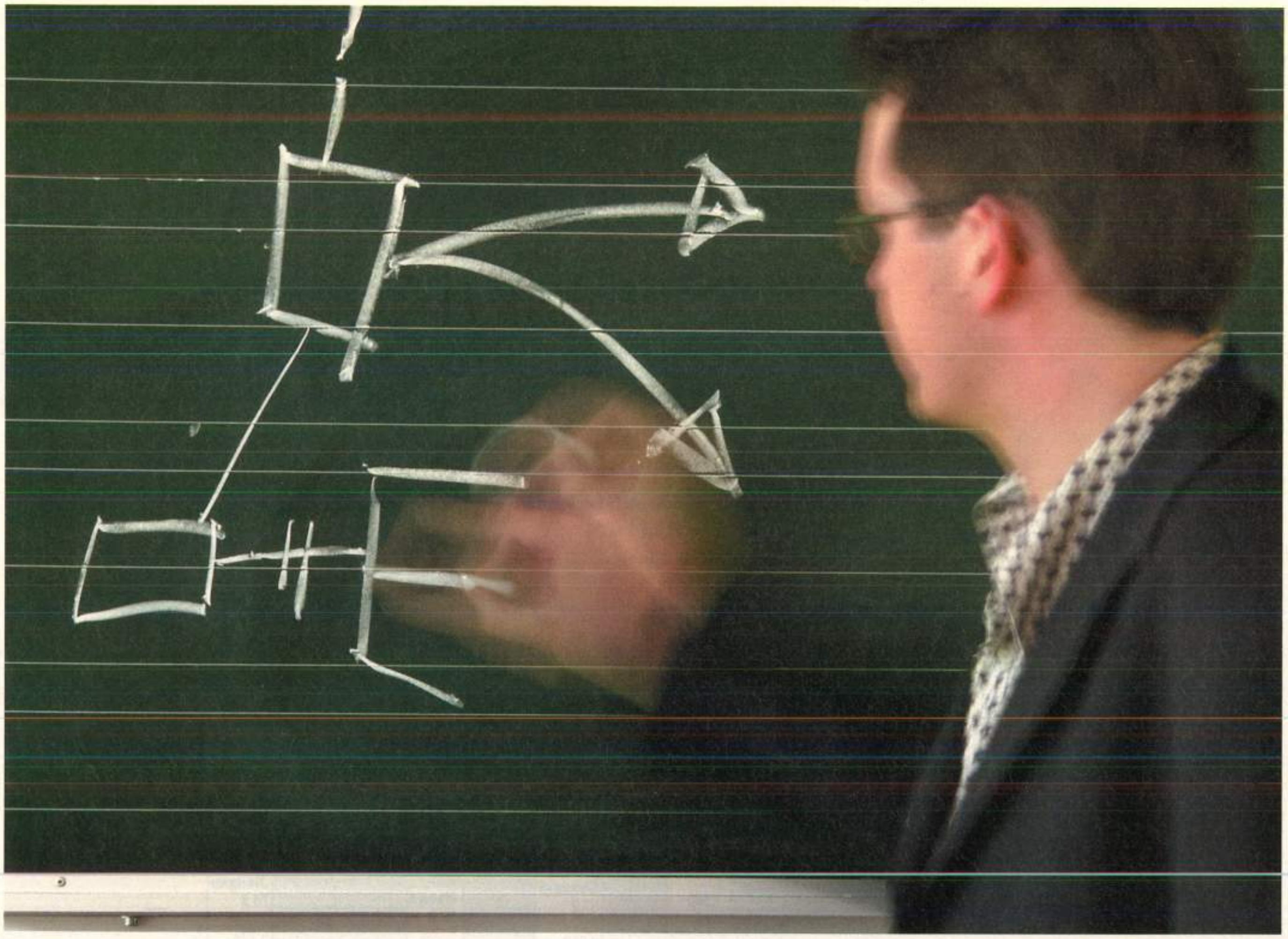
nption Across China

Population, Income, and Retail Sales, 2005

National Totals

Population: 1.31 billion
Avg. UDI: ¥10,196 per household
Avg. RNI: ¥3,512 per household
Total retail sales: ¥6,796 billion

Notes: UDI = urban disposable income; RNI = rural net income. $1 = ¥7.6
Source: *China Statistical Yearbook 2006*



Rethinking M&A in China

With China's new mergers and acquisitions rules in place, foreign and domestic investors need to find more creative ways to structure their investments

Marcia Ellis and Auria Styles

Foreign private equity investors for the past several years have often invested in PRC companies by bringing the Chinese founders of such companies offshore and investing together with the founders in an offshore special purpose vehicle (SPV). The investors successfully exited their investments by listing the SPV on a foreign stock exchange or selling the shares—through a trade sale—to another fund or strategic investor. This investment strategy, commonly known as "round-tripping," was essentially prohibited when the Provisions on Acquisition of Domestic Enterprises by Foreign Investors (mergers and acquisitions [M&A] rules) took effect on September 8, 2006.

As a result, private equity investors must rethink their investment structures and move their joint ventures (JVs) with the Chinese founders of the investee companies from relatively unregulated tax havens, such as the Cayman Islands and British Virgin Islands, to the more restrictive environment of mainland China. These changes, however, have not deterred foreign investors and their Chinese partners from structuring investments in Chinese JVs that replicate, to the extent possible, the features of their offshore JVs.

Anatomy of the M&A rules

The final M&A rules are similar to the 2003 Interim Provisions on the Acquisition of Domestic Enterprises by Foreign Investors, which provided the first firm legal basis for the acquisition of the equity of a non-foreign-invested PRC company by a foreign investor and permitted a number of transaction structures that previously had been of dubious legality. For foreign investors, the most troubling aspect of the interim measures was the antitrust provisions that required the PRC Ministry of Commerce (MOFCOM) and the State Administration for Industry and Commerce to review acquisitions that met certain thresholds. In retrospect, however, these provisions appear largely to have been a trial balloon for China's long-awaited Antimonopoly Law—slated to pass this year—and have yet to be used by MOFCOM to block foreign acquisitions.

The final M&A rules retain most of the provisions of the interim measures but also include sections that attempt to control the various forms of round-tripping by requiring MOFCOM approval for such transactions, regardless of the size of the investment. The criteria that MOFCOM currently uses to determine which, if any, round-trip transactions it will approve remain unclear, and, to date, there have been few reported cases of such approvals. Thus, many private equity funds are seeking alternative means of structuring investments to avoid the requirement of MOFCOM approval.

Onshore investments

Structural challenges

To avoid MOFCOM approval for round-tripping transactions, companies can invest directly in JVs in China. The fundamental nature of foreign-invested enterprises (FIEs), however, renders onshore investments more difficult. For example, in the United States and offshore tax havens, it is possible to create two classes of stock—preferred and common—but in China, only one class of equity is available for FIEs. As a result, it is difficult to structure investments in a way that would allow funds to enjoy some of the basic preferential rights associated with private equity investments, such as preferential payment of dividends and liquidation proceeds. In addition, without two classes of shares it is impossible to effect a value adjustment—for instance, when the investee company fails to meet certain financial targets—by automatically adjusting the rate at which preferred shares are converted into common shares. Investors without these protections are relatively unprotected in a downside scenario, making these onshore investments in China inherently more risky.

Although it is possible to structure dividend preferences in an onshore investment in a cooperative JV (CJV), obtaining approval for such investment vehicles is becoming increasingly difficult in some areas of China. Some local PRC officials are now carefully scrutinizing CJV structures to ensure that investors do not abuse the flexibility of the structure for purposes of creating dividend preferences that are not otherwise permitted. Currently, PRC law allows for liquidation preferences in both equity and cooperative JVs, and in several localities in China, foreign investors have obtained approvals for favorable liquidation preferences in their onshore JVs.

Another difficulty with setting up mainland JVs is that conversion price adjustments (sometimes called valuation adjustment mechanisms [VAMs]) require skillful structuring in an onshore investment. VAMs essentially permit investors to exchange their preferred shares for a larger number of common shares if the investee company does not meet certain financial targets. For example, an investor generally calculates its purchase price based on a multiple of the investee company's earnings for the following year. If the investee's earnings do not meet that amount, a VAM will be triggered, and the percentage of the total number of the investor's preferred shares that can be converted into the common shares of the investee will increase. Because there is only one class of equity in FIEs, and thus no conversion of preferred shares into common shares, it is impossible to directly implement a VAM in an FIE.

To structure VAM-like mechanisms in FIEs, foreign investors must use either debt that is capitalized at a different rate, depending on whether the relevant financial targets are met, or use a holdback provision—which transfers a certain percentage of equity to the founder if and when the financial targets are met. Provisions incorporating these features into the transaction documents must be drafted carefully to avoid various pitfalls—such as potential conflicts with statutory rights of first refusal—and comply with PRC law. In some cases, these provisions must also comply with extra-legal requirements imposed by approval authorities when reviewing JV contracts. For example, investors must address officials' concerns that foreign parties are obtaining too many benefits and that an overall "fairness" requirement has been breached.

Finally, structuring and implementing call and put options—the rights to purchase or sell equity at a certain time at a certain price—in an FIE is also challenging. Although it is possible to receive approval for call and put

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provisions in a JV contract that comply with PRC law, implementing them proves more difficult. After the initial JV contract approval, the actual transfer of equity requires additional board and government approvals. If the JV partner is a state-owned enterprise, it may not determine, at the time of the original transaction, the exercise price because the value of the interest to be transferred must be appraised by a duly qualified asset valuation firm at the time of the transfer, and the exercise price cannot be less than the appraised value. Thus, such structuring requires creativity and deep knowledge of PRC regulations and how they are implemented.

Exit challenges

Perhaps the greatest challenge faced by a foreign private equity investor that invests in an onshore JV is finding a viable exit strategy. Without round-tripping, an overseas listing would be hard to accomplish. Although the M&A rules permit founders and investors to swap the equity of an onshore entity for the shares of an SPV incorporated for the purpose of a listing shortly before it lists, such an undertaking cannot occur unless other requirements in the M&A rules are met. For example, a minimum initial public offering price must be set months before it actually takes place. Because these requirements are so onerous, and the uncertainty of obtaining approval so great, most private equity funds are, for the moment, pursuing other methods.

A-share listing

One of those options is to list A shares on a Chinese domestic stock exchange. To do so, an FIE must first obtain MOFCOM approval at the national level to convert into a foreign-invested company limited by shares (FICLS), which must then apply to the China Securities Regulatory Commission (CSRC) for listing. If approval is obtained and the shares of the FICLS listed, each shareholder of the FICLS will be subject to lock-ups stipulated by law and the rules of the relevant stock exchange that prohibit the sale of shares of stock for a specified period—from one to three years depending on when each shareholder made its investment and the percentage interest it holds in the FICLS. After the lock-up period expires, an investor can either sell its shares on the A-share market or effect a private sale.

Because investors face long waiting periods for approvals and lock-ups, it is unclear whether the domestic stock markets will be developed enough to provide the desired liquidity at the time of exit. Despite these hurdles, a number of funds are optimistic about the possibility of exits through A-share listings.

Swap for shares of a listed entity

Another exit alternative permitted under the M&A rules is to make the original investment through a share swap, in which the equity of the domestic investee company is swapped for shares of an offshore listed company. Again, MOFCOM must approve such swaps, but once approved, the fund's ability to exit the investment is essentially guaranteed because it already holds listed shares.

Investors must address officials' concerns that foreign parties are obtaining too many benefits and that an overall "fairness" requirement has been breached.

Another possibility would be to swap the shares of an offshore special purpose acquisition corporation (SPAC) for the equity of a PRC domestic company. US securities regulations allow a SPAC to be incorporated and listed immediately, before it acquires any assets. In effect, the SPAC is simply a holding company with a plan to acquire assets but has no existing assets at the time of listing. After listing, the founders of the PRC domestic company could receive the SPAC's shares in exchange for their equity in the domestic company. In turn, the proceeds from the SPAC's listing could be used to expand the business of the domestic company. Implementing such a share swap under the M&A rules and relevant US regulations could present certain difficulties, not the least of which is that listed shares being swapped must have been steadily traded for the 12-month period prior to the swap—a requirement that many SPACs would be unable to meet.

The Internet structure

Some funds are adopting a structure that has been widely used in China's Internet sector to circumvent the need for MOFCOM approval of a round-trip transaction. Often called a Sohu, Sina, or NetEase structure after the PRC Internet giants that pioneered its use, the structure has been used in industries where foreign investment is restricted, such as telecom and media and publishing. Under this structure, the foreign private fund and the PRC founder establish an offshore SPV that in turn forms a wholly foreign-owned enterprise (WFOE) in China. The PRC founder continues to hold all of the equity of the actual onshore operating company, which then enters into a series of contractual arrangements with the WFOE that allows it to take over the operating company and to receive all the after-tax profits of the operating company as fees.

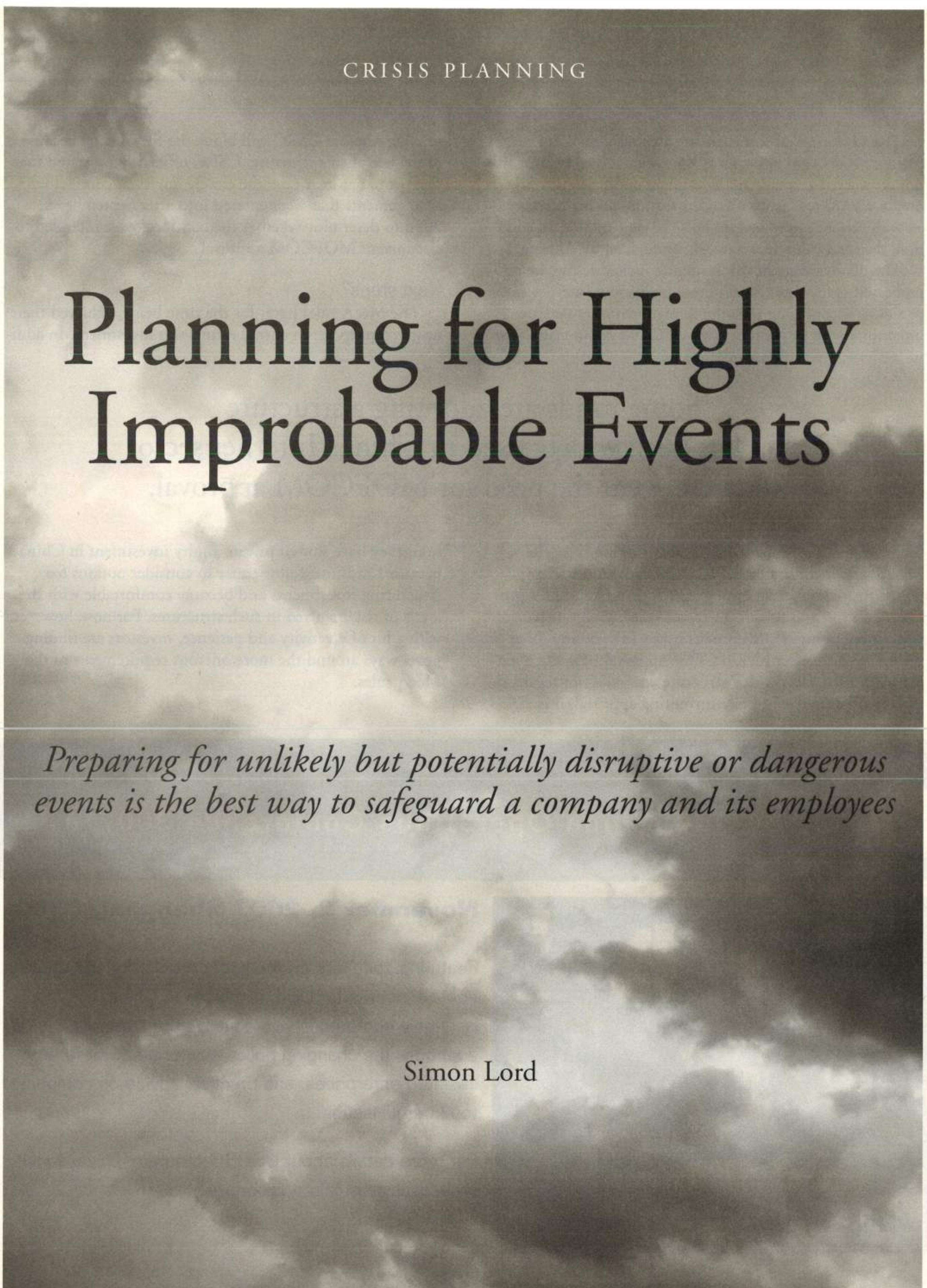
The advantages of this structure are that it does not require MOFCOM approval at the national level because it is not considered a round-trip investment and that the fund can obtain a VAM and enjoy all of the features normally associated with private equity investments through an SPV. In addition, the fund can achieve an exit through an SPV listing.

The disadvantage of this structure is that despite being replicated many times by Chinese media and Internet companies, it is confusing to some foreign investors that are unfamiliar with it. Moreover, MOFCOM could claim that such a transaction constitutes round-tripping since the M&A rules include a broad catch-all provision under which such contractual arrangements could fall. (This provision, set forth in Article 11 of the rules, prohibits parties from using domestic investment by an FIE "or any other means" to circumvent MOFCOM approval.) Finally, even if MOFCOM accepts this structure and does not regard it as "any other means" of circumventing approval, it is unclear whether CSRC will block the SPV listing because of the use of this structure. CSRC officials have stated that they would at least examine closely any such contractual arrangements that were entered into after September 8, 2006 to determine whether the contracts were intended to circumvent MOFCOM approval.

Some funds are adopting a structure that has been widely used in China's Internet sector to circumvent the need for MOFCOM approval.

Next steps?

The M&A rules have, for the time being, achieved their unstated purpose: to curtail round-trip investment. In addition, they have slowed private equity investment in China because funds must now pause to consider options for structuring investments and become comfortable with the levels of risk involved in such structures. For now, however, with a bit of creativity and patience, investors are finding novel ways around the more onerous requirements of the M&A rules. 完



Planning for Highly Improbable Events

Preparing for unlikely but potentially disruptive or dangerous events is the best way to safeguard a company and its employees

Simon Lord

Companies that fail to plan for improbable events run the risk of severe business disruption. One example of such an event is an avian influenza pandemic. Indonesia, Vietnam, Thailand, and China occupy the top four places in total fatalities from the H5N1 virus (commonly known as avian influenza), according to the World Health Organization (WHO), but companies should not assume that the disease will remain a predominantly Asian problem. Air travel, which allows people to cross the globe in hours, provides the perfect vehicle for the spread of a pandemic.

Since the first outbreak in 1997, in Hong Kong, various strains of the avian influenza virus—in particular H5N1—have evolved. As of July 25, 2007, WHO has confirmed only 319 cases and 192 deaths worldwide (of these, 25 cases and 16 deaths have occurred in China), and the disease remains largely confined to birds. Why should the global business community recognize, and budget for, something that may never actually pose a major threat to humans?

What if?

Companies must consider the following questions: What if H5N1 mutates and causes a pandemic, killing millions of people? What if global business consequently grinds to a halt, even for just a few days? What if half of the workforce is absent? What if schools, hospitals, and transport networks close because of lack of personnel? What if communication networks break down because of lack of servicing?

When discussing a perceived pandemic risk, companies have two main concerns: how best to look after personnel and how best to protect the company's image or brand name. Their next question is often: What might happen if we do nothing about this threat?

The best way to protect personnel and the company is to plan ahead. Doing nothing could lead to grave consequences, ranging from interruptions in the company's business to, in the direst cases, death of employees. During incident management planning, a company must repeatedly ask the same two questions: What if? So what? Developing a process that allows the requisite management to work through a pre-prepared—and practiced—decisionmaking cycle is the best way to prepare for such an event. Companies should draw up an incident management plan to guide readers through a series of simple questions that will allow them to make the best decisions with the information they have during the incident, bearing in mind that the situation is likely to be in constant flux. An avian influenza plan is best viewed as an annex to a business continuity plan or an incident management plan, as planning for a pandemic will overlap significantly with planning for other types of crises. In all continuity plans, a great deal of flexibility is required.

Preparation

A study conducted by AT&T Inc. earlier this year found that 30 percent of US company executives do not regard business continuity planning as a priority. Business continuity—the planning undertaken by an organization to prepare it for a potential incident(s), thus allowing it to function during a crisis—is usually regarded as an information technology (IT) issue. Preparations for avian influenza should, however, extend far beyond the IT department and focus primarily on the human resources (HR) department.

Nevertheless, since 2001, the rise of terrorist activity across the globe has made incident management a new priority for many businesses that had never considered it a serious issue. Companies that have already planned for other potential crises—fire, terrorist attack, or natural disaster—can use the basic components as a starting point for an avian influenza plan. All incident management plans should be as flexible as possible. It is vital that the people tasked with dealing with an incident are well prepared for a variety of scenarios. They should be chosen based on previous experience, willingness, seniority (though not necessarily the most senior person), ability to make timely decisions under pressure, and leadership qualities. They may be required to devote a large portion of their time to the project and must be given the necessary financial and moral support along the way.

The key to good preparation is practice. Military specialists spend weeks at a time practicing different potential scenarios. But when a real incident occurs, it will almost certainly differ from the practiced scenarios. Understanding how the plan evolves from the initial pieces of available information into a deliverable solution and, most important, developing a flexible decisionmaking process invariably helps to find a solution and formulate a coherent response plan. (Companies can foster a flexible decisionmaking ethos by regularly training and testing their management personnel with scenario-based exercises designed to put them under varying degrees of pressure and stress.)

Employees, particularly those responsible for making the difficult decisions, may be reluctant to discuss incident management planning because the subject offers them few guarantees or certified solutions and may make them look bad in front of their colleagues and senior management. Many employees have not dealt with such uncertainty before, and the learning curve can be steep.

Drawing up the plan

First, and most important, the person preparing the plan *must* have the backing of the company's senior staff, who will need to underline the importance of the plan to all employees.

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Next, the person charged with overseeing the formulation of the plan should ascertain whether in-house personnel are the most qualified to draw up the plan, and if so, who is best placed to take the lead. If someone is unwilling to take on the extra responsibility, chances are he or she will not do a good job. If there are no obvious candidates in house, the company can hire an outside contractor with more experience in incident management planning. Whoever is preparing the plan will require access to sensitive information, including personnel databases, IT infrastructure, finance, and communications and legal information. That person's integrity, and the company's confidence in his or her ability, is therefore paramount. If a contractor is hired to draft the plan, the company should remember that this person or team will be there only for the preparatory phases and not during the actual incident[s]. It is essential that whoever is responsible for the plan within the organization helps the contractor develop the plan.

The initial process of incident planning follows a fairly predictable risk analysis format: questionnaire, interviews, and initial report. How long this initial process takes depends on the size of the company—a smaller company will need one to two months, while a large multinational corporation would likely need six to nine months. Companies should remember that no template suits all known eventualities; if someone offers one, be skeptical. A number of topics will appear in most incident management plans—internal and external communications, trigger points for decisionmaking, and roles and responsibilities of

It is vital that the people tasked with dealing with an incident are well prepared for a variety of scenarios.

Avian Influenza Information and Planning Resources

World Health Organization (WHO)

The WHO's avian influenza page features the latest information on avian influenza outbreaks worldwide in addition to preparedness planning information.
www.who.int/csr/disease/avian_influenza/en

US Centers for Disease Control and Prevention (CDC)

The US CDC website contains basic information about avian influenza, information for health professionals, and links to flu information for workplaces and employees.
www.cdc.gov/flu/avian

Avianflu.gov

Managed by the US Department of Health and Human Services, Avianflu.gov is the US government site on avian influenza and pandemic flu. The section on workplace planning has links to several checklists, including one for US businesses with overseas operations; several guides to protecting employees against flu; and preparedness planning information from other organizations.
www.avianflu.gov

US Department of Labor

The Occupational Safety and Health Administration website features a guide for protecting employees against avian influenza.
www.osha.gov/dsg/guidance/avian-flu.html

Government of New Zealand

The Government of New Zealand has posted pandemic planning information for the business community, including an example of a company influenza pandemic plan.
www.med.govt.nz/templates/contenttopicsummary_14451.aspx

The Conference Board

The website of the Conference Board, a nonprofit business membership and research organization, features a section on avian influenza with links to articles and other resources on business continuity planning, business planning checklists, benchmarking surveys on how businesses are preparing, company practices and preparations, health and safety, and legal issues.
www.conference-board.org/knowledge/resources/resource_avianflu.cfm

Hong Kong Special Administrative Region (SAR)

The Hong Kong SAR government page on avian influenza has links to updates on avian influenza in Hong Kong as well as planning information. The Trade page has information specifically for businesses.
www.info.gov.hk/info/flu/eng/index.htm

For more links, see the online version of this article at www.chinabusinessreview.com the incident/crisis management team (I/CMT)—but each company must tailor a plan to suit its own needs.

The format of the plan is important and should reflect the users' preference, whether that is a spreadsheet, a visual representation, a word document, or something else. Once the format begins to take shape, it requires constant review to ensure that it remains succinct, logical, and easy to follow and implement. Companies need to remember that someone who has not been involved in the planning process could ultimately implement it.

Training, testing, and revising

Once the draft plan is complete, the training can begin. Everyone in the company needs to know the contents of the plan and their role in implementing it. Finding time to fit this training into everyone's schedule can be difficult, but it is necessary.

After more tweaking based on feedback from the training exercises, the company will finally be ready to test the plan. The budget allocated to the project will dictate the level of testing to be carried out. A desktop scenario for the I/CMT is the best place to start, followed by larger exercises using as many people as necessary, or as the budget allows. By now, depending on the size of the company, three to six months may have elapsed since the drafting process began.

Once the plan has been written, the staff trained, and the plan tested, companies can temporarily relax, knowing they have a tested plan in place. Companies need to remember, however, that the plan is a living document and must be reviewed on a regular basis—at least quarterly or biannually. New personnel must be trained on its contents, and local and world events that could have an impact must also be factored in. Finally, companies must provide continual financial and moral support to whoever is responsible for updating the plan and training new staff. Without this type of support, staff may be unable to follow the plan when it is needed.

Risking it all?

History—and current news—is filled with events that seemed improbable: nuclear bombs, natural disasters, global warming, US and other countries' forces in Iraq and Afghanistan, and violence at the G8 summit, to name but a few. Unforeseen events can unfold quickly, taking companies by surprise. Companies must decide whether they are willing to spend the time and effort necessary to mitigate some of these unknown and highly improbable events by preparing their businesses and employees as well as they can now, not later.

A company that does not plan for the highly improbable, whether because of a lack of time or resources or another reason, will be more exposed to the impact of a pandemic or other potentially serious incidents. Companies must decide whether they are willing to risk being unprepared for an improbable but potentially catastrophic event—and all the implications that such a lack of preparation has for business success and staff wellbeing. 完

China's Investment Climate City by City

Continued from page 27

year and that overstaffing averages 2.0–2.7 percent of the workforce. Importing and exporting seems to proceed relatively efficiently in Urumqi and Xi'an, Shaanxi, but is slower in other northwestern cities.

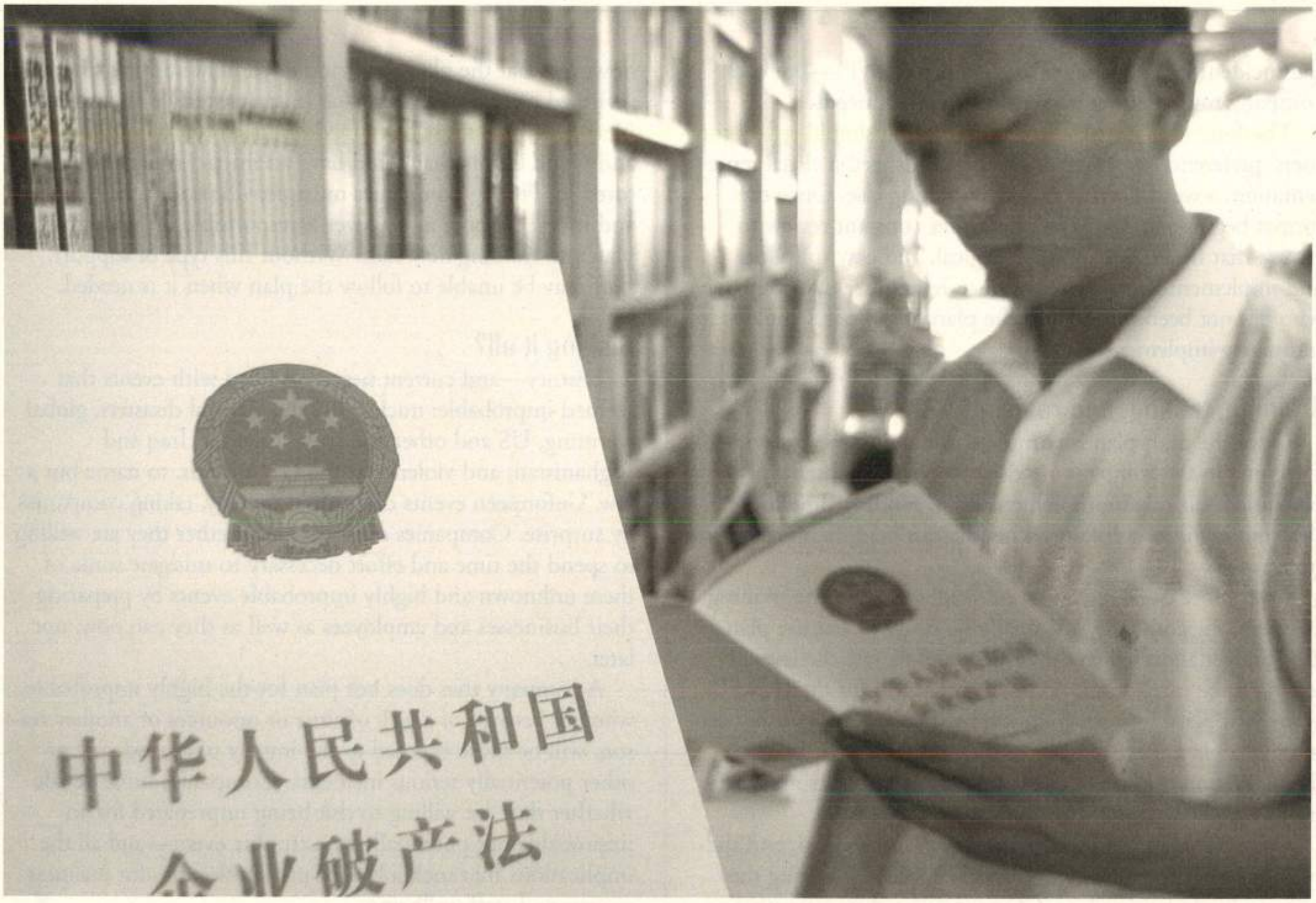
Quality of life measures

The survey finds a correlation between local government efforts to achieve a good investment climate and local progress toward achieving a good quality of life, as seen in differences in the environment, health, and education. For example, air quality tends to be best in the Southeast and Southwest and worst in the Northwest, and per capita expenditures on education are highest in the Southeast and about 40 percent lower in the Northwest.

"Second tier" does not mean "second best"

Only six cities are ranked in the highest quintile for all survey measurements—overall investment climate for domestic and foreign firms, government effectiveness toward domestic and foreign firms, and progress toward achieving a good quality of life. All six are in the coastal Southeast or Bohai Bay regions: Hangzhou and Shaoxing, Zhejiang; Qingdao and Yantai, Shandong; Suzhou, Jiangsu; and Xiamen, Fujian.

Thus, rather than considering only China's best known and biggest cities, a potential foreign investor should explore one of the emerging second-tier cities in China's coastal provinces. These cities can be competitive in terms of the business-friendliness of local government and urban quality of life. The more competitive cities in central and western China that are eager to attract foreign investment also warrant consideration. 完



China Foto Press

Solving the Insolvency Puzzle

China's new bankruptcy law could bring the country's legal framework closer to international norms—if it is implemented effectively

Steven T. Kargman

After 12 years of debate and deliberation, China adopted the long-awaited PRC Enterprise Bankruptcy Law (EBL) in August 2006. The new law, which took effect on June 1, 2007 and replaced the previous insolvency laws, represents, at least on paper, a major advance in China's insolvency law framework. As with any new national insolvency law, however, especially in emerging markets, the key to success lies in implementation. It will also be important to see how the gaps and ambiguities in the new law—of which there are several—are addressed.

Overview of the new law

In emerging markets, a modern insolvency law can give parties greater confidence in the legal framework that underlies lending and investment decisions, including decisions by foreign investors whether to invest in a particular jurisdiction. These lending and investment decisions in turn are important factors that can affect a nation's prospects for economic growth and development. Moreover, in an economic system such as China's, where state-owned enterprises (SOEs) have been important players, a modern insolvency law may provide a valuable tool for resolving situations of financial distress in a more commercial manner as well as a potential means of addressing SOE reform.

Briefly stated, China's new law incorporates a number of features of a modern insolvency law found in the international standards set by organizations such as the World Bank and the United Nations Commission on International Trade Law (UNCITRAL). Among other major elements, the EBL features the possibility that enterprises in financial distress may be subject to court-supervised reorganization. (The new law also provides for the liquidation of insolvent enterprises and a procedure known as "conciliation.") In contrast, previous PRC laws on the subject appeared to emphasize liquidation, and prior Chinese government practice, especially pursuant to government policies adopted in the mid-1990s, encouraged the resolution of financial problems facing SOEs by various additional means, such as mergers, spinoffs, and asset sales.

The new law essentially introduces a two-part test, both parts of which must apparently be satisfied, for determining whether a debtor is eligible to commence an insolvency proceeding: a liquidity or cash flow test (an inability to pay debts as they fall due) and a balance sheet test (the amount of liabilities exceed the value of assets). The new law also incorporates the notion of an "involuntary" insolvency filing where a creditor may initiate an insolvency proceeding against the debtor. In such a case, only the liquidity or cash flow test for insolvency must be satisfied. Broadly speaking, these new standards under the EBL for commencing an insolvency case rely on concepts that are familiar in the international insolvency world, but the EBL's requirement that a voluntary insolvency filing satisfy both tests, as opposed to only one, is a more stringent requirement than the recommendations found, for example, in the UNCITRAL *Legislative Guide on Insolvency Law.* Of course, it will be important to see how the PRC courts apply the commencement criteria set forth in the EBL and whether the need to satisfy a two-part test for commencement of voluntary cases serves as a barrier to insolvency filings by debtors.

Other major changes include the following:

Unified treatment of SOEs and non-SOEs

The EBL, which applies to all "enterprise legal persons" provides for unified treatment of SOEs and non-SOEs, including private enterprises and foreign-invested enterprises (FIEs). This contrasts with the previous bifurcated structure in which SOEs were subject to the 1986 PRC Enterprise Bankruptcy Law (for Trial Implementation) and non-SOEs were subject to Chapter 19 of the 1991 PRC Civil Procedure Law. (The situation was further complicated by the existence of other significant regulations, decrees, and interpretations on insolvency matters.) Significantly, the new law also permits SOEs to file for insolvency without first obtaining the permission of their supervising government department, which was a requirement under the old law.

Despite the new law's promise of unified treatment of SOEs and non-SOEs, the PRC government has exempted roughly 2,100 financially distressed SOEs from the application of the new law until the end of 2008. During this period, the insolvencies of these exempted SOEs will proceed according to the "policy bankruptcy" framework, under which insolvencies are administered by the government and State Council regulations essentially outline how to address the financial issues facing insolvent SOEs. Under these regulations, workers effectively enjoy priority rights to the proceeds from the sale of "land use rights," which were to be used to pay for the resettlement of displaced employees and certain other employee benefits, despite the fact that the previous insolvency laws would have granted priority to claims of secured creditors over employee claims.

Ranking of claims

During the debate surrounding the new insolvency law, the ranking of claims, particularly how secured claims would rank vis-à-vis employee claims, remained a major point of contention until the new law was finally adopted. Under the EBL, secured claims take priority over employee claims, which in turn rank ahead of unsecured claims. Nonetheless, the new law "grandfathers" certain types of employee claims that arose before the new law was adopted in August 2006 and gives those claims priority over secured claims.

Bankruptcy administrator

The new law also establishes the position of bankruptcy administrator, which is vested with a wide range of significant responsibilities, including taking over the assets of the debtor, deciding the internal management of the debtor, and managing and disposing of the debtor's assets. The new law provides that the role of the administrator may be filled by a professional services firm, such as a law firm or an accounting firm, which could enhance the professionalism of the position and bring necessary expertise to bear. The new law is silent on whether the administrator must be Chinese, and it therefore remains to be seen whether foreign professional service firms will be permitted to fill that role. According to the new law, PRC courts will appoint administrators and determine their remuneration, and in April 2007 the Supreme People's Court issued two detailed pronouncements intended to provide guidance to

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the courts on these matters. (Among other matters, one of the pronouncements deals with conflicts of interest.)

Some observers note that a strong administrator may create an important counterweight to the role of People's Court judges in insolvency proceedings. Despite the administrator's importance, the EBL allows for the possibility of what is essentially a modified "debtor in possession" approach whereby the debtor may apply to the court for a court order that permits the debtor to remain in charge of its own assets and business operations as long as the debtor remains under the supervision of the administrator.

Reorganization mechanism

Several important features of the new law are meant to support an effective reorganization mechanism. For example, the EBL calls for the convening of a creditors' meeting and the related creation of a creditors' committee, which is given broad powers to, among other things, "supervise the management and disposal of the debtor's assets." The law also requires the debtor or bankruptcy administrator to explain to the creditors' committee any matter within its scope of responsibilities. Furthermore, the new law provides a time-bound procedure for reorganization and a limited "cram-down" for obtaining approval of a reorganization plan over the objection of dissenting creditors.

Preservation of insolvency estate and post-commencement finance

The new law contains other provisions that are designed to help preserve or reconstitute the assets of the debtor's insolvency estate. As with such provisions in any nation's insolvency regime, these provisions can increase the possibility of a successful reorganization, but they can also be helpful if a liquidation becomes necessary. Specifically, the new law incorporates provisions that permit the administrator to "avoid" or invalidate transactions that, in the parlance of bankruptcy law, would be referred to as avoidable preferences and fraudulent transactions. The new law also provides for a stay of certain types of enforcement and other actions against the debtor. (The stay does not take effect until the court has accepted a bankruptcy application. This creates a gap period between filing and acceptance during which the debtor is potentially exposed to enforcement and other actions.) Any civil actions or arbitration involving the debtor may resume after the administrator takes over the debtor's assets. In addition, the new law provides for the rejection or assumption of what are generally referred to as "executory contracts" or what the EBL defines as a "contract that has been established before the acceptance [of the bankruptcy application] yet has not been fully performed by both parties concerned."

Moreover, in a brief discussion, the new law alludes to the possibility of post-commencement finance (known in the United States as "debtor-in-possession" financing), which can be critical in determining the success of a reorganization attempt since the availability of such finance can give the debtor some breathing space and allow it to continue to operate as a going concern. Since the concept of post-commencement finance is described in minimal detail in the new law, it may be unlikely that post-commencement finance will become a serious financing option in China until the relevant legal framework is much more fully developed.

Implementation

Although it is difficult to predict with any certainty how the EBL will be implemented, several factors could affect its implementation, including: employee claim and labor issues, the role of SOEs, the role of the courts, the role of asset management companies (AMCs) and other nonperforming loan (NPL) holders, and the role of foreign banks.

Employee claim and labor issues

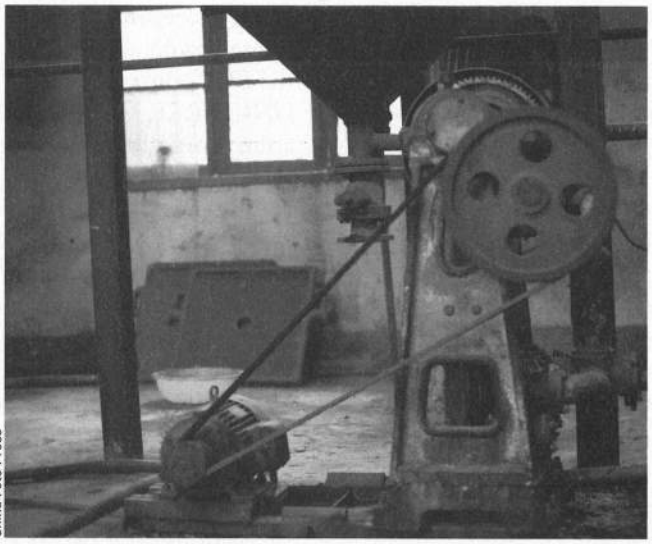
In insolvency proceedings, employees' interests can be adversely affected in several ways, including through layoffs and wage concessions. During a liquidation, even more so than in a reorganization, these issues can come into sharp relief because only a limited amount of money is available to distribute for payment of all of the outstanding claims according to the priority scheme established under the relevant insolvency law.

In China, whether the courts and relevant government authorities will permit labor interests to be adversely affected by a neutral application of the EBL is an open question. As noted above, the EBL generally ranks employee claims below secured creditor claims, but whether the courts and relevant government authorities will respect this ranking in cases where it would cause undue dislocation to employees of an insolvent enterprise remains to be seen.

In short, the new law may be tested if the interests of labor and social stability conflict with a strict application of the ranking of claims provided for in the new law. The manner in which the PRC courts and government authorities deal with this issue may depend in part on what type of social safety net exists to protect the interests of displaced workers. If the courts believe that the social safety net provides sufficient protection for displaced workers, they may be more willing to strictly apply the ranking of claims as set forth in the new law.

SOEs

Given their precarious financial situation, many SOEs should be prime candidates for having their financial situations addressed under the EBL as opposed to the "policy bankruptcy" framework. It is unclear what will happen to the roughly 2,100 SOEs that have been exempted from the EBL until the end of 2008 if their financial situations are not fully addressed by the end of that period. For example, would the government extend the exemption? In addition, given the large number of SOEs that have been exempted from the EBL for the time being, it is unclear how many SOEs will actually have their financial situations addressed under the new law. Finally, for SOEs dealt with under the new law, it remains to be seen how much protection local governments and courts will extend to SOEs that are important at the local level and whether doctrines such as "too big to fail" will be invoked to shield certain large SOEs from the effects of the new law.



The role of courts

As with any new law, China's EBL may only be as good as the courts that administer it. In this respect, the EBL may face some serious challenges. For one thing, not many Chinese judges, particularly outside of the large cities, have had significant experience handling insolvency matters. Insolvency law is a fairly technical and complex area of the law that requires, among other things, a sound understanding of commercial matters. The implementation of the EBL could be hindered if the judges charged with enforcing it are not specialists, or at least conversant, in insolvency law or other complex commercial matters. Thus, judges across China will likely need training in basic principles of insolvency law as well as in the specific details of the EBL.

Furthermore, since the EBL has several ambiguities and gaps, courts applying it may see themselves as having considerable latitude in how they interpret the law, which could lead to the inconsistent application and interpretation of the new law. Judges might also use ambiguities in the EBL as a pretext for developing interpretations that may be inconsistent with the law's underlying purpose and philosophy.

As in many emerging market jurisdictions, PRC courts also face concerns about independence, corruption, and transparency. For example, allegations of corruption concerning several bankruptcy judges in the Shenzhen Special Economic Zone came to light last fall. Moreover, the PRC courts, whose judges are appointed by government officials, are not viewed as being entirely immune from governmental and political pressures.

The role of AMCs and other NPL holders

PRC banks and AMCs, which were originally created to take over the NPLs of the four largest state-owned banks, have a large stock of NPLs on their books. The exact magnitude of the NPL problem has been a matter of considerable controversy in recent years. Some foreign observers have estimated that the stock of NPLs could amount to hundreds of billions of dollars, whereas the PRC government has provided significantly lower estimates. Moreover, some foreign observers believe that a significant batch of new NPLs could result from the lending activities of Chinese banks in recent years, especially in the real estate sector.

A key question will be whether holders of NPLs—PRC banks, AMCs, or outside purchasers of NPL portfolios—will regard the EBL as an effective mechanism for resolving the financial difficulties of insolvent debtors and for achieving decent debt recovery rates. If NPL holders perceive the new law to be a useful mechanism for addressing the situation of insolvent debtors, they may be willing to use it as part of an overall debt recovery strategy for the NPLs they hold. Of course, given the time and legal costs involved in pursuing an insolvency proceeding, NPL holders may well consider using remedies under the EBL only in certain well-defined circumstances.

In sum, NPL holders may use the new insolvency process and develop a vested interest in seeing that the new law works effectively and efficiently, particularly with respect to protecting creditor interests. Moreover, even if the holders of NPLs do not regularly resort to the EBL, they may still benefit from the law if they can use it as a credible threat against their underlying debtors to bring debtors to the bargaining table to negotiate an acceptable out-of-court restructuring plan.

The role of foreign banks

Foreign banks and financial institutions have taken minority stakes in a range of PRC banks. In some emerging markets, particularly where foreign banks have acquired a majority stake in domestic banks, the entry of foreign banks has, in the view of some observers, led to greater discipline in domestic banking systems with respect to the handling of NPLs and related debt recovery activities. In this view, foreign banks may be less hesitant to take aggressive action against borrowers, such as opening involuntary insolvency cases against debtors, than their domestic counterparts. In certain cases, domestic banks may be reluctant to upset close pre-existing relationships with local borrowers and their controlling shareholders by aggressively pursuing debt recovery.

Currently, foreign banks in China may not be in a position to significantly shape the debt recovery activities of domestic banks, particularly since foreign investors have been limited to minority stakes in PRC banks. Yet, if China were to open its banking sector more fully, foreign banks and financial institutions might acquire more influence and possibly develop a vested interest in seeing that the EBL protects, or at least is not prejudicial to, the interests of creditors.

Areas of interest to foreign parties

Two important areas related to the new law are of special interest to foreign parties: how cross-border insolvencies are handled and how foreign creditors are treated in comparison to domestic creditors.

Handling of cross-border insolvencies

The UNCITRAL Model Law on Cross-Border Insolvency effectively sets the international standard for addressing cross-border insolvencies in a nation's domestic insolvency legislation. The UNCITRAL Model Law, which has been adopted by more than a dozen nations, including the United States, provides a general framework for courts of one nation to recognize and cooperate with courts overseeing insolvency proceedings in another nation.

Although the EBL is intended to have extraterritorial effect, meaning that PRC proceedings are intended to apply to a debtor's assets located outside of China, the new law takes a narrower view with respect to inbound insolvency proceedings. Specifically, it does not incorporate the UNCITRAL Model Law but instead relies on principles of reciprocity and the existence of treaties with foreign nations in deciding whether to recognize a foreign insolvency proceeding. Moreover, the new law contains a further limitation that an order issued in a foreign proceeding must "not violate the basic principles of the laws of the People's Republic of China, ...not damage the sovereignty, safety or social public interests of the state, ...[or] damage the legitimate rights and interests of the debtors within the territory of the People's Republic of China...."

As a practical matter, the EBL's requirements and limitations pertaining to cross-border insolvency may present serious obstacles to the ability of PRC courts to enforce orders of foreign insolvency proceedings, at least in the near term. The EBL's provisions on cross-border insolvency may not lead to the recognition of foreign proceedings for some time because "China has not entered into any relevant treaties or reciprocal relations on this topic," and does not even have a bilateral agreement with Hong Kong on this issue, according to a 2005 article in the *Columbia Journal of Asian Law* by Professor Charles Booth of the University of Hawaii Law School.

The failure of the new PRC insolvency law to incorporate the UNCITRAL Model Law may create some uncertainty with respect to multi-jurisdictional insolvencies that include China. For instance, it could affect situations where the offshore non-Chinese parent or other affiliate of an FIE in China is involved in a foreign insolvency proceeding outside of China that requires the cooperation of a PRC court to handle assets or other matters in China.

In addition, with the overseas expansion of Chinese corporations and the establishment of offshore corporate affiliates in Hong Kong and other jurisdictions, any insolvency proceedings outside of China involving such corporations could also require cooperation and involvement by the PRC courts. The new law's failure to incorporate the UNCITRAL Model Law, however, may make this cooperation more difficult to obtain.

Treatment of foreign creditors

The UNCITRAL *Legislative Guide on Insolvency Law* recommends that a nation's insolvency law "should specify that all similarly ranked creditors, regardless of *whether they are domestic or foreign creditors*, are to be treated equally with respect to the submission and processing of their claims" (emphasis added). The EBL does not specifically address how the claims of foreign creditors will be handled vis-à-vis the claims of domestic creditors.

Thus, although foreign creditors might welcome some of the potential improvements in the overall insolvency framework brought about by the EBL, they may have to wait to see whether they will receive equal treatment vis-à-vis similarly situated domestic creditors under the new law and whether PRC authorities issue any clarifications or other implementing measures that address this issue.

A work in progress

The EBL will likely be a work in progress for some time, and it may be difficult to render any definitive judgment on its efficacy until a meaningful number of cases have been addressed under the new law. A series of implementing regulations and decrees will almost certainly be issued in the coming months. The question will be whether any of these set major new policy directions for the law's implementation. In addition, it may be instructive to observe whether government authorities and other parties in China view the EBL as a help or a hindrance in the transition of the Chinese economy, especially with respect to SOE reform. Moreover, as courts begin to apply the law, interested parties should also observe how the implementation of the new law compares with its letter and spirit.

Observers may also wish to assess how the new law fits into the overall Chinese political economy. In particular, they may wish to know how the courts and government authorities will balance the drive for economic modernization, which could favor a strict application of the new law, with the desire to maintain social stability, which could favor a more flexible application of the new law.

Finally, the new law may have arrived at a propitious moment, given the concern in certain circles that parts of China's economy may be at some risk of overheating, particularly in sectors such as real estate. If there were to be a downturn or correction in the Chinese economy, the new law could be put to the test, which would provide a clear and concrete indication of how it will be implemented. 完

Sales and Investment

May 16–July 15, 2007

The following listings contain information from recent press reports of business contracts and negotiations exclusive of those listed in previous issues. For the most part, the accuracy of these reports is not independently confirmed by the *CBR*. Firms whose sales and other business arrangements with China do not normally appear in press reports may have them published in the *CBR* by sending the information to the attention of the editor.

Compiled by Catherine Hagbom and Yoko Uchida

Automotive

CHINA'S EXPORTS

Chery Automobile Co., Ltd. (Anhui)
Will produce vehicles for US-based Chrysler LLC. 07/07.

Chery Automobile Co., Ltd. (Anhui)
Reached framework agreement to produce 100,000 engines annually for Italy-based Fiat SpA's Alfa Romeo. 06/07.

CHINA'S IMPORTS

General Motors Corp. (US)
Will provide automotive components and fully assembled Cadillacs to its joint venture, Shanghai General Motors Corp., Ltd. $700 million. 05/07.

CHINA'S INVESTMENTS ABROAD

Ayass Motors (Jordan)/Hebei Zhongxing Automobile Co., Ltd.
Signed agreement to develop car assembly and manufacturing plant in Jordan. $30 million. 05/07.

INVESTMENTS IN CHINA

Continental AG (Germany)
Will build Hydraulic Brake Systems plant in Changshu, Jiangsu. $89.5 million. 06/07.

Fuji Heavy Industries Ltd., a subsidiary of Sumitomo Corp. (Japan)/China International Marine Containers (Group) Ltd. (Guangdong)
Will form joint venture to manufacture garbage trucks. (Japan:47%-China:53%). $18 million. 06/07.

PSA Peugeot Citroën SA (France)/Harbin Hafei Automobile Industry Group Co., Ltd. (Heilongjiang)
Signed MOU to establish joint venture in Shenzhen, Guangdong, to manufacture and sell high-grade commercial vehicles. (France:50%-China:50%). 06/07.

Siemens VDO Automotive AG (Germany)
Will open manufacturing, administrative, and logistics unit in Wuhu, Anhui. 06/07.

Israel Corp. Ltd./Chery Automobile Co., Ltd. (Anhui)
Will form joint venture to manufacture sedans and sport utility vehicles in Wuhu, Anhui. (Israel:45%-China:55%). $750 million. 05/07.

OTHER

Quantum LLC (US), an affiliate of Israel Corp. Ltd./Chery Automobile Co., Ltd. (Anhui)
Will form joint venture to produce high-end vehicles in China for sale overseas. (US:45%-China:55%). $725 million. 05/07.

DaimlerChrysler AG (Germany)
Sold its stake in Yaxing-Benz Co. Ltd., making Jiangsu-based Yangzhou Yaxing Motor Coach Co. Ltd. the sole shareholder. 05/07.

Aviation/Aerospace

CHINA'S EXPORTS

BHA Aero Composites Co., Ltd. (Tianjin), a joint venture between Boeing Co. (US), Hexcel Corp. (US), and AVIC I (Beijing)
Will provide composite panels for vertical fins of Boeing planes. 07/07.

Changhe Aircraft Industry Group Co., Ltd. (Jiangxi), a subsidiary of AVIC II (Beijing)
Will supply helicopter airframes to Sikorsky Aircraft Corp., a subsidiary of US-based United Technologies Corp. 07/07.

Chengdu Aircraft Industrial (Group) Co. Ltd. (Sichuan), a subsidiary of AVIC I (Beijing)
Signed agreement to supply ailerons and spoilers to US-based Boeing Co. 07/07.

Hafei Aviation Industry Co., Ltd. (Anhui), an affiliate of AVIC II (Beijing)
Will produce composite parts for US-based Boeing Co. 07/07.

Xi'an Aircraft Industry (Group) Co. Ltd. (Shaanxi), a subsidiary of AVIC I (Beijing)
Will supply commercial aircraft parts and components to US-based Boeing Co., including parts for the Boeing 747-8 intercontinental passenger and freighter aircraft. 07/07.

CHINA'S IMPORTS

China Southern Airlines Co. Ltd. (Guangdong)
Will purchase 20 A320 jets from France-based Airbus SAS. 06/07.

China Southern Airlines Co. Ltd. (Guangdong)
Will purchase 25 B737-800 planes and 320 jets from US-based Boeing Co. 06/07.

Hamilton Sundstrand Corp., a subsidiary of United Technologies Corp. (US)
Will provide the APS 3200 auxiliary power unit for 50 new Airbus A320 aircraft to Guangdong-based China Southern Airlines Co. Ltd. $60 million. 06/07.

Pratt & Whitney, a subsidiary of United Technologies Corp. (US)
Will supply Shanghai-based China Eastern Airlines Corp. Ltd. with International Aero Engines' V2500 engines to power 30 Airbus A320 aircraft. $260 million. 06/07.

Pratt & Whitney, a subsidiary of United Technologies Corp. (US)
Will supply Hainan Airlines Co., Ltd. with International Aero Engines' V2500 engines to power 20 Airbus A319 aircraft. $180 million. 06/07.

INVESTMENTS IN CHINA

Airbus SAS (France)
Will form joint venture with Beijing-based AVIC I and II to assemble roughly 300 A320 jets in Tianjin by early 2016. (France:51%-China:49%). 06/07.

Bombardier Inc. (Canada)/AVIC I (Beijing)
Will form joint venture to develop five mid-sized commercial aircraft. (Canada:20%-China:80%). $500 million. 06/07.

Singapore Airlines Ltd., a subsidiary of Temasek Holdings Pte Ltd. (Singapore)
Will acquire a 24% stake in Shanghai-based China Eastern Airlines Corp. Ltd. $930 million. 05/07.

OTHER

China Southern Airlines Co. Ltd. (Guangdong)/Air France-KLM Group (France)
Signed agreement to discuss establishment of joint venture cargo airline in China. 07/07.

Shanghai SR Aircraft Technics Co., a joint venture between Shanghai Foreign Aviation Service Corp. and SR Technics (Switzerland)
Will supply line maintenance services to Singapore Airlines and technical support for Boeing 777 and 747 aircraft during layovers at Shanghai Pudong International Airport. 07/07.

Continental Airlines Inc. (US)/ China Southern Airlines Co. Ltd. (Guangdong)
Signed agreement for strategic partnership for frequent flyer and airport lounge access reciprocity and code-sharing. 06/07.

U-Freight Holdings Ltd. (Hong Kong)/Guangzhou Baiyun International Airport (Guangdong)
Signed strategic partnership agreement to boost cargo volumes and help develop the airport as an air cargo hub for Southern China. 05/07.

Banking & Finance

CHINA'S INVESTMENTS ABROAD

State Foreign Exchange Investment Co. (Beijing)
Acquired a non-voting stake of less than 10% in US-based Blackstone Group LP. $3 billion. 06/07.

INVESTMENTS IN CHINA

ABN AMRO Holding NV (the Netherlands)
Opened new branch, ABN AMRO (China) Co., Ltd., in Shanghai to expand RMB-denominated banking services in China. $526.7 million. 07/07.

Accel Partners (US)/IDG Technology Venture Investment (Beijing)
Will form joint venture, IDG-Accel China Growth Fund II, to finance investment and to target Internet and mobile-phone contracts. $510 million. 07/07.

Espirit Financial Group Inc. (US)
Acquired Check 21 China, a sister company of International Express Payment (Jiangxi) Corp. 06/07.

Nikko Asset Management Co., Ltd. (Japan)
Acquired a 40% stake in Guangdong-based Rongtong Fund Management Co., Ltd. 06/07.

Turkiye Garanti Bankasi AS (Turkey)
Signed agreement with Shanghai-based China Unionpay Co., Ltd. to issue credit cards for consumers in China. 06/07.

Woori Financial Holdings Co., Ltd. (South Korea)
Acquired Beijing-based China Great Wall Asset Management Co. $20 million. 06/07.

Société Générale Asset Management Co. Ltd., a unit of Société Générale Group (France)
Raised its stake from 33% to 49% in Shanghai-based Fortune SGAM Fund Management Co., Ltd., its joint venture with Shanghai-based Baoshan Iron & Steel Co., Ltd. (France:49%-China:51%). 05/07.

OTHER

Xinhua Finance Media Ltd. (Shanghai)
Signed agreement with Belgium-based Fermat Private Ltd. to distribute and support its risk and performance management software solutions in mainland China. 07/07.

The Export-Import Bank of China Ltd. (Beijing)
Opened representative office in St. Petersburg, Russia. 06/07.

Fortis Global Export & Project Finance (Belgium)/China Export & Credit Insurance Corp. (Beijing)
Signed comprehensive business cooperation agreement to jointly develop products, exchange market information, and promote business. 06/07.

ICBC (Beijing)
Applied for banking licenses in the United States and Russia. 06/07.

Promsvyazbank (Russia)/ABC (Beijing)
Signed agreement on direct correspondent relations to simplify payments and minimize currency exchange risks. 06/07.

Chemicals, Petrochemicals & Related Equipment

INVESTMENTS IN CHINA

BASF AG (Germany)
Opened BASF Polyurethanes Specialties Co. Ltd. in Shanghai for R&D and thermoplastic polyurethane production. 06/07.

BASF AG (Germany)
Signed memorandum of cooperation with Chongqing Chemical and Pharmaceutical Holding (Group) Co. to build a plant with an annual production capacity of 400,000 metric tons of crude methylene diphenyl diisocyanate. 06/07.

SK Corp. (South Korea)/SINOPEC (Beijing)
Will jointly build a large ethylene project in Wuhan, Hubei. $1.9 billion. 05/07.

OTHER

Indian Oil Corp. Ltd. (India)/SINOPEC (Beijing)
Signed MOU to promote international trade and collaborate on engineering and technical services. 05/07.

Consulting

OTHER

Citadel International (Dubai), Hill & Associates (Hong Kong)
Will jointly provide security and hospitality services at the 2008 Beijing Olympics. 05/07.

Electronics, Hardware & Software

CHINA'S IMPORTS

Gateway, Inc. (US)
Will supply notebook computers to Beijing-based Digital China Holdings Ltd. 06/07.

Ingenico SA (France)
Will supply electronic payment terminals to Shanghai-based China Unionpay Co., Ltd. 06/07.

Abbreviations used throughout text: **ABC**: Agricultural Bank of China; **ADB**: Asian Development Bank; **ASEAN**: Association of Southeast Asian Nations; **ATM**: automated teller machine; **AVIC I and II**: China Aviation Industry Corp. I and II; **BOC**: Bank of China; **CAAC**: 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; **GPS**: global positioning system; **ICBC**: Industrial and Commercial Bank of China; **IP**: Internet protocol; **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.; **OEM**: original equipment manufacturer; **PAS**: personal access system; **PBOC**: People's Bank of China; **PetroChina**: PetroChina Co., Ltd.; **RMB**: renminbi; **R&D**: research and development; **SARFT**: State Administration of Radio, Film, and Television; **SASAC**: State Assets Supervision and Administration Commission; **SEZ**: special economic zone; **SINOPEC**: China Petroleum & Chemical Corp.; **SINOTRANS**: China National Foreign Trade Transportation Corp.; **UNDP**: United Nations Development Program; **SME**: small and medium-sized enterprise; **Wi-Fi**: wireless fidelity; **WFOE**: wholly foreign-owned enterprise

INVESTMENTS IN CHINA

Intel Capital, a subsidiary of Intel Corp. (US)/51.com (Shanghai)
Signed capital injection agreement. 05/07.

Intel Capital, a subsidiary of Intel Corp. (US)/Phoenix Microelectronics Co., Ltd. (Beijing)
Signed capital injection agreement. 05/07.

Symantec Corp. (US)/ Huawei Technologies Co., Ltd. (Guangdong)
Will form Chengdu-based joint venture to develop security and storage products for telecom companies worldwide. (US:49%-China:51%). 05/07.

OTHER

Hewlett-Packard Co. (US)/ Tsinghua University (Beijing)
Will collaborate to develop multimedia technologies, including automated photo sorting, facial expression recognition, and video and music analysis. 05/07.

Energy & Electric Power

CHINA'S IMPORTS

Siemens AG (Germany)
Will construct a high-voltage transmission system for Yunnan-based China Southern Power Grid Corp. Ltd. $413 million. 06/07.

CHINA'S INVESTMENTS ABROAD

Huadian Power International Corp. Ltd. (Shandong)/Saigon Fuel Co. (Vietnam)
Signed MOU to jointly invest in a power project in Vietnam. $650 million. 05/07.

INVESTMENTS IN CHINA

Areva T&D Holding SA (France)/Sunten Electric Co., Ltd., a subsidiary of Guangdong Macro Co., Ltd.
Formed joint venture to manufacture transformers. (France:50%-China:50%). $264 million. 05/07.

Environmental Equipment & Technology

CHINA'S IMPORTS

GT Solar Inc. (US)
Will supply polysilicon reactors and converters to Jiangsu Shunda Electronic Materials Co. Ltd., a subsidiary of Jiangsu Shunda Group Corp. $39.5 million. 06/07.

IDE Technologies Ltd., a joint venture of Delek Group Ltd. and Israel Chemicals Ltd.
Will build a desalination facility in China for the Tianjin Beijiang power station. $119 million. 06/07.

INVESTMENTS IN CHINA

CIMC Vehicles Group Co., Ltd., a subsidiary of China International Marine Containers (Group) Co., Ltd. (Guangdong)/Fuji Heavy Industries Ltd., Sumitomo Corp. Group, and Shanghai Sumitomo Trading Co., Ltd. (Japan)
Will form joint venture, Qingdao CIMC Eco-Equipment Co., Ltd., to provide R&D, manufacturing, marketing, and services related to environmental protection. (Japan:49%-China:51%). $54.4 million. 06/07.

Synthesis Energy Systems Investments, Inc., a subsidiary of Synthesis Energy Systems, Inc. (US)/Inner Mongolia Golden Concord (Xilinhot) Energy Co., Ltd., a subsidiary of Golden Concord Holdings Ltd. (Hong Kong)
Formed joint venture, SES-GCL (Inner Mongolia) Coal Chemical Co. Ltd., to build an integrated coal gasification plant and methanol and dimethyl ether production plant in Inner Mongolia. (US:51%-China:49%). 06/07.

Food & Food Processing

INVESTMENTS IN CHINA

Carlsberg A/S (Denmark)/Lanzhou Huanghe Enterprise Co., Ltd. (Gansu)
Will form joint venture to build a brewery in Lanzhou, Gansu. (Denmark:40%-China:60%). $26.5 million. 05/07.

Tata Tea Ltd. (India)/Zhejiang Tea Import & Export Corp. Ltd.
Formed joint venture to manufacture and market green tea extracts, instant tea, and liquid tea concentrates. $16 million. 05/07.

Vin & Sprit AB (Sweden)/ Jiannanchun Group Co., Ltd. (Sichuan)
Will form joint venture to produce liquor products in Chengdu, Sichuan. (Sweden: 51%-China:49%). 06/07.

Forestry, Timber & Paper

CHINA'S IMPORTS

Metso Oyj (Finland)
Will provide Henan Puyang Longfeng Paper Co., Ltd. with a lightweight-coated paper manufacturing line. $136.8 million. 06/07.

INVESTMENTS IN CHINA

Inner Mongolia Maple Leaf Nursery Co. Ltd., a subsidiary of Maple Leaf Reforestation Inc. (Canada)/Huize Forestry Co. Ltd. of Changzhi (Shanxi)
Will form joint venture to grow and sell Maple Leaf's tree seedlings in Shanxi. (Canada:52%-China:48%). $1.3 million. 06/07.

Style Ltd. (Australia)
Acquired remaining 50% stake in Zhejiang-based Anji Yafeng Bamboo Products Ltd. $6 million. 05/07.

Healthcare Services & Investment

INVESTMENTS IN CHINA

Asklepios Harzkliniken GmbH, Siemens AG (Germany)/Tongji University (Shanghai)
Formed joint venture to build a Sino-German Friendship Hospital in Shanghai. $132 million. 05/07.

Infrastructure

CHINA'S IMPORTS

RiT Technologies, Ltd. (Israel)
Will supply PatchView intelligent infrastructure management solution services to manage ports at a large Chinese corporation. 07/07.

Insurance

INVESTMENTS IN CHINA

AEGON Group (the Netherlands)/Industrial Securities Co., Ltd. (Fujian)
Formed asset management joint venture. (the Netherlands:49%-China:51%). 05/07.

OTHER

BOC Hong Kong, a subsidiary of BOC Ltd. (Beijing)/China Life Insurance Co., Ltd. (Beijing)
Will cooperate to sell China Life insurance products through BOC in Hong Kong. 05/07.

Internet/E-Commerce

CHINA'S IMPORTS

China Expert Technology, Inc. (Hong Kong)
Will build e-government systems in three cities in Fujian and Guangxi. $83.6 million. 06/07.

INVESTMENTS IN CHINA

BroadWebAsia (US)
Will form joint venture with Shanghai-based Mofile Inc. and Shanghai Hubo Information and Technology Co. Ltd. to expand its network. 07/07.

Amazon.com, Inc. (US)
Increased investment in Beijing-based Joyo.com and co-branded site as "Joyo Amazon.cn." 06/07.

Google Inc. (US)
Will set up R&D center in Shanghai. 06/07.

Finet Group Ltd. (Hong Kong)
Will acquire Zhejiang-based Tianchang Network Technology Co. Ltd., a leading online game company. $26 million. 05/07.

OTHER

Google Inc. (US)/Sina Corp. (Shanghai)
Formed strategic partnership to improve Internet searches for users in China. 05/07.

Machinery & Machine Tools

INVESTMENTS IN CHINA

Cornerstone Financial (Group) Inc. (US)
Acquired 30% stake in Liaoning-based Shenyang Machine Tool (Group) Co., Ltd. 06/07.

Jana Partners LLC (US)
Will acquire 30% stake in Liaoning-based Shenyang Machine Tool (Group) Co., Ltd. $132.5 million. 06/07.

OTHER

NPO Saturn OAO (Russia)/China Precision Machinery Import-Export Corp. (CPMIEC) (Beijing)
Signed partnership agreement under which CPMIEC will sell NPO Saturn OAO compressor gas units in China. 06/07.

Omron Corp. (Japan)
Opened Omron R&D Collaborative Innovation Center in Shanghai. $9.7 million. 06/07.

Media, Publishing & Entertainment

CHINA'S INVESTMENTS ABROAD

Xinhua Finance Media Ltd. (Shanghai)
Acquired Hong Kong-based Convey Advertising Co. $33 million. 07/07.

INVESTMENTS IN CHINA

Mega Vision Productions Ltd., a subsidiary of See Corp. Ltd. (Hong Kong)/Greater China Media and Entertainment Corp. (Beijing)
Will form joint venture to produce a movie, *Tough Guy.* (Hong Kong:50%-China:50%). $1 million. 06/07.

Microsoft Corp. (US)
Acquired less than 1% of Sichuan Changhong Electric Co., Ltd. $12.4 million. 06/07.

Thomson Financial, a subsidiary of Thomson Corp. (Canada)
Acquired non-China news operations of the finanical news arm of Shanghai-based Xinhua Finance Media Ltd. 06/07.

Electronic Arts Inc. (US)
Acquired 15% stake of Shanghai-based The9 Ltd. $167 million. 05/07.

Les' Copaque Production Sdn. Bhd. (Malaysia)/Zhongnan Group Animation Video Co. Ltd.
Signed MOU to co-produce a 3D animated feature film based on *The Art of War.* $3.3 million. 05/07.

Ticketmaster (US)
Acquired majority stake in Beijing-based Emma Entertainment Holdings HK Ltd. 05/07.

OTHER

Actoz Soft Co., Ltd. (South Korea)
Licenced a three-dimensional (3D) online table tennis game from Shanghai-based Shanda Interactive Entertainment Ltd. 06/07.

The Associated Press (US)
Opened bureau in Beijing for comprehensive Olympics coverage. 06/07.

Microsoft Corp. (US)/ Shanghai Media Group
Will jointly create entertainment applications for computers, televisions, and mobile phones. 06/07.

Microsoft Corp. (US)/Sichuan Changhong Electric Co., Ltd.
Will jointly develop entertainment products linking Internet and TV. 06/07.

G10 Entertainment Korea Corp. (South Korea)
Will give Shanghai-based The9 Ltd. exclusive license to operate *Audition 2*, an online dancing game. 05/07.

Medical Equipment & Devices

INVESTMENTS IN CHINA

OraSolv AB (Sweden)
Acquired Guangdong-based Shenzhen ScienceWay Biotech Co. Ltd. $400,000. 06/07.

OTHER

Ion Beam Applications SA (Belgium)
Opened a new factory and headquarters in Beijing. 06/07.

Metals, Minerals & Mining

CHINA'S EXPORTS

Baoji Titanium Industry Co., Ltd. (Shaanxi)
Will supply 4,300 tons of titanium products to US-based Boeing Co. $130 million. 06/07.

CHINA'S IMPORTS

Siemens Metals Technologies, a subsidiary of Siemens AG (Germany)
Will supply new welding machines to Hebei-based Tangshan Hengtong Accurate Sheet Metals Co. Ltd. and Tangshan Bainite General Steel Works Co. for their strip-processing lines. 06/07.

Centrex Metals Ltd. (Australia)
Will supply hematite iron ore to Liaoning-based Shenyang Orient Iron & Steel Co. Ltd. and Inner Mongolia-based Baotou Iron and Steel (Group) Co. Ltd. 05/07.

Fortescue Metals Group Ltd. (Australia)
Signed a 10-year iron ore offtake agreement with Hebei-based Tangshan Iron and Steel Co., Ltd. $10.3 billion. 05/07.

CHINA'S INVESTMENTS ABROAD

Chinalco Canada B.C. Holdings, Ltd., a subsidiary of Aluminum Corp. of China Ltd. (Beijing)
Purchased 9.9% of Peru Copper Inc. (Canada). 06/07.

INVESTMENTS IN CHINA

Alcan Inc. (Canada)
Will open a facility in Tianjin to produce alloy cable products. $40 million. 06/07.

TINO Stone Group SA (Spain)
Will build Asia-Pacific operation facility in Jiangsu. $60 million. 06/07.

OTHER

Sinosteel Corp. (Beijing)
Signed MOU with US-based JPMorgan Chase & Co. to further improve its overall strength and competitiveness. 06/07.

Southwest Research Institute (US)/Institute of Metal Research (Shenyang), a branch of Chinese Academy of Sciences (Beijing)
Formed strategic alliance to develop and apply materials engineering and research. 05/07.

Packaging & Labeling

INVESTMENTS IN CHINA

Avery Dennison Corp. (US)
Opened new pressure-sensitive tape facility in Kunshan, Jiangsu. $10 million. 06/07.

Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

The Tokyo Electric Power Co., Inc. (Japan)
Signed contract with Beijing-based State Grid Corp. of China to provide consulting services on high-voltage power lines. 06/07.

INVESTMENTS IN CHINA

Albemarle Corp. (US)
Will raise stakes in Zhejiang-based Ningbo Jinhai Albemarle Chemical & Industry Co., Ltd. from 25% to 75%. 07/07.

Albemarle Corp. (US)
Will raise stakes in Shanghai Jinhai Albemarle Fine Chemicals Co., Ltd. from 25% to 75%. 07/07.

Utilise Training & Development Solutions (UK)/XinAo Group (Hebei)
Will form joint venture to train gas workers and managers. 06/07.

Air Products & Chemicals, Inc. (US)/CNOOC Oil Base Group Ltd., a subsidiary of CNOOC (Beijing)
Formed joint venture to build liquefier factory in Fujian and produce liquefied oxygen, nitrogen, and argon products. 05/07.

Pharmaceuticals

CHINA'S EXPORTS

Hutchison Whampoa Guangzhou Baiyunshan Chinese Medicine Co. Ltd. (Guangdong)/FHC Group (South Africa)
Signed agreement to produce bottled herbal tea for Africa. $20 million. 06/07.

OTHER

Hutchison Whampoa Guangzhou Baiyunshan Chinese Medicine Co. Ltd. (Guangdong)/FHC Group (South Africa)
Signed agreement to develop artemisinin, an antimalarial drug. $120 million. 06/07.

Ports & Shipping

CHINA'S EXPORTS

Nantong Huigang Shipbuilding Co., Ltd. (Jiangsu)
Will supply four vessels to Singapore-based STX Pan Ocean Co. Ltd. 07/07.

China Harbour Engineering Co. Group (Beijing)
Will construct a 35-km bridge to connect Boubyan port to the Kuwaiti mainland. $410 million. 06/07.

CHINA'S IMPORTS

Cargotec Oyj (Finland)
Will supply eight ship cranes to Beijing-based COSCO. $41 million. 07/07.

INVESTMENTS IN CHINA

APM Terminals International BV, a subsidiary of the A.P. Moller Maersk AS (Denmark)/China Merchants Holdings (International) Co. (Hong Kong)/Dachan Bay Port Investment and Development Co., Ltd. (Guangdong)
Will form joint venture to develop and operate the Shenzhen Dachan Bay Phase 2 Container Terminal. (Denmark:51%-Hong Kong:14%-China:35%). $960.7 million. 06/07.

Wärtsilä Corp. (Finland)/Zhenjiang CME Co. Ltd. (Jiangsu), a subsidiary of China State Shipbuilding Corp. (Beijing)
Will use joint venture, Wärtsilä CME Zhenjiang Propeller Co. Ltd., to open a new propeller factory in Jiangsu. $13.5 million. 06/07.

Rail

CHINA'S EXPORTS

Government of Jordan/Infrastructure Development Co. (China)
Will create a light commuter railway connecting Amman and Zarka, Jordan, and Damascus, Syria. $432 million. 05/07.

CHINA'S IMPORTS

Alstom (France)
Will supply subway trains to Jiangsu-based Nanjing Puzhen Rolling Stock Works. $165 million. 05/07.

INVESTMENTS IN CHINA

Denso Corp. (Japan)
Will open Denso (Changzhou) Fuel Injection System Co., Ltd. in Jiangsu to produce common rail systems for diesel vehicles. $33 million. 06/07.

Real Estate & Land

INVESTMENTS IN CHINA

Van Shung Chong Holdings Ltd. (Hong Kong), Fit Team Holdings Ltd. (Hong Kong)
Will form joint venture to acquire a property in Shanghai. $55.3 million. 07/07.

High Tech Computer Corp. (Taiwan)
Will acquire plot in Kangqiao Industrial Zone in Nanhui District, Shanghai, to develop second production base. $9.4 million. 06/07.

VXL Capital Ltd. (Hong Kong)
Purchased 11 star-rated hotels from Heilongjiang-based China Post Group Corp. $26 million. 06/07.

Kowloon Development Co. Ltd. (Hong Kong)/Citic Group (Beijing), Tianjin Flying Investment Development Co., Ltd.
Will collaborate to build a residential and commercial complex in Tianjin. (Hong Kong:61%-China:39%). $3.5 billion. 05/07.

OTHER

Aetos Capital, LLC (US)/China Life Asset Management Co., Ltd., a subsidiary of China Life Insurance Co. Ltd. (Beijing)
Signed strategic partnership agreement to identify and evaluate real estate investment opportunities in China. 06/07.

Research & Development

OTHER

Cleantech Group LLC (US)
Opened environmental R&D facility in Xuzhou, Jiangsu. 05/07.

Retail/Wholesale

CHINA'S IMPORTS

Kinderbedarf Gmbh & Co. Kg (Germany)/Shanghai Foxtown Industrial Co.
Signed franchising agreement to sell baby and children's clothing in China. 06/07.

INVESTMENTS IN CHINA

Kemira Oyj (Finland)
Established new sales company, Tikkurila (Beijing) Paints Co., Ltd. 05/07.

Tikkurila (Beijing) Paints Co., Ltd., a subsidiary of Kemira Group (Finland)
Will acquire Guangdong-based sales company CEIEC-Feelings, a subsidiary of Beijing-based CEIEC-OTC. 05/07.

OTHER

Giorgio Armani SpA (Italy)
Will open 10 home-furnishing stores in China in the next four years. 06/07.

Lotte Shopping Co. Ltd. (South Korea)
Will open retail store, Lotte Silvertie Department Store, in Beijing in 2008. 06/07.

Telecommunications

CHINA'S EXPORTS

ZTE Corp. (Guangdong)
Will supply telecom equipment to Russia-based AFK Sistema OAO. 06/07.

CHINA'S IMPORTS

Nokia Siemens Networks (Finland)
Will provide Beijing-based China Mobile with its Push-to-Talk over Cellular solution equipment and services. 07/07.

Cable & Wireless plc (UK)
Will provide service to 200 cities across China through Beijing-based China Telecom. 06/07.

Sony Ericsson Mobile Communications AB (UK), a joint venture between Sony Corp. (Japan) and Telefonaktiebolaget LM Ericsson (Sweden)
Will supply mobile phones to Beijing-based China Postel Mobile Communications Equipment Co., Ltd. 06/07.

Sony Ericsson Mobile Communications AB (UK), a joint venture between Sony Corp. (Japan) and Telefonaktiebolaget LM Ericsson (Sweden)
Will supply mobile phones to Shenzhen Telling Telecom Development Co., Ltd. 06/07.

Qualcomm Inc. (US)/ZTE Corp. (Guangdong)
Signed contract to increase orders of Qualcomm-made semiconductors. $500 million. 06/07.

Alcatel-Lucent (France)
Will provide mobile network equipment and services to Beijing-based China Mobile. $340 million. 05/07.

Alcatel-Lucent (France)
Signed contract to provide high-speed data network to Beijing-based China Unicom. $120 million. 05/07.

INVESTMENTS IN CHINA

Telefonaktiebolaget LM Ericsson (Sweden)/China Mobile (Beijing)
Signed agreement to expand GSM networks in 19 provinces, municipalities, and autonomous regions in China. $1 billion. 06/07.

OTHER

Sony Ericsson Mobile Communications AB (UK), a joint venture between Sony Corp. (Japan) and Telefonaktiebolaget LM Ericsson (Sweden)
Opened a new manufacturing plant in Beijing. 06/07.

sardari.com

The Come-Back City

Paula M. Miller

Capital of Liaoning and one of China's 10 most populous cities, Shenyang is a major economic, political, and industrial center in northeastern China. The city is also the Northeast's transport hub and largest commodity distribution center. Shenyang's GDP reached ¥248.3 billion ($32.9 billion) in 2006, up 16.5 percent over 2005 (see Table). Though the city has experienced economic difficulties in the recent past, it has reenergized and is beginning to boom.

History in brief

Shenyang's history dates back more than 2,000 years, and the city is perhaps best known as the birthplace of the Qing Dynasty (1644–1911). Russia occupied the city at the end of the 19th century and began to industrialize it and build railways to connect coastal ports to key cities. Under the Japanese occupation of Manchuria (1931–45), Shenyang developed into a center of heavy industry. After Japan surrendered at the end of World War II, Shenyang successively fell under the control of Soviet (1945), Nationalist (1946), and Communist (1948) forces. The city was an industrial stronghold throughout the Maoist era (1949–76).

Though Shenyang was one of the first cities to develop under Mao Zedong's planned economy, it was slow to embrace China's market reforms during the 1980s and 1990s. In the late 1990s, the city undertook a massive reform of state-owned enterprises (SOEs), which led to bankruptcies, layoffs, and social unrest. Despite these reforms, Shenyang remains a significant base for SOEs.

In 2001, Shenyang was hit by corruption scandals that brought down the city's top leadership. Since then, Shenyang's government has strived to clean up the city (both politically and environmentally), modernize its industrial base, and develop new industries and sectors, such as financial services and tourism. China's campaign to "Revitalize the Northeast," launched by the State Council in 2003, has helped jumpstart the area (see p.57).

Geography and natural resources

With a population of more than 7.2 million residents, of which about 4.9 million are registered urban residents, Shenyang and areas under its jurisdiction cover an area of 13,000 km². Rich in natural resources—including minerals, coal, and natural gas—Shenyang lies between the Liaohe Plain and the Changbai Mountains. About 147,000 hectares of forest and 82,000 hectares of pasture lie within the city limits. The Liao, Hun, and Xiushui rivers flow around the city.

Seven satellite cities, also rich in natural resources, lie within a 150 km-radius of Shenyang: Anshan, known for steel; Benxi, known for coal and iron; Fushun, known for coal; Fuxin, a coal and electricity base; Liaoyang, a chemical fiber base; Panjin, a petroleum base; and Tieling, known for coal and grain.

Transportation

Shenyang is the Northeast's air and land transportation hub. The Shenyang Taoxian International Airport, which can handle more than 6 million passengers each year, is the largest airport in Northeast China. By plane, Shenyang

An industrial rust belt city in China's Northeast polishes itself up

is about one hour from Beijing, four hours from Hong Kong, 1.5 hours from Seoul, and three hours from Tokyo. The Shenyang airport serves about 60 domestic and 15 international cities, including cities in Hong Kong, Japan, Russia, Singapore, South Korea, and Thailand. In 2006, 630,000 tons of freight passed through Shenyang's airport.

Shenyang boasts about 5,252 km of highway, including 236 km of super-highway (highways with six or more lanes). Expressways cross the province and link Shenyang to key cities such as Beijing; Changchun, Jilin; Dalian, Liaoning; Harbin, Heilongjiang; and Tianjin. The eight-lane Shenyang-Dalian Expressway connects Shenyang to Liaoning's key port city, while the six-lane Jingshen Expressway links Shenyang to Beijing. Last year, 167 million tons of goods were transported by road through Shenyang.

The city has one of the most heavily used rail hubs in China—six lines intersect in Shenyang, extending south to Beijing, north to the rest of northeast China and Russia, and southeast to North Korea. In 2006, 8.5 million tons of goods were transported by rail via Shenyang. The PRC Ministry of Railways has marked Shenyang as one of 18 Chinese cities to be developed into a state-of-the-art intermodal container hub terminal by 2010 (see the *CBR*, July–August 2005, p.8).

Within the city, subway lines one and two are scheduled to be completed in 2009 and 2010, respectively. The lines will help connect downtown commercial areas to manufacturing zones in the suburbs.

Revitalize the Northeast Campaign Results

China's "Revitalize the Northeast" campaign, launched in 2003, aims to reform and privatize state-owned enterprises, boost infrastructure, and modernize targeted industrial sectors. According to a May 2007 State Council assessment report of the campaign, Northeast China's annual GDP grew about 12.6 percent a year from 2004–06, a growth rate that averaged 2.3 percentage points higher than national GDP growth. The region's economy is still a fraction of China's total, however. In 2005, the GDP of Heilongjiang, Jilin, and Liaoning accounted for about 3 percent, 2 percent, and 4.4 percent of China's GDP, respectively.

According to the May State Council report, foreign direct investment in the three provinces hit $8.5 billion in 2006, up 48.3 percent over 2005. The three provinces' combined exports reached $39.8 billion in 2006, up from $32 billion in 2005, and their combined imports reached $29.4 billion in 2006, up from $25.1 billion in the previous year.

As the *CBR* went to press, the State Council approved a Northeast China economic revitalization program, which aims to build bases for equipment manufacturing, raw materials and energy, technological development, and commodity grains and animal husbandry. The State Council has proposed that projects be financed by national fiscal measures, financial services, and tax incentives.

—Paula M. Miller

City layout

Agriculture, animal husbandry, and agricultural product processing dominate northeastern Shenyang; eastern Shenyang is an auto parts hub; southern Shenyang is a high-tech industrial base; and western Shenyang is home to heavy machinery manufacturing. The city center specializes in retail and financial services.

The city features two main commercial areas: Heping District's Taiyuan Jie, Shenyang's busiest street; and Shenhe District's Zhong Jie, Shenyang's 400-year-old business street. Until recently, Shenyang had few foreign-invested stores and restaurants but the city is now home to several, including Wal-Mart, Inc.; Carrefour Group; Parkson Retail Group Ltd.; B&Q plc; Starbucks Corp.; McDonald's Corp.; Pizza Hut, Inc.; and KFC Corp.

Japan, Russia, South Korea, and the United States have consulates in Shenyang's Heping District; North Korea has a consulate in Huanggu District. France recently announced it will open a consulate general's office in Shenyang in September.

Industry and services

Once China's titan of heavy industry, Shenyang has been diversifying and modernizing its industry in recent years. Today, the city is strong in machinery, autos and auto parts, petrochemicals, pharmaceuticals, aviation, textiles, electronics, food processing, building materials, metallurgy, and light industrial products. In 2001, the city began establishing software parks and plans to finish constructing a new 100-hectare Shenyang International Software Park over the next few years. In addition, Shenyang has a strong agricultural base, harvesting crops such as rice, corn, wheat, soybean, and various oil crops and vegetables.

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

The city has also boosted its services sector—especially banking, insurance, securities, financial consulting, commerce and trade, and real estate development. The first foreign-invested bank, South Korea's Hana Bank, arrived in Shenyang in May 2004. In 2005, the Bank of Tokyo-Mitsubishi UFJ became the first Japanese bank to open in Shenyang. Hong Kong's Bank of East Asia Ltd., Singapore's United Overseas Bank Ltd., and HSBC Holdings plc opened branches in April, June, and July 2007, respectively. In 2006, the city boasted a total of 1,063 banks and bank branches and 144 insurance-related companies, most of which were domestic. By 2010, it aims to attract 30 foreign banks and 60 non-bank financial institutions.

Shenyang has also attempted to boost its tourism industry and attract conferences and expositions. Most notably, Shenyang's new Olympic Sports Center Stadium will host eight Olympic soccer matches during the 2008 Beijing Olympics. From June to October this year, the city is hosting the World Cultural and Natural Heritage Expo. (The UNESCO World Heritage Committee has classified Shenyang's Imperial Palace and the Fu and Zhao mausoleums, which date from the Qing Dynasty, as world heritage sites.) Shenyang also hosts annual cultural events such as the International Qing Dynasty Culture Festival, South Korean Week, and International Ice and Snow Festival. Shenyang will host the Northeast Asia Commodities Fair in September. Last year, the city hosted the International Horticultural Exposition, which drew several million attendees over six months and featured exhibits from 23 countries.

According to the Shenyang Statistical Bureau, the city received a total of 45.5 million domestic and foreign tourists in 2006, up 28 percent over 2005. Last year, tourism revenue hit ¥27.2 billion ($3.6 billion). The city has 5 five-star hotels, 15 four-star hotels, and 54 three-star hotels.

Foreign fan favorites

Like other cities in northeastern China, Shenyang has benefited from China's "Revitalize the Northeast" campaign and the value-added tax policies that followed. Throughout the Northeast labor costs are low and energy supply is ample. Shenyang also boasts a solid industrial foundation, a good land and air transport network, abundant natural resources, and a skilled workforce. (Roughly 30 colleges and universities and numerous research and training institutions are located in Shenyang.) In addition, local authorities grant investment subsidies to multinational corporations (MNCs) that set up regional

Shenyang at a Glance

By the Numbers

	2006	% increase over 2005
GDP	¥248.3 billion	16.5
Fixed-asset investment	¥179.0 billion	31.3
Government revenue	¥23.6 billion	30.3
Urban disposable per capita income	¥11,651.4	15.4
Rural net per capita income	¥5,712.5	13.1
Consumer price index	1.8	NA
Total retail sales of consumer goods	¥104.9 billion	14.6
Registered unemployment rate in urban areas	5.1%	NA
Foreign Direct Investment		
Amount contracted	$8.5 billion	NA
Amount utilized	$3.03 billion	42.9
Number of projects approved	863	NA
Trade		
Total trade	$5.3 billion	16.0
Exports	$2.7 billion	13.4
Imports	$2.6 billion	18.6

Note: NA = not available/not applicable
Source: Shenyang Statistical Bureau

Government Contacts

Party Secretary: Chen Zhenggao
Mayor: Li Yingjie
Vice Mayors: Zhao Changyi, Li Baoquan, Xing Kai, Guo Yunchong, Wang Ling, Wang Ying, Wang Xiangkun, Liu He, Song Qi, and Zou Dating

Shenyang Municipal Government General Office
Address: 260 Shifu Road
Tel: 86-24-2272-7864
Fax: 86-24-2272-2264
www.shenyang.gov.cn

Shenyang Administration for Industry and Commerce
www.sygsj.gov.cn

Shenyang Bureau of Commerce
www.sysyj.gov.cn

China Council for the Promotion of International Trade, Shenyang Sub-Council
www.ccpit-sy.org.cn

Useful Links

Shenyang Municipal Development and Reform Commission
www.shenyang.gov.cn

Shenyang Municipal Bureau of Foreign Trade and Economic Cooperation
www.symoftec.gov.cn

Development Zones

Shenyang Economic and Technological Development Area
www.sydz.gov.cn

Shenyang Xihe Economic Zone
www.syxh.gov.cn

Shenyang Hunnan New Area/Shenyang National New and High-Tech Industrial Development Zone
www.hunnan.gov.cn

offices or headquarters in Shenyang. The city also offers smaller operational subsidies to companies that set up representative offices or branches in Shenyang, and companies that invest at least $10 million in constructing certain types of facilities can receive rent reductions.

Shenyang's utilized foreign direct investment more than doubled from 2004 to 2005; it hit $3.03 billion in 2006, up another 42.9 percent. In 2005, 26 foreign-invested enterprises with investment of more than $5 million were based in Shenyang. According to the China Council for the Promotion of International Trade, Shenyang Sub-Council, the top sources of foreign investment in Shenyang are South Korea, Hong Kong, the United States, Japan, and EU countries.

Both US companies interviewed for this article—Tyco International and General Motors (GM) Corp.—are expanding their operations in Shenyang and generally praised the city. A Shenyang resident since 1998, Dennis Adams, general manager of Tyco Safety Products, Shenyang, listed the city's top advantages as low direct and indirect labor costs; a deep pool of skilled, technical labor; good transportation; low land-use fees; and solid government support. He noted, "In Shenyang, Tyco is a big fish in a small pond—we were the city's third-largest exporter in 2005 and 2006 and will likely be the second-largest exporter in 2007. If needed, it's possible to arrange a meeting with the Shenyang mayor; it would be difficult to do that in Shanghai or Shenzhen. The development zone is also supportive."

Tyco has done well in Shenyang; it expanded from one employee in 1997 to nearly 2,000 employees in 2007. Tyco decided to consolidate much of its electronic article surveillance hard tag and label production in Shenyang and now operates two facilities in the city.

Chris Gubbey, former executive vice president of Shanghai GM Corp. Ltd., saw GM's operations expand across three cities—Shanghai; Yantai, Shandong; and Shenyang—in the seven years he lived in China. (Since being interviewed, Gubbey has become the chair and managing director of GM Holden Ltd. in Australia.) In August 2004, GM consolidated its Shenyang operations under a new joint venture (JV) Shanghai GM (Shenyang) Norsom Motors Co. Ltd. Shanghai GM owns 50 percent of the JV, while GM and the Shanghai Automotive Industry Corp. each own 25 percent. In contrast to its first JV plant, which produced 2,500 Chevrolet Blazers a year, the new JV plant has an annual capacity of 50,000 vehicles and produces Buick GL8 and FirstLand executive wagons. The JV plans to expand the plant and the number of models it produces.

Gubbey explained, "We needed a lot of provincial and local government support for the new JV. Restructuring could have been difficult, but it went relatively smoothly, and we're expanding now. We had to have confidence in the city and how the restructuring would be done to make that decision." Gubbey also said of the city, "Shenyang's labor and land-use costs are cheaper than Shanghai and Yantai. But the city needs to encourage suppliers to set up localized plants there. It is said that every job in the auto industry creates several more jobs in other sectors. But Shenyang hasn't been hit by the second wave yet."

Shenyang Finance and Trade Development Zone
www.syftd.gov.cn

Shenyang Huishan New and High-Tech Agricultural Development Zone
www.syaaa.gov.cn

Shenyang European Union Economic Development Zone
www.syeu.gov.cn

Shenyang Qipan Mountains Tourism Development Zone
www.qipanshan.gov.cn

For more information on Shenyang's development zones, see www.chinabusinessreview.com.

The competition

When Shenyang city and development zone officials were asked to list the city's top competitors, the overwhelming response was "Dalian." Perhaps the most progressive city in Liaoning, Dalian has the largest, deepest international port in northeastern China and a tourism industry supported by its popular beaches. The city is known for its strong shipbuilding and software industries. Many MNCs, including Accenture Ltd., General Electric Co., Hewlett-Packard Co., IBM Corp., Matsushita Electric Industrial Co., Ltd., and Sony Corp., have operations there.

Supporters of Shenyang, however, note that Shenyang is relatively near three Liaoning ports—Dalian, Dadong, and Yingkou—though the latter two are much smaller. Tyco's Adams noted that Shenyang's distance from international ports is not a problem, "Tyco ships five 40-foot containers a day through Dalian. From Shenyang, that's a 3.5-hour drive on an eight-lane super-highway."

Seeking a higher profile

A knowledgeable Shenyang observer recently commented that Shenyang is the next "Shanghai on the make" and that in the next five years the city and China's Northeast will take off. The same observer, however, commented that the Northeast suffers from a low profile—that foreign tourists and investors often do not think about the Northeast as a possible travel or investment destination. Shenyang will likely need to raise its profile before it can truly take off. 完

The Challenge for Brands in the Other China

Continued from page 31

ning across the tiers. Foreign brands must use local and in-store media to trigger shoppers' impulses and allow them to compare products, while TV can focus on building the emotional value of brands and communicate related news. Abundant advertising opportunities also exist in magazines that target consumers in lower tiers.

Engagement with shop owners in lower tiers is crucial because they play a key role in influencing consumer choices. Designers for large retail chains, who are primarily absorbed in creating impressive displays for hypermarkets and flagship stores, must be ready to respond to the lower tiers' in-store media needs.

Population and GDP, 2005

Source: *China Statistical Yearbook, 2006*

Brands

Brand performance across tiers

Brand power is only beginning to set in, especially in the smaller cities. More than two-thirds of respondents in Tier 3 said they were unwilling to pay more for a famous international brand. Moreover, consumers in lower tiers have fewer choices, making local, and often regional, brands more popular.

Perhaps as a result, the openness with which consumers in Tier 3 adopt foreign brands is quite low. Moving from Tier 1 to Tier 3, the number of foreign brands in the top 10 favorite list is halved—from 8 to 4. Haier, the Chinese consumer durable brand, remains the favorite for most people across all tiers. Nokia, Samsung, Nike, and Olay do well among the foreign brands. Interestingly, services sector brands are absent from the list. While Google may be perched atop the BrandZ list (a survey of brands undertaken by WPP Group plc, Ogilvy's parent company) worldwide, and China Mobile may well be among the top five, consumers in China seem to still value tangibility when evaluating brands. Patriotism also plays a role in brand selection, especially in the lower tiers.

International entertainment, on the other hand, is easily absorbed. South Korean soap operas, such as *Winter Sonata,* are equally popular in smaller towns and large cities. Retail supermarket chains like Carrefour—which serves as both an entertainment venue and a place to seek out new brands—are also welcomed in the lower tiers as the stores expand with breakneck speed into smaller towns.

Fast-moving consumer goods (FMCGs)

The shopping basket analysis in the study shows that foreign brands perform well in many FMCG categories, though some categories are dominated by local brands. For example, Coca-Cola, Danone, Nestlé, Dove, Pantene, and Colgate are strong foreign brands in Tier 1 cities, while Nong Fu, Kang Shi Fu, Wahaha, Tsingtao, and Meng Niu are strong local brands.

Consumer durables

Consumers in lower tiers are the target audience for most Chinese durable goods brands. For example, the TV market is completely dominated by Changhong, Konka, TCL, Hisense, and Skyworth, while Haier, Little Swan, and Royalstar are among the top washing machine brands. In the refrigerator category, Haier, Ronshen, and Frestech round out the top three, while Siemens is the only foreign brand that made the top five list. Gree, Midea, and Haier dominate the air conditioner market across the three tiers, and the DVD player market is dominated by Chinese brands such as Amoi, BBK, Shinco, Malata, and Nintaus. (Some people attribute the popularity of locally made DVD players to the fact that they are better equipped to handle pirated DVDs.)

In the mobile phone and digital camera markets, however, foreign brands dominate. Chinese brands have been unable to keep up with the rapid pace of innovation in these categories and have largely been driven out of the market. Sony is the leading brand of digital cameras across the tiers, though Kodak also does well in Tier 3. Canon, Samsung, and Olympus are also popular in the lower tiers. Nokia, Motorola, Samsung, and Sony Ericsson are the top mobile phone brands, snatching up about 70 percent of the China market across the tiers and leaving local brands such as Lenovo and TCL far behind.

In the consumer electronics category, planned purchases over the next year vary across the tiers. Most residents in Tier 1 surveyed plan to upgrade their tube TV sets to plasma and liquid-crystal display technology and their film cameras to digital ones. A greater percentage of residents in Tier 2 than those in Tiers 1 and 3 plan to buy new DVD players, air conditioners, and washing machines. Many residents in Tier 3, on the other hand, plan to purchase mobile phones, computers, digital cameras, and refrigerators for the first time. When consumers in lower tiers are shopping for these products, they will seek information on product features and greater functionality at an affordable price. Comparative communication, especially in-store, can provide salespeople with the necessary information to help consumers make choices.

Autos

Although Volkswagen is the current market leader in terms of having the highest ownership rate—21.9 percent—that rate falls to 10.9 percent among those who intend to buy a new car within the next year, according to the survey. Hyundai and Honda lead the way in Tier 3, with 13.6 percent of respondents saying that they plan to buy those brands over the next year. About 12.7 percent are considering buying a Chery, one of China's leading car brands.

Apparel and sportswear

Nike is the leading sportswear brand in Tier 1 (34.5 percent of the respondents said they own a Nike-branded item), followed closely by Li Ning (31.1 percent). The order flips in Tier 2, with 38.3 percent and 23.9 percent of the respondents owning Li Ning and Nike, respectively. In Tier 3, the top two brands are Li Ning and Anta. This pattern clearly follows the overall trend: the lower the tier, the stronger the local brands.

Implications

These brand performance figures show that market leadership is transitory in China and that the lower tiers can have a

Research Objectives and Methodology

Ogilvy Discovery and Mindshare Insights surveyed consumers in 22 cities across China in 2006.

Research objectives

- To understand what drives people to make choices in their lives and adopt new ideas and brands;
- To audit brand and communication presence at different types of retail formats—from hypermarkets to neighborhood mom-and-pop stores—and conduct shopper interviews to get a real sense of the choices, including impulse buys, made during that shopping trip; and
- To photograph families and their favorite possessions, shopping environments, and in-store and near-store communications to paint a vivid picture of consumers and their retail environment.

Methodology

The study covered the second tier, which is comprised of 17 provincial capitals, 50 prefecture-level cities, and 15 other cities with populations between 500,000 and 2 million, and the third tier, comprised of 200 county-level towns. Interviewers visited nearly 3,500 homes and 300 retail stores and interviewed 4,000 people in 22 cities, 10 of which were in Tier 3, 7 in Tier 2, and 5 in Tier 1 for a point of comparison (see Table).

The research was conducted primarily with quantitative questionnaires. Five locations in Tier 2 and 3 towns were chosen for family visits and free-flowing conversations with residents about their lives, aspirations, consumption, and problems. In these towns, the research team observed the shopping environment and shoppers in local marketplaces, all of which were photographed.

The study spanned hypermarkets, supermarkets, and neighborhood mom-and-pop stores and covered 25 product and service categories, ranging from autos and insurance to banking and soft drinks. In addition, data on consumers, their shopping and media habits, and drivers of consumer choice were collected. Respondents were equally represented among the three income classes—high, middle, and low.

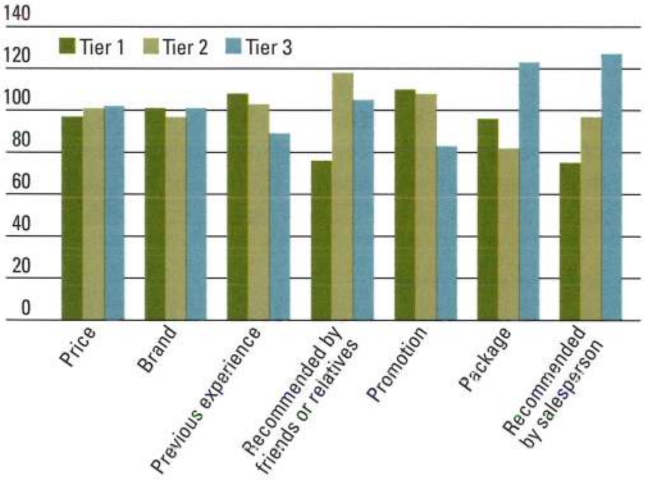
—*Kunal Sinha*

Cities in which the Research was Conducted

Tier 1	Tier 2	Tier 3
Beijing	Lanzhou, Gansu	Cenxi, Guangxi
Ji'nan, Shandong	Maoming, Guangdong	Dangyang, Hubei
Shanghai	Mudanjiang, Heilongjiang	Hailin, Heilongjiang
Wuhan, Hubei	Nanning, Guangxi	Linfen, Shanxi
Xi'an, Shaanxi	Shijiazhuang, Hebei	Linxia, Gansu
	Taiyuan, Shanxi	Taian, Shandong
	Yichang, Hubei	Xianyang, Shaanxi
		Xinyi, Guangdong
		Xinyi, Jiangsu
		Zhangjiahou, Hebei

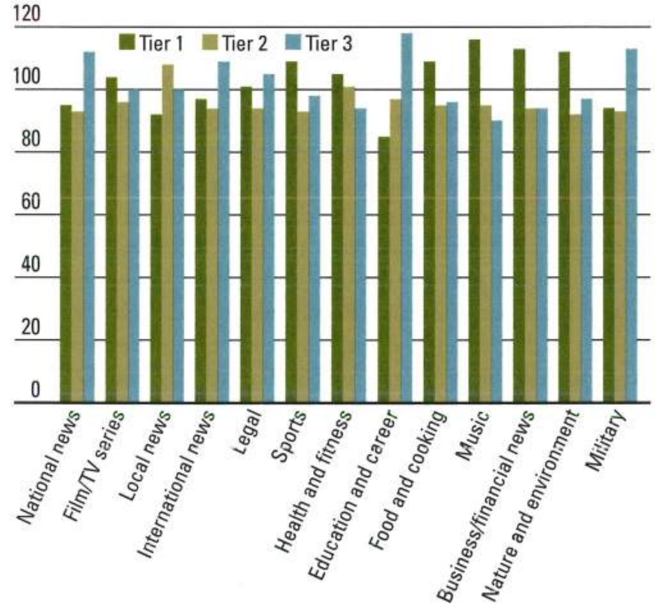
Note: The survey intentionally excluded typical Tier 1 cities such as Guangzhou and Tianjin to collect more data points.
Source: Ogilvy Discovery & Mindshare Insights

Figure 1: Index of Purchasing Decisions Across Tiers



Source: *Real China Revealed,* Ogilvy Discovery & Mindshare Insights

Figure 2: Index of Media Habits Across Tiers



Source: *Real China Revealed,* Ogilvy Discovery & Mindshare Insights

significant impact on changing the fortunes of a brand. No uniform formula can be applied to the lower tiers because marketing and communication do not work like a scale along which aspirations and ownership can be easily calibrated. Consumers in lower tiers are not swayed easily by claimed benefit or pedigree. They look for proof of performance.

It is essential for brand owners to take into account the differences in preferences while deciding to market to consumers in lower tiers. Consumer durable companies must consider the different stages of market development and demand curves across the tiers and design a multi-tier strategy. They must not strip down products to reduce cost because consumers, even in smaller towns, are looking for more features and higher quality.

The assumption that lower-tier means lower price or quality is mistaken. As the foreign mobile phone, digital camera, auto, and FMCG companies have shown, consumers in lower tiers are willing to loosen their wallets if they are given good value for their money. Appealing to those consumers' sense of practicality may help brand owners, but they must also boost brand images and focus on innovation.

Brand-building

To build differentiated brands that match consumer preferences in lower tiers, brand communication must shift from simply providing information and repeating messages to creating emotional connections with the consumers. This can be achieved by aligning communication with specific value systems and through story-telling. For example, a former brand manager at Olay credits the brand's success in China to a communication strategy that emphasized subtle stories.

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In the future, communication that teases the imagination and entertains will distinguish itself from the huge mass of TV commercials and other outdoor and in-store advertising to which the consumer is exposed.

As foreign brands infiltrate the lower tiers, it may not be necessary to emphasize their origins or use terms such as "international." Unlike the urbane Chinese consumer for whom the pedigree of French wine, German engineering, or Italian design may be important, consumers in lower tiers may perceive such associations as signs of unaffordable luxury. When targeting those consumers, localizing the product and using a culturally relevant communication strategy might work better.

Companies must find ways to surround consumers in lower tiers with favorable word-of-mouth exposure to build confidence in the brand. Thus, shop owners and current users of the brand must be motivated to spread the word and constantly reassure consumers that they have selected the right brand. This may be achieved through simple in-store schemes for the consumer or through distributing leaflets laden with examples to the shop owner.

Foreign companies must devise ways to engage consumers in lower tiers and not underestimate their potential, aspirations, and unique relationships with brands. Marketers should understand that consumers in smaller cities are nearly as savvy as residents in Tier 1 cities, though they tend to not spend as liberally as those in the first tier. Although certain local brands dominate market segments in the lower tiers, international brands can still find many opportunities to compete. Offering culturally relevant and high-quality products is one of the keys to a successful marketing campaign in smaller towns and cities across China. 完