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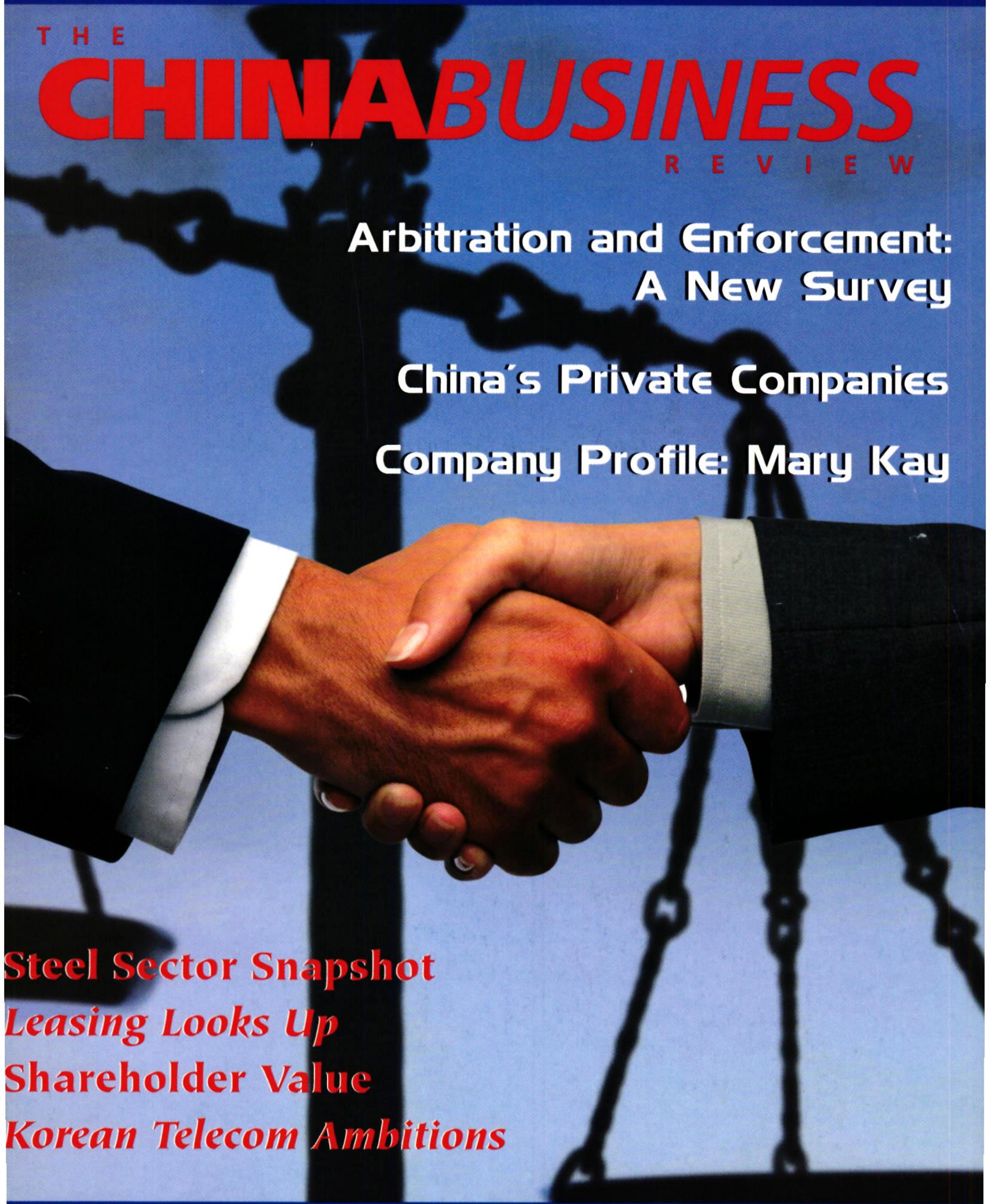
THE CHINA BUSINESS REVIEW



Arbitration and Enforcement: A New Survey

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Leasing Looks Up

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Korean Telecom Ambitions

Cover by Benjamin Hurd

THE **CHINA BUSINESS** REVIEW

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Letter from the editor

US-China Relations And the New Administration

As *The CBR* goes to press, the outcome of the US presidential election is (finally) no longer in doubt. But most China experts here in Washington agree that the changeover in the executive branch won't affect US-China relations much. US companies trying to assess the effects of the new administration on US-China commercial relations can at least be sure—for better or worse—that the priorities of Mr. Bush where China is concerned are not much different from those of the outgoing administration. At least one of these shared priorities is a stable bilateral commercial relationship.

But the experts also agree that Mr. Bush will have no honeymoon on China policy, thanks to the 2001 calendar. For one thing, China will host the Asia Pacific Economic Cooperation meetings this fall in Pudong, Shanghai, where the new US president and PRC President Jiang Zemin are likely to meet. As Bob Kapp mentioned in his Letter from the President in our November-December 2000 issue, the new president may also have to contemplate China's annual Normal Trade Relations status if the slow negotiations in Geneva over terms of China's World Trade Organization (WTO) membership do not finish before this spring.

To my mind, it's the uncertainties over the health of the two nations' economies that should probably worry companies most. After all, the once-booming US economy is showing clear signs of a slowdown. And the Chinese economy, although limping along a little faster in 2000 than 1999, is bracing for WTO entry and a new round of difficult reforms. If the US slowdown leads consumers to buy fewer Chinese imports, and US corporate resources for new investments (overseas or at home) dry up, stable US-China commercial relations will be difficult to sustain no matter how the political relationship fares.

Catherine Gelb
Editor

Notice to Readers: Printer's Error in November-December 2000 Issue

The CBR has received notice from a few of our readers that their copies of the November-December 2000 *CBR* were missing pages. Our printer has assured us that only a few copies have been affected. Nevertheless, we would like to offer our sincere apologies to any subscribers who received defective issues. If you received a faulty copy, please give us a call (202.429.0340) or send us an e-mail (*publications@uschina.org*) and we will be more than happy to mail out a replacement. We only ask that you mail in your defective copy, for our records (we will reimburse all mailing costs). Thank you, and apologies again.

—*CG*

Capital Market Reforms Accelerate

Press reports last fall that foreign-invested enterprises (FIEs) would soon be able to list on China's A-share stock markets were among the highest-profile indications that Beijing is stepping up the pace of capital market reforms. Incremental financial reforms have taken place over the past several years, and Chinese officials appear closer than ever to mapping out a schedule to allow new financial instruments and broaden participation in capital markets. They also seem to be developing some of the legal and regulatory underpinnings that are prerequisites for fully functioning capital markets.

In September, securities officials announced a five-step reform plan, the first step of which is to eliminate the restriction on the ownership forms of companies allowed to list on Chinese exchanges. This change would allow FIEs to apply to list on China's A-share market, rather than merely undertake private placements, as is currently the case. The second reform, according to a *People's Daily* report, is to facilitate online trading. The third is to set up a new exchange, similar to Hong Kong's Growth Enterprise Market, for high-performing companies. This new bourse will likely reside in Shenzhen. China currently has two stock markets, one in Shenzhen, Guangdong Province, and one in Shanghai, which reportedly will be merged next year and located in Shanghai. The fourth step calls for the establishment of joint-venture fund-management companies, the first of which was formed in October. Finally, the report says that state-owned financial institutions will be allowed to list on the stock markets for the first time.

Chinese officials have also issued rules to establish open-end mutual funds and enable PRC insurance firms to invest more of their assets in the stock markets, and have indicated that foreign firms may eventually be able to underwrite PRC government bonds in local currency.

Major step in mutual funds

The Provisional Rules on Open-End Mutual Funds, which the China Securities Regulatory Commission (CSRC) issued on October 12, 2000, are one of the more concrete steps China has taken in recent months to modernize capital markets. The new rules follow on the 1997 Provisional Measures on Mutual Fund Management, and together they enable Chinese companies, and eventually foreign financial institutions in joint ventures with PRC firms, to offer a new financial instrument to Chinese investors.

China reportedly now maintains 30 closed-end mutual funds worth about ¥80 billion ($9.7 billion). While a closed-end fund issues a limited number of shares that trade on stock exchanges, an open-end fund issues new shares on demand and fund managers must redeem them on demand at market prices. The prices of open-end fund shares thus track the fund's underlying assets more closely than the prices of closed-end shares, which rise or fall depending on demand for the limited number of shares issued.

The new fund rules set out the basic guidelines for companies interested in establishing open-end funds. Among the key provisions:

- Companies that apply to CSRC must be in no legal trouble and must submit an "implementation plan" for the proposed fund.
- Once approved, fund managers have six months to establish the fund, and must raise ¥200 million ($24.2 million) from at least 100 investors within three months of publication of the fund prospectus.
- Purchasing and buyback can only be frozen for three months "during the initial phase of establishment." Thereafter, subscription, purchase, buyback, registration changes, fund transfers, and other activities are to occur only on "open days"—of which there must be at least one per week. The fund's net asset value is to be calculated at the end of each open day.
- Fund managers' fees for purchases may not exceed 5 percent of the purchase price, and for sales, 3 percent of the sales price.

Experts appear to agree that the rules are reasonable and should pave the way for the formation of new funds within the next few months. Major foreign financial institutions, which will be able to act as fund managers in joint ventures, have already allied themselves with several leading PRC brokerages and other financial institutions. Chinese regulators have not yet stated when joint-venture asset management companies can begin operating, though American International Assurance Ltd., a unit of American International Group, Inc., was recently named the first foreign participant in a joint-venture fund management company.

Keeping the markets clean

The creation of these new instruments will pressure China to devise rules for stock index futures and other derivatives, which are necessary to help investors hedge risk effectively. China has shied away from futures

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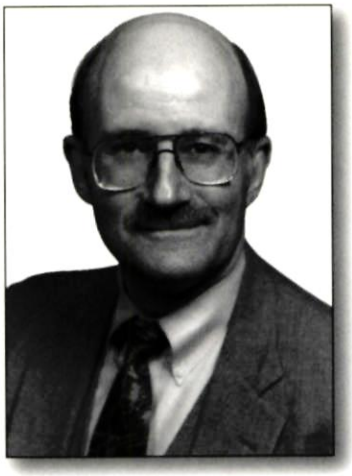
(Signed) Catherine Gelb, Editor



LETTER from the President of the US-China Business Council

China's Dialogue on the Coming of WTO

Robert A. Kapp

The Chinese are engaged in a heavy discussion of what the WTO means for China

While America grinds through its election and post-election rituals and prepares for a new administration, hoping that the newcomers will make fewer of the inevitable first-year mistakes than most of their predecessors have made, China grapples with the coming of the World Trade Organization (WTO).

Even before the tortuous Geneva accession negotiations conclude, the Chinese are engaged in a heavy discussion of what the WTO means for China—not just in terms of jobs or exports, but in terms of China's own future as an economy and a society. I have read several lengthy and well-informed book-length analyses of the likely impacts of WTO membership on the Chinese economy, sector by sector. Articles from every province and city appear in print and online daily.

Combined with the avid study of information about the WTO's rules, operations, and dispute resolution experiences, the sheer volume of published material on the WTO—what Chinese are saying to each other where all can see and hear it—is impressive, and ought to be of real interest to US business and to US policymakers. As in any debate over a big new international trade agreement in any country, some of the material is repetitive, even predictable; certainly that was the case in the United States during the NAFTA and Uruguay Round debates. But taken as a whole, China's current debate reveals where China hopes—and sometimes worries—the WTO will take it.

Our dialogue with China on the WTO, as on other matters, will be more productive if Americans have a living sense of issues under debate within China on any given subject, and indeed if the Chinese, in turn, have that same living sense of America's key concerns on issues we debate regarding China. The WTO offers a good example.

Here, then, is a short example of what is being said within China about the WTO. The writer, Zhao Yihuai, is an official of the Shanghai Municipal Office for Restructuring the Economy. He published his piece recently in the major Shanghai newspaper, *Liberation Daily*. The article was then posted to a rich compendium of WTO essays found on the website of the national newspaper of the Chinese Communist Party itself, the *People's Daily* (*www.peopledaily.com.cn*). You have to read Chinese to plow into this "China Enters the WTO" collection, but if you do, or if you know someone who can help you, it is a worthwhile trip.

What follows are excerpts from "How Should the Government Respond to WTO Entry?" by Zhao Yihuai (my translation):

China's entry into the WTO is first and foremost a government entry. Never mind whether it is the central government or local governments: all have to be adequately informed. For a long time, our economy has been a government-led economy: government policies and system regulations were formed from a single, internal, national understanding and set by the nation's own circumstances. After China enters the WTO, it faces a new environment. China must accept rules of the game already put in place by the WTO. We may not simply change those rules without authorization, but instead must obey and support them. Therefore, governments need to ratchet up the modification of our laws and regulations to make them compatible with the basic principles and the basic spirit of the WTO, so that we can effectively adapt to this new economic environment. Concretely, we should start with the following:

- The first step, naturally, is to speed up our own structural reforms. Compared to the reform process in the past, the biggest change in our reform process after WTO entry will be from "We Want Reform" to "We Must Reform Ourselves." This imposes a new system of reform upon us. To meet this challenge, governments must consciously increase the intensity of their reform efforts, and speed up the steps leading to the marketization of the national economy. In keeping with the requirements of the WTO, we must deepen the reforms of our financial structures, our food distribution structures, our social insurance systems, and so on, rooting

"Any country entering the WTO is considered to be a market economy.... Conceptually, this means changing from 'omnipotent government' to 'limited government.'"—Zhao Yihuai, "How Should the Government Respond to WTO Entry?"

—Liberation Daily

out the discrepancies and the frictions between our domestic systems and international rules. Elimination of such conflicts is the precondition for the true alignment of our national economy with the world economy.

● Next, we must expand the grounding of government policy in law, and increase the transparency of government policies. Enhancement of legality is necessitated by the requirements of the market economy. Any country entering the WTO is considered to be a market economy. This requires government conduct to advance along tracks defined by law. Conceptually, this means changing from "omnipotent government" to "limited government." With WTO entry, China must erect both a new conceptual basis to undergird government conduct and new forms of government action. Looking at today's realities, the first task is to eliminate many outmoded internal regulations and policies that are not compatible with WTO rules. For example, in dealing with the non-public economic sector, governments must realize the commitment to nondiscrimination, in order to create a fair environment for the operation of the nongovernmental economy. That means to the greatest possible extent avoiding preferential policies and subsidies for state-owned enterprises, in order not to provoke retaliation from abroad.

● Next, China must energetically enhance the economic management abilities of governments. WTO entry does not signal the general weakening of the managerial skills of governments. On the contrary, it is through the reform of government systems of economic management and the strengthening of the rational professional skills of governments that we will be able to preserve the basic interests of the people and the national economic security in a globalized environment of intense competition.

● Specifically, this means, a) providing correct guidance and active fine-tuning. These roles are recognized under the WTO system.... And b), it means energetically supporting our own interests. We must utilize all the safeguard methods authorized by the WTO for its members to use in guarding their infant industries. We must actively explore effective support mechanisms, to defend against the massive onslaught against our national production sectors and our vulnerable products in the midst of bitter competition. Of course, the purpose of such government protections is not to protect backwardness; rather, it is ultimately to end such protections and to raise the international competitive power of the producers and products afforded the protection.

In sum, entering the WTO drives forward our country's historic opportunity to develop along market economy lines. It serves as a new driver of all facets of our nation's reform and "opening." Agencies of government cannot but actively rise to this challenge, advance the reform process within the framework of the WTO, and only by so doing preserve the autonomy of our nation's economy amidst the competition of a global economy.

As America endures a laborious political transition, and US companies peer into the future at home and overseas, China's discussion of its future in a WTO-based global economy goes on apace. The adjustment to life in the WTO may not be easy for China or its trade partners. But there is plenty of evidence—far more than I've been able to offer here—that suggests that the WTO is being taken with the greatest seriousness in the PRC, and that its implications for economic and other changes within China are very much in public view. The more we can know about the dynamics of the WTO discussion within China, the more effectively the US-China Business Council and its member firms can pursue with Chinese counterparts the full and successful realization of China's new rights and responsibilities. 完

Enforcement of Arbitral Awards in China

A survey of foreign parties' experiences with the enforcement of arbitral awards

Randall Peerenboom

Nothing frustrates parties more than to discover, after prevailing at a hard-fought and costly arbitration, that the arbitral award cannot be enforced. Parties want money, not a piece of paper. The perceived enforceability of awards will influence an investor's decision about whether to settle, arbitrate, or litigate; where to arbitrate; and perhaps in some cases, whether to invest at all. Unfortunately, foreign parties doing business in the PRC or with PRC companies have had to make such important commercial decisions based on very little reliable evidence about the enforceability of awards in China.

The lack of a firm empirical foundation has not stopped disgruntled foreign investors and commentators from sounding a general alarm, claiming that enforcing arbitral awards is all but impossible in China. In contrast, official and semi-official PRC sources present a much rosier view, though again without a firm empirical foundation. Even the available anecdotal evidence has been surprisingly scanty. Many of the most extreme claims about the hazards of enforcing arbitral awards in China have been based largely on the single widely reported case of Florida-based firm Revpower. In this case, the foreign party struggled for six years to get a Shanghai court to accept its application to enforce an award issued in its favor. By the time the Shanghai court finally succumbed to pressure from the Supreme People's Court, and accepted the application and recognized the award, the Chinese respondent had apparently transferred its assets to other companies.

In fact, enforcement is neither as hopeless as foreign investors and reporters are wont to suggest, nor as trouble-free as official and semi-official Chinese sources would have us believe. In a survey of 72 foreign and China International Economic and Trade Arbitration Commission (CIETAC) arbitral award enforcement cases, I found that almost half were enforced, in the sense that the party recovered at least some portion of the award. The survey was conducted between 1995 and 1998 and was funded by a grant from the Smith Richardson Foundation, with additional funding from the UCLA School of Law, the UCLA Academic Senate, and the UCLA International Studies and Overseas Program.

Arbitration in China

Chinese law divides arbitral awards into three main types: foreign, foreign-related, and domestic. Foreign arbitral awards refer to any awards made outside of China. Foreign awards include both Convention awards, which are enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention), and non-Convention awards.

Foreign-related awards, which are awarded in cases that involve a foreign element, are made by CIETAC, the China Maritime Arbitration Commission (CMAC), or local arbitration commissions. Domestic awards are awards, which do not involve a foreign element, made by local arbitration commissions and, since October 1, 2000, CIETAC.

Awards from Hong Kong, Macao, and Taiwan fall into another category. Of the three, Hong Kong awards are by far the most significant and are now enforced in China pursuant to the Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region, effective February 1, 2000.

The author's survey results: Is the cup half empty or half full?

Between 1995 and 1998, I collected information on 89 foreign and CIETAC arbitral award enforcement cases. Interviews, in some instances with the parties but usually with the lawyers who handled the cases, supplied information on 66 cases. Written sources such as press reports, academic articles, or the *Supreme People's Court Gazette* furnished information for 18 cases. A combination of written sources and interviews provided information for five cases. Because information was incomplete for a number of cases, including several pending cases, I was able to calculate enforcement rates for 72 of the 89 cases.

Table 1 indicates that 49 percent of foreign and CIETAC awards were enforced to some de-

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For a more extensive discussion of the methodology and the results of the survey, see Randall Peerenboom, "Seek Truth from Facts: An Empirical Study of the Enforcement of Arbitral Awards in the People's Republic of China," *American Journal of Comparative Law* (forthcoming, 2001).

gree. The enforcement rate for foreign awards was 52 percent, slightly higher than the 47 percent success rate for CIETAC awards (*see* Tables 2 and 3). These numbers require further clarification, however.

Obviously, there is a big difference between recovering 1 percent and 100 percent of an award. While even a 1 percent recovery was considered an enforcement case and in that sense a success, investors would not be satisfied with such a low return and thus would want some idea of the probability of a better enforcement outcome. An analysis of the survey results revealed that an applicant had a 17 percent chance of recovering 100 percent, a 17 percent chance of recovering 75-100 percent, a 7 percent chance of recovering 50-75 percent, and a 10 percent chance of recovering less than half of the award. That is, in about one-third of the cases, the applicant was able to obtain 75-100 percent of the award, and in about 40 percent of the cases, at least half of the award.

There is also a big difference between a court refusing to enforce an award on legal grounds and a court being unable to enforce the award for practical reasons, such as a respondent's lack of assets. Of the 37 cases in which enforcement did not occur, the court refused enforcement on legal grounds in 18 cases and was unable to enforce the award because of lack of assets in 16 cases. The reason for not enforcing the award was unclear in the remaining three cases.

According to both the 1958 New York Convention and Article 260 of the 1991 PRC Civil Procedure Law, PRC courts may refuse to enforce foreign and foreign-related awards in the event of certain procedural violations or if enforcement would be contrary to public interest. The courts cited the following as grounds for refusal in the survey cases: a procedural problem with respect to the appointment of the arbitrators (1 case); the arbitration tribunal's lack of jurisdiction over the subject matter (2 cases); that the respondent was not a party to the arbitration agreement (1 case); the lack of a valid arbitration agreement (3 cases); the lack of notice (3 cases); that the arbitration tribunal exceeded its authority (5 cases); the violation of public interest (2 cases); and insufficient evidence (2 cases).

Accounting for success or failure

Given all of the obstacles to enforcement and the many distressing stories of investors whose awards were not enforced, it is easy to forget that many awards are enforced. Why are some applicants successful and others not? Of course, in many instances applicants are successful for the simple reason that the system has worked as it should: the accused party refuses to comply with the award voluntarily, even though it has the means to do so; the prevailing party applies for enforcement; the court enforces the award—end of story.

Table 1
Enforcement Rates for 72 Cases Surveyed

Year	Applications	Enforced	Not Enforced
1991	5	3	2
1992	1	0	1
1993	3	1	2
1994	3	2	1
1995	15	6	9
1996	12	4	8
1997	15	6	9
1998	13	10	3
1999	5	3	2
Total	**72**	**35 (49%)**	**37 (51%)**

SOURCE: Randall Peerenboom

Table 2
Enforcement Rates for Foreign Awards

Year	Applications	Enforced	Not Enforced
1991	3	3	0
1992	0	0	0
1993	1	1	0
1994	2	2	0
1995	5	3	2
1996	5	1	4
1997	4	1	3
1998	4	3	1
1999	2	0	2
Total	**25**	**13 (52%)**	**12 (48%)**

SOURCE: Randall Peerenboom

Table 3
Enforcement Rates for CIETAC Awards

Year	Applications	Enforced	Not Enforced
1991	3	1	2
1992	1	0	1
1993	2	0	2
1994	1	0	1
1995	10	3	7
1996	7	3	4
1997	11	5	6
1998	9	7	2
1999	3	3	0
Total	**47**	**22 (47%)**	**25 (53%)**

SOURCE: Randall Peerenboom
NOTE: CIETAC = China International Economic and Trade Arbitration Commission

Conversely, in some cases the award is clearly defective or unenforceable for the narrow procedural reasons set forth in the New York Convention or in Article 260 of the PRC Civil Procedure Law.

● Insolvency of the respondent

The respondents' lack of assets was by far the leading reason for non-enforcement, accounting for approximately 43 percent of the non-enforcement cases. Frustrated investors have a right to complain about the PRC legal system when a respondent lacks assets because of the illegal transfer of its assets to another company, or because of triangular debt—that is, where the respondent's only assets are accounts receivable from another company, which often is itself owed money by a third company. There is little any legal system can do, however, when the respondent is legitimately insolvent. Given the sorry economic condition of many state-owned enterprises, and China's ongoing march toward the market, one would expect the number of bankrupt or insolvent companies to continue to grow.

The size of the award is negatively correlated with the rate of enforcement, with small awards more likely to be enforced than large awards.

All too often, however, foreign investors themselves are to blame for the unhappy outcome when they fail to conduct adequate due diligence, either at the time of contracting with the Chinese party or later, when deciding whether to seek arbitration and then apply for enforcement.

● Location and size of award

Both the location and size of the award affect the likelihood of enforcement. As many foreign investors might expect, applicants are more successful in enforcing awards in major foreign investment centers such as Beijing; Guangzhou, Guangdong Province; and Shanghai, than in other cities. The size of the award is negatively correlated with the rate of enforcement, with small awards more likely to be enforced than large awards.

The survey suggests that an applicant would have an 85 percent chance of enforcing an award of under $20,000 in Beijing, Guangzhou, or Shanghai, but only a 63 percent chance in other smaller cities (*see* Table 4). When the amount of the award is between $200,000 and $2 million, the applicant's chances of enforcing the award fall to 60 percent in the three major investment centers and to just 38 percent in other cities.

Table 4
Probability of Enforcement, by City Size and Amount of Award

Amount of Award ($)	Total	Large City	Other Cities
$20,000	72%	85%	63%
$200,000	59	74	49
$2,000,000	47	60	38
$20,000,000	39	46	32

SOURCE: Randall Peerenboom
NOTE: Probabilities were calculated from logistic regression coefficients.

● Local protectionism

Although foreign investors and government officials alike tend to assume that local protectionism (*difang baohu zhuyi*) is a major obstacle to enforcement, it did not emerge as a statistically significant factor. This counterintuitive finding may result from the difficulty of specifying and quantifying local protectionism.

Local protectionism can take many forms, some more serious than others. Local government officials may pressure a court to decide a case in favor of the local party, deny an outsider's application for enforcement, or just drag out the enforcement process, usually by requesting additional documents or leaving a case pending.

Local protectionism is therefore a matter of degree: it may impede, or be an absolute bar to, recovery. Thus, although parties attributed difficulties in enforcement at least partly to local protectionism in almost 60 percent of the cases, the successful enforcement rate was only marginally higher (61 percent) in the absence of local protectionism than when local protectionism existed (54 percent).

● The role of the Chinese Communist Party

Chinese Communist Party (CCP) interference does not appear to be a major obstacle to the enforcement of arbitral awards. Several studies have found that Party organs are rarely the source of local protectionism, and that government officials are three times as likely to interfere with the courts than the CCP. Consistent with such studies, there was only one case in the survey in which a Party member blocked the enforcement of arbitral awards.

Moreover, rarely does the Party get involved. CCP interference usually boils down to interference by an individual Party cadre who has a personal relationship with one of the parties or their lawyers. In the one case cited above, for example, the vice secretary of the CCP Political-Legal Committee was the brother of the general manager of the Chinese respondent. Indicative of the continuing strength of the Party, the foreign party was unsuccessful even though it secured the assistance of its ambassador to the PRC, senior judges of the Supreme People's Court, and the mayor of the city.

In general, however, the view among most PRC lawyers is that the CCP on balance plays a positive role in the enforcement of awards. The Party rarely has a significant interest in the outcome of any particular economic case and gains little by fostering local protectionism. To the contrary, the CCP has invested considerable resources to attract foreign investment and does not want China's reputation sullied by negative publicity resulting from cases such as Revpower. Because the Party prefers that cases be handled fairly, local counsel is often able to turn to the Party to attack local protectionism. And indeed, in a few cases in the survey the involvement of the secretary or other senior member of the CCP Committee or Political-Legal Committee appeared to be decisive or at least instrumental in securing enforcement.

In the long run, reliance on the CCP to enforce awards is detrimental to the development of the legal system and the realization of rule of law, even if it does produce short-term benefits in particular cases. The dominance of the CCP and its concern with maintaining a tight grip on power have prevented the judiciary and to some extent the legal profession from achieving autonomy and independence. By turning to the Party whenever it suits their immediate interests, PRC lawyers and foreign investors undermine attempts to realize a system in which the Party acts in accordance with law and law is supreme.

● Weak courts

PRC courts are much weaker institutionally, and judges and the judiciary have a much lower stature, than their counterparts in the United States or even in many civil law countries. These differences have a direct impact on the enforcement of arbitral awards.

Courts in China answer to the People's Congress at the equivalent level, which supervises its work and appoints and removes judges. Moreover, courts are financially dependent on the corresponding level of government for salaries, housing, and benefits. This lack of security of tenure, combined with fiscal dependence, has left judges beholden to their government counterparts. Not surprisingly, local protectionism has been a problem as courts refuse to enforce awards and court judgments against respondents with strong government support.

In addition, although the courts have considerable power to compel discovery or hold in contempt, and even imprison, parties that refuse to comply with the court's orders, they rarely do. This is in part because they are too weak and do not want to risk the embarrassment of not being able to make good on such threats. The weakness of the courts contributes to the tendency on the part of judges to push parties to settle rather than to rely on compulsory enforcement. Given that the parties had ample opportunity to settle the dispute before and during arbitration, one would think that the chances for settlement would be slim at the enforcement stage. However, in most successful enforcement cases the applicant reaches settlement with the respondent, with most settlement cases mediated by the court. Indeed, only rarely does a court seize or freeze assets.

● Judicial competence and professionalism

In most cases, judges act competently and professionally, and either enforce arbitral awards or refuse (or are unable) to enforce awards for legitimate reasons. Nevertheless, the lack of professionalism and competence of some judges has contributed to enforcement problems. Despite China's efforts to improve the competence level of the judiciary, many judges remain poorly trained, particularly in the enforcement chambers. In several of the cases surveyed, the judges were unfamiliar with the rules regarding enforcement. Often courts would be encountering an application for enforcement of a foreign award for the first time. In one case, the court was unsure which chamber should decide whether to recognize the award and what documents were required. It took more than 18 months just to get the application accepted. In a second case it took 13 months to complete the application process. Again, the court was unsure which documents were required and which needed to be translated, notarized, and approved by the PRC consulate or embassy. One chamber was responsible for deciding to recognize the award and another chamber for enforcing the award. But there was little coordination between the two chambers, and each charged a separate fee.

In other cases, the courts have applied the wrong standard. For instance, in two cases the courts held that the arbitration clause was not valid under PRC law, when they should have applied foreign governing law to the question of the validity of the arbitration agreement. One High People's Court ordered the seizure of goods already seized by another court. In another case, the Intermediate People's Court ignored the limited liability of the Chinese party, demanding that the

Although foreign investors and government officials alike tend to assume that local protectionism is a major obstacle to enforcement, it did not emerge as a statistically significant factor.

An Explanation of Arbitration Research Institute Survey Discrepancies

In an effort to counter the negative effects of the Revpower case, and to address the lack of reliable statistics on enforcement, China International Economic and Trade Arbitration Commission (CIETAC)'s research arm, the Arbitration Research Institute (ARI), conducted two surveys, the first in 1994 and the second in 1997.

ARI found that 71 percent of foreign awards were enforced, but the survey I conducted found that only 52 percent were. And whereas the ARI survey found that 77 percent of CIETAC awards were enforced, I found that only 47 percent were. Moreover, my survey counted any case in which the party recovered any amount at all as an enforcement case, while the ARI survey implies that the applicant received the amount in full in successful enforcement cases.

What accounts for the strikingly different results? The most likely explanation for the difference is selection bias. ARI relied on information obtained from only 43 out of 310 Intermediate People's Courts and Maritime Courts. But courts that had not enforced cases in accordance with the law presumably would either not report at all or not report the non-enforcement cases. Even when the court may have had perfectly legitimate reasons for not enforcing the award, it may have been reluctant to report such cases. PRC courts, like other state agencies, have a long history of reporting only good news.

—Randall Peerenboom

Results of ARI Surveys

Survey/Award Type	Applications	Awards Enforced	Enforcement Refused	% Refused
1994 Survey CIETAC Awards	30	17	6	20%
1997 Survey CIETAC Awards	164	127	37	23%
1997 Survey Foreign Awards	14	10	4	29%
SOURCE: Randall Peerenboom				

Chinese party cause its wholly owned subsidiary to sell its shares in a third listed company

Each case is fact-specific and turns on a host of variables, including the amount at stake, the nature of the parties, and the respondent's own connections.

● ***Guanxi***

Applicants need not sit back and passively accept whatever comes their way. They can and often do attempt to influence the outcome of enforcement cases in a variety of ways. They can establish their own relationship (*guanxi*) networks by hiring lawyers with *guanxi*, or by building relationships with local governments or officials with the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and other ministries. They can complain to their home country's trade or legislative representative, foreign service, commercial associations, joint trade commissions, or PRC embassy. They can even take their case to the foreign or PRC media.

It is difficult to assess the relative merits of these different strategies. Of 21 successful enforcement cases, 15 involved some use of connections. However, parties often rely on several different channels, and it is hard to sort out the impact of the various channels. Lawyers, for example, have an economic incentive to claim that it was their *guanxi* that proved decisive. Moreover, each case is fact-specific and turns on a host of variables, including the amount at stake, the nature of the parties, and the respondent's own connections.

Establishing good relations with the judge and the court handling the case is clearly important. In several cases, judges took an aggressive approach to the case and were even able to bend the rules in favor of the foreign applicant, thanks largely to the personal connections between the lawyer representing the applicant and the enforcing judge.

Enlisting the support of higher-level courts may also be of use. While intervention by members of the Supreme People's Court seems to have helped in several cases, it is not always decisive. Nevertheless, because of the value of good relations with both local judges and judges in higher courts, some applicants will hire more than one attorney.

Clearly, good relationships with the local government are helpful in overcoming local protectionism. However, in most cases, the Chinese respondent will have better relations with local government officials than the foreign applicant. Accordingly, some foreign investors try to develop their own relationships at the provincial and central levels. Government officials are less likely to be swayed by local protectionism the higher they are up the hierarchy. But provincial- and even national-level officials may still be inclined toward the Chinese party. In any event, the ability of higher-level governments to influence lower-level governments has diminished considerably as a result of economic reforms.

● **Other factors**

A number of other factors make enforcement of arbitral awards difficult in China. For instance, shortcomings in the regulatory framework—such as the lack of clear time deadlines for each of the stages of enforcement—allow courts to avoid enforcement. Similarly, corruption in the court system or incompetent legal counsel may undermine an applicant's attempt to enforce an award.

Some factors may play less of a role than many investors believe. For example, while fraudulent transfers of funds are a problem, they appear to be less common than some of the surveyed lawyers expected. Only five cases appeared to involve fraudulent conveyances, perhaps because respondents need not go to such lengths if local governments protect them from enforcement.

Sometimes, the applicant has economic leverage over the respondent that increases the likelihood of recovering on the award. This may come, for instance, from the Chinese party's desire to list its shares either in China or abroad, in which case it will not want pending litigation to reduce its attractiveness to investors. Or sometimes the parties will be longstanding trading partners or joint-venture partners. The applicant may thus be able to obtain additional leverage over the respondent either by relying on personal appeals or threatening to terminate future business. The possibility of future deals also increases opportunities for offset, whereby the respondent works off the debt by providing future goods or services, which may be necessary given that PRC respondents tend to be short of cash. A willingness to settle also contributes to success in recovering on an award. Often it is enough to forego the interest owed. Other compromises include accepting *renminbi* rather than foreign exchange.

The bottom line

Enforcement of arbitral awards is a problem, though not as large a one as the press often suggests. Moreover, a high rate of non-enforcement does not necessarily tell the whole story. Even if no foreign or CIETAC awards were ever enforced in China, foreign investors might still be willing to take their chances on arbitration if in 99 out of 100 cases the losing party voluntarily complied with the award and hence no enforcement was necessary. At present, however, there is no way of determining how often the losing party voluntarily complies with awards.

Nevertheless, investors should not have to rely on the good graces of their contracting partners. They should be able to turn to the courts for enforcement, assuming the losing party has assets available. Unfortunately, the institutional weakness of the courts and the other systemic and institutional problems are simply not amenable to immediate solutions. As a result, investors can expect to continue to encounter difficulties in the enforcement of awards for some time to come. 完

China's Home-Grown Entrepreneurs

Neil Gregory and Stoyan Tenev

Where they came from, where they are going

China's economy has undergone a dramatic transformation during the last decade. Most prominent in this process have been the restructuring of state-owned enterprises (SOEs) and the surge in foreign direct investment. But an equally important change has been the emergence of a vibrant domestic private sector. As a result, China has shifted from heavy reliance on state-owned and collective enterprise to a mixed structure in which private enterprise also plays a strong role. By 1998 the domestic private sector had grown to about 27 percent of GDP, making it second only to the state enterprise sector (*see* Figure 1). A constitutional amendment in 1999 formally recognized this shift, thereby allowing the domestic private sector to emerge from the shadows and play a prominent role in China's future development.

To help understand this new and important segment of the Chinese economy, the International Finance Corporation (IFC) and China's State Economic and Trade Commission conducted a study of the status of the domestic private sector, and the issues and constraints facing it. As part of this study, consultants surveyed over 600 companies, and interviewed over 300 CEOs, in Beijing; Chengdu, Sichuan Province; Shunde, Guangdong Province; and Wenzhou, Zhejiang Province. The study showed how private enterprises have been shaped by the difficult circumstances under which they evolved. While many have achieved spectacular growth rates in spite of the constraints, they now face important challenges in adapting to a more open economic environment.

Keep it under your hat

Private business was gradually abolished following the 1949 Communist revolution, so that by the 1950s it had all but disappeared. It was first revived after the Cultural Revolution as a way to respond quickly to the mounting pressures of unemployment and economic stagnation. It was allowed on the fringes of the economy and was initially regarded as a supplement to the state and collective sectors. Private enterprise first took hold in the rural sector, as an outgrowth of the virtual privatization of agriculture, and in small-scale individual enterprises in the urban sector.

During the 1980s, larger private enterprises grew out of these rural and individual enterprises, and out of collectives (enterprises with common ownership by the employees, under state supervision) and SOEs. Some were sole proprietorships (*getihu*) that grew and took on more employees. By 1988, when private firms were first officially recognized, China had 500,000 *getihu* that could be called private firms (*siying qiye*). Some larger private enterprises emerged from the leasing of state or collective enterprises to individuals. The private entrepreneur paid the collective a fixed rent and operated the firm as if it were his own—and in many cases accumulated considerable assets. These enabled him to reduce the share of collective ownership and gradually transform the enterprise into a solely owned firm.

Many large private firms disguised their true identities by maintaining the formal status of a collective or SOE, a process known as "wearing the red hat." Collective status allowed a degree of local government involvement in the enterprise. This could be helpful in obtaining access to land, bank loans, government contracts, and tax breaks. On the other hand, wearing the red hat meant that enterprises could not operate on a fully commercial basis, but had to cooperate, to some degree, with the local government's wishes.

The change in political sentiment following the events of 1989 caused a temporary setback to the growth of private enterprise, but Deng Xiaoping's famous "Southern Tour" in September 1992, during which he called for continuation of the reform effort, opened the way for renewed growth. During the 1990s, government encouraged the privatization of smaller, nonstrategic SOEs and allowed collectives to transform into private enterprises. As a result, the number of registered private firms (excluding sole proprietorships) rose from 108,000 in 1991 to 960,000 in 1997. In March 1998, the government issued a directive requiring all the red hat firms to "take off the hat," or show their private

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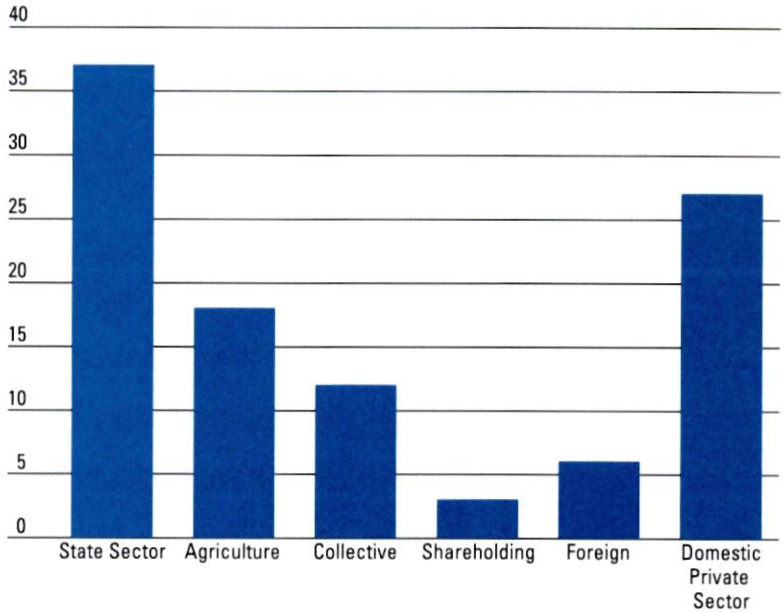
ownership, by November 1998. In effect, government was playing catch-up with the reality of how these enterprises were operating. However, because of the advantages of maintaining connections to local government, many privately run enterprises have maintained their collective status.

The case of the Stone Group, one of China's largest information technology companies, illustrates how China's collectives shifted to private ownership. Originally established in 1984 by scientists from a state-owned computer factory, the Stone Group began as a collective under the authority of Sijiqing Township in Haidian District in Beijing. In 1992, the government gave Stone permission to corporatize SET, one of its subsidiaries, and list it on the Hong Kong Stock Exchange. SET then became the private holding company that controlled the other Stone subsidiaries. Through a process of stock option allocation, by 1994 the staff of Stone had gradually acquired equity in SET. In 1999, with IFC assistance, the employees bought out the 51 percent of the equity still held by the collective, completing its transformation to a wholly private enterprise.

Figure 1
Composition of China's GDP, 1998 (Percent)



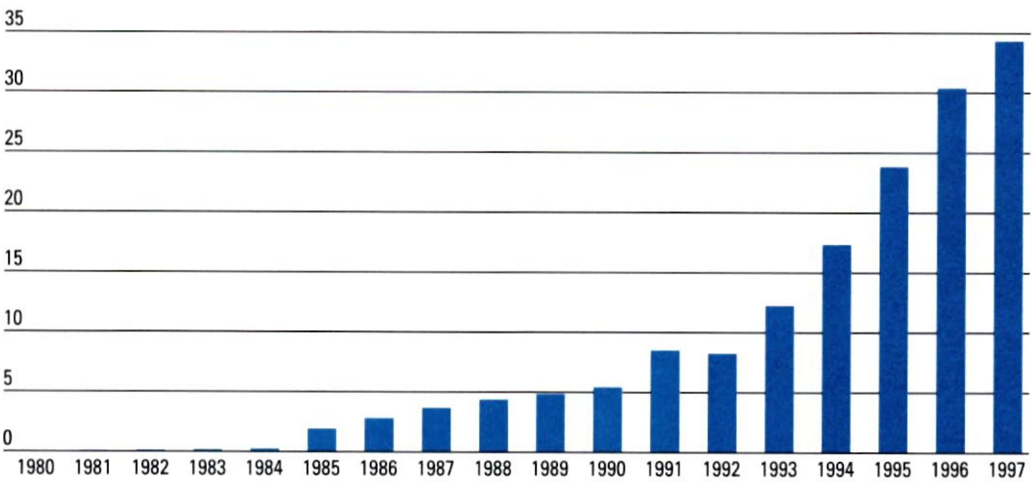
SOURCE: Neil Gregory, Stoyan Tenev, and Dileep Wagle, *China's Emerging Private Enterprises.* Washington, DC, International Finance Corporation (IFC), 2000. p.18.

Business is booming

The private sector is now the most dynamic component of the domestic economy. Between 1985 and 1997, its share of national industrial output rose from 2 percent to more than 34 percent (*see* Figure 2). The IFC estimates that the domestic private sector (excluding agriculture) accounted for 27 percent of GDP in 1998, compared to 6 percent for foreign private enterprises. In total, the private sector share of GDP (33 percent) was nearly as large as the SOE share of GDP (37 percent). The direction of change is clear: in recent years, new employment in the private sector has exceeded the combined total for state, collective, and township-and-village enterprises. This explosive development is in sharp contrast to the decline of the SOEs and collectives. The private sector has become an important source of job creation, absorbing a significant number of workers laid off from SOEs (*see* Figure 3).

Because of the way the domestic private sector emerged from the shadows, it is organized in a very informal way. Many enterprises possess

Figure 2
Share of Private Sector Industrial Output in National Total (Percent)



SOURCES: *Yearbook of China Industrial and Commerce Administrative Management,* 1992-1998, and *China Statistical Yearbook,* 1982-98
NOTE: Data include *getihu* and from 1991 onward, *siying qiye.*

only the vaguest of property rights, ownership structures, corporate governance mechanisms, financial records, and rights to market access. They are often part of complex groups of companies, spanning many different activities. For example, one Beijing group founded in 1983 began in construction, which led on to real estate ownership and management. It then diversified into manufacturing refrigeration equipment though a joint venture with a Japanese company. Later, it established manufacturing facilities for pharmaceuticals and health products, which are now its main lines of business.

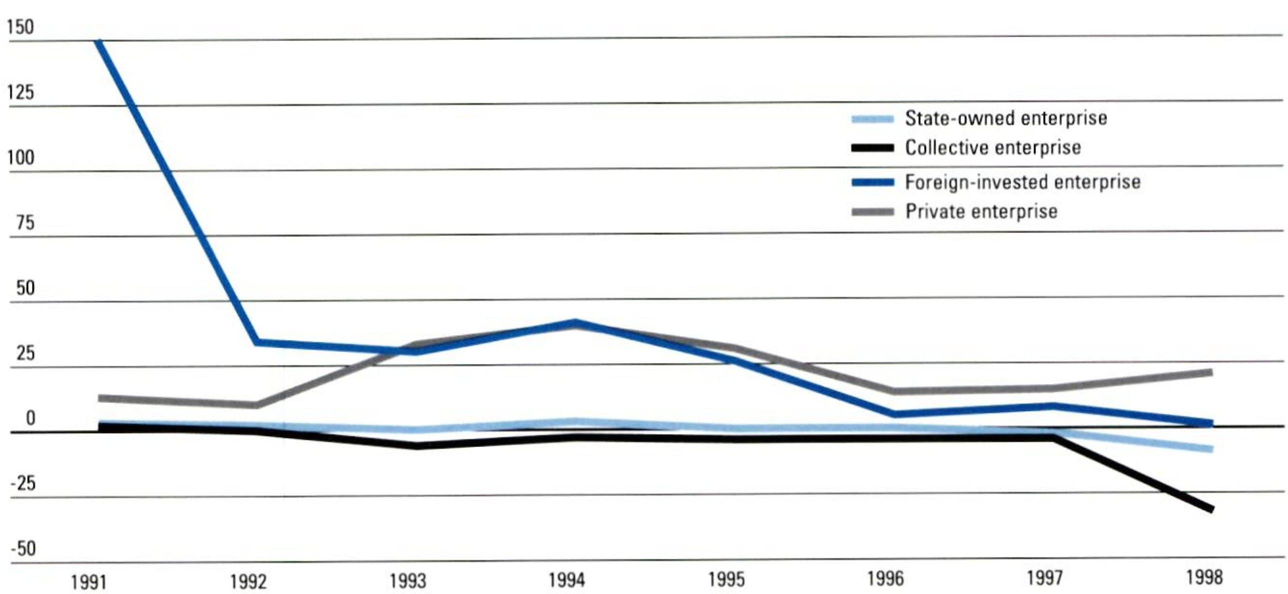
Because of the way the domestic private sector emerged from the shadows, it is organized in a very informal way. Many enterprises possess only the vaguest of property rights, ownership structures, corporate governance mechanisms, financial records, and rights to market access.

This informality gives entrepreneurs great flexibility to respond to an uncertain business environment composed of unclear and rapidly changing government policies, taxes, and regulations. However, it hampers their ability to raise capital, reward managers and employees, and operate efficiently. As a result, even large, mature businesses have many of the strengths and weaknesses more often associated with small startups.

Companies typically go through a "life cycle" of formation, growth, and maturity. Starting as a sole proprietorship, family business, or startup, they gradually expand their ownership as closely held corporations. Eventually, the largest become publicly traded to tap wider sources of capital. Their legal structure, financial structure, corporate governance, and market relationships all change during the life cycle. For example, startups and sole proprietorships provide minimal financial disclosure, while public corporations provide extensive financial information. Similarly, startups generally lack formal governance structures, while more mature companies have formal systems by which owners hold managers accountable for their performance and protect investor interests.

However, firms in China's private sector have a limited ability to evolve beyond the first, informal stages of life, and tend to become stuck in a framework of legal, financial, and governance structures that they have outgrown in terms of the size and complexity of their business. Thus the informality of the private sector is particularly problematic for larger, more mature enterprises. It is becoming an even more serious constraint now that the private sector is beginning to play a larger role in the Chinese economy. Private enterprises need to expand beyond the scale of a small family business. They must be able to gain access to external capital, hire skilled managers, and engage in partnerships with other enterprises. To do these things, enterprises need to display greater transparency and structure in their financial management and corporate governance.

Figure 3
Employment Growth Rates by Type of Employer, 1991-98



SOURCE: *China Statistical Yearbook*, 1999

Growing up...fast

The policy environment to date has heavily favored SOEs, whether in providing access to markets or to finance. Markets closed to private enterprise include banking, telecommunications, wholesale distribution, metals, audio products, primary real estate development, and taxi services. Until 1998, few private enterprises were allowed to export directly; the rest had to work through state-owned trading companies. Bank loans have been freely available to SOEs, but virtually impossible for private enterprises to obtain. Similarly, access to the government-determined quota for stock-exchange listings has been heavily biased toward state-owned enterprises.

Since the government recognized the private sector as a pillar of the economy alongside the state sector in 1997, it has faced the difficult reform agenda of leveling the playing field between the public and private sectors. One of the high priorities of this agenda will be to shift from a discretionary, particularistic way of regulating and taxing the private sector toward a rules-based system. For instance, government needs to make the registration of private enterprises simple, cheap, and automatic. But the future growth of private enterprise also depends on progress in more fundamental reforms, such as strengthening property rights and ensuring that the judicial system enforces them.

The smallest enterprises will require less change. The prevalent model of owner-managed, closely held family enterprises will continue to suit them. For larger companies, the best opportunities for building the business, expanding the management team, and obtaining external financing lie in converting to limited-liability shareholding companies.

● New corporate forms

New corporate forms imply new formal structures of corporate governance. In particular, incorporation as a joint-stock company imposes responsibilities on the company toward its shareholders. One of these responsibilities is to manage the company transparently and in shareholders' best interests. Where outside equity is sought, it is especially important for companies to adhere to the required governance standards. This requires major changes to the way private businesses in China operate.

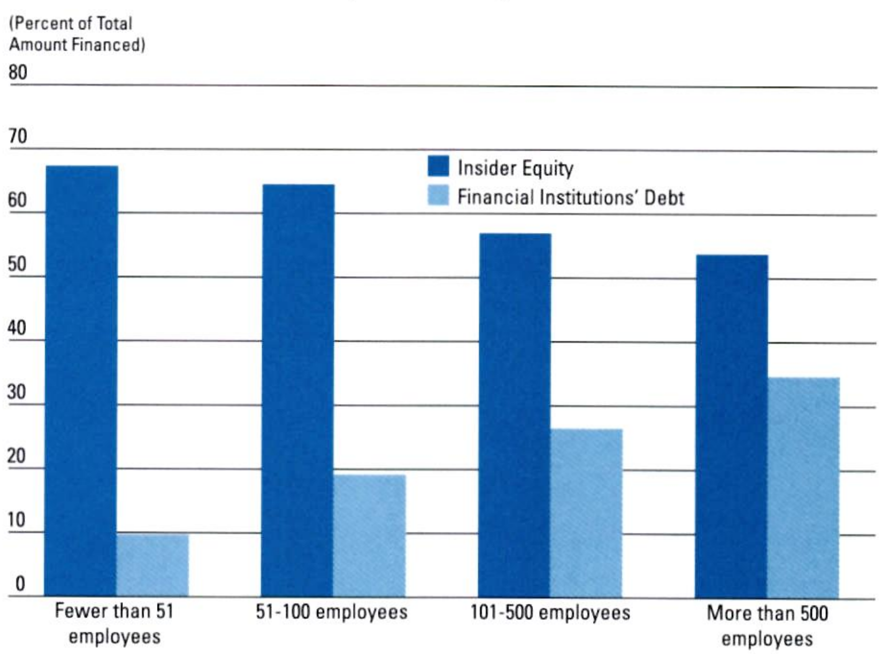
To make corporate governance simpler and more transparent, many enterprises may need to reorganize their complex structures of holding companies and affiliated companies. The opacity inherent in such structures may have been beneficial for an informal enterprise but is a handicap for a formal one. Firms of this nature find it more difficult to define their assets and liabilities, to report financial performance lucidly, and to assign clear management responsibilities and performance measures. Thus, improving corporate governance will in part involve restructuring related enterprises into a single corporate structure, or separating companies into wholly separate enterprises.

● Finance

Above all, business cannot grow without access to financing. This is a particularly acute problem for China's domestic private sector: only 1 percent of bank credit goes to private firms, and only 1 percent of listings on the Shanghai and Shenzhen exchanges are private. As a result, private firms rely heavily on self-financing for their growth (*see* Figure 4). But that source will be inadequate once they move beyond the startup, high-growth phase. As with other issues, the solution requires a mix of straightforward regulatory changes (such as allowing private firms greater access to equity markets) and more fundamental reform (such as building a commercial banking system that allocates credit on the basis of commercial decisions, rather than government direction). However, access to finance will not improve until private en-

The policy environment to date has heavily favored SOEs, whether in providing access to markets or to finance. Markets closed to private enterprise include banking, telecommunications, wholesale distribution, metals, audio products, primary real estate development, and taxi services.

Figure 4
Sources of Finance in Surveyed Firms, by Firm Size



SOURCE: IFC survey

terprises make their financial position, corporate governance, and beneficial ownership more transparent.

China's law of incorporation imposes limited financial disclosure requirements. These may be a step forward for many enterprises but are still much less stringent than international best prac-

Enterprises that hope to attract foreign investment or trade in international markets will need to adopt international financial disclosure standards. Before firms can adopt such standards, they need appropriate internal financial systems and controls.

tices. Enterprises that hope to attract foreign investment or trade in international markets will need to adopt international financial disclosure standards. Before firms can adopt such standards, they need appropriate internal financial systems and controls to ensure more accurate, timely financial reports. They will also have to observe higher standards of external auditing than they do now to vouch for the accuracy of these reports.

Recent financial and SOE reforms have made significant progress in hardening SOEs' budget constraints and reducing government interference in bank lending. However, the playing field is still uneven when it comes to bank lending. Local governments continue to influence bank lending in favor of SOEs by, among other methods, extending explicit or implicit guarantees for bank loans to enterprises with state ownership. As a result, banks impose heavy transaction costs and collateral requirements on private enterprises applying for loans, deterring all but the largest private firms from seeking bank loans (*see* Figure 5).

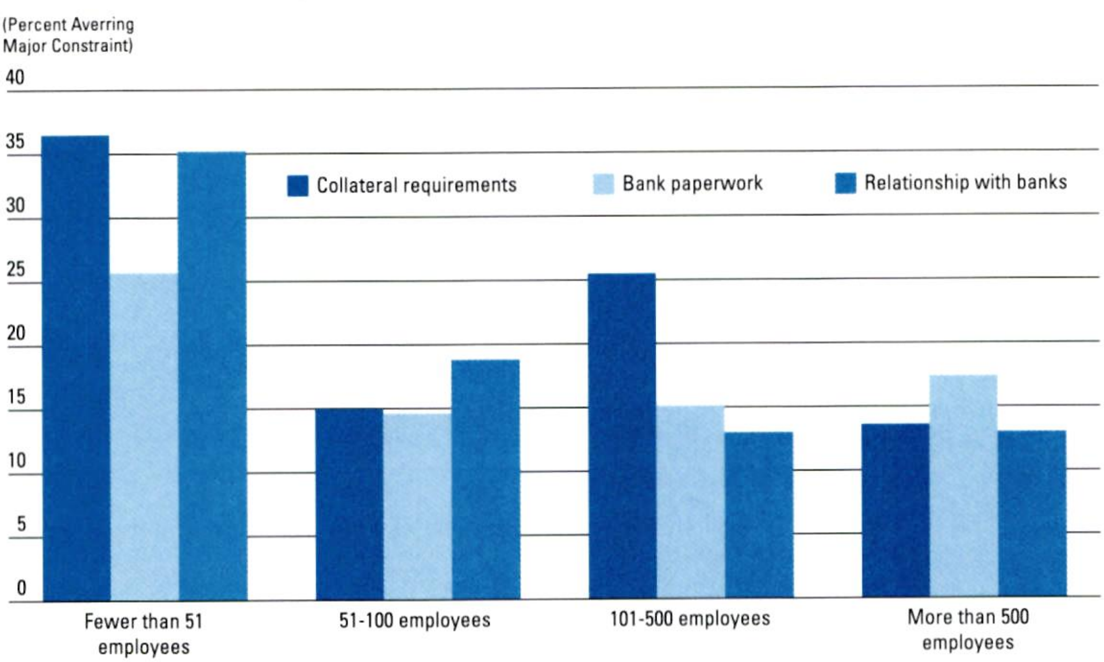
Competing under new rules

China's impending accession to the World Trade Organization (WTO) provides new impetus for the government to move toward a rules-based, nondiscriminatory policy environment for private enterprise. This will not only expose the domestic private sector to new competition from abroad, but will also introduce new financial institutions to serve the needs of private business. Hence the environment for domestic businesses will continue to evolve rapidly. The challenge for the government and entrepreneurs alike is to put the domestic private sector on solid ground, so that it will be ready to seize new opportunities as they arise.

Assuming that the government becomes less involved in determining market access and places less emphasis on distortionary policies and regulations and on the role of SOEs in many markets, the risk for private enterprises of focusing on one line of business will decline. In response, capital and labor markets will improve, there will be fewer advantages to obtaining capital and labor from within a conglomerate, and the inefficiencies of managing across multiple industries will be shown up by competition from firms that obtain their capital and managers from the market. To withstand this competition, China's enterprises will have to show the same focus and efficiency as foreign companies.

China's home-grown entrepreneurs have shown impressive flexibility and dynamism in expanding their businesses in the absence of secure legal frameworks, and with very limited access to external finance. Recent policy changes offer businesses a sounder footing and access to new sources of capital. China's ability to compete with foreign firms depends on the ability of these entrepreneurs to grow up quickly and match best practices in the West. Their proven ability to respond quickly to changes in the business environment suggests that many will rise to this challenge, and that the domestic private sector will play an ever more important role in the Chinese economy. 完

Figure 5
Constraints on Accessing Bank Loans Among Surveyed Firms, by Firm Size



SOURCE: IFC survey

Chinese Millionaires

Eric Harwit

China's reforms have not only allowed budding capitalists to establish profitable and efficient private companies, but have allowed some of them to accumulate impressive fortunes. Dot-com millionaires are the highest-profile among the youthful rich pack in China, but are by no means the only citizens who have managed to build successful companies in their early careers. Interviews with three young, wealthy entrepreneurs reveal their secrets to success, the role they see themselves playing in China, and their goals for the future.

Three case studies reveal the diverse backgrounds of China's new business tycoons

J. P. Huang, PhD: Conglomerate entrepreneur

Huang Jianping has managed to build a powerhouse of disparate enterprises. The JPI Group of Companies has divisions that cover several market segments, including agriculture, education, the environment, railroad construction, telecommunications, and social security. Despite the danger of such wide diversification diluting a company's core strengths, the privately held company reached sales of $92 million in 1999, up from $77 million in 1998, with net income of some $6 million. The Beijing-based company now employs 140 people in several Chinese cities.

Though he now leads a secure and comfortable existence, Huang's path to success had some dramatic ups and downs. As a child in 1960s China, he lived a life of relative luxury, as his father was a military general supportive of Chairman Mao Zedong's Cultural Revolution ally, General Lin Biao. But when Lin died while fleeing arrest for plotting against Mao in 1971, Huang's father, though not prosecuted, fell from his elite position.

Huang began to repair his social standing after China's colleges fully reopened after Mao's death. In 1977, he enrolled in the Sichuan Foreign Language Institute in Chongqing, and went on to study for a Master's degree in English literature at Xiamen University in Fujian Province. Upon graduation in 1984, the Ministry of Foreign Economic Relations and Trade (MOFERT, now the Ministry of Foreign Trade and Economic Cooperation [MOFTEC]) hired him, after a competitive national search, to serve at their Chinese mission to the United Nations in Vienna, Austria.

It was during this assignment that Huang began building key political connections that would serve him well in his future business career. Before completing the first year of a four-year assignment in Vienna, Huang was recalled to Beijing to serve in then-Premier Zhao Ziyang's office. He acted as an assistant in multilateral affairs, and sometimes as an interpreter for Zhao. He also worked with then-Foreign Trade Vice Minister Li Lanqing, who later became the head of the ministry and is now a vice premier.

In early 1987, Huang returned to academic life as one of the first students enrolled in a PhD program at Beijing's prestigious University of International Business and Economics. Even before he received his doctoral degree in 1990, however, Huang had begun developing key domestic and foreign corporate connections, ones that inspired him to found his own private firm.

He began his company, JP International (JPI), as a consulting organization, and quickly expanded JPI when he entered into a joint venture to make components for bottled-water stands. Over the next decade, Huang used his political ties along with personal business drive to create a global company.

Shortly after China established ties with Israel in 1992, he spent some six months there setting up joint ventures using advanced Israeli agricultural techniques. The company's Far East Agricultural Technology division now designs and manufactures greenhouses and components, and the 2000 JPI annual report claims it has 25 percent of China's market for these products. Another project in cooperation with Israel's Tadiran Telecommunications Co. and other foreign companies helps manage telecommunications services such as billing, call centers, wireless access, and data analysis.

In the company's environmental division, a joint venture with several Swiss companies man-

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ufactures water treatment and air quality analysis equipment. According to Huang, this company built the wastewater treatment plant for Baskin Robbins's facility in Beijing. Other divisions supply railway ties for the country's expanding transportation network, dyes and chemicals for textile production, and labor training and social security planning for the Ministry of Labor and Social Security.

Perhaps the most innovative of the JPI Group's current endeavors is the China-USA Business University (CUBU), which opened in 1997 as the PRC's first independent joint-venture university. CUBU has enrolled more than 200 MBA students over the past three years, and, with instruction primarily in English, taps lecturers from the United States for teaching duties, and foreign professionals based in Beijing for a regular lecture series.

Huang explains that his success has hinged on relationships. Even the wealthiest of China's business elite must form alliances with top-level government officials, he says, who help to nurture private business. It is even possible to find officials who help private executives translate their economic power into political power. For example, he says, if an executive has important economic interests in a particular city, he or she can work with provincial-level officials to facilitate continued profitable activities. Of course, problems can occur if the private entrepreneur chooses, willingly or by misjudgment, to cooperate with the corrupt officials. The businessperson should be careful to advise the official if he or she is exceeding the bounds of reasonable behavior.

But Huang says he now rarely needs to resort to political connections in running his company. Furthermore, though he constantly encountered corrupt officials in the early years of his business a decade ago, he asserts that the anticorruption drives of recent years have reduced the burden of dealing with officials who regulate private business.

Huang believes the elite must maintain a certain degree of anonymity in society. He explains, "if you claim you're wealthy, your lifetime is short." The necessity for anonymity extends to the formation of organized groups. As long as those with money avoid a concerted challenge to the government, they will be tolerated and seen as part of the country's economy, Huang says. In any case, he doesn't see himself or his fellow businesspeople as interested in power. "Having money doesn't mean you want power—it means you want to make more money."

Still, Huang does see the beginning of polarization in Chinese society. He forecasts eventual violence by poor Chinese citizens against the rich, and cautions the elite classes to avoid ostentation. Huang drives a Shanghai-made Volkswagen, rather than a flashier import, for this reason. Huang also sees a need for successful private businesspeople like him to undertake charitable projects, so he has set up a foundation to contribute scholarship money to a college in Sichuan.

Huang believes the elite must maintain a certain degree of anonymity in society. He explains, "If you claim you're wealthy, your lifetime is short."

Jack Ma: Internet baron

Jack Ma, like many young entrepreneurs around the globe who have risen quickly in the Internet business, spends most of his time traveling around the world to foster new partnerships, expand website membership, and manage the global team for his business, Alibaba.com. Unlike Huang, Ma, now 36 years old, was born into a typical working-class Chinese family. His father was employed in a cultural association in the family's hometown of Hangzhou, Zhejiang Province, and his mother worked in a clock factory. Both are now retired.

Ma's early academic career was also less impressive than Huang's. His elementary and high schools were not prestigious, and he subsequently failed his college entrance exam three times. After graduating from Hangzhou Municipal Teacher's College in 1988, he began teaching English in a local technical school.

In early 1995, Ma visited the United States as a translator, and had his first introduction to the newly emerging world of the Internet and web browsers. He quit his teaching job on returning to China, and founded the company Zhejiang Dife-Hope Information Development Co. Ltd. (Chinapages) to create and host websites. A subsidiary of rival state-run telecom giant China Telecommunications Corp. Ltd. acquired the corporation in 1997.

After leaving his first high-technology company, Ma went to work for MOFTEC in Beijing. There, he helped build the China International Electronic Communication Center, one of the first organizations to promote business-to-business electronic commerce in China. According to Ma, the company had revenue of ¥2.8 million ($340,000) in its first year.

Before long, Ma realized he could build his own company to bring businesses together on the Internet, and he took six of his Beijing colleagues with him in early 1999 to Hangzhou to found Alibaba.com. The new company raised $60,000 to open its doors. Since then, Alibaba has caught the attention of major international investors, who have continued to provide funding. Alibaba employs about 150 workers, mostly Chinese, though Ma is the only PRC citizen among the seven-member board of directors. The rest of the board hails from Canada, Europe, India, and the United States.

There are some 450,000 registered users at Alibaba's website, about 70 percent of whom are small and medium-sized Chinese exporting companies. As of late 2000, manufactured items such as chemicals, industrial supplies, and foodstuffs made up the bulk of the inventory on offer for sale or solicitation.

Continued on page 27

China's Steel Sector in Transition

Thomas Brizendine and Charles Oliver

Despite the risks, foreign steel-makers would do well to start looking at China

With World Trade Organization (WTO) entry for China now a certainty, the time for stepped-up foreign involvement in China's steel sector is approaching rapidly. To attract foreign interest, however, the industry will have to overcome its pervasive and high-profile troubles, from backward management practices and poor product quality to government interference of all kinds at all levels. No industrial sector in China is more representative of the condition of state-owned enterprises (SOEs) today than China's steel industry, with its problems of over-employment, poor management, low efficiency, and social cost burdens.

Partly in preparation for WTO entry, SOE reforms have been intensifying. The short-term impact of WTO on the steel sector will be mixed, however. On one hand, PRC importers will be free to supply their clients in a more open and transparent environment. On the other hand, WTO membership will enable China to seek redress for antidumping and other unfair trade practices through formal WTO mechanisms.

An industry in disarray

China, which produced 123 million tons of steel in 1999, is already the world's largest producer of steel by a rapidly growing margin. By the end of 2000, this margin was roughly 20-30 million tons per year. At the same time, PRC steel producers are enormously inefficient: they waste and abuse resources, maintain redundant employees, and serve as increasingly reluctant employers to entire cities. Without government protection, only a handful of these companies could compete regionally, and none globally.

The numbers tell a grim story. China's finished steel productivity per employee is approximately 37 tons per year. In developed nations this figure is closer to 400 tons. The modern steel industry is capital- and knowledge-intensive, but China's comparative advantage lies largely in its low labor costs. Per-person productivity indicates not only the bloated nature of enterprise payrolls, but more significantly, provides a direct measure of management effectiveness.

Domestic consumers are demanding higher quality steel in ever-larger quantities, and China's domestic industry has great difficulty meeting their requirements. Though it is the world's largest steel producer, China consistently imports higher grades of steel and specialized steel products.

Steel enterprises, like other SOEs, face rising taxes and social burdens even as their financial results deteriorate. And yet China's steel authorities still retain central-planning habits and controls. They appoint managers based on political rather than performance criteria, approve and fund investments, arrange shotgun-marriage mergers, set production levels and prices, and promote import-substitution policies.

One reason for government involvement is that the steel sector's performance directly influences China's unemployment rate and social stability. The World Bank estimates that China has between 16 and 18 million unemployed urban workers, a figure many analysts view as conservative. China's steel industry employs 3 million, mainly urban, workers, and several times that number depend on China's steel enterprises for their pensions, health care, and housing.

One example is the city of Handan, Hebei Province, where city and health officials' estimates of urban labor force unemployment range from 30 to 70 percent. Handan is also the home of Handan Steel Co., one of China's more efficient producers, at 103.5 tons per employee per year, according to government figures. Handan Steel employs 28,176 people directly. Were the company to raise its productivity to 250 tons per employee per year without raising output, it would have to lay off 16,510 people—over half of its workforce—in a city that already has 50 percent unemployment. Clearly Handan's corporate decisionmaking is an issue for provincial and local officials, who also depend on Handan for tax revenue, no matter what policies emerge from Beijing.

The recent rebound in overall economic growth and the likely development of a domestic housing market will relieve some steel enterprises, but most are doomed, and increasingly

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desperate. Baoshan Corp. (Baosteel) and other large enterprises (*see* Box) will probably survive because of the government's strong support for these "key" employers and producers. Among smaller key enterprises and non-key enterprises, the winners will be those that successfully discover actual costs; reform marketing, sales, and distribution; and focus on a limited number of products—while disentangling themselves from the SOE mentality. The changing environment presents the astute foreign investor with a series of opportunities—and corresponding risks.

Reasons to invest

Careful examination of product requirement trends and the capacity of the domestic steel industry reveals a series of product demand and supply mismatches. Foreign investors can thus supply China's domestic demand with a wide range of finished products that the domestic industry cannot. These mismatches also make potentially fertile hunting ground for strategic, limited investments in the sector. The joint venture remains the primary investment vehicle, as wholly foreign-owned enterprises are forbidden in the steel industry and will remain so after WTO entry.

One example of the opportunities that can be found in such mismatches is the joint venture approved in 1997 between Germany's Krupp Thyssen Nirosta and a subsidiary of Baosteel. By far the largest steel foreign investment project in China, it is also the only one to be approved at the national level. Total investment exceeds $300 million for the construction of a factory to produce integrated stainless steel, which is in short supply in China's domestic market.

Another example is the PRC antidumping case against importers of sheet steel for the appliance market. Chinese market participants estimate that the gap between domestic production and demand in these product lines is now about one million tons annually, and is growing in the low- to mid-double digits. Domestic producers not only produce insufficient quantities of the steel, but also produce steel of inadequate quality in the areas of thickness, surface consistency, and treatment. To make matters worse, domestic suppliers typically do not meet endusers' size demands. For example, the minimum sheet steel width from Baosteel in 1999 was 900mm, while endusers require widths of 750mm, 785mm, and 810mm. The result is an alarming level of waste in highly competitive PRC industries, particularly the home-appliance market. This market demand is currently being satisfied by imports.

China's new antidumping procedures against foreign competitors (*see The CBR*, May-June 2000, p.30) enable Chinese steel enterprises to force their enduser industries to accept higher costs and lower standards. In the short term these antidumping efforts give the steel companies a little more time to reform. But in the long term the Chinese trade authorities will not be able to protect the steel industry to such an extent. This is because many of the injured endusers, such as appliance makers, are among China's most competitive companies. It makes little sense for China's authorities to weaken other industries' international competitive advantage to protect the steel industry. The more likely long-term solution will be an easing up on imports and an increase in investment by the larger key enterprises in specific remedies. For example, Baosteel is already establishing a sheet-cutting center that will address the sheet-width issue. For the time being, however, direct investment is the only realistic way to avoid this kind of administrative protectionism.

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Acquisitions ahead

In addition to product supply and demand mismatches, opportunities for foreign investors exist in the industry's high level of wasting as-

China's Key Steel Enterprises

China's government, in an attempt to rein in the steel industry and coordinate the allocation of government resources, established a list of key steel enterprises (*guojia zhongdian gangtie qiye*). In 1998, China officially counted 1,078 steel and iron manufacturing enterprises, of which 75 were designated as key enterprises. Non-key enterprises are ineligible for government support.

China's steel industry can be divided into four categories (data for 1998 unless otherwise noted):

The Big Four

- **Number of companies:** 4 (Anshan Corp., Baoshan Corp., Shougang Corp., and Wugang Corp.)
- **Combined production of finished steel:** 23 percent of national output
- **Average annual output:** 6.13 million tons (finished steel); 6.12 million tons (crude steel)
- **Combined continuous casting ratio (production via the energy-efficient continuous casting method, as a percentage of total production):** 86.8 percent

Medium-Sized Companies

- **Number of companies:** 25-30, depending upon whether the firms are pre- or post-merger. The year-end 1999 figure will probably be 23, but the merger process is picking up steam.
- **Combined production of finished steel:** 37.3 percent of national output
- **Average annual output:** 1.54 million tons (finished steel); 1.84 million tons (crude steel)
- **Combined continuous casting ratio:** 68 percent

Small Companies

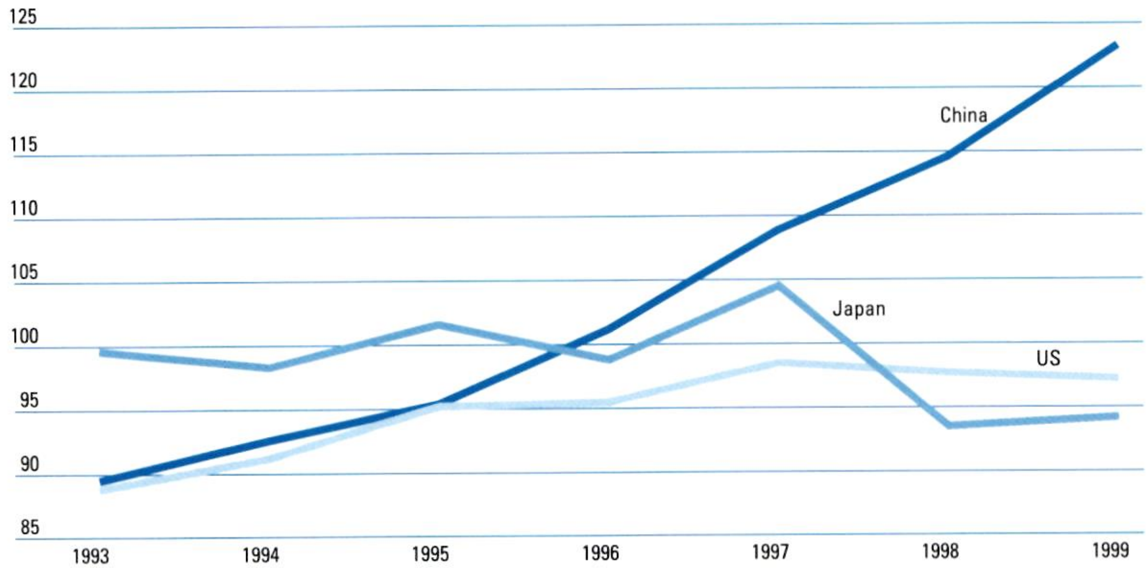
- **Number of companies:** 41
- **Combined production of finished steel:** 10.9 percent of national output
- **Average annual output:** 320,000 tons (finished steel); 471,000 tons (crude steel)
- **Combined continuous casting ratio:** 60.4 percent

Non-Key Enterprises

- **Number of companies:** roughly 1,000
- **Combined production of finished steel:** 28.7 percent of national output
- **Average annual output:** 30,000 tons (finished steel); 15,900 tons (crude steel)
- **Combined continuous casting ratio:** unavailable

—*Thomas Brizendine* and *Charles Oliver*

Figure 1
Crude Steel Production in China, Japan, and the United States, 1993–1999 (million metric tons)



SOURCE: International Iron and Steel Institute, GCIS

sets—fixed assets that hold the potential for positive economic returns, but earn negative returns as a result of poor management or other factors. China began steel industry reforms in earnest in the early 1990s, intending to build a number of world-class steel manufacturing and processing enterprises. Government investment in the sector has been heavy throughout the decade but the allocation of investment has been spread far wider than was originally intended. A typical government-funded upgrade provides a top-grade foreign factory, integrated with domestic equipment as feasible. Because of poor management, among other reasons, these investments have not produced anything close to acceptable economic yields. Many of the investments have become trapped, and are just wasting assets employed in economic loss-making.

Some of these facilities will soon go on the block—perhaps as early as this year. At this time valuations are still unreasonable and government-forced mergers are the primary resolution. But over 60 steel enterprises are currently on the waiting list for debt-equity swaps with the new asset management companies (*see The CBR*, July-August 2000, p.22). In the next couple of years, through direct negotiation and investment as well as deals with asset management companies, many of these assets will become available for foreign participation, if not outright purchase.

Another source of opportunity is the "white knight" phenomenon. As endangered enterprises run out of options, whether they are non-key enterprises facing unbearable pressure or key enterprises facing unwanted mergers, companies are increasingly desperate to find strong partners to bail them out. Imminent WTO accession may assure foreign investors—potential white knights—that, given time, successful enterprises in China will be able to export. This will create opportunities mainly in niche or regional markets. But in China, a regional market is typically larger by population than a medium-sized country. Examples of niche and regional markets in China include tool and bearing steels, large sections for shipbuilding, sheet steel in the Shanghai region, and construction rebar in Sichuan Province. The Krupp Thyssen investment, an integrated stainless steel facility, is an example of this strategy.

In addition to these areas of opportunity, other trends make investing in China's steel sector strategically important for foreign steelmakers.

● **Product substitution** The mature steel industries of developed nations rely on efficiency im-

Table 1
Financial Status of China's Steel Industry

Year	Steel Industry Revenues ($ billion)	Steel Industry Pretax Profits ($ billion)	Pretax Profits as Percentage of Short-Term Liabilities	Total Taxes ($ billion)	Total Taxes Divided by Pretax Profits
1995	35.2	1.40	4.7	2.9	2.1
1996	34.4	0.50	1.7	2.6	4.9
1997	35.2	0.12	0.4	2.6	18.0
1998	35.1	0.11	0.3	2.0	18.2

SOURCES: China Bureau of Iron and Steel Industry, GCiS
NOTE: In 1993 industry revenues were $34.2 billion and pretax profits were more than $3.5 billion. The situation has deteriorated rapidly since then for several reasons, including taxes, mismanagement, poor investment, poor production quality, mounting unsold inventories, regional protectionism, and government "guidance."

provements and technical product innovations to bring better returns. As a material, steel has held its ground far better than anyone might have predicted 15 years ago, but creeping substitution by plastics, composites, aluminum, magnesium, and related alloys is held at bay only by advancing product and manufacturing technologies and systems. The only realistic way to drive significant growth is in new markets—among which China stands out.

● **Global integration** Globalization is forcing multinationals to integrate China into their supply chains. Bearing steels and other steel products in which China is strong are already being incorporated into global product and distribution systems. As heavy steel users progress down this path, the impact on foreign steel producers will become ever more apparent. Also, Chinese enterprises are exporting increasing amounts of steel in finished-product form. Foreign producers and distributors that do not participate in China's market will gradually lose control over progressively larger portions of their traditional customers' steel consumption.

● **Market size** A comparison with the United States illustrates how large China's steel industry could become. Average US per capita steel consumption is approximately 0.35 tons per person per year. In China, assuming a population of 1.3 billion people, this number is currently only 0.1 tons. China's housing and automobile industries, two primary steel consumers, are in their early stages of development. Add to this machinery, appliances, and the export of components of the housing and automobile industries, and it seems likely that domestic demand alone could propel China's steel production to 160 million tons per year and beyond by the end of the decade. And with domestic demand of this scale, export competitiveness is a given.

Invest, but with caution

The reasons and the strategic imperatives for action are clear, but the fact remains that such investments will require a long-term perspective and will involve almost unprecedented risks. The steel sector at this time represents the worst of China's investment climate. Below are some of the more troublesome risks of investing in China's steel industry:

● **Economic risks**

Major projects in the steel industry require a great deal of capital. Though the participation of industry champion Baosteel and the presence of various soft-financing supports reduces the risk of the Krupp Thyssen/Baosteel project, industry observers are skeptical of success for a variety of reasons. Schedule and budget overruns can quickly become problems with a project of this size. The bulk of the economic risk of a large steel project lies in the project's execution stage. So when choosing to invest this level of capital, investors are right to be cautious and conservative. Proper homework on all aspects of the deal is a prerequisite—one that far too many foreign investors in China have ignored, usually to their own detriment.

The valuation of assets and liabilities is a clear economic risk. In some cases, as mentioned above, wasting assets can be rescued at a discount and made productive. The Chinese government must approve all asset valuations. However, like much in China, this process is frequently manipulated for various purposes—almost always to the disadvantage of the foreign investor. In addition, huge liabilities hang over many of these enterprises, ranging from pension, health, and social service liabilities to problems of triangular debt. Despite practices recently established in other PRC industries, where foreign investors have been able to avoid taking on SOEs' historical liabilities, the steel industry's so-called "old guard" is likely to resist adopting similar practices, at least at first.

● **Personnel risks**

The second risk in working with domestic companies is the role of the old guard. These steel industry managers are 50- and 60-year-olds who

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Table 2
China's Steel Industry Trade

Year	Net Steel Imports ($ billion)	Iron Ore Imports ($ billion)	Total ($ billion)	Imports: Metric Tons (million)	Imports: $ billion	Imports: $ Per Metric Ton	Exports: Metric Tons (million)	Exports: $ billion	Exports: $ Per Metric Ton
1996	5.41	1.32	6.73	15.9	7.1	445	4.5	1.7	388
1997	4.58	1.61	6.19	13.2	6.5	492	4.6	1.9	419
1998	4.66	1.47	6.13	12.4	6.3	506	3.6	1.7	474
1999	5.66	1.38	7.04	14.9	7.0	471	3.7	1.4	383

SOURCES: China Iron and Steel Yearbook, China Customs Data, GCiS

NOTE: Not only are finished steel exports significantly smaller in terms of tonnage, but finished steel exports are considerably less expensive than imports on a per ton basis. This hints at a qualitative in addition to quantitative difference.

Investors should examine medium- and smaller-sized key enterprises for possible partners, preferably ones with recoverable assets.

were trained in the former Soviet Union or Eastern Bloc countries. They spent their careers in the politically intense but economically crippled SOE system. In many ways these managers are as unfamiliar with the needs of foreign investors today as they were at the start of the reform era. This not only causes all kinds of relationship and communication problems, but exacerbates all of the common problems—from foreign currency issues to finding competent management and staff—that foreign investors encounter in China (*see The CBR*, November-December 2000, p.8).

● **Government risks**

Another major area of risk for foreign investors is government, at all levels. Globally, the steel industry has always had a close relationship with governments, and this relationship will probably remain close in China in the future. Because of the strength of the relationship between the government and the steel industry in China, Baosteel and other large key enterprises will have an advantage in any potential conflicts with their foreign partners. Indeed, domestic competitors, no matter their size, enjoy a wide variety of benefits, and key enterprises have explicit government support. Nearly all steel enterprises enjoy local and provincial support, which may include preferential concessions on utilities, resources, and land. In addition, domestic producers' abilities are improving, and they will eventually be able to fill any supply gaps. Inevitably, foreign investors and domestic producers will collide in the market. Chinese enterprises use their strong relationships at all levels of government to negotiate deals to their advantage and to their foreign counterparts' disadvantage.

Interestingly, the collusion of regional and local governments with their enterprises to obscure national policy intent only hastens the impact of marketization. In effect, the governments enable the discontinuity in planning through which market forces gain control.

China's steel industry is also one of the last strongholds of China's central planners. Though central planners are not likely to relinquish power easily or quickly, market forces cannot be held off indefinitely. Central planners can dictate certain terms, but they cannot force an enterprise to make a saleable product, and they cannot force customers to buy.

Not to be overlooked is the interference of international governments and their agents outside of China. International organizations are already playing a role in China's steel industry. The German Development Agency's involvement in the Krupp Thyssen/Baosteel joint venture illustrates the European Union's longstanding pattern of assisting its own companies abroad by providing concessionary financing. Of course, the European Union is not alone in this regard, and US trade practices can be criticized as well. These kinds of activities on the part of foreign governments and international institutions only distort the market—thus arbitrarily increasing risks for all investments in the industry, especially existing investments.

Strategic concerns

If foreign steel-makers are able to import successfully into China's market after its entry into the WTO, then trade is a natural and low-risk path to take. Foreign firms are likely to face protectionism, however. Tools such as antidumping legislation and import-substitution tax breaks are used the world over to protect domestic steel industries, and China will be no different.

Companies thus must consider investment in China not just to overcome tariff and non-tariff trade barriers but for strategic reasons, particularly the need to stay ahead of China in the areas of product quality and efficiency. In 10 years, China's steel industry may be producing in the neighborhood of 200 million tons per year and supporting more sophisticated enduser industries such as appliances, machinery, automobiles, and eventually even construction.

If foreign steel-makers come to China, they must decide what form their investment will take and with whom to work. One choice is to work on major projects with key enterprises, as Krupp Thyssen did. The other choice is to work with smaller partners in specific product lines for regional or niche markets, as several other companies have done. The second choice offers a number of advantages. Smaller projects allow for more clearly defined partnerships, better overall leverage, and better chances for success. All forms of risk mitigation are easier to undertake. Political interference is less likely than in large projects in this industry, which are by nature political. Also, making small investments today does not preclude expanding projects or making larger investments at a later date. The Chinese market is changing rapidly; there is no assurance that any of the major producers, other than the four large key enterprises, will be viable enterprises a decade from now.

Investors should look at markets in which both the quality and quantity of domestic supply is insufficient. With this knowledge, they should examine medium- and smaller-sized key enterprises for possible partners, preferably ones with recoverable assets. Aggressive investors might even examine some of the larger or more competent non-key enterprises in upstream industries such as infrastructure and construction. Investors should also define the project in the tightest terms possible, negotiate management control, and avoid assigned employee transfers from the Chinese partner.

The first deals will be slow to materialize, but for many foreign investors now is the time to begin the process. The fact remains that China's steel sector will develop into a global force of unprecedented size. Foreign steel companies ignore this fact only at their own long-term risk. 完

Ma does not reveal current revenue totals but admits that the company currently runs in the red. He expects profits to come from charging for premium membership, advertising, and fees for trade-related services. The decline in American high-technology stocks in spring 2000 hurt the company's chances to list on the NASDAQ stock exchange, but Alibaba has enough cash to last into late 2001, and so may yet outlast its rivals.

As for his relations with political powers, Ma highlights the benefits of working in Hangzhou, a city off the beaten track of the Beijing-Shanghai-Guangdong coastal business nexus. As an example of the cooperation Ma receives from the smaller local government, he points out that municipal officials are quick to help new Alibaba employees who are relocating from elsewhere in China to change their official residence registration (*hukou*) so that they can work legally in Hangzhou. The city has also helped the company secure vital telecommunications lines. Ma asserts that the government now realizes the critical role the Internet can play in developing China's economy, and this realization transcends the need for personal connections (*guanxi*) when dealing with officials.

Despite his company's recent success in the nascent world of the Internet, Ma plans to retire in four years, when he turns 40. "It is healthy for the company founder to leave," he says, adding that others in the company are capable of taking the reins. After he leaves Alibaba he plans to return to a career in teaching, but this time his lessons will be on how to build a successful company.

Echo Tian: Successful businesswoman

Echo Tian has had more exposure to life outside of China than either Huang or Ma. Like the other two, though, she founded her company in her homeland.

Tian's father, a Manchu descendant of the last ruling imperial dynasty, the Qing, has served in important positions in the local Beijing government. Her family background inspired her to seek education abroad. Though she began university study at the Beijing Language and Culture University, she grew impatient for more stimulating instruction, and left the university before graduating. In 1988, she finished two years of study in fashion at the Parsons School of Design in New York. She returned to the PRC in 1992.

Her first attempt to build a company focused on what she knew best—fashion. In this company, Echo Fashion, she modeled her early designs on Coco Chanel's, and began releasing designs twice a year. By 1994, she was managing 20 boutiques throughout China. Unfortunately, the company grew too quickly for Tian, and she now realizes she lacked the necessary experience in marketing and distribution to make a large company prosper. When Echo Fashion failed in 1995, Tian resorted to real estate to bolster her income.

Undaunted, Tian founded a new company, Cheer Arts Trading, and served as the exclusive agent for the French home fashion company Yves Delorme. She then turned to another French company, Groupe Fremaux, to form a Beijing-based joint venture. The cooperative business, Beijing La Maison de Domitille Home Co., specializes in selling high-end imported home fashion products, such as sheets, bath towels, and other interior textile products. Target customers include urban Chinese citizens who are now able to purchase new or existing housing from the state, and who wish to tailor their home's interior to their own taste.

Though Tian is the joint venture's president and CEO, she benefits from the expertise of her foreign partners. The company so far is more prosperous than her previous endeavors—in 1999, it had sales of $4 million and projects 2000 sales at $15 million. With regional offices in Chengdu, Sichuan Province; Guangzhou, Guangdong Province; and Shanghai, the company plans to spread to markets in nearly all parts of the country. In addition to large state-owned retail outlets, the company focuses on emerging foreign hypermarkets such as Wal-Mart Stores, Inc. and Carrefour as channels for sales in China.

Like Huang and Ma, Tian declines to reveal her personal profits from business transactions, but acknowledges she received Western-standard compensation for both her textile and real estate activities. Though Tian has prospered in a society dominated by males, she says her recent success is driven by her need to provide for the future of her small family. A brief marriage left her with custody of her young daughter, and she also takes care of her invalid mother.

For Tian, as for Huang and Ma, translation of wealth into power is not part of her plans. She has little admiration for some of her friends who have tried to find positions in organizations such as the semi-governmental Chinese People's Political Consultative Conference. She tries to maintain a low profile for her child, who takes buses and taxis to school, rather than a chauffeured car. However, unlike Huang, Tian prefers to drive a Mercedes-Benz.

The future of the wealthy

The Chinese have allowed the accumulation of large fortunes under single-party rule. Indeed, these three cases demonstrate that the young, wealthy elite work well within the system, and ironically, are probably playing key supporting roles in China's economy. If the moneyed class can avoid sparking resentment among underprivileged citizens, China's current leadership will likely tolerate and even encourage the activities of the PRC's wealthiest citizens. 完

South Korea's Telecom Ambitions

Caroline Cooper

South Korean companies want a large piece of China's CDMA pie

Foreign companies' stakes in China will only expand once China becomes a member of the World Trade Organization (WTO). For South Korean firms, the stakes are especially high. On one hand, after China's WTO entry, they will confront greater competition from China in industries such as steel, textiles, and apparel. On the other hand, South Korea has much to gain from the opening of China's telecommunications market, particularly in the area of wireless communications. Leading South Korean telecom companies—Samsung, LG Group, and SK Telecom—which have already established a foothold in China's code division multiple access (CDMA) market, have the most to gain as China's interest in CDMA wireless communication technology grows.

Since they established diplomatic ties in 1992, South Korea and China have expanded two-way trade significantly (*see* Table 1). The reason is simple: China and Korea share more than just customs, they continue to engage in close economic cooperation. Trade between China and Korea increased by 20-30 percent annually until the 1997-98 Asian financial crisis. In 1999, two-way trade rebounded and reached a record high of $25 billion, according to Chinese customs statistics, making China South Korea's third-largest trading partner and South Korea China's fourth-largest trading partner. By the first half of 2000, two-way trade had reached a new record of $26.7 billion.

Recent studies have shown that, in the early 1990s, trade between the two countries was largely complementary: the majority of Korean exports to China were intermediate goods, while China exported mostly consumer products to Korea. In recent years, however, trade has become much more competitive, especially in areas such as steel, where Chinese firms have benefited greatly from the transfer of South Korean technology. Increased competition has given rise to a number of trade disputes between the two countries. In the case of steel, for example, China and Korea continue to feud over allegations by the Chinese government that Korean companies are dumping products on the Chinese market.

In seeking to build its high-technology sector, China has once again sought South Korea's know-how and technology. Over the past year, the two countries have engaged in a number of exchanges to discuss collaboration on CDMA development. The further opening of China's wireless sector promises to bring new opportunities for South Korea's leading telecom companies, which have already established themselves as innovators in wireless communications.

South Korea's leap of faith

South Korea took a leap of faith in 1993 by adopting the US-invented CDMA as its wireless standard, while much of Asia remains dominated by the global system for mobile communications (GSM) standard. South Korea's interest in CDMA began in the early 1990s when the Korean Electronics and Telecommunications Research Institute formed a partnership with US firm Qualcomm Inc. to develop CDMA. After Samsung, an equipment provider, and Shinsegi, a service provider, teamed up to deliver the world's first commercial CDMA service in 1996, CDMA use in South Korea exploded. South Korea has more than 5,000 CDMA cell sites to feed growing demand. The *Financial Times* reported

Table 1
South Korea-China Trade ($ billion)

Year	South Korea's Imports	South Korea's Exports
1999	7.80	17.22
1998	6.25	15.01
1997	9.12	14.92
1996	7.49	12.48
1995	6.68	10.29
1994	4.40	7.31
1993	2.86	5.36
1992	2.40	2.62

Source: *China Statistical Yearbooks,* 1993-2000

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that in 1999, South Korean CDMA users made up 60 percent of global subscribership. As of October 2000, South Korea had 26.4 million wireless subscribers, all of whom use either CDMA mobile service or CDMA personal communications service (PCS) digital networks. PCS use has grown tremendously since its introduction in 1997, and PCS subscribers now account for nearly half of South Korea's wireless users.

Analysts have found that large domestic demand for CDMA has spurred competition not only among South Korea's conglomerates, such as SK Telecom—South Korea's leading CDMA service provider—and LG, but also among South Korea's many small businesses. The result has been a rapid increase in new developments in wireless technology. One small business, Pantech Co. Ltd., has entered into contracts with major US manufacturers such as Motorola Inc. to expand its production of handsets, and is now embarking on major technological innovations for South Korea's next generation of wireless communications. Pantech recently reached an agreement with Motorola to supply 4.5 million handsets in 2000. Larger South Korean service providers such as Korea Telecom Freetel have announced plans to offer GSM service for South Korean tourists (domestic use of GSM is prohibited).

Now that South Korea's CDMA equipment makers and service providers have conquered their home market, they are turning to China. Though most PRC mobile phone service providers use the GSM wireless standard, the Chinese government has indicated its intention to follow international trends and include 3G CDMA technology in future wireless networks. Analysts say that because CDMA's transmission of multiple call signals is more efficient than GSM, it will help China's limited bandwidth serve an ever-growing number of mobile phone subscribers. The announcement that China United Telecommunications Corp. (China Unicom) will embark on the construction of a CDMA network using technology developed by Qualcomm has opened the door to South Korean providers.

China announced it would test three technologies in March 2001 in preparation for the move to a 3G standard. Chinese companies, such as Datang Telecom Technology Co., in cooperation with Germany's Siemens AG, have been pioneers in the development of time-division synchronous CDMA (TD-SCDMA). Wideband CDMA (W-CDMA) is another leading candidate, as it is said to be most compatible with the dominant GSM standard. China Unicom, meanwhile, recently decided to use Qualcomm's first-generation narrow-band CDMA technology to expand the small CDMA network it inherited from China Telecom Great Wall, a former joint venture between the People's Liberation Army (PLA) and China Telecommunications Group Corp. China Unicom's moves give CDMA more of a toehold in China's wireless market, but the market is still dominated by the GSM standard, and 3G technology is still a couple of years away in China.

Playing for high stakes

The garlic trade war of 2000 revealed the importance that South Korea attaches to the Chinese market. As reported in ChinaOnline and other press reports, the South Korean government, under pressure from South Korean farmers, increased the tariff on garlic imports from China from 35 percent to 315 percent. The Chinese government retaliated by banning South Korean mobile phone imports. This clash occurred at the same time that Chinese and South Korean officials were negotiating to collaborate not only on CDMA development in general, but also on 3G standards specifically.

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The South Korean government agreed to end the feud, fearing that an ongoing dispute might exclude South Korean companies from participating in the further development of China's CDMA networks. Meetings between Chinese Premier Zhu Rongji and South Korean President Kim Dae Jung at the Asia-Europe Meeting in October 2000 secured South Korea's participation in China's future CDMA development. Zhu assured Kim that South Korean CDMA companies would be well placed to benefit from China's growing wireless market—a statement that seems borne out by industry reports.

According to the *Chosun Ilbo*, China had approximately 62 million cellular subscribers at the end of July 2000, making it the largest wireless market in Asia. Only a few hundred thousand of these subscribers use CDMA technology. The newspaper estimates that by 2004, China will have well over 180 million mobile phone subscribers, 75 million of which will be CDMA customers. In comparison, South Korea's total mobile phone subscribers numbered only 26.5 million at the end of July 2000. South Korea's wireless sector suffered a slight decline in users over the summer, but was expected to have more than 30 million subscribers by year's end.

South Korea exported very few mobile phones to China during the first years of trading between the two countries (*see* Table 2). Between 1996 and 1999, however, mobile phone exports increased by more than 3,000 percent, reaching

Table 2
South Korean Mobile Phone Exports to China ($ billion)

Year	Exports
1999	41.00
1998	14.80
1997	9.67
1996	1.15
1995	0
1994	0
1993	0.07

Source: Korea International Trade Association nearly $41 million in 1999. Though exports grew at an incredible rate that year, mobile phone handsets to China represented barely 2 percent of South Korea's total exports to China. Though Korea's economy is likely to experience slower growth this year, its information-technology sector is expected to fare well. So, if estimates are correct that an expansion of China's CDMA service would create demand for $25 billion in mobile phones, mobile phone exports from South Korea could increase by nearly 600 percent.

Samsung first achieved success in 1997, when it won the largest of four Chinese government tenders to supply CDMA hardware to develop wireless communications networks in Shanghai and Tianjin.

CDMA comes to China

The path leading up to the recent China Unicom deal, and CDMA's formal adoption in China, was far from smooth. The PRC government initially wanted domestic firms to develop their own CDMA technology before letting in foreign firms. The Chinese government's consideration of which 3G technology to pick may also have delayed the adoption of CDMA.

Press reports in July and September of 2000 noted that certain foreign and domestic entities, including the PLA and the Dutch company KPN, were unable to obtain commercial CDMA licenses. While the PLA went ahead with its plans for a CDMA service, KPN abandoned the market. China Unicom is currently the only Chinese company with a commercial CDMA license.

Reports surfaced in late 1999 that China Unicom would have a CDMA network in operation by summer 2000, but the company only made its formal decision in October. *Reuters* reported that China Unicom began accepting bids in November to construct a CDMA system capable of servicing one-sixth of China's current wireless subscribership. Foreign companies are now locked in competition over bids to provide the technology for China Unicom's CDMA network.

Samsung: South Korea's major wireless player

There are only a few major wireless communications players in China, and Samsung Electronics, a subsidiary of the Samsung *chaebol* (a large South Korean conglomerate), is the sole South Korean company among them. Since 1997, Samsung has been among the few companies able to compete in China's CDMA marketplace. Samsung first achieved success in 1997, when it won the largest of four Chinese government tenders to supply CDMA hardware to develop wireless communications networks in Shanghai and Tianjin. The only other South Korean company vying for the tenders—LG Information & Communications—lost out to Nortel Networks Corp., Motorola, and Lucent Technologies.

In cooperation with Shanghai Great Wall Mobile Communications, Samsung Electronics supplied the hardware and network capability to offer wireless service to 67 base stations in Shanghai and 11 in Tianjin. And in February 2000, Samsung reportedly entered a $200 million contract with Hebei Century Mobile Communications Co. to develop a CDMA business network—the first in China.

Samsung was the only South Korean firm to make it through the first round of bidding for the contract to provide China Unicom with CDMA technology. Reports suggest that Samsung has two factors in its favor in bidding for the new Unicom contract: its alliance with Shanghai Panda Electronics Co. and its willingness to share technology. Samsung and other South Korean companies hold the rights to over 200 commercial deployment and operation technologies. In October of last year, Samsung opened a $3 million research center for cdma2000 (a wideband 3G standard) in Beijing's Zhongguancun Technology Park—a sure indication of its willingness to share its technology.

Samsung plans to expand its operations in China through various joint ventures, including one with Shanghai Bell, now awaiting approval from the Chinese government. Samsung's top priorities include increasing market opportunities for its wireless local loop (WLL) and PCS products.

South Korea's other players

Though Samsung Electronics is the clear leader in the wireless sector, other South Korean telecommunications companies have sought to invest in China's CDMA market as well. Some South Korean companies, such as Standard Telecom and Sewon Telecom, have reportedly won contracts to supply and develop CDMA handsets with Chinese firms, while other companies hope to make bigger gains based on joint-venture relationships or new technological innovations. In most cases, equipment manufacturers have done more business than service providers, because China prohibits foreign investment in telecommunications services. Successful companies have carved out their own niches. Many of the larger companies have restructured since the Asian financial crisis in order to compete with the growing number of small South Korean businesses operating in China.

● **LG Group** LG is another South Korean *chaebol* that has made inroads into China's growing CDMA market, but LG's success has been shorter-lived than Samsung's. Though LG has been exporting networking equipment to China since 1999 through its affiliate LG Information and Communications (now LG Electronics), it was not until December of that year that LG Electronics announced the establishment its first China joint venture. Much of LG Electronics's competitive advantage can be attributed to it having been one of South Korea's first companies to commercialize CDMA WLL.

LG first provided CDMA WLL systems to China in December 1999 through a joint venture with Guangzhou Post & Telecommunications Equipment Co. and Guangdong Telecommunications Academy of Science & Technology. The venture was intended to produce and distribute CDMA WLL in Guangdong Province. In February 2000, LG announced that it would provide CDMA WLL technology to China Unicom, enabling Unicom to become the first Chinese company to commercialize CDMA WLL service in Sichuan Province.

In June 2000, LG signed an agreement with ZTE Corp., one of China's leading telecommunications equipment producers, to set up Shenzhen ZTE-LG Mobile Communications Ltd. to produce CDMA mobile systems in Shenzhen. This alliance has boosted LG vis-à-vis other foreign competitors, as ZTE is reported to be the first Chinese company to receive a networking license for its CDMA service. The joint venture has expanded LG's market share in China.

In late October, LG displayed its 3G handsets at EXPO COMM China 2000 in Beijing. If China adopts W-CDMA as its standard, LG will benefit, as it was the first company to commercialize W-CDMA WLL worldwide and remains a leader in the technology.

● **SK** SK has, until recently, been much less aggressive than the other *chaebol* in tapping China's CDMA market through its subsidiary SK Telecom. Like LG Electronics, SK Telecom is reported to have been negotiating with ZTE to collaborate on CDMA development. However, its only concrete move to date has been a 1999 comprehensive management agreement with China Unicom. According to SK, the agreement seeks to improve CDMA network design in China through technological exchange.

In the future, SK may have an advantage over other South Korean companies in providing CDMA service in China, thanks to its 51 percent stake in service provider Shinsegi. Analysts have been paying close attention to the ongoing consolidation of South Korea's wireless service industry, but this consolidation is particularly notable in that China Unicom has also expressed interest in establishing an alliance with Shinsegi to develop CDMA service systems.

● **South Korea's up-and-coming competitors** Industry watchers point to a number of other South Korean companies that want to participate in China's CDMA market. These companies have either a small presence in the PRC or none at all. The success of these companies will be measured by how much they can offer to China and how well they adapt to its marketplace.

Hyundai, for instance, currently does not have a large operation in China. It hopes to tap into the PRC's CDMA market with the development of (IS)-95C, a third-generation CDMA technology which the company claims can transmit data at speeds up to 153.6 KBPS.

Among smaller firms, Pantech is one of South Korea's most successful exporters of CDMA equipment to China. With 470 employees, Pantech specializes in developing CDMA chips and PCS terminal starts. It established its first sales center in Beijing in 1994.

In the future, SK Telecom may have an advantage over other South Korean companies in providing CDMA service in China, thanks to its 51 percent stake in service provider Shinsegi.

Maxon is another small South Korean business that has become a major producer of CDMA and GSM equipment. Opened in 1974 with 720 employees, Maxon today has ten subsidiaries in eight countries with 3,670 employees. Maxon began producing CDMA technology shortly after South Korea adopted the standard in 1993, and now spends $70 million annually to manufacture both GSM and CDMA equipment. It first entered China's market in 1998.

Established in 1992, Telson Co. is one of Korea's major producers of CDMA PCS. The company, which has more than 670 employees, has been exporting telecommunications products to China since 1994.

Mobile ambitions

South Korean telecom companies have made a good start in tapping China's CDMA market. Though it will take time for this market to ripen, South Korean telecom companies have a strong advantage over other companies for two reasons. First, Korean companies have been pioneers in using and marketing CDMA technology. Their knowledge will be useful as they seek opportunities in China for the first time. Second, the Chinese and South Korean governments continue to collaborate on the future of wireless communications.

As South Korea's wireless market grows and domestic competition increases, South Korean companies will need new markets for their products. As China adopts a new wireless standard, it can benefit from the knowledge and experience of South Korean CDMA service providers and equipment makers. Once China enters the WTO and lifts restrictions on foreign investment, opportunities will abound not only for South Korean equipment providers, but also companies offering telecommunications services. 完

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Capital Market Reforms Accelerate

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markets ever since it closed the Treasury-bond futures market in spring 1995 after a series of market-manipulation scandals.

Widespread price manipulation and poor corporate disclosure reportedly plague the existing stock markets. CSRC will have to strengthen its enforcement of rules against illegal trading activity to avoid undermining the stability of both existing and future exchanges.

Improvement in monitoring and enforcement is already one of the government's highest priorities, as witnessed by CSRC's recent announcement that listed firms will have to file more detailed—and more frequent—financial disclosure reports. At present, companies only need to publish financial reports twice a year. CSRC officials will apparently begin requiring quarterly filings this year. CSRC may also require the companies to appoint independent board members.

In another indication that the PRC government recognizes the need to establish an international-standard regulatory framework, over the past several months CSRC has hired a number of Chinese experts away from international financial institutions to serve as high-level advisers.

FIE listings: Small scale for now

Despite clear indications that China is opening its markets to FIEs, FIEs will probably not be able to list on China's exchanges on any scale until the government has figured out how to reduce its ownership shares in state-owned enterprises (SOEs) without flooding the market with securities. Many of China's listed SOEs will be restructured over the next several years, and some reduction in state ownership will be inevitable.

Moreover, until the government's efforts to clean up the social insurance system are on firmer ground, it will be difficult for SOEs to restructure sufficiently to compete against PRC domestic private enterprises, which will be able to list on the new board in Shenzhen, and listed FIEs. Indeed, the World Bank reports that the jump in SOE profitability in 2000—an increase of 110 percent in the first seven months—was due mainly to higher prices, particularly for oil, and reduced interest payments as a result of debt-equity swaps. For these reasons, China will probably only allow a small number of FIEs to list at first, and will gauge the results before opening the floodgates.

Liquid future

Chinese leaders clearly recognize that financial markets must be able to function more efficiently if they are to support PRC reforms. Financial markets will also have to supply the liquidity necessary to fuel the economy after the country's World Trade Organization entry exposes Chinese firms to international competition. Establishment of the appropriate laws is well under way. It is how well the government enforces these laws that will make the difference between success and failure.

—*Catherine Gelb*

Catherine Gelb is editor of *The CBR*.

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COMMENTARY

Creating Shareholder Value Through China Ventures

Sigmund Floyd

The financial failure of foreign investments in China is often not the result of unfortunate circumstances that disrupt an otherwise brilliant strategy. Rather, the financial outcome of most foreign investments, especially joint ventures (JVs), can often be predicted even prior to the contract signing.

An argument for maximizing a China venture's chances of success through realistic financial analysis

The best way to assess the success or failure of a venture is by looking at the shareholder value created or destroyed. What causes ventures to fail in terms of shareholder value? How can companies maximize the probability of success?

Shareholder value is defined simply as dividends plus share-price appreciation. From the investor's viewpoint, the value of a company can only be sustained by recurring cash flows, which are discounted at a rate, known as the "cost of capital," to yield a net present value of the company in today's dollars. The cost of capital is itself critical to a company's potential to create value, since a high cost of capital results in low value even if cash flows are large and positive. The cost of capital is determined mainly by the company's debt-equity structure and the perceived riskiness of its business (as reflected in beta, a measure of the volatility of a company's stock relative to the overall market). Typical large US companies whose stocks are as volatile as the overall market have a cost of capital in the range of 10 percent.

A foreign venture fails when it has not achieved its financial objectives based on a targeted return on capital employed. In addition to normal returns for the company as a whole, the targeted return on capital must sufficiently compensate shareholders for the additional risk entailed in embarking on a venture in a developing country, including any risk inherent in the venture itself. By this definition, a venture may be a failure even if it is producing and selling products, employing people, and being a good citizen in its community. But it is a mistake to assume, conversely, that a venture can be successful if it ignores the legs on which its success is based—customers, employees, and community, including its relations with the government.

US firms generally accept the need to maximize shareholder value, though companies select different yardsticks with which to do so. Nevertheless, very few companies apply an explicit, shareholder-value-based methodology to their operations in China.

How ventures fail

Joint ventures, still the dominant entry vehicle for China investments, are more complex than wholly foreign-owned enterprises (WFOEs) and appear to be at greater risk for failure. In reality, however, a JV can be successful—if it avoids the five elements responsible for financial failure in China ventures:

● **Reverse process** In this situation, a venture is initiated in an economically irrational manner, usually by executive fiat. Often, a CEO or senior line executive decides that there is going to be a China strategy and, as part of the strategy, that a venture (wholly foreign-owned or otherwise) shall be born. As a result of this decree, the business strategy is set in stone. Only at a late stage, after a partner is chosen, does the financial feasibility study begin. Since the outcome has been pre-ordained, those responsible for the feasibility study give the market information and production costs a favorable twist. Where necessary, they add rosy assumptions, until the feasibility study is doctored up enough to pass the company's internal criteria. Criteria based on relatively short time horizons further distort the feasibility study.

Failure sets in when the financial results fall far short of the beautifully painted scenarios in the optimistic feasibility study. Recriminations begin

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to fly between the partners, and repercussions for company staff are a certainty. Frantic cost cutting begins in an attempt to restore the "original" profitability. Malaise swamps the venture when employees realize they are working for a "loser," and customers become disappointed when cost cutting takes a toll on quality and service.

● **Differences in partner objectives** A second frequent source of failure in JVs is a lack of appreciation of the partner's objectives. Even among US companies, the definition of making money can vary enormously. One company's yardstick may be return on assets, while a more shareholder-value-savvy company may be using Economic Value Added (defined as Net operating income - [Cost of capital × Total capital employed]), or even better, a cash-flow-based measure.

Chinese partners often face additional demands on the economic pie, including the need to maintain employment, generate foreign exchange through exports, and produce short-term cash dividends for additional investments with other partners. Failure to recognize these objectives, or treat them as legitimate interests, is sure to create stresses that, in extreme cases, can lead to JV fracture. Unfortunately, American investors tend to believe that their profit-oriented objectives are transparently correct, and often overlook their partners' other interests. Though companies often have the option today of forming WFOEs—and will have even more opportunities to do so after China's accession to the World Trade Organization (WTO)—companies that continue to employ the JV structure need to pay close attention to their partners' interests.

● **Settling for less** The third reason ventures fail is that foreign investors are often willing to settle for second-best partners, particularly when there is strong pressure from top management to clinch a deal quickly. Joint ventures will inevitably fail if a partner—including the US partner—is not trustworthy, or even if the partner's corporate culture is simply too different. Chinese companies are every bit as individual as US firms. Even among Chinese state-owned enterprises (SOEs), company culture can range from extremely socialist to highly entrepreneurial. Regional differences also abound: the industrial northeast generally tends toward the socialist model, Shanghai displays the best elements of a "planned market economy," and Guangdong Province in the south resembles a laissez-faire free-for-all.

Generally, US firms have great difficulty in dealing with both the rigid socialist bureaucracy of some SOEs and the freewheeling spirit of township enterprises. Foreign firms should exercise caution when undertaking a venture with these types of partners. Fortunately, the reform mindset has permeated many companies throughout China, enabling partners to agree on basic financial objectives even under the non-business-related constraints that the Chinese sides often face.

Ventures also short-change themselves through second-rate staffing practices, usually with cost as the justification. Many if not most companies operating in China today have, in effect, a two-tier structure, with JV staff (sometimes including the general manager) on one pay scale and set of benefits, and representative-office staff on another. While some differences may be unavoidable, firms should establish a clear set of criteria based on experience, language ability, and results to determine relatively consistent pay scales. Doing so will help firms avoid the costly morale problems that arise when JV employees realize they are "second class citizens" when it comes to pay and benefits. While representative offices are important for promoting an overseas company's image in China, JVs (and more recently WFOE production centers) are the key determinants of the company's strategic future—and their employees should be treated accordingly.

Foreign investors are often willing to settle for second-best partners, particularly when there is strong pressure from top management to clinch a deal quickly.

● **Hidden agendas** Lack of understanding or caring about a partner's interests breeds contempt, beginning with the preliminary or contract negotiations and carrying on through operations. Hidden agendas, or a lack of forthrightness about the real objective of the venture, are the most frequent expressions of this attitude. Some companies have even been known to have "secret partners." While this is an extreme case, firms should recognize that pursuing undisclosed, separate agendas can hardly be the basis for a successful relationship. Some US companies also have a more-or-less explicit objective of "milking" the JV in favor of the American parent by maximizing transfer price, as well as royalty and services income, at the expense of the JV's operating income—not a solid foundation for developing a long-term relationship in China. Though hidden agendas are always present, the degree to which they dominate ultimately affects the success of the joint venture.

● **Complex, convoluted structures** The highly complex structures and contracts that are often imposed on JVs do not serve them well. In many cases, such structures result directly from the dictate to extract the maximum amount of profit from the venture for the foreign parent. A joint venture can be so loaded down with complex transfer price arrangements, service fees, technical service fees, and technology licenses that it requires the efforts of a small army of accountants just to keep tabs on the various obligations. In this situation, it is also typical for the general manager to be negotiating almost daily with the partner rather than productively engaged in the universal objectives of a business: making products and serving customers. Of course, a certain degree of complexity is unavoidable—indeed in some cases it may be the only solution to the Chinese side's overvaluation of its assets. However, from the standpoint of smooth operations, simpler is better.

The five reasons for venture failure, which are often linked, lead directly to the destruction of shareholder value. All are inherently predictable and hence, in principle, avoidable. That they are not avoided is largely due to misperceptions of the China market by headquarters and even local staff, whose careers are often based on short-term results.

How to do it right

Executing a venture in China that succeeds in creating shareholder value is certainly no easy task. But by considering the causes of failure presented above, it is possible to outline a more successful approach.

The biggest single element that will ensure a venture's success is the right internal process. The first priority in such a process is the development of a consistent set of financial objectives, in the form of a draft feasibility study, which will achieve the required returns. In all subsequent steps, it is critical to keep the feasibility study in mind and to keep it up-to-date with changing conditions.

Prior to entering into detailed negotiations, each side should attempt to assess the major objectives of their potential partner(s) through analysis of where the partner is situated regionally, politically, and in its industry. Understanding the partner's needs and concerns will lead to a conceptual structure for the venture that recognizes the objectives of both parties. Dividing the venture's economic benefit proportionately among the parties will help stabilize the venture in the long term. The contracts should be kept as clean and simple as possible, with ancillary clauses and appendages kept to a necessary minimum. In all cases, language should be simple and unambiguous. One set of venture contracts that the author encountered, for example, referred to the transfer of product at the "market price" without defining that term. This caused needless effort and delay during the critical startup period as the partners haggled over how to define market price.

The objective in any venture negotiation is to reach a conclusion as to the economic feasibility of the project. As early as possible in project preparation, the partners should agree to use the same feasibility study. This can be difficult because the parties may not wish to disclose certain information to each other before signing the agreement. However, the importance of jointly conducting a rational economic analysis cannot be overemphasized.

Throughout the negotiation, a company's ability to walk away, whether because of a partner's unethical behavior or because of the project's lack of viability, is extremely important. It is equally important to quantify the potential economic benefits of the project as soon as possible. Long and protracted negotiations are not beneficial if the project is not viable. Walking away at a later stage is more likely to lead to recriminations and the possibility of tarnished images with other possible partners or customers.

Design for Success

1. Develop financial objectives *first*
2. Assess partner's needs and objectives
3. Devise the simplest possible structure
4. Negotiate fairly, without hidden agendas
5. Staff with only your best
6. Negotiate fairly in daily operations

—Sigmund Floyd

The feasibility study

The feasibility study is of critical importance to the project and it must be done thoroughly and objectively. To examine the feasibility study of a typical joint venture from a true shareholder-value perspective, it is necessary to define some financial terminology.

Cash flow can be defined in a number of ways, but for our purpose the following suffices:

Cash flow = - Invested Capital + Net Income + Depreciation - Increase in Working Capital

This formula expresses what happens when an investment takes place. To emphasize its importance, the investment term comes first. Once invested, the capital cannot be recovered—except in the form of cash flow returns in the uncertain future. Net income means the after-tax operating income of the venture. Note, however, that taxes must be adjusted to the actual cash taxes paid. Depreciation, which is charged against gross income, is simply an accountant's way of spreading the capital investment over time. Since it is not a real cash charge (the cash was already spent as invested capital), it must be added back to net income. Finally, the increase in working capital (receivables plus inventories less payables) that occurs when a venture starts up represents a net outlay of cash, and hence must be subtracted.

A hypothetical feasibility study for a joint venture is shown in spreadsheet form in Table 1. This feasibility study is based on fairly typical ratios and gross profit margins, and the financials are not especially impressive. Reflecting a common situation in China, the venture gets off to a slow start, with sales at 30 percent, 60 percent, and 90 percent of nominal capacity in the first three years of operation. The gross profit margin at full capacity is 44 percent. Selling, administration, and research (SAR) expenses, and the working capital-to-sales ratio, which represents how much cash is tied up in inventories and receivables, are each assumed at a constant 15 percent. This simplified example also assumes 10-year straight-line depreciation of the initial $10 million investment (wholly equity financed), and does not consider tax holidays.

All feasibility studies have two main parts: the explicit forecast period and an additional term called the continuing value. The explicit forecast period simply refers to the projected financials, for a period of usually five to ten years, which are derived from basic information like sales and cost forecasts, projected SAR budgets, and so on.

The adjustments to net income shown above are used to calculate cash flow. The cash flow is then discounted back to the present using the discount rate to arrive at a net present value (NPV), which is the mathematical prediction of shareholder value created. The discounted cash flow for a given year N, using a discount rate k, is cash flow divided by $(1+k)^N$.

What will be less intuitive for some readers is the continuing value, which is the extension of the value of the business to the period beyond the explicit forecast. Consultants working at McKinsey & Co. demonstrated in the 1980s that the continuing value generally accounts for over 50 percent of a company's stock price. Since companies are just agglomerations of projects, why should any individual project be any different? The calculation of the infinite continuing value in a given year is C/k where C is the cash flow in the first following year, and k is the discount rate. Thus, in Table 1, the continuing value in year 10 dollars is simply the year 11 cash flow divided by the discount rate. Like all the other cash flows, the continuing value must then be

Table 1
Joint Venture Feasibility Study Example

All figures in thousands of dollars

Year	0	1	2	3	4	5	6	7	8	9	10	11(CV)
Income Statement												
Volume		300	600	900	1,000	1,000	1,000	1,000	1,000	1,000	1,000	
Average selling price		9	9	9	9	9	9	9	9	9	9	
Sales		2,700	5,400	8,100	9,000	9,000	9,000	9,000	9,000	9,000	9,000	
Average unit cost, excluding depreciation		4	4	4	4	4	4	4	4	4	4	
Cost, excluding depreciation		1,200	2,400	3,600	4,000	4,000	4,000	4,000	4,000	4,000	4,000	
Depreciation		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	
Full cost		2,200	3,400	4,600	5,000	5,000	5,000	5,000	5,000	5,000	5,000	
Gross profit		500	2,000	3,500	4,000	4,000	4,000	4,000	4,000	4,000	4,000	
Selling, administration, and research expenses		405	810	1,215	1,350	1,350	1,350	1,350	1,350	1,350	1,350	
Selling expenses		270	540	810	900	900	900	900	900	900	900	
Administration expenses		81	162	243	270	270	270	270	270	270	270	
Research expenses		54	108	162	180	180	180	180	180	180	180	
Income before taxes		95	1,190	2,285	2,650	2,650	2,650	2,650	2,650	2,650	2,650	3,650
Tax		31	393	754	875	875	875	875	875	875	875	1,205
Net income		64	797	1,531	1,776	1,776	1,776	1,776	1,776	1,776	1,776	2,446
Profitability Indicators												
Gross profit margin, %		18.5	37.0	43.2	44.4	44.4	44.4	44.4	44.4	44.4	44.4	
Net income, %		2.4	14.8	18.9	19.7	19.7	19.7	19.7	19.7	19.7	19.7	
Cash Flow Calculation: Corrections to Net Income												
Investment (−)	10,000											
Depreciation (+)		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	0
Working capital change (−)		405	405	405	135	0	0	0	0	0	0	0
Deferred taxes (+)		0	0	0	0	0	0	0	0	0	0	0
Cash flow	-10,000	659	1,392	2,126	2,641	2,776	2,776	2,776	2,776	2,776	2,776	18,749*

Present Value Calculation	
Discount factor	15%
Net present value (NPV)	3,973
Internal rate of return (IRR) (10 years)	16.2%
Continuing value (CV) as a percentage of NPV	88%

Parameters	
Selling costs, as a percentage of sales	10%
Administration costs, as a percentage of sales	3%
Research costs, as a percentage of sales	2%
Working capital costs, as a percentage of sales	15%
Cash tax rate, percentage of pretax income	33%

SOURCE: Sigmund Floyd
NOTE: Example is hypothetical and has no relation to any real venture.
*For convenience of viewing, the Year 10 CV is placed in the Year 11 column; in this case, for the NPV calculation to be performed properly it must be multiplied by a factor of 1+k.

discounted back to the present to be included in the NPV for the project.

Of course, readers may object that projecting out to infinity does not make any sense when actual plant and business lifetimes are finite. While the McKinsey writers and others have no difficulty interpreting stock prices on the basis of the infinite value calculation, more conservative analysts can shorten infinity to an arbitrary number of years by applying an appropriate correction factor to the continuing value.

The key question then becomes this: What is the proper discount factor to use? For projects in a home-country or similar environment with an average risk profile, the cost of capital would be the right answer. However, in a developing country such as China, analysts must consider a higher risk profile. This profile includes foreign exchange risk, project risk, and so-called country risk. Our approach evaluates project risk according to four key parameters, using specific criteria:

1. Is **growth** less than GDP?
2. Is **competition** entrenched or growing?
3. Can the **technology** be copied or devalued?
4. Might **regulation** become unfavorable?

Companies can decide for themselves how to evaluate these qualitative parameters, but for each question answered as "yes," they should add at least one percentage point to the cost of capital. Finally, at least one percentage point should be added for a JV because the potential for conflict and disagreement in JVs makes them inherently risky. Most research literature places the operational failure rate for JVs at anywhere from 30 to 70 percent (though this includes cases where a venture is absorbed by one of the partners).

For example, a company that decides to invest in a Chinese JV for environmental services, a new market in China which might be expected to grow quickly, has little competition, and expects to benefit from favorable regulatory trends. If its cost of capital is 10 percent, a discount rate of 10 percent may be sufficient for investing in a WFOE.

On the other hand, consider a company investing in a joint venture in a mature industry segment, which has numerous competitors and a growth rate at best equal to GDP. Its production technology is relatively advanced and regulatory trends (such as those promoting more environmental protection) should be favorable, but few technological barriers to domestic entrants exist. This company, which has the same cost of capital (10 percent) as the environmental services firm, should not be satisfied with its joint venture project unless its discount rate is at least 15 percent (four percentage points above the cost of capital for negative risk factors and one for a joint venture). Table 1 uses a 15 percent discount rate to evaluate a project that would probably be viewed as marginal if evaluated on the basis of its 10-year internal rate of return (IRR) of 16.2 percent. However, the continuing value accounts for 88 percent of the value created in this project, amounting to $4 million for a $10 million investment. Assuming the estimate of continuing value is reasonable, this project will eventually contribute significantly to shareholder value.

Because of the contribution of continuing value, it is quite possible for projects that do not yield rapid returns to contribute to shareholder value.

In fact, many companies use a hurdle rate of around 15 percent but apply it only to the first 10 years of earnings, neglecting continuing value. In most cases, this is actually too conservative, and certainly is unlikely to produce an objective feasibility study. Companies are better off simply recognizing that it is difficult to make money in China in the short term and focusing more on the source of value created in the long term. In assessing the continuing value, it is important to address issues such as the expiration of the tax credit for depreciation and the need for maintenance beyond the explicit forecast. In essence, the continuing value must accurately represent the long-term standardized cash flow that the business is expected to produce. Provided this is done, there is no reason to omit the continuing value from any realistic project assessment.

All's well that ends well?

The nature of the project returns described above leads to a very interesting dichotomy in China projects. Because of the contribution of continuing value, it is quite possible for projects that do not yield rapid returns to contribute to shareholder value. Table 2 illustrates such a case, in which the same project as the first example is assumed to suffer a one-year delay with no sales. Although the IRR is now only 12 percent, based on the fact that the continuing value remains the same, the project eventually manages to deliver shareholder value. This can support, to some extent, the argument for "strategic" projects in China.

However, the old adage "time is money" is nowhere more true than in shareholder value creation. The value created in the delayed case ($2.3 million) is half of the value according to the original feasibility study of Table 1. The continuing value now represents 154 percent of the total value created—in other words, the value created in the 10-year forecast period is negative. This means that the discounted cash flows in the first 10 years are insufficient to recoup the original investment. Clearly, the difference between a good project (one with a large NPV) and a mediocre one (one that has a very small NPV) lies in the speed of execution.

In conclusion, shareholder value can be created in China ventures when proper techniques are used throughout the process, starting with a sound feasibility study. Since continuing value typically makes up a large proportion of the shareholder value contributed by projects in China, the stability of ventures is very important. While subsequent restructuring may sometimes create value, firms planning such restructuring should consider the possible disruptions to customer relationships. The value created for the

Chinese partner in a joint venture is no different from that created for the Western partner—though its proportion may be different. The Chinese partner's perception regarding the value created is also likely to differ. Nevertheless, maximizing the value the venture creates and sharing it equitably will help the venture to be stable.

Chinese authorities, who have adopted policies to attract investment fairly indiscriminately, would do well to consider the impact of failing ventures on future investment. Despite the widening window of opportunity presented by China's WTO accession, companies that have been badly burned by their investments in China are likely to become overly cautious in the coming investment cycle. Also, delays in achieving positive cash flow destroy a huge percentage of potential shareholder value. This should have implications for Chinese policymakers, who sometimes procrastinate to gain advantages that may turn out to be transient. In the long run, the quality of the investments in China, not their sheer number, will determine the contribution of foreign investment to China's economic success. 完

Table 2
Joint Venture Feasibility Study Example (No sales in first year)*

All figures in thousands of dollars

Year	0	1	2	3	4	5	6	7	8	9	10	11(CV)
Income Statement												
Volume		0	300	600	900	1,000	1,000	1,000	1,000	1,000	1,000	
Average selling price		9	9	9	9	9	9	9	9	9	9	
Sales		0	2,700	5,400	8,100	9,000	9,000	9,000	9,000	9,000	9,000	
Average unit cost, excluding depreciation		4	4	4	4	4	4	4	4	4	4	
Cost, excluding depreciation		0	1,200	2,400	3,600	4,000	4,000	4,000	4,000	4,000	4,000	
Depreciation		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	
Full cost		1,000	2,200	3,400	4,600	5,000	5,000	5,000	5,000	5,000	5,000	
Gross profit		-1,000	500	2,000	3,500	4,000	4,000	4,000	4,000	4,000	4,000	
Selling, administrative, and research expenses		300	405	810	1,215	1,350	1,350	1,350	1,350	1,350	1,350	
Selling expenses		0	270	540	810	900	900	900	900	900	900	
Administrative expenses		0	81	162	243	270	270	270	270	270	270	
Research expenses		0	54	108	162	180	180	180	180	180	180	
Income before taxes		-1,300	95	1,190	2285	2,650	2,650	2,650	2,650	2,650	2,650	3,650
Tax		0	0	0	749	875	875	875	875	875	875	1,205
Net income		-1,300	95	1,190	1,536	1,776	1,776	1,776	1,776	1,776	1,776	2,446
Profitability Indicators												
Gross profit margin, %		0	18.5	37.0	43.2	44.4	44.4	44.4	44.4	44.4	44.4	
Net income, %		—	3.5	22.0	19.0	19.7	19.7	19.7	19.7	19.7	19.7	
Cash Flow Calculation: Corrections to Net Income												
Investment (−)	10,000											
Depreciation (+)		1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	0
Working capital change (−)		0	405	405	405	135	0	0	0	0	0	0
Deferred taxes (+)		0	0	0	0	0	0	0	0	0	0	0
Cash flow	-10,000	-300	690	1,785	2,131	2,641	2,776	2,776	2,776	2,776	2,776	18,749**
Present Value Calculation												
Discount factor	15%											
NPV	2,279											
IRR (10 years)	12.2%											
CV as a percentage of NPV	154%											

SOURCE: Sigmund Floyd

*All other conditions and parameters are the same as in Table 1. Example is hypothetical and has no relation to any real venture.

**For convenience of viewing, the Year 10 CV is placed in the Year 11 column; in this case, for the NPV calculation to be performed properly it must be multiplied by a factor of 1+k.

Mary Kay in China: More than Makeup

Virginia A. Hulme

The company adapts to China's business environment and finds its place

Dallas-based cosmetics firm Mary Kay Inc.'s mission is "to enrich women's lives"—an unusual goal for a company, but one that thousands of Chinese women have welcomed. Since Mary Kay first set up in China in 1995, it has invested $20 million in its China operations. Over $10 million was spent on a wholly foreign-owned plant in Hangzhou, Zhejiang Province—the company's first overseas manufacturing facility. (It also manufactures in Neuchâtel, Switzerland, and Dallas, Texas.) By the end of 1997, wholesale sales topped $12 million in China, and a nearly 12,000-strong sales force was making inroads into China's cosmetic markets.

Adjusting to China

In 1996, Mary Kay China opened a branch in Shanghai, and by the end of 2000 had branches in 16 other Chinese cities, mostly in east and

Mary Kay sales promoters

Photos courtesy of Mary Kay Inc.

Virginia A. Hulme is associate editor of *The CBR.*

northeast China. Mary Kay hopes to open new branches in six cities each year for the next four years. The company chooses cities in areas of the country where incomes are higher than average and cosmetics and skin care products are used most often. According to Paul Mak, president of Mary Kay China, people in eastern and northern China use these products more often than people in the south, partly because of the climate and partly because skin types tend to differ across the country.

Mary Kay sells about 200 products in China, with prices ranging from ¥6 ($0.72) for an eye shadow applicator to ¥380 ($45.91) for perfume. Most cost between ¥40-200 ($4.83-24.16). These products fall into nine categories: skin care, dietary supplements, color cosmetics, body care, sun protection, fragrances, mother and baby care, and men's skin care. The Hangzhou factory produces everything Mary Kay sells in China. The facility also exports to Malaysia, the Philippines, and Thailand. Though the company currently exports only a small percentage of its PRC output, it plans to export 20 percent within five years. Over 90 percent of the raw materials and 5 percent of the components are imported. Mary Kay may build a second PRC manufacturing facility once sales are high enough to justify construction.

Some products differ from those sold in the company's home market. For instance, skin whitener is popular in Asia, but not in the United States. And because China's baby product market is relatively new, Mary Kay has more of a competitive advantage in that category than at home, where other brands are well entrenched. The company's main PRC competitors are joint-venture brands, as imported cosmetics are still too expensive for most Chinese consumers.

Packaging also differs in China. PRC labeling rules are much more stringent than those in the United States. All cosmetics packages must be printed with the product name, manufacturer name and address, container volume, production date or shelf life, license and serial number, and, if necessary, safety warnings and storage and usage instructions.

Mary Kay hires an outside transportation company to move goods directly from the factory to beauty centers. Then the products move through the sales force to the consumer. This system differs from most other companies' distribution systems, in which products are sold several times over (to the distributor, wholesaler, and retailer) before they reach the consumer. In 2000, Mary Kay opened a regional distribution center in Wuhan, Hubei Province, and plans to have two more regional distribution centers in Beijing and Guangzhou, Guangdong Province, by mid-2001.

A Mary Kay beauty class

Chinese sales promoters emerge

Mary Kay has had to tinker with its business model in China. In the United States, the sales force consists of beauty consultants and sales directors, all of whom are private entrepreneurs (*see* Box). But in China, Mary Kay relies on sales promoters, who do not buy the company's goods for resale, and sales directors to sell its products.

Mary Kay recruits sales promoters mainly through advertisements and referrals. Its Chinese website makes clear that sales promoters must be over the age of 18. Full-time students, active service people, and people who may not work for commission under Chinese law cannot become sales promoters. Mary Kay interviews all candidates for sales promoter positions, and requires candidates to submit a written application. In addition, promoters must pass a certification exam, which Mary Kay administers. Mary Kay must certify the promoters according to standards set by the Bureau of Internal Trade.

Once accepted, incoming sales promoters must sign a "Sales Promoter's Agreement." New promoters then generally undergo three types of training. Skin and product knowledge classes teach about skin types and which products are appropriate for each type. Color makeup training introduces color theory and basic color makeup techniques. The third class teaches basic sales techniques. After completing this training, they hold small classes to introduce Mary Kay products to potential customers, perform free skin analyses, recommend products suitable for each customer's skin type, and deliver orders to customers, all free of charge.

Mary Kay offers Chinese women business opportunities and work options that are otherwise hard to find in China. With unemployment soaring because of state-owned enterprise reform and general economic restructuring, women are often the first fired and last hired.

Unlike US beauty consultants, Chinese sales promoters rarely visit customers' homes. Instead, they set up appointments through referrals, hold classes in beauty centers and offices, and promote products in the cities where they are licensed to do so. An average class (three to six people and two to three hours per class) can reportedly bring in ¥500 ($60.40) in sales to the company, of which the sales promoter usually gets the Mary Kay standard 40 percent commission, though this percentage may vary with the amount sold. Full-time sales promoters can earn several times the wage of an average Chinese worker.

Sales directors in China also have a slightly different set of responsibilities from their US colleagues. They must possess an independent business license for cosmetics sales and consulting, pass the company's examination and verification process, and sign the "Mary Kay Distributor Agreement." Sales directors must establish a retail outlet to sell and display products, and provide space for sales promoters to hold classes. They also appoint specialized trainers, who must be approved by the company, to train sales promoters. Sales directors' commissions are based on the difference between retail and wholesale prices, and they also collect a percentage of facility, training, and consulting fees. Outstanding sales directors have the chance to become high-level sales directors. In contrast to its US operations, where directors progress from the ranks of beauty consultants, sales directors in China come to the company through several different channels.

As in the United States, top achievers are rewarded with jewelry and trips. In China, the company also awards pink cellular phones. Though Mary Kay does not import the famous pink Cadillacs to award its top producers in China, it has given out three Shanghai-made pink Volkswagen Santanas. As in other foreign

Mary Kay in the USA

After 25 years of having her ideas brushed aside, and after she was passed over for promotion in favor of a male employee whom she had trained, Mary Kay Ash quit her job, and decided to write about her experiences and the discrimination women faced in the workplace. As she wrote, it occurred to her that what she was writing could be used as a guide for a company friendly to women.

With her quarter-century of experience in direct sales and $5,000 raised from her family, she started her own business on Friday, September 13, 1963. Despite the inauspicious date, Mary Kay's fledgling cosmetics company thrived, surpassing $1 billion in sales at the wholesale level and $2 billion at the retail level worldwide in 1999. As of 2000, the company had 3,500 employees and around 650,000 beauty consultants worldwide.

Dallas-based Mary Kay Inc. was founded by and for women, to give women opportunities that simply weren't available to them 30 years ago. In many ways, the company's culture embodies the opposite of what Mary Kay Ash experienced as a saleswoman in a male-oriented corporate culture.

From the beginning, Mary Kay knew what management gurus took a few more decades to figure out: praise and recognition are far better motivators than criticism. For reaching their sales goals, beauty consultants have always been rewarded with jewelry, trips, clothing, cars, and other incentives. Most famous is the pink Cadillac earned by top sellers. It is not given outright, but consultants have the use of the car for two years, as long as they meet their sales quotas. (If the consultant fails to meet her quota, she must return the car to the company. If the consultant continuously meets her quotas, the car is hers to drive for another two years.) Prizes have been updated to keep up with fashion and political correctness: fur coats are out, fax machines and exercise equipment are in, and red Pontiac Grand Ams and white GMC Jimmys have been added to the Mary Kay fleet of pink Cadillacs.

The most important motivator, however, is public recognition of a job well done. Every year Mary Kay holds a convention in Dallas, at which top sellers receive prizes and recognition. Top-selling beauty consultants inspire their peers by relating their stories of success.

Mary Kay beauty consultants in the United States are all private entrepreneurs, not employees. Each must buy a $100 starter kit and may choose to receive training in makeup application, sales, bookkeeping, and other business techniques. Such training is given by a recruiter or the company, and is usually one-on-one or in small groups. The company also sets sales quotas for beauty consultants, who buy products at wholesale prices directly from Mary Kay and sell them at a hefty 40 percent markup. As individual entrepreneurs, however, beauty consultants may decide to give discounts or set higher prices. Mary Kay produces around 200 different skin care and beauty products, all with a money-back guarantee.

Beauty consultants also recruit new consultants and gain a percentage of their recruits' sales. This percentage does not cut into the recruited consultant's 40 percent, however, as it comes out of the wholesale price. When a beauty consultant recruits five others, she becomes a team leader. When she recruits around 30 consultants, she becomes a director. As the number of recruits and total sales rise, so does she—to senior director, executive director and, finally, national sales director. As independent entrepreneurs, beauty consultants are paid solely in commissions and prizes, and receive no employee benefits, such as health insurance.

—*Virginia A. Hulme*

countries, top sellers win trips to the company's annual convention in Dallas. For promoters, recognition is based on sales; for directors, recognition is based on the sales they make and those generated by the promoters they trained and counseled.

Opportunities for women

Mary Kay offers Chinese women business opportunities and work options that are otherwise hard to find in China. With unemployment soaring because of state-owned enterprise reform and general economic restructuring, women are often the first fired and last hired. Mary Kay allows women to work either full-time or part-time to supplement their incomes. It also offers avenues for advancement—successful sales promoters may, upon obtaining a business license and signing the "Mary Kay Distributor Agreement," become business consultants and chief business consultants.

Another plus for workers without much experience is the company's free training of its sales promoters. Not all training is mandatory, but at a minimum, new promoters must learn and understand the basic requirements of their position. More accomplished members of the sales force receive training in management. New sales directors and distributors learn basic business development and management, while the more-experienced learn leadership skills and more-advanced management techniques.

Mary Kay's code of conduct stresses that sales promoters and directors should sell products at fixed prices, issue receipts, accept returns according to company policy, not promote other companies' products, and protect company secrets and trademarks. If a promoter or director violates these rules, the company may take disciplinary action, including a warning, suspension from work, earnings deductions, termination of the agreement, and cancellation of the consultant's qualifications.

Mary Kay's sales force in China is made up entirely of women, and Mak estimates that 80 percent of the company's regular employees are women. Mary Kay does not experience high turnover among its full-time employees in China, a fact Mak chalks up to good benefits and salaries, as well as to staff development, training, and promotion opportunities. The company sends upper management to local executive MBA programs, and provides in-house training for staff at other levels. Within the last three years, the company has reduced its expatriate staff from six to one, signaling to its local employees that there is room for them at the top.

Surviving the direct sales ban

In 1998, Mary Kay and other direct sales companies were hit by a central-government ban on all direct sales. The ban effectively closed all companies using this sales method for several months. Mary Kay's sales reportedly dropped 40 percent, and its sales force shrank dramatically. Though Beijing's main target was unscrupulous pyramid schemes that were bilking innocent citizens of their hard-earned savings (and sparking protests around the country), its blanket ban hit all direct sales firms, including foreign firms with legitimate operations and reputations for fairness. Eventually, 10 firms, including Mary Kay, were allowed to reopen using modified sales models.

Before the ban, Mary Kay labeled itself a "single-level" direct selling company, and sold its products through beauty consultants, who were independent entrepreneurs who bought their wares from the company's beauty centers and then sold them directly to the consumer. The consultants had to meet a minimum sales target to remain active, but could choose which products they wanted to buy, and in what amounts.

Under the new system, sales promoters promote and sell Mary Kay products for the company, but no longer buy and resell them.

The Ministry of Foreign Trade and Economic Cooperation, the State Administration for Industry and Commerce, and the Bureau of Internal Trade issued the Circular on Related Issues Concerning the Selling Methods of Foreign-Invested Chain-Selling Enterprises, which allowed direct sales companies to reopen if they sold goods only through retail outlets or promoters (*tuixiaoyuan*). The circular stated that these firms could set up shops to sell their own goods, or sell through department stores. They would also have to provide after-sales services and fixed prices—regardless of whether the goods are sold at retail outlets or through promoters. Though the company had no retail experience, Mary Kay opted to use both promoters and retail channels. The company's 17 beauty centers now also function as retail outlets, and distributors with their own business licenses can open their own retail outlets.

Under the new system, sales promoters promote and sell Mary Kay products for the company, but no longer buy and resell them. According to Chinese law, sales promoters must be paid on the basis of the sales they make on behalf of the company. Government regulations require that they sign a contract with the company for a minimum of one year, have at least two years' work experience, have sales-promotion training or be a graduate of a technical secondary school or higher, and be a permanent resident of the city in which they operate. The company is legally responsible for the activities of sales promoters, who can only make deals with endusers. Promoters may only buy Mary Kay products for personal use, and managers of promoters must be formal employees of the enterprises. (Mary Kay's sales promoters are managed directly by the company.) In addition, the new regulations require that promoters pass a certification exam. Promoters must sell a minimum amount to maintain their active status with the company.

China easier for Mary Kay and other direct sales companies. China has agreed to allow "sales away from a fixed location," which many observers interpret as direct selling. If China interprets the agreement the same way, Mary Kay may be able to return to its original sales structure, which has served it well for 37 years in the United States and other countries. WTO-mandated reductions of import duties and the lifting of restrictions on imports of finished products will also help, for several reasons. First, the company will pay less duty on imported raw materials used in its Hangzhou factory. Second, if the local market is not yet big enough to justify producing a particular product in China, the company will be able to import products for sale in China. The company will also be able to import products for test marketing purposes.

The company's attention to training and incentives has smoothed its path in China and can serve as an example to other foreign firms that staff satisfaction is as essential to success in China as elsewhere.

The 1998 circular required the sales directors to possess a business license and their own business locations. The contractual relationship between Mary Kay and the director is no longer one between the company and an individual, but business-to-business. The role of the sales director is essentially the same, however.

After more than a year under the new model, Mary Kay has more than 10,000 independent sales force members in China, of which about 4 percent are sales directors. Though the company does not disclose sales forecasts, Mak confirmed that sales have recovered to 1997 pre-ban levels. Nevertheless, some problems persist. When pyramid sales and direct selling were banned, these sales methods received a great deal of bad press in China. Consumers approached by promoters are often wary, as Mary Kay's new structure is not readily apparent from the outside. Moreover, since the company can no longer sell to sales promoters at wholesale prices, it must pay tax on the retail price, which cuts into profit.

Looking forward to WTO

Several provisions in the US-China bilateral market-access agreement may make business in

Like other foreign companies in China, Mary Kay has suffered its share of headaches from trying to comply with sudden changes in China's maze of regulations. The company's attention to training and incentives, however, has smoothed its path in China and can serve as an example to other foreign firms that staff satisfaction is as essential to success in China as elsewhere. Despite the regulatory hurdles the company has faced, patience and perseverance are beginning to pay off—the company's horizon in China has a distinctly rosy glow. 完

A Mary Kay pink Volkswagen Santana

www.China

www.taiwansecurity.org Taiwan Security Research, run by Dr. Phillip Yang at Taiwan National University, collects information on Taiwan and regional security issues, including cross-Strait relations, US policy, and the PRC military. The site posts articles, academic studies, and relevant reports and organizes them by subject and location. Use is free of charge, and a search option allows access to material dating back to 1998.

www.apec-china.org.cn The official website for the Asia-Pacific Economic Cooperation (APEC)'s China meeting provides the schedule for the major meetings and events of this year's APEC forum. The site also features APEC news updates, officer lists, and general travel and tourist information.

www.statchina.com Icapital, based in Hong Kong, offers Chinese statistical data through an online database of PRC government documents—for a fee. Visitors may browse statistical profiles of China's regions, explanations of the PRC ministries and bureaus, and links to national and regional PRC government sites free of charge.

www.chinaupdates.com Run by the International Business Institute of the National University of Singapore, this site is a good source for links to Chinese and foreign businesses, governmental organizations, and nongovernmental organizations. Research papers and articles may also be read online.

www.unchina.org The homepage for United Nations (UN) organizations in China offers relevant news and publications, background information, and links to nongovernmental organizations working in China. Homepages for the 13 separate UN organizations in China can all be found here, as well as links to other UN organizations worldwide.

www.jobchina.net This employment service for bilingual professionals looking for work, and companies recruiting staff, in China offers an e-mail newsletter and resumé posting. Fees apply for executive and MBA candidate searches.

www.china-embassy.org The website of the PRC embassy in Washington, DC, offers background and contact information for embassy personnel, the five US regional consulates, and PRC government ministries. Visa and passport information and application forms are available, as is some rudimentary information on educational exchanges. The site also includes political, historical, and geographical information on China, and a range of official position pieces and press releases.

www.ifc.org/publications/china_private_ent.pdf The International Finance Corp. has published online the first significant study on private enterprises in the PRC, *China's Emerging Private Enterprises: Prospects for the New Century*. The report covers the emergence and current condition of the private sector, the legal status of private enterprises, the legal environment, and the financing difficulties that afflict the private companies, and finishes with recommendations to strengthen the sector (*see* p.14).

SITES IN CHINESE

www.look100.com This anticounterfeiting site features information on how to detect counterfeit goods and what materials can be used to protect goods from being counterfeited. The site posts recent articles dealing with counterfeiting problems, links to other anticounterfeiting organizations, and the newsletter of the China Trade Association for Anticounterfeiting.

www.drcnet.com.cn Run by the State Council Development Research Center, this site provides information on a wide range of Chinese economic issues. Articles and reports are written by both State Council and outside researchers, and topics are organized according to sector and issue.

—Drake Weisert

The Leasing Industry's Legal Environment Improves

Lester Ross and C. Stephen Hsu

The leasing industry in China is becoming a viable avenue for foreign investors, after encountering serious difficulties in the late 1980s and early 1990s. These difficulties stemmed from the industry's inadequate legal framework.

New legislation is paving the way for a rebound in China's leasing industry

Indeed, as with other economic institutions in post-1978 China, leasing appeared not so much because a law or notice permitted it, but because no law or notice prevented it at the time. It was not until 1985 that the former Ministry of Foreign Economic Relations and Trade, former State Planning Commission, and former State Economic Commission issued the Notice on Approving the Establishment of Chinese-Foreign Cooperative Leasing Companies. Foreign (principally Japanese) and Chinese-foreign joint-venture lessors, operating in an uncertain legal environment, relied heavily on explicit or implicit local-government guarantees rather than the creditworthiness of the lessee and the enforceability of the contract (*see The CBR*, July-August 2000, p.48). Undercapitalization, shortages of trained personnel, and lax supervision spawned a host of irregularities among Chinese-invested leasing companies, including failure to deliver or maintain the leased item, government protection of lessees who failed to perform their obligations, and inaccurate record-keeping.

The central government rendered local-government guarantees invalid in 1988, which undermined the industry's legal foundation. In 1992, the Supreme People's Court held that guaranties issued prior to the 1988 decision were valid. Notwithstanding central-government directives issued in 1994 and 1996, and the allocation of some central-government funds to help localities honor their guaranties, funding and enforcement problems left many guaranties unperformed. Only the aircraft leasing industry continued to develop, in part because the leased assets were operated internationally and therefore subject to repossession by the foreign lessors in the event of default. At the time, the most commonly leased items were capital equipment, including manufacturing equipment, medical devices, construction equipment, and civil aircraft. Recently, automobiles, computers, telecommunications equipment, and construction equipment have become popular items to lease.

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Beijing's support for the leasing industry grows...

Despite such a troubled start, by the late 1990s the central government recognized that a vibrant leasing industry could reduce upfront capital expenses, stimulate consumption, and help develop a more comprehensive financial industry in the runup to China's entry into the World Trade Organization (WTO). Renewing its focus on the development of an indigenous leasing industry, particularly financial leasing, the central government has licensed several financial leasing companies since 1999 in Shenzhen, Guangdong Province, and elsewhere. According to officials from the relevant government authorities, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) has approved 42 equity-joint-venture leasing companies, and the People's Bank of China (PBOC) has approved 15 domestic financial leasing companies. And more than 300 non-bank financial institutions are exclusively or partially engaged in financial leasing. However, Article 42 of the Commercial Banking Law prohibits commercial banks from engaging in commercial leasing.

...but foreign investment remains stunted

The Catalogue Guiding Foreign Investment in Industry (Guiding Catalogue) classifies the financial leasing industry as "restricted" rather than "encouraged." Therefore, foreign-invested financial leasing companies may be established only as joint ventures. In contrast, Chinese-invested operating leasing companies are classified as service businesses subject only to registration with the State Administration for Industry and Commerce and loose regulation by the State Economic and Trade Commission. The approval requirement for foreign-invested operating leasing companies should be eliminated after China joins the WTO. (Unlike a financial lease, the lessee under an operating lease does not assume the economic risks of ownership, and the lessor generally provides all of the maintenance and services with respect to the leased asset.)

Currently, the establishment of foreign-invested financial leasing companies is subject to MOFTEC approval, but after their formation they are subject to PBOC regulation. However, pending regulations will transfer approval and licensing authority to PBOC, as is the case with foreign banks. Under the Administrative Measures on Financial Leasing Companies (discussed below) released in 2000, PBOC indeed seems to have claimed the licensing authority over non-bank foreign-invested financial leasing companies. A transfer of approval authority with respect to leasing companies would resolve the current jurisdictional inconsistency.

Such a move would also be consistent with China's pending accession to the WTO, which prohibits regulatory burdens on foreign investors that do not apply to their domestic counterparts. Under the US-China bilateral market-access agreement, foreign bank branches and financial leasing corporations will be permitted to offer financial leasing services when Chinese institutions are permitted to do so. Chinese commercial banks face a steep learning curve, however, which may jeopardize their ability to compete with their foreign counterparts.

A stronger legislative foundation

Recent central-government support notwithstanding, China's leasing industry remains relatively small. Annual industry volume is less than 10 percent of South Korea's and less than 1 percent of the US leasing industry's, according to *Market Outlook* (*Shichang Liaowang*). For China's leasing industry to develop, it needs a sound legislative foundation establishing the basic elements of the transaction, the rights and obligations of the parties, and the basis for enforcement. The 1999 Contract Law and the Administrative Measures on Financial Leasing Companies (the Financial Leasing Company Measures) issued in 2000 constitute important steps in the establishment of this necessary legal foundation. The Contract Law is helpful even for contracts with foreign lessors that are governed by foreign law. The Administrative Measures on Foreign-Invested Financial Leasing Companies are reputedly in preparation but have not yet been promulgated. They may appear in the next year or so.

In addition to chapters of general application to economic contracts, the Contract Law includes two chapters on leases. Neither chapter is very detailed, but together they establish the basic rules for lease contracts. The absence of excessive detail allows the parties substantial discretion to craft a mutually agreeable contract. In practice, lessors are able to prepare form contracts that satisfy their requirements as long as they do not violate any of the rules relating specifically to lease contracts or other applicable laws.

Chapter 13 of the Contract Law, entitled "Lease Contracts," covers both operating and real estate lease contracts. The lessor is required to deliver the leased item to the lessee in accordance with the lease contract and to maintain the item for the use provided in the contract (Article 216). The obligation to maintain and repair the leased item falls on the lessor unless otherwise agreed (Articles 220-21). The lessee is conversely required to use the item in accordance with the use specified in the contract or, if the use is unspecified or unclear, in a manner consistent with the item's nature (Article 217). The lessee bears no liability for damage to or depletion of the leased item provided that it is so used (Articles 218-19), but is liable if the item is damaged or lost because of the lessee's failure to exercise due care (Article 223).

For China's leasing industry to develop, it needs a sound legislative foundation establishing the basic elements of the transaction, the rights and obligations of the parties, and the basis for enforcement.

Chapter 13 includes several lessee-friendly provisions. The lessee is entitled to a reduction or suspension of rent if a third-party claim prevents the lessee from using or earning income from the leased item (Article 228), or if the leased item is damaged or lost for reasons not attributable to the lessee (Article 231). Articles 228 and 231 apply even if the parties agree to shift the burden of maintenance and repair to the lessee, so a prudent lessor should procure sufficient insurance to cover such risks. Indeed, the lessee may cancel the contract if its purpose cannot be achieved because the leased item has been damaged or lost (Article 231).

The lessee may cancel the contract at any time, even after the leased item has been accepted and entered into service, if the leased item presents a danger to the lessee's security or health (Article 233). The reach of this provision remains unclear, although some commentators have argued that a leased item may not be deemed dangerous merely because it is substandard. Nevertheless, these lessee-friendly provisions together substantially diminish the enforceability of a net lease or "hell or high water" clause.

Financial leases are governed by Chapter 14. Though also rather thin, Chapter 14 adheres more closely to the typical features of a financial lease. The lessor is required only to warrant the lessee's right to possession and use of the leased item (Article 246). The lessor bears no liability if the leased item does not conform to the contract, unless the lessee has relied on the lessor in determining the leased item or the lessor has interfered in the selection of the leased item (Article 245).

Proponents of a vigorous leasing industry have argued that China could further stimulate expansion by providing greater tax incentives. For example, accelerated depreciation rules would make leasing more attractive to lessors by reducing the cost of leased items.

Financial leasing companies

The Financial Leasing Company Measures govern the licensing of non-bank financial institution leasing companies. Their promulgation followed the crackdown on financial irregularities begun in 1998, which closed some unlicensed leasing companies. No company may include "financial leasing" (*jinrong zulin*) in its name unless PBOC licenses it to do so. To address the problem of undercapitalization, such companies are required to have a minimum registered capital of ¥500 million ($60.4 million). To engage in foreign exchange business, financial leasing companies must have additional foreign exchange capital funding equivalent to $50 million.

PBOC supervises financial leasing companies through various capitalization and other prudential ratios, management qualifications, and other supervisory rules. Rent and processing fees are determined by the parties, however, not by PBOC or any other regulatory authority.

Individuals are only permitted to hold shares in public financial leasing companies. Foreign investment is permitted, although the financial leasing industry is still restricted under the Guiding Catalogue. Additional clarification governing foreign investment may have to await the release of the Administrative Measures on Foreign-Invested Financial Leasing Companies.

Lease approval and registration requirements

China does not have general government approval requirements for lease contracts or for the registration of interests in leased items, with some exceptions, notably civilian aircraft. The civil aviation industry is closely regulated by the Civil Aviation Administration of China, which approves all aircraft acquisitions to regulate competition and conserve foreign exchange.

Medium- and long-term foreign exchange financial leases from foreign and foreign-invested enterprise lessors are treated as foreign exchange loans subject to approval and registration by the State Administration of Foreign Exchange under the 1997 Procedures on the Administration of Borrowing of International Commercial Loans by Domestic Organizations. Short-term financial loans are subject to less-stringent verification requirements. Neither operating leases nor foreign exchange financial leases from Chinese-invested financial lessors are subject to such requirements.

Furthermore, non-financial institution legal persons may undertake foreign exchange leases from foreign or foreign-invested financial lessors only after satisfying several preconditions, including three successive years of profitability and government permission to engage in foreign trade.

Which taxes apply?

Foreign-invested leasing companies and foreign leasing companies with an establishment in China are subject to the same enterprise income tax as other FIEs: 30 percent national tax and 3 percent local tax, subject to any preferential taxes for which they may qualify. Foreign leasing companies without establishments in the PRC, or that derive income from PRC sources unconnected with their PRC establishments, are subject to a 20 percent withholding tax, which itself is subject to reductions under applicable tax treaties. Foreign leasing companies without establishments in the PRC were exempt from withholding tax with respect to income derived from civilian aircraft leases until 1999.

The State Administration of Taxation issued Notice No. 514 in July 2000 to clarify, among other things, whether business tax or value-added tax (VAT) should be levied on lease transactions. The Notice assesses a 5 percent business tax on financial leasing companies licensed by PBOC and other financial leasing companies if title to the leased item is not transferred to the lessee. VAT, which is more onerous, is assessed if the lessor is not licensed by PBOC and title to the leased item is transferred to the licensee. To avoid the VAT obligation, then, contracts should specify that the title remains with the lessor. The contract may provide, however, that title belongs to the lessee at the end of the term, at which time the value of the item will have depreciated, and thus VAT will be less burdensome.

Proponents of a vigorous leasing industry have argued that China could further stimulate expansion by providing greater tax incentives. For example, accelerated depreciation rules would make leasing more attractive to lessors by reducing the cost of leased items. The restoration of the income tax exemption for rental income of foreigners without an establishment in China, abolished in 1990, would also help. However, foreign financial lessors without an establishment in China are eligible for reduced withholding tax treatment if the effective interest rate of the lease does not exceed the export loan interest rate in the lessor's country. Such an incentive is of little value outside the world of subsidized exports, however.

Settling disputes

Although many lessors may elect to resolve disputes through arbitration, foreign-invested leasing companies should be familiar with China's rules for judicial resolution, which may guide arbitration tribunals. In 1996, prior to enactment of the Contract Law, the Supreme People's Court promulgated the Regulations on Certain Issues in the Trial of Disputes Involving Financial Lease Contract Matters (the Trial Regulations). The Trial Regulations were promulgated to help the judiciary cope with the surge in litigation involving financial lease contracts, in which the courts lacked experience. While the Trial Regulations ought to be amended or superseded to conform to the Contract Law, in practice their close correspondence to the Contract Law should render the Trial Regulations a reliable map for the handling of such disputes even under the new statutory regime.

The Trial Regulations provide that the parties may select any forum with jurisdiction for adjudication. Thus, a Shanghai-based lessor may demand that disputes involving its leases be adjudicated in Shanghai, rather than where the lessee lives or where the leased item is located. Foreign-invested lessors should monitor the work of the courts in their jurisdiction to determine whether the courts perform in a predictable manner and are hospitable to lessors.

More thorough and comprehensive supervision by PBOC should have a healthy effect on the financial leasing industry as a whole and should benefit foreign-invested lessors, who tend to have both more experience and stronger capitalization.

As with other contracts, a financial lease contract is deemed invalid if government approval is required but not obtained. The lessor must therefore ensure that all government-approval and registration requirements are satisfied, including foreign exchange registration requirements for foreign financial leases treated as loans. The Trial Regulations also provide that a financial lease contract is invalid if it violates applicable state laws and regulations. Given the troubled history of financial leasing in the PRC, it is not surprising that the Trial Regulations also deem invalid any guaranty issued by a government body that exceeds the scope of that body's powers. The Trial Regulations provide that a government body that issues an invalid guaranty is obligated to pay damages to the creditor or lessor, but enforcement of that provision has proven difficult.

Smoother sailing ahead

After a long and rocky beginning, the prospects for the development of China's leasing industry have improved dramatically. A stronger legal foundation provides the parties with substantial discretion in crafting a mutually agreeable contract. More thorough and comprehensive supervision by PBOC should have a healthy effect on the financial leasing industry as a whole and should benefit foreign-invested lessors, who tend to have both more experience and stronger capitalization. Such supervision would facilitate the lifting of the ban on commercial banks' participation in leasing, and thereby increase investment and competition in the industry. But more stringent requirements for the licensing of FIEs than Chinese firms, and limitations on foreign equity investment, continue to impede foreign investment in the financial leasing industry, and some sectors of the economy remain off limits with respect to operating leases. Lower business tax rates, as opposed to VAT rates, are available under financial leases—provided that the contract makes the critical distinction between a sale of goods and a lease. Even more generous tax incentives concerning depreciation, which would hasten the development of the leasing industry, would have to overcome strong resistance from the Ministry of Finance, and for the foreseeable future remain unlikely. Nevertheless, the prospects for crafting viable leasing arrangements in China are better than they have ever been. 完

China Business

Sales and Investment

SEPTEMBER 16-NOVEMBER 15, 2000

Compiled by Mark Dunn

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

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

Accounting and Insurance

INVESTMENTS IN CHINA

New York Life International, Inc. (US)
Will invest in Chongqing Municipality and Sichuan Province to help develop the service sector. $500 million. 10/00.

Agricultural Commodities and Technology

OTHER

Government of the PRC
Will set up a urea fertilizer plant in Sirajganj, Bangladesh. $353 million. 10/00.

Banking and Finance

CHINA'S IMPORTS

INVESCO Funds Group Inc., a subsidiary of AMVESCAP (US)
Will provide consulting services to Penghua Fund Management Co., Ltd. of Guangdong Province to improve its fund management capacity and customer service. 10/00.

Diebold, Inc. (US)
Sold 100 automated teller machines to the Agricultural Bank of China for use in Sichuan and Guangxi provinces. 9/00.

INVESTMENTS IN CHINA

Qunitalux Ltd. (Hong Kong)/China (Shenzhen) Hightech Fund Investment Co., Ltd. (Guangdong)
Will form joint investment company to invest in high-technology companies in the PRC. (Hong Kong:80%-PRC:20%). $6 million. 11/00.

ADB
Will invest in Hubei, Jiangxi, Sichuan, and Yunnan provinces to help develop small and medium-sized businesses. $25 million. 10/00.

Shenyin Wanguo Ltd. (Hong Kong), a subsidiary of Shenyin & Wanguo Securities Co. (Shanghai)
Will purchase the Shanghai brokerage unit of Shenyin & Wanguo. $487,300. 9/00.

OTHER

American International Group, Inc. (US)/BOC
Signed agreement to share resources and offer comprehensive financial services to their customers in the PRC. 11/00.

Banque Marocaine du Commerce Extérieur (Morocco)
Opened branch in Beijing. 10/00.

China E-Commerce Technologies Ltd., a subsidiary of Internet Corp. (US)/China Merchant Bank (Guangdong), China Telecom
Launched multipurpose Internet banking card, the iBanking Card. 10/00.

Tower Financial Services Group (New Zealand)
Will open representative office in Beijing. 10/00.

Chemicals, Petrochemicals, and Related Equipment

CHINA'S INVESTMENTS ABROAD

Myanmar Petrochemical Enterprise/China National Machinery Import and Export Corp. (Beijing)
Signed contract to build two liquefied petroleum gas factories in Myanmar. $13 million. 10/00.

INVESTMENTS IN CHINA

Chevron Phillips Chemical China Co., a unit of Chevron Phillips Chemical Co., a joint venture between Chevron Corp. and Phillips Petroleum Co. (US)
Established a polystyrene plant in Zhangjiagang, Jiangsu Province. $92 million. 11/00.

Dequest Business Group, a unit of Solutia Inc. (US)/Wujin Fine Chemicals (Jiangsu)
Formed joint venture, Solutia Xiafeng Fine Chemical Co., Ltd., to market phosphate products in the PRC. (US:51%-PRC:49%). 11/00.

Abbreviations used throughout text: ADB: Asian Development Bank; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CATIC: China National Aero-Technology Import-Export Corp.; 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.; ETDZ: Economic and Technological Development Zone; ICBC: Industrial and Commercial Bank of China; MII: Ministry of Information Industry; MOU: Memorandum of Understanding; NA: Not Available; NORINCO: China North Industries Corp.; P&T: Posts and Telecommunications; PBOC: People's Bank of China; RMB: Renminbi; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SDPC: State Development Planning Commission; UNDP: United Nations Development Program

Formosa Plastics Corp. (Taiwan)
Will invest $100 million in Zhejiang Province to build a polyvinyl chloride plant. $100 million. 10/00.

Rhodia SA (France)
Opened vanilic aldehyde plant, Rhodia-Haining Fine Chemicals Co., Ltd., in Zhejiang Province. 10/00.

Shell Chemicals, a unit of Royal Dutch/Shell Group (the Netherlands)/ CNOOC
Signed contract to form joint venture, CNOOC and Shell Petrochemicals Co., Ltd., to develop a petrochemicals complex in southern China. $4 billion. 10/00.

General Electric Co. (US)
Opened synthetic plastic factory in Pudong, Shanghai. $30 million. 9/00.

OTHER

Bayer AG (Germany)
Established research and development center in Shanghai. 10/00.

Consumer Goods

OTHER

Shanghai Givaudan Ltd., a joint venture between Givaudan SA (Switzerland) and Shanghai Sunve Pharmaceutical Corp.
Opened the Shanghai Givaudan Ltd. Sensory and Technology Center to help create new fragrances and flavors. 10/00.

Metro AG (Germany)/Chengdu City Land Bureau, Qingyang District People's Government (Sichuan)
Signed land-use and residential removal contract for Metro to build a warehouse store. 10/00.

Wal-Mart Stores, Inc. (US)
Will establish its Asia-Pacific headquarters in Shenzhen, Guangdong Province. 10/00.

Wal-Mart Stores, Inc. (US)
Will open outlets in Guangdong Province. 10/00.

Electronics and Computer Software

CHINA'S IMPORTS

Intentia International AB (Sweden)
Will provide Tianjin Pipe Corp. with electronic applications for financial management, order processing, and business performance management. $1.2 million. 11/00.

UTStarcom, Inc. (US)
Will supply Xi'an, Shaanxi Province, with ethernet switching equipment. 10/00.

Extreme Networks, Inc. (US)
Provided Beijing University with Black Diamond and Summit switches to support its high-speed campus network. 9/00.

GTECH Holdings Corp. (US)
Signed agreement to provide a turnkey lottery system to operate the Beijing Welfare Lottery Center. 9/00.

I&C Co., Ltd., Miraesung Corp. (South Korea)
Will supply China Record Corp. of Beijing with five million MP3 players. $18 million. 9/00.

INVESTMENTS IN CHINA

Compex System Pte Ltd., a subsidiary of Powermatic Data Systems Ltd. (Singapore)
Opened plant in Shenzhen, Guangdong Province, to produce 10,000 network interface cards and 1,000 hubs daily. $1 million. 11/00.

Matsushita Electric Industrial Co. (Japan)/Shanghai Guangdian (Group) Co., Shanghai Industrial Investment (Group) Co., and Shanghai Vacuum Electron Devices Co.
Will form joint venture, Shanghai Matsushita Plasma Display Co., in Shanghai to produce plasma display panels for TVs and monitors. (Japan:51%-PRC:49%). $100 million. 11/00.

Orbis Oyj, PMJ Automec Oyj (Finland)
Set up joint venture to install and maintain testing systems and automation equipment in China. 11/00.

Southland Financial, Inc. (Australia)
Acquired 60% of Ai Wei Technology Corp., Ltd., a joint venture with China Changfeng Aerospace Science and Technology Industry (Group) Corp. of Beijing, to supply identity smart cards to PRC citizens. 11/00.

STS Co., TradeCatalyst Co. (US)/Subteck (Hunan) Data System Co. Ltd., Hunan Huaxiangteng Digital Technology Co. Ltd.
Will establish an international electronic technology and software development center in Changsha, Hunan Province. $12 million. 11/00.

VTech Holdings, Ltd. (Hong Kong)/South China University of Technology (Guangdong)
Will form joint venture, SCVTech, to develop an e-commerce platform. (Hong Kong:50%-PRC:50%). 11/00.

Compaq Computer Corp. (US)
Will increase investment in its Chinese operations over the next two years to build more e-commerce centers and develop digital management techniques. $30 million. 10/00.

Great Wall International Information Products (Shenzhen) Co., a joint venture between IBM Corp. (US) and China Great Wall Computer Shenzhen Co.
Established the Great Wall International Information Products (Shenzhen) Co., Futian Duty-Free Zone Branch, to produce 1 million computers annually. 10/00.

IBM Corp. (US)
Will build new chip packaging facility in Shanghai. $300 million. 10/00.

i-One.Net (Beijing) Co., Ltd., a unit of i-One.Net (Singapore)/Sino V Technology Development (Liaoning)
Formed joint venture to provide Internet infrastructure-related business in Dalian, Liaoning Province. (Singapore:86.7%-PRC:13.3%). 10/00.

Intel Corp. (US)
Will increase investment in its Shanghai facility to build computer peripherals. $200 million. 10/00.

Lucent Technologies (US)
Will build a new program-controlled switchboard production base in Qingdao, Shandong Province. $22 million. 10/00.

Quanta Computer Inc. (Taiwan)
Will set up a motherboard production plant and a computer case assembly plant in Shanghai. $26 million. 10/00.

TCL Industrial Holdings (Hong Kong) Co., Ltd./Wuxi Dianyi Asset Management Co. (Jiangsu)
Signed agreement to form joint venture, TCL Digital Science and Technology Co., Ltd; to produce digital color TV sets, portable computers, and palm computers. (Hong Kong:70%-PRC:30%). $29.6 million. 10/00.

First eChina Inc. (US)/China National Corp. for Overseas Economic Cooperation, Zhao Tong Information Center (Beijing)
Formed joint venture, Beijing Unitrade E-Commerce Co. Ltd., to operate a Chinese-language business-to-business e-commerce portal. 9/00.

The Hartcourt Companies, Inc. (US)
Signed agreement to purchase 60% of the outstanding shares of Beijing Total Solution System, Ltd. 9/00.

Hitachi, Ltd. (Japan)
Will produce flat-panel displays at the Hitachi Display Device (Suzhou) Co. Ltd., in Jiangsu Province, for computers and mobile telephones. $28 million. 9/00.

NCR Corp. (US)
Will build a data warehouse to process data for the Shanghai Securities Central Clearance and Registration Co. 9/00.

Triphol Co. (Japan)/Huadong Electronics (Group) Co., Nanjing Xingang High-Tech Co., Ltd. (Jiangsu)
Signed letter of intent to establish the Nanjing Huari LCD Technology Co., Ltd. to produce and market STN-LCD displays, modules, and related products. $25 million. 9/00.

OTHER

Aptech Beijing Beida Jadebird Co., a joint venture between Aptech Ltd. (India) and the Government of the PRC
Will expand the number of software education and training centers in the PRC to 75. 11/00.

Three-Five Systems, Inc. (US)
Established full-service design engineering center in Beijing. 11/00.

Analog Devices Inc. (US)
Will open the Beijing Design Center to develop integrated circuits for the telecommunications industry, the consumer market, and other industries. 10/00.

Ansoft Corp. (US)
Opened Advanced Training Centers to help train new engineers at the Beijing Institute of Technology and Xidian University, Shaanxi Province. 10/00.

Ansoft Corp. (US)
Opened new support office in Shanghai. 10/00.

Avanti Co. (US)
Donated VDSM integrated chip design software to Qinghua and Beijing universities. $24 million. 10/00.

Hewlett-Packard (China) Co., a unit of Hewlett-Packard Co. (US)/SinoProjects.com (Beijing)
Signed agreement to provide e-commerce services to Chinese businesses. 10/00.

LM Ericsson AB (Sweden), MyWeb Inc.com (US)
Signed MOU to develop and promote E-secretary, an Internet-based application featuring personal business assistant services. 10/00.

Motorola Computer Group, a unit of Motorola Inc. (US)
Will open design center in Shanghai. 10/00.

NetEase.com, Inc. (Beijing)
Opened office in Newark, California. 10/00.

Samsung Electronics Co., Ltd., a unit of Samsung Group (South Korea)
Opened the Beijing Samsung Communication Technology Research Center to focus on the research and development of third-generation mobile communications technology. 10/00.

Sun Microsystems, Inc. (US); Wangtong Kehui Ltd. (Hong Kong)/Shenzhen China International High and New Technological Achievements Trade Center, Shenzhen China International High and New Technological Property Rights Exchange
Established the iForce New Business Incubation Center in Shenzhen, Guangdong Province. 10/00.

AsiaInfo Holdings Inc. (US)/Intrinsic Technology (Shanghai)
Will develop wireless Internet solutions for mobile operators. 9/00.

Chinaepot; Cisco Systems, Inc.; Compaq Computer Corp.; IBM Corp.; Intel Corp.; and Oracle Corp. (US)
Formed alliance to support the development of the information technology industry in Xinjiang Uygur Autonomous Region. 9/00.

Communication Intelligence Computer Corp., Ltd., a joint venture between Communication Intelligence Corp. (US) and Jiangsu Bureau of Information Industries/Ministry of Agriculture
Signed licensing agreement for Communication Intelligence Corp.'s InkTools and Office Automation Systems Solutions. 9/00.

Extreme Networks, Inc. (US)
Will establish new sales offices in Beijing; Chengdu, Sichuan Province; Shanghai; and Wuhan, Hubei Province. 9/00.

IBM Corp. (US)/Golden Medicine Commodity Network Co., Ltd. (Beijing)
Teamed up to create website that offers drug ordering and drug product catalogue information services to pharmaceutical manufacturers, distributors, and hospitals. 9/00.

Intel Corp. (US)/Capital Online (Beijing)
Agreed to develop comprehensive solutions to server co-location services for small and medium-sized enterprises. 9/00.

InterNetworking Systems, a unit of Lucent Technologies (US)/Jiangsu Xinwang Shixun Technologies Co.
Agreed to develop applications for Lucent's leading switching systems, access equipment, and fiber-optic cable network systems. 9/00.

Linuxlab (US)/Red Flag Linux Software Co. (Beijing)
Signed agreement to develop and sell Linux products in international markets. 9/00.

Microsoft Corp. (US)/Haier Group Co. (Shandong)
Agreed to cooperate on software for electrical home appliances, wireless communications, and software development. 9/00.

Nortel Networks Corp. (Canada)/Jitong Communications Co., Ltd. (Shanghai)
Formed alliance to promote the development of information service networks in the PRC. 9/00.

Reuters Group Plc (United Kingdom)/Qingniao.net Holdings Pte Ltd. (Beijing)
Signed agreement for Qingniao.net's business website to provide Reuters with information and stock quotations. 9/00.

SIPEX Corp. (US)
Opened new sales, marketing, and technical applications organization in Shenzhen, Guangdong Province. 9/00.

Sun Microsystems, Inc. (US)
Opened bonded warehouse in Shanghai's Waigaoqiao Bonded Zone. 9/00.

Engineering and Construction

INVESTMENTS IN CHINA

Matsushita Electric Works Ltd. (Japan)
Will build plant in Shanghai to manufacture construction equipment. $1.11 million. 10/00.

OTHER

Government of the PRC
Will provide the Government of Vietnam with loans to fund construction of two hydroelectric power stations, a copper smelter, and a fertilizer plant. $300 million. 10/00.

Environmental Technology and Equipment

CHINA'S IMPORTS

ITT Industries, Inc. (US)
Will supply 30 pumps to Shanghai's Suzhou Creek sewage treatment project. $10 million. 10/00.

INVESTMENTS IN CHINA

International Bio-Recovery Corp. (Canada)
Will construct a plant in Nanhai, Guangdong Province, to convert organic waste into fertilizer. 10/00.

OTHER

Government of the PRC
Provided a grant to Tanzania for a water supply construction project. $4.6 million. 10/00.

Government of Poland
Granted the PRC a concessional loan for environmental projects. $85 million. 9/00.

Food and Food Processing

CHINA'S EXPORTS

Hechuan City (Chongqing)
Signed contract to export pork to Japan. $1 million. 11/00.

CHINA'S INVESTMENTS ABROAD

Tsingtao Brewery Co., Ltd. (Shandong)
Will establish breweries in Malaysia and South Africa. 9/00.

INVESTMENTS IN CHINA

Danone Group (France)
Will acquire minority stake in Shanghai Bright Dairy. 10/00.

F. Hoffman-La Roche Ltd. (Switzerland)/Shanghai New Asiatic Pharmaceuticals Ltd.
Partnered to open vitamin plant in Shanghai. $28.4 million. 10/00.

OTHER

Clements Citrus Sales of Florida, Inc., a subsidiary of Clements Golden Phoenix Enterprises Inc. (US)/NA (Guangdong)
Signed deal to distribute Clements frozen concentrated orange juice to customers in Guangzhou and Shenzhen, Guangdong Province. 10/00.

Adatom.com Inc. (US)/Shanghai Longwu Fruit Co.
Signed agreement enabling US fruit and vegetable vendors to sell agricultural products directly to the Shanghai wholesale market. 9/00.

Machinery and Machine Tools

INVESTMENTS IN CHINA

Ingersoll-Rand Co. (US)
Formed joint venture, Nanjing Ingersoll-Rand Compressor Co., Ltd., in Jiangsu Province, by acquiring an 80% share in Nanjing Sanda Machinery Co. 9/00.

Medical Equipment and Devices

OTHER

BioSignia, Inc. (US)/Beijing HealthWay Management Co.
Signed distribution agreement to market BioSignia's "Know Your Number" program. 10/00.

Metals, Minerals, and Mining

CHINA'S IMPORTS

Uhrhan & Schwill GmbH (Germany), a unit of Lincoln Electric Holdings, Inc. (US)
Won contract to design, manufacture, and install pipe welding systems for Julong Steel Pipe Co., Ltd., Hebei Province. $1.2 million. 10/00.

CHINA'S INVESTMENTS ABROAD

China Non-Ferrous Metal Foreign Construction Co. (Beijing)
Will construct an aluminum smelter in Malaysia. $2 billion. 10/00.

INVESTMENTS IN CHINA

Airtrust Pte Ltd. (Singapore); Hunting Oilfield Services International (US)
Opened joint-venture steel threading facility in Tianjin. 10/00.

OTHER

Butler (Shanghai) Inc., a unit of Butler Manufacturing Co. (US)
Will expand its workshops in Shanghai from 5,700 m^2 to 15,000 m^2 and increase production. 10/00.

Sumitomo Special Metals Co., Ltd. (Japan)/Beijing Qinghua Innovation Technology Development Co., Ltd.
Signed a patent license agreement to export PRC magnets. 10/00.

Park-Ohio Industries Inc., a unit of Park-Ohio Holdings Corp. (US)
Opened Asia headquarters in Shanghai. 9/00.

Miscellaneous

CHINA'S INVESTMENTS ABROAD

Government of Namibia/Government of the PRC
Signed agreement for the establishment of a PRC space-tracking, telemetry, and command station in Namibia. 10/00.

INVESTMENTS IN CHINA

Macao Miramar Travel Agency/Gansu New Western Tourism Co.
Established a tourism joint venture, the Gansu Western United International Tourism Co. 11/00.

Extreme Networks, Inc. (US)
Will provide Beijing University of Aeronautics and Astronautics with its first training and technology center. 9/00.

Morningstar Travel Service (Hong Kong)/Fangzhou International Travel Agency (Beijing)
Established joint-venture travel agency, the Beijing Morningstar-Fangzhou International Travel Service. 9/00.

OTHER

RSA Security Inc. (US)
Will establish office in Shanghai. 11/00.

The Smile Train (US)/China Charity Federation (Beijing)
Will provide free cleft lip and palate surgery to 24,000 children in the PRC. 11/00.

Citibank, a unit of Citigroup, Inc. (US)/Fudan University (Shanghai)
Launched joint management training program at Fudan University. 10/00.

German Research Federation/China National Science Foundation Committee (Beijing)
Established research center in Beijing to promote cooperation and exchange in the natural sciences. 10/00.

IDG China, a unit of International Data Group (US)/China State Council Information Office (Beijing)
Will co-publish a one-time magazine to commemorate the Chinese Cultural Festival 2000. 10/00.

International Finance Corp., a unit of the World Bank Group
Signed MOU with the Wan Jie Tumor Hospital in Zibo, Shandong Province, to provide loan for cancer treatment. $15 million. 10/00.

Kintetsu World Express, Inc. (Japan)
Upgraded its offices in Nanjing, Jiangsu Province; Qingdao, Shandong Province; and Tianjin Municipality to full-service branches, with increased distribution capabilities and larger customer service responsibilities. 10/00.

Korea Trade-Investment Promotion Agency
Will open new offices in Qingdao, Shandong Province, and Wuhan, Hubei Province. 10/00.

ON Semiconductor (US)
Donated funds to build a new school for underprivileged children near Leshan, Sichuan Province. $36,000. 10/00.

The Procter & Gamble Co. (US)
Donated funds to the Ministry of Health and Project Cradle to help promote public health. $480,000. 10/00.

San Francisco Exploratorium (US), Sony Corp. (Japan)
Opened the Sony ExploraScience youth educational center in Beijing. 10/00.

University of the Incarnate Word (US)/South China Normal University (Guangdong)
Opened joint venture, China Incarnate Word Education Center, in Zengcheng, Guangdong Province, to promote educational and cultural exchange. 10/00.

Ohana Foundation (US)/People's Education Press
Signed agreement to develop multimedia instructional technology to facilitate English-language teaching in PRC schools. 9/00.

Packaging, Pulp, and Paper

CHINA'S IMPORTS

Metso Corp. (Finland)
Will provide Jilin Shixian Paper Co., Ltd. and Shandong Chenming Paper Holdings Ltd. with papermaking lines. $115 million. 11/00.

Petroleum, Natural Gas, and Related Equipment

CHINA'S IMPORTS

Government of Saudi Arabia
Will provide China United Petrochemical Corp. of Beijing with 180,000 barrels of crude oil per day in 2001. 11/00

Andersen Consulting (US)
Will provide restructuring and management consulting services to Sinopec. 10/00.

CHINA'S INVESTMENTS ABROAD

China National Machinery Import and Export Corp. (Beijing)
Will construct two mobile liquefied petroleum gas factories in Myanmar. $13 million. 10/00.

INVESTMENTS IN CHINA

The Lubrizol Corp. (US)/Lanzhou Refinery Co. (Gansu)
Formed joint venture, Lanzhou Lubrizol Refining Additive Co., to produce petroleum-based compound agents. 11/00.

Royal Dutch/Shell Group (the Netherlands)
Will purchase 20% of CNOOC's initial public offering and will help CNOOC develop opportunities in oil and gas exploration and production. $300 million. 11/00.

CGU-CDC China Capital Partners, a joint venture between CGNU Plc and CDC Capital Partners (United Kingdom)
Will invest in CNOOC, Ltd. to assist in exploration and development of oil resources. $10 million. 10/00.

OTHER

Texaco Inc. (US)/China United Coalbed Methane Corp. Ltd. (Beijing)
Signed contracts to extend Texaco's operation in the Ordos Basin of Shaanxi and Shanxi provinces, and Inner Mongolia Autonomous Region. 11/00.

Digital Gas, Inc. (US)/Dong Sheng Corp. (Shandong)
Signed contract to improve oil and gas production in all of Dong Sheng's fields. 10/00.

CNPC (Hong Kong) Ltd./North China Petroleum Bureau, a unit of CNPC (Beijing)
Signed letter of intent to set up joint venture to manufacture large-diameter oil and natural gas pipes in the PRC. $9.75 million. (Hong Kong:50%-PRC:50%). 10/00.

Husky Energy Inc. (Canada)/CNOOC
Signed contract to develop two oil fields in the South China Sea. 10/00.

Pharmaceuticals

INVESTMENTS IN CHINA

Nycomed Amersham (United Kingdom)/Shanghai Hua Hai Pharmaceutical Factory, Shanghai Zhangjiang High-Tech Park Development Co.
Will form joint venture, Shanghai Nycomed Pharmaceutical Co. (United Kingdom:80%-PRC:7%, 13%). $34 million. 10/00.

OTHER

Pan-Pacific Pharmaceutical Ltd. (US)/Jintansheng Biological Technology Development Co., a unit of the North China Pharmaceutical Group Corp. (Hebei)
Signed agreement to develop PX3, a medicine for rheumatoid arthritis. 9/00.

Ports and Shipping

CHINA'S EXPORTS

Shanghai Zhenhua Port Machinery Co., Ltd.
Won contract to supply the Long Beach Port Office of the United States with 20 post-Panama quayside container cranes. $140 million. 11/00.

CHINA'S IMPORTS

Nanjing Goulds Pump Co., a subsidiary of ITT Industries, Inc. (US)
Won contract to provide 48 deep-well pumps for five permanent ship locks to be built on the Yangzi River. $604,595. 11/00.

See Hup Seng Special Coating Equipment & Engineering (Shanghai) Co., a unit of See Hup Seng Ltd. (Singapore)
Will provide Shanghai Waigaoqiao Shipbuilding Ltd. with corrosion-prevention materials. $1.72 million. 11/00.

OTHER

FedEx Corp. (US)
Began one-day delivery to Beijing; Guangzhou and Shenzhen, Guangdong Province; and Shanghai. 9/00.

Power Generation Equipment

CHINA'S EXPORTS

China National Machinery Import and Export Co. (Beijing)
Signed contract to construct the first phase of a 1,200 MW power plant in Samarra, Iraq. $200 million. 11/00.

China National Machinery Import and Export Co. (Beijing)
Constructed a gas-powered 222 MW power station in Kiruk, Iraq. $75 million. 11/00.

Guangzhou International Economic and Technical Cooperation Co. (Guangdong)
Will provide the Dhaka Electric Supply Authority of Bangladesh with a loan to upgrade Dhaka's power distribution system. $60 million. 11/00.

CHINA'S IMPORTS

ABB High Voltage Technologies Ltd., a unit of ABB Group (Switzerland)
Won order to provide 500 kilovolt gas-insulated switchgear for Jiangsu Nuclear Power Corp. $17.4 million. 9/00.

INVESTMENTS IN CHINA

Government of Thailand/Yunnan Power Co.
Will construct Jinghong Power Station in Jinghong, Yunnan Province, to provide electricity to Thailand. (Thailand:70%-PRC:30%). $1.2 billion. 11/00.

OTHER

ABB Group (Switzerland)
Will increase its investment in the PRC to $1 billion within the next 3-4 years. 10/00.

Ovonic Battery Co., Inc., a subsidiary of Energy Conversion Devices, Inc. (US)
Signed patent license agreement with SANIK Battery Co., Ltd. of Guangdong Province for proprietary nickel-metal hydride battery technology. 10/00.

Property Management and Development

CHINA'S IMPORTS

Ascott Ltd., a unit of DBS Land Ltd. (Singapore)
Signed deal to manage a 166-unit residential and service apartment project in Beijing. 10/00.

Telecommunications

CHINA'S IMPORTS

Advanced Recognition Technologies (Israel)
Won contract from Konka Group Co., Ltd. (Guangdong) to integrate its smARTspeak software into Konka's cellular phones, allowing for voice-activated dialing. $1.5 million. 10/00.

Belle Systems Asia Pte Ltd., a unit of Belle Systems A/S (Denmark)
Won contract to help China Unicom deploy its post-paid VoIP services. 10/00.

C-COR.net (US); LM Ericsson AB (Sweden)
Won contract to implement a broadband network for Zhuhai, Guangdong Province. 10/00.

Lucent Technologies (US)
Won contract to provide Suzhou Telecom, a subsidiary of China Telecom, with optical networking systems. $5 million. 10/00.

Marconi Plc (United Kingdom)
Will provide telecommunications equipment to be built into the network solutions of Datang Telecom Technology Co. of Shaanxi Province. $50 million. 10/00.

Marconi Plc (United Kingdom)
Will provide China Telecom of Beijing with synchronous digital hierarchy equipment to upgrade fixed and mobile phone networks in Beijing. 10/00.

Oy Nokia AB (Finland)
Will provide Fujian Center of Radio & Movie Information Network with Nokia Media Master digital multimedia terminals to support digital television broadcasts. 10/00.

Oy Nokia AB (Finland)
Will supply Jinan Telecom of Shandong Province and Nanjing Telecom of Jiangsu Province with a broadband access system that uses DSL technology at local access network exchanges to provide high-speed Internet services. 10/00.

Qualcomm Inc. (US)
Will supply China Unicom with narrow-band CDMA technology to build a mobile phone network. 10/00.

Sewon Telecom (South Korea)
Will supply Ningbo Bird Co., Ltd., Zhejiang Province, with 550,000 GSM mobile phones. 10/00.

IBM Corp. (US)
Will supply Huawei Electric Technologies Co., Ltd. of Shenzhen, Guangdong Province, with next-generation Internet Protocol routers and synchronous digital hierarchy optical transmission systems. 9/00.

Lucent Technologies (US)
Signed contract with China Unicom to build high-capacity optical networks in Jilin, Hebei, Henan, Zhejiang, Hunan, Hubei, Hainan, and Guangxi provinces. $14 million. 9/00.

Lucent Technologies (US)
Won contract from Fujian Mobile Communication Co., Ltd. to build three 10-gigabit backbone optical networks in Fujian Province. $8.8 million. 9/00.

Nortel Networks (Canada)
Will provide next-generation wireless Internet and data service networks to China Unicom. $275 million. 9/00.

Oy Nokia AB (Finland)
Won contract to expand the GSM network of China Unicom in Shanghai and Anhui, Hunan, and Gansu provinces. $100 million. 9/00.

UTStarcom, Inc. (US)
Signed contract to install city-wide wireless personal access systems equipment in two cities in Henan Province. $7 million. 9/00.

INVESTMENTS IN CHINA

Century Vision Network, a subsidiary of China Broadband Corp., Ltd. (Hong Kong)/Yunnan Broadcasting & Television Information Network Group Co., Ltd.
Formed joint venture to develop and operate an interactive broadband cable television network in the PRC. 10/00.

China Mobile (Hong Kong) Ltd., Vodafone Group Plc (United Kingdom)
Formed alliance to acquire the China Mobile Telecommunications Corp. networks of Hebei, Liaoning, Shandong, and Guangxi provinces and Beijing, Shanghai, and Tianjin municipalities. $32.84 billion. 10/00.

Cyber First Technology Ltd., a subsidiary of T S Telecom, Ltd. (Canada)/Beijing Zhongdian Yiping Science & Technology Ltd.
Formed joint venture, Beijing Telecom Science-Soft Information Systems Co., Ltd., to develop large-scale software platforms and applications for fixed-line and mobile telephones in the PRC. (Canada:80%-PRC:20%). $1.2 million. 10/00.

Marconi Plc (United Kingdom)/MII
Formed joint venture, Guilin Marconi Telecom, to supply telecommunications equipment in the PRC. 10/00.

Taiwan International Securities Corp.
Will build the Dingxun Cellular Phone Plant to manufacture GSM and CDMA mobile phones. $20 million. 10/00.

Toshiba Corp. (Japan), Toshiba (China) Co., Wong's Industrial Group (Hong Kong)/Nanjing Putian Telecommunications Co. (Jiangsu)
Formed joint venture, Nanjing Putian Wong Toshiba Telecommunications Co., to concentrate on research and development, production, and sales of CDMA technology. $6 million. 10/00.

ADC Telecommunications Inc. (US)
Established manufacturing plant in Nanjing ETDZ, Jiangsu Province. $10.1 million. 9/00.

OTHER

Intel Corp. (US)/Beijing Telecommunications Co.
Signed agreement under which Intel will provide website hosting services to Beijing Telecom's customers. 11/00.

Multa Communications Corp. (US)/China Unicom
Signed agreement to establish a shared-capacity undersea fiber-optic cable connection between the US and the PRC. 11/00.

Vianet Technologies, Inc. (US)/China Unicom
Signed MOU to promote and market Vianet's products to Unicom's Internet, wireless, and paging customers. 11/00.

Intel Corp. (US)/Konka Group Co., Ltd. (Guangdong)
Signed agreement to develop chips for third-generation mobile phones. 10/00.

LM Ericsson AB (Sweden)/China Unicom Wuxi Branch, Wuxi Securities Co. (Jiangsu)
Will introduce WAP mobile stock-trading services. 10/00.

LM Ericsson AB (Sweden)/Guangdong Mobile Communications Co., Ltd.
Launched General Packet Radio Service trail network in Guangdong Province, which offers high-speed wireless communications services to GPRS handset users. 10/00.

Samsung Electronics Co., Ltd., a unit of Samsung Group (South Korea), Shanghai Bell, a joint venture between Alcatel Bell NV, Belgian Development & Cooperation Fund (Belgium), and Huaxin P&T Economic Development Center (Beijing)
Will expand cooperation on CDMA 2000-based third-generation mobile communications technology. 10/00.

Texas Instruments Inc. (US)/Beijing Huahong IC Design Co., Ningbo Bird Co. Ltd. (Zhejiang), Shenzhen Zhongxing Telecom Co., Ltd. (Guangdong), and Xiamen Overseas Chinese Electronics Co. (Fujian)
Signed MOU to employ TI's Digital Signal Processors to develop version 2.5 GSM products. 10/00.

Textiles and Apparel

INVESTMENTS IN CHINA

E.I. du Pont de Nemours & Co. (US)
Will increase its investment in Dupont Fibres (China) Ltd., a joint venture with China Worldbest Development Corp. of Shanghai and Toray Industries Inc. of Japan, to expand annual fiber production capacity. $70 million. 11/00.

China Resource Enterprise Ltd., Giordano International Ltd. (Hong Kong)
Formed joint venture to develop a retail and wholesale distribution business in the PRC. $12.83 million. 10/00.

E.I. du Pont de Nemours & Co. (US)/Lianyungang Zhongshan Spandex Co., Ltd. (Jiangsu)
Will form joint venture to manufacture and sell generic spandex fibers. (US:50%-PRC:50%). 10/00.

OTHER

i-textile On-Line Co. Ltd. (Hong Kong); Giantex Textiles Co. Ltd., Nien Hsing Textile Co. Ltd., Tah Tong Textile Co. Ltd. (Taiwan)/Shanghai Anda Cotton Fabrics Mill and six other leading textile enterprises in the PRC

Formed network of partnerships to launch a new online marketplace for textiles. 9/00.

Transportation

CHINA'S IMPORTS

International Aero Engines, a consortium of Aero Engine Corp. (Japan), DaimlerChrysler AG (Germany), Rolls-Royce Plc (United Kingdom), and United Technologies Corp. (US)

Will supply engines for China Northern Airlines Corp.'s new Airbus Industrie airplanes. $120 million. 11/00.

Korea Aerospace Industries

Will sell 70 SB427 helicopters to Hainan Feima General Airlines Co., Ltd. 11/00.

Pratt & Whitney, a division of United Technologies Corp. (US)

Won contract to service the engines of Air China's Boeing airplanes. $50 million. 11/00.

The Boeing Co. (US)

Will provide Hainan Airlines with five 737-800 aircraft. $290 million. 10/00.

DENSO Corp. and Toyota Tsusho Corp., units of Toyota Motor Corp. (Japan)

Won contract to provide 14,000 in-vehicle units for an electronic toll collection system in Chongqing. 10/00.

Robert Bosch GmbH (Germany)

Will provide electronic injection systems to two Shanghai auto manufacturers. 10/00.

The Siemens Communications Technology Group, a unit of Siemens AG (Germany)

Will provide operations control equipment for the construction of the No. 2 subway line in Guangzhou, Guangdong Province. $21 million. 10/00.

Aerobus International, Inc. (US)

Signed contract to provide Chongqing with a light rail mass transit system. $40 million. 9/00.

Caterpillar Inc. (US)

Sold 18 off-highway trucks to the China National Coal Development Corp. for use in the An Jia Ling coal field in Shanxi Province. 9/00.

CHINA'S INVESTMENTS ABROAD

Shanghai Subway Construction Co., Ltd.

Signed contract to build an 11 km urban railway line in Bangkok, Thailand. $300 million. 10/00.

INVESTMENTS IN CHINA

Fairchild Dornier Corp. (US)/China Aviation Industry Corp. I and II (Beijing), China Hainan Airlines Co.

Signed agreement to produce Dornier feeder-line planes. 11/00.

Compagnie Générale des Etablissements Michelin (France)/Shanghai Tire and Rubber Corp.

Established joint venture to produce and market Ziwuxian Tires. (France:70%-PRC:30%). 10/00.

TNT Post Group NV (the Netherlands)/Shanghai Automotive Industry Corp.

Signed letter of intent to form joint venture, An Ji TNT Automotive Logistics Co., to provide logistics services to the PRC automotive industry. (the Netherlands:50%-PRC:50%). $30 million. 10/00.

Volkswagen AG (Germany)

Will increase investment in the PRC over the next five years. $1.33 billion. 10/00.

Yulon Motor Co. (Taiwan)

Will acquire a 25% share of Jetford Co. of Guangdong Province. $16 million. 10/00.

DaimlerChrysler AG (Germany)

Will increase investment in its Beijing Jeep factory, a joint venture of DaimlerChrysler AG and Beijing Automotive Industry Corp., to manufacture a new model. $226 million. 9/00.

Park-Ohio Holdings Corp. (US)/Shanghai Electric Appliance (Group) Corp.

Will manufacture bolts for the Chinese auto industry. 9/00.

Pilkington Plc (United Kingdom)

Will acquire 51% stake in Shanghai Fu Hua Glass Co. from Ford Motor Co. of the United States. $7.14 million. 9/00.

OTHER

BAE Systems (United Kingdom)

Transferred its work on Airbus A320 wings to its Chinese partner, China Aviation Industry Corp. I, of Beijing. 11/00.

Air China

Will introduce a fifth flight on the Paris-Beijing-Shanghai route. 10/00.

ASEAN

Will construct railway line to connect Cambodia, Laos, Malaysia, Myanmar, Singapore, Thailand, and Vietnam to Kunming, Yunnan Province. $2.5 billion. 10/00.

China Southern Airlines Co., Ltd.

Launched routes from Guangzhou, Guangdong Province, to Singapore and Kuala Lumpur, Malaysia. 10/00.

Deutsche Lufthansa AG (Germany)/Air China

Signed codesharing agreement. 10/00.

Government of the PRC

Will lend funds to improve the Karakorum Highway in Pakistan. $6 million. 10/00.

Japan Air System Co., Ltd./China Southern Airlines Co., Ltd.

Signed codesharing agreement. 9/00.

Council Bulletin

Event Wrap-Up

Washington

October

Luncheon Honored PRC Vice Minister of Foreign Affairs Yang Jiechi

November

Issues Luncheon The 2000 Election: Implications for US Foreign Policy, East Asian Policy, and China Policy Featured Robert L. Suettinger of the Brookings Institution; Douglas Paal, president of the Asia Pacific Policy Center; and Ted Posner, trade counsel to Representative Sander Levin

WTO Briefing Featured Don Phillips, assistant US Trade Representative for China, Hong Kong, Taiwan, and Mongolia

December

Roundtable Discussion Featured Assistant Secretary Amanda DeBusk, Bureau of Export Administration, US Department of Commerce

Issues Luncheon: Getting the New White House on Track with China Policy Featured David M. Lampton, George and Sadie Hyman Professor and director of China Studies at The Johns Hopkins School of Advanced International Studies, and director of Chinese Studies at The Nixon Center in Washington, DC

Meeting Featured delegation from Tianjin Economic and Technological Development Area

Shanghai

November

Luncheon Featured Robert A. Kapp, president of the US-China Business Council

Hong Kong

December

Briefing Featured Robert A. Kapp, president of the US-China Business Council

Upcoming Events

Forecast 2001, Washington, DC

January 31 Evening Reception

February 1 Meeting

Topics: Economic, Political, and Investment Trends
Structuring China Strategy to Ensure Success
US-China Relations in the New Administration

China Business 2001: Trends and Market Opportunities

February 5 Houston

February 6 Chicago

Featuring: Patrick J. Powers and Karen Sutter, The US-China Business Council

For more information, see below.

美中贸易全国委员会

THE US-CHINA BUSINESS COUNCIL'S

Forecast 2001

A Members-Only Event

EVENING RECEPTION
Capitol Hill
Wednesday, January 31, 2001

MEETING
Thursday, February 1, 2001 8 AM - 3 PM
JW Marriott, 1331 Pennsylvania Avenue, NW, Washington, DC

Luncheon Address

Registration fee by Jan. 5: $350 ..... includes reception, meeting and luncheon
..... **$100 luncheon only**

Registration after Jan. 5: $375 ..... entire program
..... **$125 luncheon address only**

Hotel Accommodations for Wednesday, January 31: Please call Marriott Worldwide Reservations at 1.800.228.9290 or JW Marriott directly (1331 Pennsylvania Avenue, NW, Tel: 202.393.2000) for reservations at a special group rate: $189 single/double + tax. Indicate that you are with the US-China Business Council's meeting group. The cut-off date for this rate is Friday, January 5. All reservations must be guaranteed with a major credit card or accompanied by a first night room deposit.

For more information, or to register, contact: The US-China Business Council
Gloria González-Micklin, Director of Programs, Tel: 202.429.0340; Fax: 202.775.2476; or visit our website:
www.uschina.org/members/programs/upcomingevents.html

last PAGE

Express Mail, Chinese Style

While traveling on business last June to Chongqing and Chengdu, Sichuan Province, I had a small adventure that illustrated a few of the problems and attitudes, pervasive among Chinese companies, that frustrate foreigners. Perhaps more important, these attitudes can undermine Chinese companies' efforts to improve their own efficiency.

For several days I stayed at a three-star Chinese hotel in downtown Chongqing. A notice in the room advised guests to leave their valuables in the room safe, the lock to which could be programmed by each guest. As I didn't want to carry my valuables around with me, plane tickets, traveler's checks, and even extra cash all went into the safe. A few days later I checked out. It was only when I reached my destination, a project site a few hours outside the city at which I would be staying overnight, that I realized I had forgotten to empty the safe. (Luckily I had not left my passport there. Chinese law requires all foreigners to travel with their passports, which must be presented whenever demanded and whenever checking into a hotel. Chinese citizens must carry their national identification card (*shenfenzheng*) at all times.) My hosts at the project assured me that my belongings would be safe, in part because Chinese tend to work to ensure that foreigners form a favorable impression of their country.

My project hosts were right, but there was an unexpected catch. I returned to the city on Saturday, and explained what had happened to the front-desk staff back at the hotel. They called in the manager on duty, and I explained it to him. He said that they had found my things, and asked me to write down everything I had left in the safe, so that he could verify that nothing was missing. He then asked me to wait. He returned sometime later, only to report that the items they had found indeed matched the list I had just written.

"Can I have them back, then?" I asked, relieved that my problem would be solved so quickly.

"Well," he replied, "Your belongings were so valuable that the manager decided to put them in the hotel's main safe."

"Good idea. But can I have them back now?" I asked again.

Beginning to look slightly uncomfortable, he said, "It's a little bit difficult, because it is Saturday and the manager isn't here. We will try to find him. Please wait."

So I waited, for nearly an hour. Finally the manager on duty came back, only to inform me that the manager had left the city for the weekend, was unreachable, and would not be back until Monday.

"Doesn't anyone else have a key?" I asked, beginning to get the feeling that this was not going to be resolved as easily as it first seemed.

"No."

I found it odd that the manager on duty had not been given keys to all parts of the hotel, and told him that, for the sake of future guests who might make the same mistake, the hotel should consider changing this policy. The manager on duty could only squirm. Since he seemed to be doing all within his (limited) power to help me, there was no point in complaining futher. He simply did not have the key, and had no way to get it. (Besides, if I hadn't forgotten my things in the first place, we wouldn't be having this discussion.) Still, the fact that the manager on duty did not have, or was not entrusted with, keys to all parts of the hotel seemed a good example of the reluctance often found in socialist societies to delegate responsibility and decisionmaking power to any but those of the highest rank within an organization.

"Well, I am taking the train to Chengdu tonight, and will fly to Beijing early Wednesday morning. What do you suggest?"

"We can send it to you by EMS [Express Mail Service] first thing on Monday."

"So I will get it Monday afternoon?"

"Probably Tuesday afternoon."

Now, just a few days earlier, I had been trying to buy a train ticket to Chengdu at this same hotel, where two young ladies staffing the business center tried their best to convince me to buy a bus ticket instead. I had started out in English, but as their English was halting, I switched to

Chinese. Then they let loose a flood of rapid Mandarin with a Chongqing accent, which one of my colleagues describes as sounding as though the speaker has a mouthful of marbles.

"The bus is much cheaper and faster than the train—only four hours!" they exclaimed. "And we will have to charge you a service fee for the train, but not for the bus," they added.

After considering the pros and cons (timing, price, and road safety in China), I decided in favor of the train. I came back later, when only one young lady was on duty, and she booked the train ticket for me without demur.

"But it takes only four hours to get to Chengdu! How can express mail take two days?"

The manager on duty didn't have an answer for this one, so I boarded the train for Chengdu that night, hoping for the best.

By Tuesday afternoon, my EMS package still had not arrived in Chengdu, and I began to wonder how difficult it would be to buy a plane ticket to Beijing on short notice. The hotel staff in Chongqing faxed me a copy of their receipt with the package number, so I knew it had been sent. While I was out at meetings, I received a message at my hotel about the package—that I should dial a three-digit number to find out if it had arrived yet. The mystery three-digit number turned out to be an EMS hotline. The hotel staff in Chengdu helped me call EMS, but we were told that the package had not arrived, and to try again later. As I hoped to catch my plane to Beijing early the next morning, I decided to go to the EMS office in person that afternoon.

The EMS office was on the other side of town. The taxi driver did not know exactly where to go, so he dropped me at one corner of the block the EMS office was supposed to be on.

Finally, I found the office, which was quite modern, but the first counter I found was the drop-off counter, so they sent me around to the back, where the packages arrive. No frills there, just a dingy hall and a dirty, well-worn counter with a pile of rubbish opposite. Nevertheless, they tapped my package number into the computer and told me it was not there. "Come back tomorrow," they advised. I explained I had a 9 am flight to Beijing the next morning and needed my package today. "Then come back tonight. Ten-thirty, OK?" I didn't have much choice, as my ticket was, I hoped, in the package.

Hoping to save a little time, I arrived at the EMS office at 10:15 that night. I went around to the back. Everything was dark. I took the elevator to the second floor, as there was no light in the stairwell, which was just opposite the elevator. There was no one in the office, and the metal gate to the mailroom was closed, but light shone through the cracks. Skirting the pile of garbage (and hoping there weren't any rats), I banged on the door, calling out, "*You ren ma*?" (Is anyone there?) "Hello! Hello!" they shouted back in English. Maybe they were expecting me. They let me in, but explained that as they didn't start work until 10:30, I would have to wait. I stood to one side as they lounged and chatted under the harsh fluorescent lights. The room was sparsely furnished—a table and a few chairs, and cubbyholes down one side of the room. One corner had been made into the office.

"But it takes only four hours to get to Chengdu! How can express mail take two days?"

Eventually a woman in a long dress appeared (the other workers were all young men in tatty undershirts and trousers or shorts). She seemed to be the manager, and soon set the guys to work. "Where is the bag from Chongqing?!" she yelled. "Someone is waiting!" Then the packages really started to fly, zapped with hand-held barcode readers and tossed into the appropriate piles. Finally they found the bag from Chongqing, and my package in it. What a relief—no need to try to find another way to get to Beijing. I arrived in the capital on time.

—*Virginia A. Hulme*