January–February 2009

# The China Business Review

USCBC
THE MAGAZINE OF
THE US-CHINA BUSINESS COUNCIL

## Appetite for Consumption

Engaging Consumers Online
Digital Age Marketing
Media & Advertising

Chongqing
Unionization
The Middle Class
30 Years of US-China Diplomatic Relations

US$22/HK$220


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Celebrating more than 30 years
of making progress possible in China
庆祝卡特彼勒在中国三十年，使进步成为可能。


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The China Business Review

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# Letter from the Editor


January 2009 will not only mark the 30th anniversary of US-China relations (see p.16), it will also mark the 35th anniversary of the *China Business Review* (*CBR*).

In January 1974, the National Council for US-China Trade (now the US-China Business Council [USCBC]) began publishing the *US-China Business Review* (now the *CBR*). In the inaugural issue, National Council President Christopher Phillips stated that the magazine's aim was "to provide the executive involved in planning China trade strategy with an indispensable resource." Of course, in those days, there was almost no foreign investment in China, and trade was conducted largely through the biannual Canton Fair.

Accordingly, the first issue of the *CBR* featured articles on the basics of doing trade with China, such as how to start importing from China, an introduction to the Canton Fair, and a list of third-country banks in the United States through which companies could conduct trade with China. The issue also included an article on the services available at the National Council's representative office at the fair. (The use of four IBM electric typewriters and a 3M desktop photocopying machine seems to have been a highly prized member benefit.) The same issue covered the National Council's first delegation to Beijing, an event we revisited in the November–December 2008 anniversary issue.

An article on China's economic and trade policies offered a few predictions for the future, many of which have come to pass. For instance, noting that China's decision to borrow from abroad would force it to boost exports significantly to repay such loans, the article foresaw that "A large scale shift of resources into the export sector in China would lead to a further polarization in development between the industrial centers in the east and northeast and the rest of the country....Thus, the decision to raise imports through acceptance of foreign credits may produce wide ranging and varied repercussions throughout China's economy and beyond into other sectors of the national life." Thirty-five years later, China is struggling to close the enormous chasm that has opened between developed coastal areas and the less-developed hinterland.

Not all forecasts were so clairvoyant, however. The focus section on oil—written at the height of the last major energy crisis and the Cold War—seemed to hope that China could become a major oil exporter, allowing the West to avoid reliance on the Middle East and the USSR for energy supplies. In 1974, it would have been nearly impossible to forecast China's extraordinary development and subsequent massive surge in energy demand. China's oil production nearly tripled from 64.9 million metric tons in 1974 to 186.7 million in 2007, but oil consumption skyrocketed from 61.9 million to 368.0 million metric tons over the same period, according to BP's *Statistical Review of World Energy 2008.* Far from being an energy exporter, China has become one of the world's major energy consumers. Like the United States, it must now search for supplies abroad.

The *CBR* has also changed over the years. Editors, staff, and departments have come and gone; technological improvements have made color printing affordable; and the rise of the Internet has allowed us to communicate with our readers in new ways. Nevertheless, we remain committed to delivering quality information and analysis to our readers. We thank our readers and hope to hear from you. We welcome comments, suggestions, and criticisms at publications@uschina.org.

Virginia Hulme

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# Short Takes

## Economic Stimulus

China's State Council on November 9, 2008 announced plans to inject ¥4 trillion ($586 billion) into China's economy. The country plans to loosen credit conditions, cut taxes, and increase spending on infrastructure to offset adverse global economic conditions that have begun to take their toll on China's economy.

Official sources have stated that the stimulus package will focus on 10 goals, including several that promise improvements in rural areas and reduced costs for export-oriented industries. Funds will also be used to encourage financial institutions to lend to infrastructure projects, small businesses, and potential home and car buyers. According to *China Daily*, three policy banks—China Development Bank, China Export and Import Bank, and China Agricultural Development Bank—will receive an extra ¥100 billion ($14.6 billion) to finance continued economic growth.

The stimulus plan came amidst reports that 2009 growth will be gloomier than originally expected. China's 2008 third-quarter growth slowed considerably to 9 percent, and shrinking demand abroad caused export-led industries to scale back production. On November 25, the World Bank revised its forecast for China's 2009 growth to 7.5 percent, down from an estimated 9.2 percent in June.

Following the release of the stimulus plan, China's provinces began looking for major investments that they could accelerate, and many announced stimulus packages of their own. Many provincial proposals may be highly inflated and include private investment and spending on projects that were scheduled before the stimulus package was announced; new public spending may only make up a fraction of the total amount. Moreover, some projects included in the planned spending had previously been denied sufficient central funding. Readers should view the provincial projections cautiously.

## Cross-Strait Relations

Chen Yunlin, head of China's Association for Relations Across the Taiwan Strait, and Taiwan President Ma Ying-jeou met in early November in Taiwan in what appears to be a diplomatic milestone in cross-strait relations. During discussions, Chen and Ma agreed to increase the number of weekly direct flights across the strait to 108, establish direct shipping links between 63 mainland and 11 Taiwan ports, and cooperate on food inspection. Representatives from both sides also indicated that they would sign a memorandum of understanding on financial services when they meet for a third round of talks in the first half of 2009.

Despite the historic nature of the meetings and recent warming in cross-strait relations since Ma Ying-jeou took office in May, the agreements have generated concern among a portion of Taiwan's population. According to a recent *China Times* poll, 56.1 percent of respondents support the agreements, while 16.8 percent disapprove. Underlining the contentiousness of these meetings, large numbers gathered in Taiwan to protest the talks.

## WTO

Canada, European Communities, and the United States signed memoranda of understanding with China on November 13 to resolve a World Trade Organization (WTO) dispute that the countries initiated in March. China agreed to designate an independent regulator and end discriminatory restrictions on foreign suppliers of financial information services, including requirements for foreign companies to serve their customers through a Xinhua News Agency-designated agent. The agreements also ended restrictions that prevented foreign financial service providers from establishing local operations in China.

The United States has three other WTO cases pending against China on auto parts, intellectual property rights enforcement, and market access for copyrighted goods. In September, China appealed an earlier February decision that it treated foreign auto parts imports improperly.

# Short Takes

## Study Abroad

Record numbers of US students are studying abroad in China and vice-versa, according to a recently released report by the Institute of International Education. The report, *Open Doors 2008*, documented a 25 percent increase in US students studying in mainland China during the 2006–07 academic year from the previous academic year. As the host of 11,064 US students, China was the fifth most popular destination for study abroad, after the United Kingdom, Italy, Spain, and France.

Meanwhile, the number of mainland Chinese students in the United States grew 20 percent to 81,127, and the number of Hong Kong students in the United States grew 7 percent to 8,236.

According to the report, the number of US students studying abroad in Asia rose 20 percent from the 2005–06 academic year. Among top Asian destinations for US students are Japan and India, which hosted 5,012 and 2,627 US students, up 24 percent and 14 percent, respectively. Still, Asia hosted only 10 percent of US students abroad. In comparison, Europe hosted about 57 percent.

# China Conference Calendar

## China-related events near you

January–June 2009

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

### China International Auto Accessories Commercial Expo

**FEBRUARY 20–23**

**Location:** Beijing National Agricultural Exhibition Center
**Organizer:** YASN International Exhibit Ltd.
**Contact:** Ruby Yang
**Tel:** 86-10-8225-0016 x 687
ruyh_02@sina.com
www.ciaacexpo.com

### International Integrated Circuit China Conference & Exhibition

**FEBRUARY 26–MARCH 10**

**Locations:** Shenzhen, Guangdong (Feb. 26–27); Xi'an, Shaanxi (Mar. 2–3); Beijing (Mar. 5–6); Shanghai (Mar. 9–10): Various venues
**Organizer:** Global Sources
**Contact:** Athena Gong
**Tel:** 86-21-5306-8968 x 1135
athenagong@globalsources.com
www.english.iic-china.com

### International Exhibition of Chemical Process Industry Technology, Environmental Protection & Biotechnology

**MARCH 4–6**

**Location:** Shanghai Mart
**Organizer:** Shanghai Global Exhibition Co. Ltd.
**Contact:** Mr. Zhao
**Tel:** 86-21-3882-1038
li-ao@ cebexpo.com
www.cebexpo.com/en/en03.asp

### SEMICON China 2009

**MARCH 17–19**

**Location:** Shanghai New International Expo Center
**Organizer:** Semiconductor Equipment and Materials International China
**Contact:** Steven Gan
**Tel:** 86-21-6448-5666 x 217
sgan@semi.org
http://semiconchina.semi.org

### China International Petroleum & Petrochemical Technology & Equipment Exhibition

**MARCH 19–21**

**Location:** Beijing: New China International Exhibition Center
**Organizers:** Zhenwei Exhibition Group; China Petroleum and Petrochemical Equipment Industry Association
**Contact:** Joanna Qiao
**Tel:** 86-10-5823-6588 x 6555
cippe@chinazhenwei.com.cn
www.cippe.com.cn/cippeen

### China International Clothing & Accessories Fair

**MARCH 26–29**

**Location:** Beijing: New China International Exhibition Center
**Organizers:** Beijing Fashion Expo Co., Ltd; Beijing Convention & Exhibition Co.; China World Trade Center Co., Ltd.
**Contact:** Zeng Qi
**Tel:** 86-10-6505-0546
zengqi@cwtc.com
www.chiconline.com.cn

### International Indoor Environment Technology & Product Exhibition

**MARCH 31–APRIL 2**

**Location:** Shanghai New International Expo Center
**Organizer:** Shanghai CMP Sinoexpo International Exhibition Co., Ltd.
**Contact:** Mark Nee
**Tel:** 86-21-6437-1178
marketing@cmpsinoexpo.com
www.cmpsinoexpo.com/clean

### World Radar Fair

**APRIL 1–3**

**Location:** Beijing International Convention Center
**Organizers:** China Enterprises International Exhibitions & Advertising Co., Ltd.; Poly Technologies Inc.
**Tel:** 86-10-6446-6631
eaciecco@mx.cei.gov.cn
www.ceieac.net

### China International Scientific Instrument and Laboratory Equipment Exhibition

**APRIL 9–11**

**Location:** Beijing Exhibition Center
**Organizers:** China Instruments Manufacturers Association
**Contact:** Chen Wei
**Tel:** 86-10-8839-5128
chenwei@cisile.com.cn
www.cisile.com.cn

### The Yangtze Business Network: The Logistics Challenges of Accessing China's Interior

**APRIL 15**

**Location:** Shanghai, Regal International East Asia Hotel
**Organizer:** Yangtze Business Services, Ltd.
**Contact:** David Lammie
**Tel:** 44-20-8874-3217
info@yangtzebusinessservices.com
www.yangtzebusinessservices.com

### The Boao Forum for Asia (BFA)

**APRIL 17–19**

**Location:** Boao, Hainan: BFA International Conference Center
**Organizer:** The Boao Forum for Asia
**Contact:** Han Xiumei
**Tel:** 86-10-6505-7377 x 619
hanxiumei@boaoforum.org
www.boaoforum.org

### International Exhibition on Nuclear Power Industry

**APRIL 19–22**

**Location:** Beijing: China International Exhibition Center
**Organizers:** China Atomic Energy Authority; PRC Commission of Science, Technology, and Industry for National Defense; Coastal International Exhibition Co., Ltd.
**Tel:** 852-2827-6766
general@coastal.com.hk
www.coastal.com.hk/nuclear

### Aviation Technology Expo

**APRIL 27–29**

**Location:** Beijing: China International Exhibition Center
**Organizers:** AVIC International Exhibition Co., Ltd.; E.J. Krause & Associates, Inc.
**Contact:** Beth Harrington
**Tel:** 1-301-493-5500
harrington@ejkrause.com
www.atecexpo.cn

### International Green Building & Sustainable Cities Exposition

**JUNE 18–20**

**Location:** Beijing International Exhibition Center
**Organizers:** China Eco Expo; PRC Ministry of Construction
**Contact:** Marc Merson
**Tel:** 1-818-906-2700
marc@ecoexpo.com
www.ecoexpo.com

30 Find more China-business events on the *China Business Review's* website at www.chinabusinessreview.com/conference-calendar.php.

# NPC and State Council Transparency Commitments: An Evaluation

The National People's Congress (NPC) and State Council both announced initiatives in spring 2008 to increase transparency and public participation in the formulation of legislation and administrative measures. The US-China Business Council (USCBC) has been tracking NPC and State Council compliance with their commitments in this area since late summer. Based on USCBC's review, the NPC has been fairly consistent in its transparency efforts, while the State Council has been decidedly less so.

## NPC

To promote open participation in its legislative process, the Standing Committee of the 11th NPC announced last April that it would solicit public comments on most draft laws and amendments reviewed by the NPC Standing Committee. It also stated it would "in general" post draft laws and amendments that have gone through a first Standing Committee review on the NPC website. In addition, it will release the draft in major media outlets, if the Standing Committee chair determines a draft law to be of immediate public interest.

In accordance with its April announcement, the NPC has posted several draft laws for public comment, including the draft Patent and Insurance laws, which were open for comment from August 29 to October 10, 2008. The NPC in late October read three drafts for the first time and subsequently posted them for comment on its website: the draft State Compensation Law, draft Earthquake Protection and Disaster Relief Law, and draft Postal Law.

## State Council

At the fourth Strategic Economic Dialogue (SED), held in June 2008, China agreed to three significant transparency-related points:

- Publish for comment all draft economic regulations and rules, not just those related to trade;
- Allow at least 30 days for public comments; and
- Publish these measures in a single location, the PRC State Council Legislative Affairs Office's (SCLAO) legislative information website (http://yijian.chinalaw.gov.cn/lisms).

Despite these commitments, as of early December 2008, few of the economic regulations and rules released for comment since late summer had been posted on the designated SCLAO website. Though the draft Ozone Depleting Substances Regulations, PRC Customs Services Guarantee Rules, and Administrative Regulations on Registration of Resident Foreign Enterprise Representative Offices had been posted there, others, such as the Technical Rules for the Circulation of Second-Hand Equipment and the Administrative Rules for Special Approval of Drug Registration, had not. Rather, these had been posted for comment only on the websites of the agencies responsible for them—the Ministry of Commerce and State Food and Drug Administration, respectively. In fact, from September 1 through December 1, these and other administrative agencies solicited comments on 14 draft regulations that were not posted on the designated SCLAO website. Moreover, during that period, the website only listed five laws and regulations for comment, two of which, the Social Welfare Law and the People's Fitness Rules, were not economic in nature. None of the regulations posted on this website have been open for comment for the full 30-day period agreed to during the fourth SED.

In addition to the SCLAO website mentioned above, however, the State Council recently added a link to another site (http://bmyj.chinalaw.gov.cn/lisms/action/guest LoginAction.do) to collect public comments on department regulations (internal regulations) and related documents. As of December 1, only three items—an amended draft of a Patent Examination Directory, Procedures for Handling Traffic Safety Violations, and Methods for Examining Land Use Plans—were posted on the site.

USCBC is aware of other regulations that the State Council has approved or issued since late summer without posting for comment on the designated SCLAO website. These include the Draft Regulations for Dairy Product Safety and the Value-Added Tax Reform Plan, which was submitted to the State Council in September 2008, approved in November 2008, and took effect on January 1, 2009.

In addition, USCBC understands that there are other regulations, specifically the Anti-Price-Monopoly Rules and draft amendments to the Anti-Unfair-Competition Law, that are making their way through the legislative process but have not yet been posted on the SCLAO website for comment. Though the Anti-Price-Monopoly Rules may not be ready for comment, the State Administration of Industry and Commerce has solicited comments on draft amendments to the Anti-Unfair-Competition Law from a few chosen organizations without posting the law for comment on either the NPC or SCLAO websites.

The State Council's uneven implementation of its commitments to transparency and public participation in the regulation-drafting process warrants further monitoring. 完

*This article is adapted from a report that first appeared in* China Market Intelligence, *the US-China Business Council's (USCBC) members-only newsletter. To find out more about USCBC member company benefits, see www.uschina.org/benefits.html.*

## Event Wrap Up

### WASHINGTON, DC

**November**

Briefing on the US-China Investment Forum

Featured Nova J. Daly, deputy assistant secretary for Investment Security and Policy, US Department of the Treasury; Tim Stratford, assistant US Trade Representative for China Affairs; Ira Kasoff, deputy assistant secretary for Asia, US Department of Commerce; and Greg Hicks, deputy director of the Office of Investment Affairs, US Department of State.

Issues Luncheon on US-China Relations on the Eve of a Presidential Transition

Featured Dennis Wilder, senior director for East Asian Affairs, the National Security Council.

Introduction to EcoPartnerships under the Strategic Economic Dialogue (SED)

Featured Treasury Department Deputy Chief of Staff Taiya Smith and Managing Director for China and the SED Dan Wright. Special thanks to the Nixon Center for providing space for the event.

**December**

Webinar on China in 2009: Perspectives on Operations and the Economy

Featured Bob Poole, US-China Business Council (USCBC) vice president of China Operations; Frank Gong, JPMorgan Chase Bank managing director, head of China research and strategy, and chief economist; and Jan Borgonjon, InterChina Consulting president. (To view the webinar, see www.uschina.org.)

Issues Luncheon on US-China Commercial Policy

Featured Christopher Padilla, managing director at C&M International, Ltd. and former under secretary of Commerce for International Trade, who discussed risks and opportunities for the new administration.

## Upcoming Events

### WASHINGTON

Issues Luncheons

February 19, 2009

March 19, 2009

Forecast 2009

Reception and Conference

January 28–29, 2009

For more information, see p.19

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

### SHANGHAI

**November**

China Operations Conference

(See p.15)

## USCBC Board Delegation Meets PRC Leadership in Beijing, Hosts USCBC's 35th Anniversary Reception

USCBC Chair Andrew Liveris, chairman and CEO of the Dow Chemical Co., and USCBC President John Frisbie led a delegation of 12 USCBC board members to Beijing at the end of October. The delegation met with Vice Premier Wang Qishan, People's Bank of China Governor Zhou Xiaochuan, and other senior officials from the National Development and Reform Commission, Ministry of Commerce, Ministry of Foreign Affairs, and the China Council for the Promotion of International Trade (CCPIT). The meetings focused on the global financial and economic outlook, bilateral commercial relationship following the US elections, and concerns of US firms operating in China.

Apart from the government meetings, the delegation hosted a reception on October 29 to mark the 35th anniversary of the establishment of USCBC. The reception was attended by about 200 guests, including PRC government officials, customers and partners of the delegation companies, and USCBC member company executives. Liveris and CCPIT Chair Wan Jifei delivered remarks.

Xinhua News Agency

Frisbie greeting Wang

Xinhua News Agency

Liveris meeting with Vice Premier Wang Qishan during a USCBC board delegation meeting

PR Photo

Liveris, Wan, Frisbie, and USCBC Vice President Robert Poole at USCBC's anniversary reception

PR Photo

Procter & Gamble Co. (P&G) COO and USCBC Board Director Robert McDonald; Poole; P&G Greater China Chair and President Daniela Riccardi; and P&G Vice Chair of Global Operations Werner Geissler

## USCBC Hosts China Operations Conference in Shanghai

Following a successful conference in Beijing earlier this year, USCBC held its second China Operations Conference of 2008 in Shanghai on November 13. The event addressed several issues important to leaders of US businesses in China, including the US election, PRC regulatory developments, rising costs, and corporate social responsibility (CSR).

The conference's keynote speaker Zhao Xiaoping, deputy director of China's new National Energy Administration, opened the conference by outlining China's macro-energy policy. Goldman Sachs Chief China Economist Hong Liang spoke on China's economic prospects. The conference also covered major political developments, with speakers on US and Chinese perspectives on the recent US elections.

In addition, panelists addressed emerging regulatory issues including high and new-tech enterprise preferential tax status approval, the Ministry of Commerce mergers and acquisitions filing process and related Antimonopoly Law considerations, and strategies for engaging China's numerous industrial standards-setting bodies. The impacts of rising costs in the Asia-Pacific region were analyzed from property, human resources, and supply chain perspectives, as were strategies for dealing with labor disputes in the PRC and recent developments in China's increasingly active labor unions.

CSR also received attention during the conference, with presentations from leading environmentalist Ma Jun, director of the Chinese nongovernmental organization (NGO) Institute of Public and Environmental Affairs, and Albert Tsang, China CEO of the US-based NGO Habitat for Humanity International, which is leading major projects related to the May 12 Sichuan earthquake rebuilding efforts.

USCBC

Amy Cai, partner at PricewaterhouseCoopers International Ltd., speaking at the China Operations Conference

USCBC

Ma Jun presenting at the conference

## USCBC Members Sponsor CereCare Wellness Center Shanghai

Contributions from USCBC member companies who attended Gala 2007 allowed USCBC to donate $15,000 to the Shanghai-based charitable organization CereCare Wellness Center in late 2007. The funds were primarily used to construct a new playground for CereCare's students. In November 2008, the center held a ceremony celebrating its fifth anniversary. During the ceremony, the center commemorated USCBC's donation and opened the refurbished playground.

CereCare Wellness Center is a residential facility that offers therapy and education to young children who suffer from cerebral palsy. Its mission is to help children with cerebral palsy to live productive and independent lives. CereCare's founder is a Shanghainese woman named Lu Shunling, who herself has cerebral palsy. More information about CereCare may be found at www.cerecare.net.

James Liu

CereCare Wellness Center on its fifth anniversary

# A Message from Clark T. Randt, Jr., US Ambassador to China

Thirty years ago this January 1, 2009, "Yi Ban" (No.1 Office), which also is where I live today, was transformed from the United States Liaison Office in China into our embassy on the occasion of the United States and China establishing full diplomatic relations. At the time, the embassy boasted a staff of approximately 60 American and Chinese employees. In October this year, the United States Embassy moved its staff of 1,100 from 26 different US government agencies into our magnificent new embassy complex (see p.55).

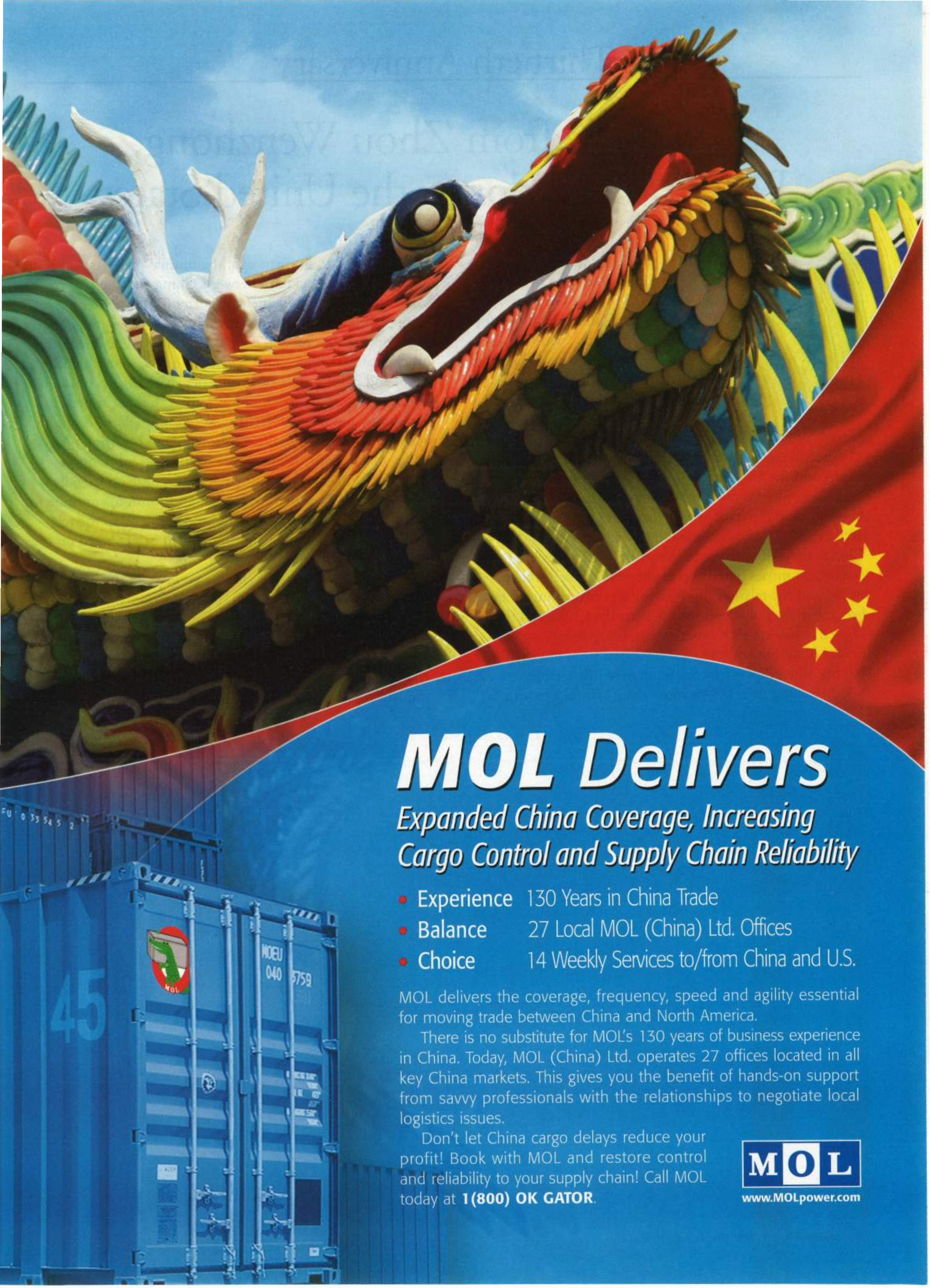
In only three decades, the US-China relationship has burgeoned into the most important bilateral relationship in the world, one that touches the lives of not only every American and Chinese citizen but also of almost every person in the world. China has an impact on the prices we pay for goods and materials, on the stability of the international financial system, on how we approach regional and global security issues, and on the very air we breathe. The US Embassy in Beijing is now the second-largest US embassy in the world.

For the United States, the reestablishment of its diplomatic presence in Beijing rested on a fundamental logic, one which President Richard Nixon described in his ground-breaking 1967 *Foreign Affairs* article: "Taking the long view, we simply cannot afford to leave China outside the family of nations, there to nourish its fantasies, cherish its hatreds and threaten its neighbors."

This 30-year period also coincides with the 30th anniversary of China's "reform and opening" policy, which has resulted in hundreds of millions of Chinese citizens being lifted out of poverty. For over 35 years, the *China Business Review* has chronicled China's stunning economic growth and the tremendous opportunities China's transformation has created for American firms. Indeed, I worked for the US-China Business Council in 1974 and wrote some of those articles. When I was the embassy's Commercial Attaché in 1982, our two-way trade with China was $5.2 billion. In 2007, that figure was $386.7 billion, making China our second-largest trading partner after Canada and our fastest-growing export market.

The United States welcomes China's rise. President George W. Bush has said that "We seek a China that is stable and prosperous—a nation that respects the peace of its neighbors and works to secure the freedom of its own people." He wants a candid, constructive, and cooperative relationship with China and has guided policy to that end. During his term, President Bush has traveled to China four times, more than any other American president, and met face to face with his Chinese counterpart an unprecedented 19 times. As a result of such high-level exchanges, there has been a marked increase in mutual understanding and trust, with the result that our relations with the People's Republic of China have never been better. Cooperating with China, however, does not mean that we cannot be candid. Our differences, whether over human rights, religious freedom, Taiwan, or trade, can only be managed when they are recognized and addressed candidly, not swept under the rug.

The United States and China have come a long way in 30 years. It is fitting that this year both the United States and China have opened magnificent new embassies in each other's capitals, embassies that tangibly reflect the growing importance of our two countries and peoples to one another in this increasingly globalized and interdependent world.



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# A Message from Zhou Wenzhong, PRC Ambassador to the United States

The year 1979 holds special and important meaning to the Chinese people. On New Year's Day of that year, China established formal diplomatic relations with the United States, opening a new era in the relationship between China and the United States. In the same year, China started to reform and open up, and moved into a new age of economic development.

Since the establishment of diplomatic relations between China and the United States, high-level contacts and dialogue between the two countries have become increasingly frequent, and the trade connections and nongovernmental exchanges have also become increasingly close. Following China's broader opening to the world, exchanges between the two countries have become increasingly active in all fields, and the relationship between the two countries has become more fully developed. Currently, China and the United States are each other's second-largest trading partners. The volume of trade has increased from less than $2.5 billion, when diplomatic relations were just established, to $302.1 billion in 2007—a more than 120-fold growth.

Compared to 30 years ago, the mutual interests and potential for cooperation between China and the United States have also greatly increased. Tremendous potential for cooperation exists for the two countries to strengthen bilateral communication and cooperation in trade, law, environmental protection, energy, science and technology, education, and culture. The two countries share broad common interests and shoulder common responsibilities in preserving world and regional security, promoting global economic growth, achieving sustainable growth, and resolving many other major issues. All of these constitute a solid foundation for China and the United States to develop friendly cooperation. We should seize the opportunities, continue to expand mutual cooperation, and further develop the relationship between China and the United States based on the existing foundation.

China is the largest developing country in the world, while the United States is the largest developed country in the world. Both countries are major powers and have global influence. The stability and development of the relationship between China and the United States will not only benefit the people of both countries but also contribute to preserving world peace, stability, and development. 完

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China Foto Press

# China Media Market Growth Drivers

## Understanding the key drivers of China's dynamic media market can help maximize media return on investment

Alex Abplanalp

China's explosive economic development since Deng Xiaoping initiated free market reforms in the late 1970s has transformed the country into one of the largest economies in the world and given rise to a vibrant base of roughly 350 million urban consumers. This consumerism has in turn created one of the largest and most dynamic global advertising markets in just over a decade. Domestic and multinational corporations (MNCs) have invested heavily in advertising their products to meet and stimulate consumer demand across a plethora of product categories, ranging from mass consumer to luxury goods.

A variety of sources track media ad spending and offer different estimates of the size of China's ad market. Most of them greatly exaggerate ad spending because their data is based on prices listed at media rate-card value—rates that few companies actually pay in a market where heavy media rate discounting is common. Based on data from China's State Administration for Industry and Commerce and iResearch Consulting Group, China Media Consulting Group (CMCG) estimates that in 2008 China ad spending reached $20.7 billion. This amount puts China into fifth place in terms of global ad spending, behind the United States ($179 billion), Japan ($41 billion), Germany ($26 billion), and the United Kingdom ($24 billion), according to ZenithOptimedia Group Ltd.'s global ad spending estimates. China's total ad spending has increased by a factor of 33 since 1994, when ad spending totaled $590 million and China ranked outside the top 40 global markets.

As the China advertising market has gained critical mass, annual ad spending growth rates have predictably slowed but have still averaged 17 percent since 2001. In 2008, ad spending was forecast to grow 21 percent, reflecting additional spending for advertising related to the Beijing Olympics. Because of the current global economic uncertainty, CMCG is forecasting 11.6 percent growth for 2009, lower than in previous years but still significantly outstripping the global ad spending growth rate, which, as *CBR* went to press, was forecast to slow to as low as 0 percent, as the major economies show more signs of instability.

China's macro-level growth indicators are positive for future ad spending. Although annual growth rates are slowing, there is a direct correlation between gross domestic product (GDP) and ad spending buoyancy. Even with a lower annual GDP forecast, ad spending will continue to grow. Ad spending as a percentage of GDP, a key indicator of the advertising market's maturity, is only half the global average, suggesting that ad spending has plenty of room to expand. Even at slower growth rates, China will overtake Japan as the second-largest global ad spending market by 2015.

## Quick Glance

- Annual ad spending rates have averaged 17 percent since 2001 and will still grow 11.6 percent in 2009 despite economic turbulence.
- Television advertising leads China's ad spending categories with 40 percent of total spending, and online advertising is on the rise with 9 percent of the total.
- Maximizing media return on investment requires skillfully navigating China's complex media environment; closely tracking media costs; and ensuring transparency in the declaration of all advertiser-entitled discounts, volume rebates, and benefits.

## Consumer goods lead the way

The main consumer product categories underpinning China's advertising market make it less susceptible than other countries to economic downturns. More than 50 percent of total ad spending is generated from just three product categories: pharmaceuticals (including Chinese tonics), toiletries, and retail, the first two of which combined account for 37 percent of total ad spending. China's ad spending on mass consumer, daily-use products as a percentage of total ad spending is much higher than that of most other countries.

In other major global advertising markets, top ad spending categories include automotive, telecom, financial services, and entertainment, all of which are more susceptible to economic cycles than China's top three categories. "Indulgence" product categories—such as personal accessories, financial services, spirits, leisure, clothing, and automotive, all of which are directly related to higher levels of disposable income—have seen the most dynamic ad spending growth in China in the past five years. These higher-end product categories are more vulnerable to economic slowdown, and ad spending has already slowed significantly, particularly in automotive and real estate, over the past 18 months. The impact on overall spending, however, is insignificant, because these higher-end categories still comprise a relatively small percentage of total ad spending.

The robustness of China's ad spending profile was demonstrated during the severe acute respiratory syndrome (SARS) crisis of 2003, which caused ad spending to fall in Hong Kong, Taiwan, and Singapore but left mainland China unscathed. In fact, ad spending in China grew 24 percent in 2003, as the core pharmaceutical, Chinese tonics, and toiletries categories ramped up their ad spending and consumers purchased more products related to health, nutrition, and personal hygiene.

CMCG's five-year forecasts do not project a significant change in China's overall ad spending product-category profile, with mass consumer products continuing to drive ad spending. The most dynamic growth will still come from the higher-end product categories, although at a slower annual growth rate than in previous years, and such categories will—as in the past—account for a relatively small percentage of the overall market.

## Key media

Given the strength of mass consumer products in China's market, it is not surprising that ad spending is heavily concentrated in mass media. Advertisers are communicating their messages to broad consumer groups to support a deep product-distribution network across China. Of the main media, television—which takes 40 percent of total ad spending—is the most intrusive and cost efficient way to reach mass audiences. The TV market is complex and multi-layered, with channels administered at city, provincial, regional, and national levels. CMCG forecasts that television will maintain a stable market share of about 38 percent for the next five years and retain its strong position as the most efficient and effective way to reach mass audiences across a large geographic area. The audiovisual commercial opportunities will be further enhanced by full conversion from analog to digital broadcasts by 2015 in China, which will enable greater interactivity and convergence with other digital platforms.

Within the print medium, newspapers took 29 percent of total ad spending in 2008, but ad revenues have been in constant and dramatic decline from 41 percent of total ad spending in 2002, as a direct result of the explosive growth of Internet access. The newspaper segment faces a significant challenge from the new digital media landscape, and its share of market will continue to fall. Most newspapers are struggling to take advantage of digital opportunities.

Out-of-home advertising comprises about 14 percent of total ad spending and has grown rapidly; new digital technologies and liquid crystal displays now illuminate major cities. The prospects for out-of-home advertising are strong, as new technologies allow greater communication innovation and demand for prime site exposure exceeds supply in major cities. Ad spending on other media, such as magazines, radio, and cinema, when combined, still makes up less than 8 percent of total ad spending, much lower than in US and major European markets.

Online advertising comprised 9 percent of total ad spending in 2008 as a result of the huge growth of Internet access and use in the first- and second-tier cities, with more than 250 million netizens now online in China (see p.32). The online ad spending product-category profile is quite different from that of mass media, with ads featuring products aimed at narrower consumer segments, such as information technology, automotive, real estate, telecom, and consumer electronics. Given the relatively low capital cost and targeted, affluent user profile, online advertising is better equipped than print advertising to weather the economic slowdown. Online advertising will experience the most dynamic growth as Internet users expand past the 300 million mark and online advertising achieves 10 percent market share by 2010.

> As the China advertising market has gained critical mass, annual ad spending growth rates have predictably slowed but have still averaged 17 percent since 2001.

## Media challenges for MNC advertisers

The dynamic growth of China's ad market directly reflects the massive scale of investment in China's economy in recent years and the importance of media advertising in building brand equity and driving consumer sales. As economic uncertainty affects key North American and European markets, the performance of MNC businesses in China has become even more critical for companies' overall performance. China's media landscape presents significant challenges in terms of quantifying and maximizing media return on investment (ROI) because key performance indicator variables—including media cost, prime-time access, effective reach, and ratings—are more volatile than in other major advertising markets.

### Media complexity

China has a large, fragmented media infrastructure with thousands of vehicles at national, regional, provincial, and city levels. The mass media boasts over 1,600 TV channels, 2,000 newspapers, 9,000 magazines, and countless out-of-home sites across more than 600 major cities. The logistics of managing media execution in China is the equivalent of planning and buying media across Europe. It is characterized by significant diversity in income, purchasing habits, attitudes, lifestyles, and dialects. Gaps exist not only between urban and rural markets but also between city tiers and geographic regions. Optimizing and measuring media buying performance in a media landscape of such complexity is highly challenging for advertisers—much more so than in other major global markets.

### Escalating media costs

One common misconception is that media costs in China are low. City-level TV media costs (measured in cost per thousand, or the cost of reaching 1,000 target consumers) in many cases exceed so-called mature market levels. Annual inflation of rate-card prices across all media still ranks among the highest in the world, averaging about 19 percent since 2002 and pushing up prices to such a degree that ROI needs to be carefully quantified, not just among cities or different media in China but also relative to other countries. China marketing teams are under even more pressure from global headquarters to further expand topline sales and enhance profit margins, yet they are faced with double-digit cost per rating point (CPRP) inflation in key cities. (CPRP, the standard media trading currency in China, is the cost of reaching 1 percent of a target audience group.) To maintain the same media weights or advertising-to-sales ratios as in previous years, they must deliver significant additional sales to cover rocketing media costs. In some key cities, a change in sales policy of the main TV station group can drive up CPRP by more than 40 percent. At these levels, the media buying ROI equation becomes critical. In a context of escalating media costs, marketing teams must be able to improve cost efficiencies and deliver consistent net media cost deflation to drive short- and long-term sales growth.

**Media buying cost variables**

Media buying costs vary enormously across buying points in China, and the differences are much larger in China than in other markets. On television, CMCG has audited CPRP differences as high as 193 percent in the same city and demographic. Several factors that influence these pricing variables set China's market apart. They include TV audience volatility, with high numbers of viewers migrating across channels because of the fragmented TV market—in major cities, households have access to more than 70 different channels; bigger differences in negotiated net costs depending on which inventory brokers a media buying agency has access to; larger margins for media buyers associated with bulk buying that are not passed on to the advertiser; and a much higher cost premium for niche-targeting opportunities than in other countries. With such extreme pricing variables, it is much more difficult for advertisers to assess the relative value of their media buys. Key performance indicators for each medium are therefore essential, first, to track costs and, second, to measure performance value against internal and external metrics.

**Media buying transparency**

China media trading has historically been a commoditized, margin-driven business in which inventory is sold in bulk to brokers and other third parties or free inventory is traded as part of media agency deals. Advertisers' risk of not getting maximum value and benefit from media buys is much higher and is exacerbated by the significant media cost variables among media buying agencies, brokers, and other media purchasers. There are different types of discounts, volume rebates, bonus inventory deals, and incentives, many of which are not on rate cards. In the past, these entitlements have often fallen into gray areas because they have not been agreed upon in advance between advertisers and media buying agencies or clearly stipulated in service agreements. Given the scale of advertiser media budgets in China, in an era of greater shareholder accountability and financial transparency, MNC advertisers are already enforcing strict checks and balances to drive greater media buying transparency. There is an absolute need to agree on clearer protocols that address specific China media trading practices, which also spills over into fairer and more performance-driven media buying agency remuneration structures. As the global economy tightens, companies are scrutinizing all costs more intensely, and every media dollar entitlement and value opportunity must be measured and accounted for.

> Of the main media, television—which takes 40 percent of total ad spending—is the most intrusive and cost efficient way to reach mass audiences.

## Maximizing media ROI

Given China's unique media buying context, advertisers in China need to track and benchmark their media costs and buying delivery with the same methodical detail they use to monitor sales and market share, because in most categories they are closely correlated. As China's contribution to MNC global businesses grows, and advertisers' media investment expands more quickly there than in other key markets, benchmarking media ROI will be vital to maximize short- and long-term business growth.

***Alex Abplanalp** is CEO of China Media Consulting Group, based in Shanghai.*

China Foto Press

# Reaching China's Digital Consumers

## Advertising and marketing in China must join the online revolution

Michael Meyer, David C. Michael, and Christoph Nettesheim

Many people outside China believe that few mainland Chinese use digital devices beyond the mobile phone and that those who do, for the most part, live in China's big eastern cities. These perceptions may have been true two to three years ago, but Chinese now use digital devices extensively, even in less developed central and western areas. Many Chinese already use broadband Internet services, computers, and mobile phones and are gravitating to instant messaging and Web 2.0 activities, such as uploading songs and pictures, blogging, and other community-oriented activities. These trends hold true even in small cities in western China.

China's enthusiastic adoption of digital devices and services will have implications that transcend the technology, media, and communications industries. In particular, the marketing and advertising disciplines will undergo a radical transformation that will affect how companies manage their brands and communicate with customers.

### China's digital revolution

To understand the sea change under way, the Boston Consulting Group (BCG) recently conducted extensive consumer research that was focused on urban China, which contains 45 percent of the country's population and 75 percent of its Internet users. BCG interviewed 3,700 people from 12 cities in 11 PRC provinces. In the course of this research, three "generations" of digital users emerged:

- **Little emperors** Members of this generation, aged 14 to 25, have grown up in a modernizing, market-oriented economy. They are familiar with opportunity and choice, and they readily embrace the Internet and mobile phones. They are also more demanding than older generations, question the authenticity and accuracy of online information, and exhibit moderate to low levels of trust and satisfaction.
- **Reform beneficiaries** The next generation's members, aged 26 to 35, witnessed tremendous change during their youth. Having benefited from the country's reforms since 1978, this demographic optimistically looks for variety and

new opportunities and values the ability to voice opinions online. It has embraced digital devices and services.

■ **Frugal middle-agers** The final generation of digital consumers, aged 36 to 50, grew up before the economic boom. People in this group recall living frugally and lacking choices in areas ranging from entertainment and consumer goods to jobs and housing. They have only partially embraced digital devices and services and want the Internet to provide practical solutions for their everyday lives—for example, by facilitating payment of bills or providing easy access to news.

Global companies that want to reach these three groups will need to understand their online behaviors and adjust their marketing and advertising campaigns accordingly. Trapped by traditional ways of thinking, many Western companies are spending heavily on television, billboard, and newspaper advertising in China, unaware that some Chinese consumers are spending less time engaged with those media. Some companies, such as Intel Corp. and Colgate-Palmolive Co., have figured out how to take advantage of—and get their messages across in—the online world.

## A recent surge

China boasts the world's most mobile phone and Internet users—616 million and 253 million, respectively—with both totals representing significant year-on-year increases. In 2007 alone, more than 86 million of China's consumers started using a mobile phone, and close to 40 million started using the Internet. From 2004 to the end of 2007, the number of mainland Chinese Internet users increased at a compound annual growth rate (CAGR) of 22 percent. In 2007, an average of more than 100,000 new users each day acquired Internet service.

Today, Internet users in China average 2.7 hours online every day, up from 1.9 hours in 2004. (For comparison, Japanese Internet users averaged 1.2 hours online each day, South Koreans spent 2.0 hours online, and Germans spent 2.0 hours online.) They search for information, chat with friends, and listen to or download music and videos (see p.32). Collectively, they are online about 680 million hours a day.

To respond to growing consumer demand, online services are exploding. Instant messaging—the mainstay of Chinese Internet activity—surged from 31 million users in 2003 to 171 million in 2007, rising at a CAGR of 53.3 percent. Web 2.0 activities are taking off, and blogging has blossomed as well (see p.28). At the end of 2007, 49 million people had added their voices to China's blogosphere. Other Chinese users are actively interacting on forums and social-networking sites.

Instant messaging is the dominant form of online communication in China. Nearly eight out of ten Internet users in urban China chat online, much more than in the United States, where e-mail rules. "I seldom use e-mail because not every one of my friends has an e-mail account," said Yang Hao, a 16-year-old Beijing high-school student who enjoys instant messaging. "QQ is a lot more fun, instant, and interactive." (QQ is an instant messenger software program, created by Tencent, Inc., that is commonly used in China.)

Chinese netizens are also deeply involved in peer-to-peer activities, such as sending and downloading music and videos within their communities. Peer-to-peer file transfers and file sharing constituted 60 percent of China's Internet traffic.

Despite these large figures, the digital revolution in China is still in its infancy, and its overall penetration rates—the percentage of the population that engages in an online activity at least once a week—remain relatively low. Just 46.5 percent of China's residents use mobile phones and 19 percent use the Internet. Even with rapid growth in recent years, China still has a long way to go before it reaches saturation.

Moreover, Chinese people tend to be much less comfortable with forms of digital activity beyond communication, especially those that involve commerce, demand large outlays of cash, or require their trust. E-commerce in China is years behind the West—only 25 percent of Chinese Internet users shop online, mostly at the Chinese site Taobao.com, and only 16 percent shop online more than 10 times a year. Even fewer take advantage of online banking services. Cash remains consumers' dominant form of payment. Consumers distrust online transactions, because they fear that they will receive poor-quality goods, be cheated, or their identity will be compromised (see Figure 1). Still, the Internet is a popular place to research products, which consumers subsequently buy offline. "If I want to buy big-ticket items, I always check the price and performance on the Internet first, but I won't shop online. I don't trust Internet security," said Sun Qian, a 28-year-old from Guilin, Guangxi.

## Market opportunities

The digital market in China is larger than most might expect. Excluding voice telephony and traditional broadcast television, the size of the market in 2007 was close to ¥580 billion ($77 billion) (see Figure 2). Two-thirds of revenues come from the sale of digital devices, including mobile phones, digital televisions, and computers. By 2015, revenues are expected to exceed ¥1.8 trillion ($264 billion).

### Quick Glance

■ China has three generations of digital users: little emperors, reform beneficiaries, and frugal middle-agers.

■ Chinese consumers are diving into all sorts of online activities—except e-commerce.

■ Savvy companies will adjust their advertising and marketing efforts to focus on these new channels.

Online advertising-related revenues are only ¥10 billion ($1.5 billion), but are rising strongly. From 2002 to 2005, online ad revenue increased at a CAGR of 79 percent, compared with 15 percent and 11 percent for television and newspapers, respectively. Most online-advertising spending is allocated to large, local portals, such as Sina.com and Sohu.com, and China's top search engine, Baidu.

The relatively underdeveloped e-commerce market may lead companies to dismiss the need for a digital strategy. That conclusion is shortsighted. Consumers routinely visit blogs and bulletin boards to learn about products. Their opinions are shaped in forums that advertising and marketing managers may not even know exist.

## A roadmap to the future

The following activities and principles will help marketing and advertising executives to address the opportunities presented by China's new digital generations.

**Be visible online**

Many companies' average customer in China spends nearly three hours online each day. To be successful, companies need a rich and attractive web presence to raise awareness of their business, brand, and products. Remarkably, many companies in China still do not showcase themselves online properly. If they have a website, they do not update it frequently or adequately. Corporate budgets for web development are generally limited, and business leaders remain skeptical about the effectiveness of, and consequently the need for, a strong online presence. Most companies have not yet built up the required capabilities to exploit this medium effectively. Nonetheless, some companies have demonstrated the value of a superior web presence.

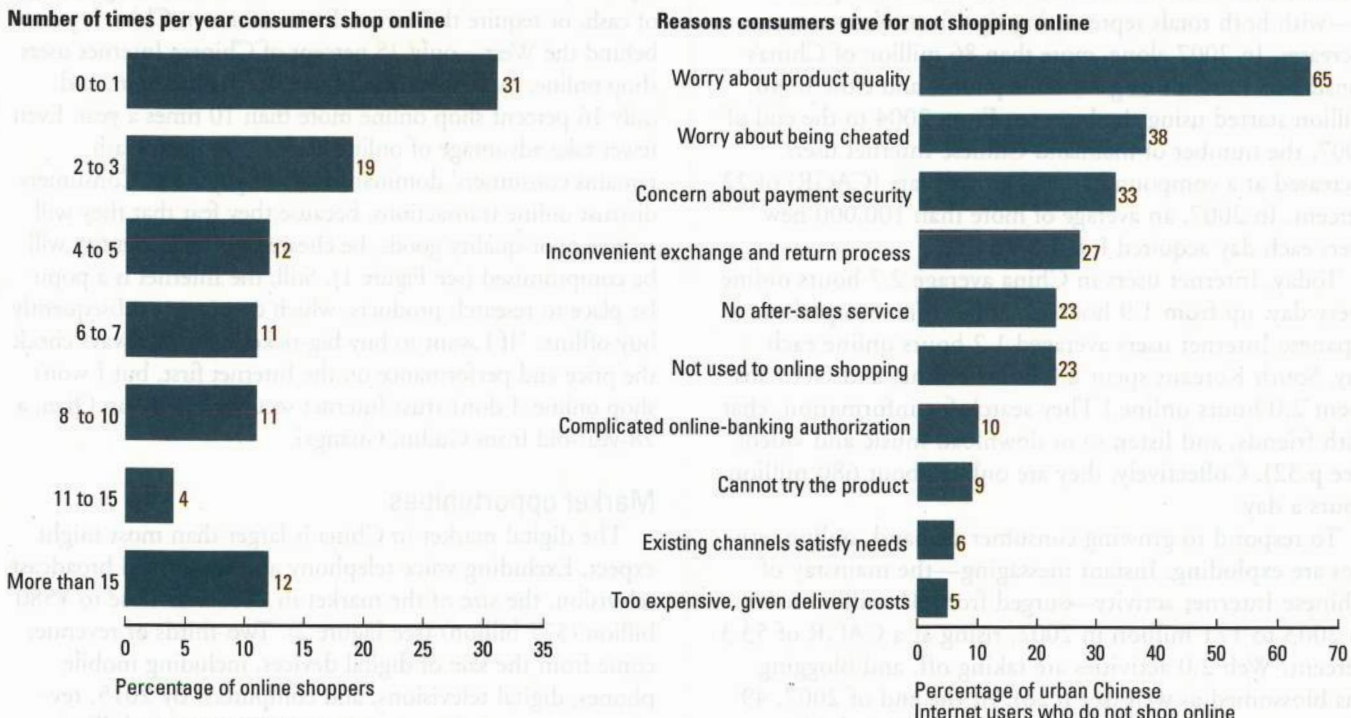
Goodbaby Child Products Co., Ltd., a leader in China's baby care products market, has become a visible presence in the daily life of young Chinese mothers through its website, which offers blogs, information about baby care and development, and a doctor referral section. Like many other companies, Goodbaby uses its website to gather consumer intelligence. By closely tracking online activity—including online sales data, webpages visited for different products, forum discussion content, and consumer questions and suggestions—companies can develop a better understanding of how consumer preferences vary by region or city, allowing them to develop successful segmentation strategies.

**Take advantage of your customers' exposure to new influencers**

Several websites have demonstrated tremendous power and influence to shape consumers' opinions. China has its own social networking sites, such as Wealink and Linkist, where users can create and join groups according to their interests. Numerous forums and blogs also sway consumer behavior. To earn the trust of China's digital consumers, companies must court the influence brokers who network, are vocal, or have gained a following online.

As a first step, companies need to be aware of the "online chatter" (see p.28). Only then can they join the conversation by, for example, sending press releases to popular bloggers or setting up company or product-specif-

**Figure 1: Quality and Security Worries Slow E-Commerce**




Source: BCG research and analysis.

ic discussion boards and blogs. Several companies operating in China have suffered negative business consequences by failing to act swiftly enough in response to small ripples of dissatisfaction that began online and spread to the sales counter. In early 2007, a leading global consumer company had to remove a product from the market after questions about the brand's quality arose. Although customers' complaints originally surfaced online, the company did not detect the degree of customers' dissatisfaction early or accurately enough. Under mounting pressure, the company had little choice but to retreat.

**Advertise your brand and build trust online**

Branding is a critical activity for companies in China. BCG research suggests that brands are more relevant for Chinese consumers than for their counterparts in Europe or the United States. Given the reluctance that Chinese consumers display toward online transactions and commerce, the power of brands and their ability to convey trustworthiness is especially important online. Many companies, however, continue to target consumers through television and outdoor advertising.

Colgate-Palmolive Co. embraced China's online environment to interact with young consumers—the target market for Max Fresh toothpaste. The campaign featured popular Taiwan singer Jay Chou as its spokesperson. To take advantage of user-generated online content among young Chinese consumers, the campaign allowed users to edit the commercial. A website visitor could change scene sequence, background music, and lyrics, and then forward their new version to friends. This campaign created online buzz among young people and attracted more than 1.5 million unique visitors in two months.

**Draw on the creativity of the online generation**

The rapid development of Web 2.0 capabilities in China allows companies to develop two-way communications with consumers, who can contribute to a company's marketing and brand-building activities. Companies can test advertising messages online and even allow product enthusiasts to drive viral marketing campaigns. For example, Intel China launched a competition inviting Chinese consumers to create a video advertisement. About 700 people submitted advertisements, and 100,000 voted to select the best entry. The campaign drew roughly 4 million unique visitors.

## Adapt to China's distinct landscape

Executives must approach China as a unique market. The nation has followed its own path in embracing the digital age. Companies that take time to understand how Chinese consumers spend their time using digital technologies will be able to effectively market and communicate to them. The rest will be bystanders in the revolution. 完

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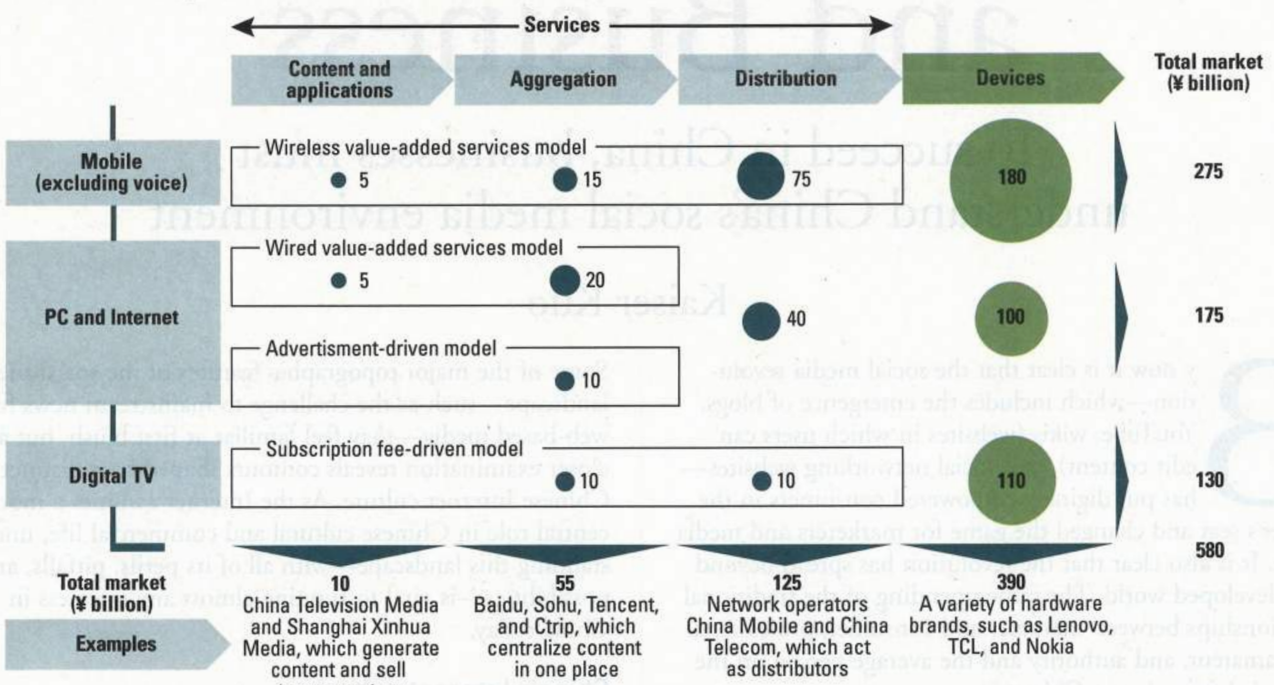
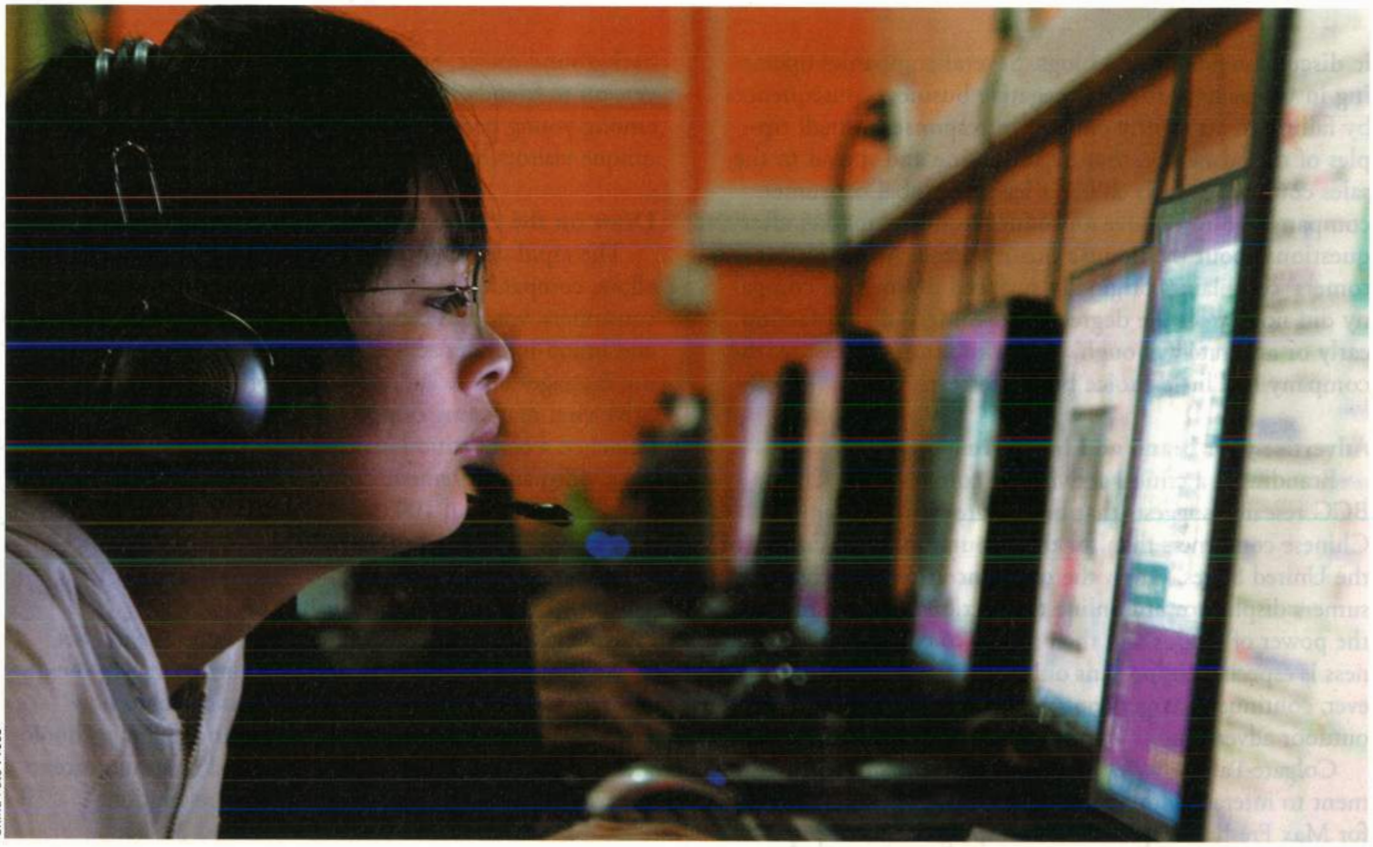
**Figure 2: China's Digital Services and Devices Market, 2007**




Note: Market sizing does not include mobile voice communications, but it does include the transmission of short messages.
Sources: Press reports, company annual reports, BCG analysis.



China Foto Press

# Blogs, Bulletin Boards, and Business

## To succeed in China, businesses must understand China's social media environment

Kaiser Kuo

By now it is clear that the social media revolution—which includes the emergence of blogs, YouTube, wikis (websites in which users can edit content), and social networking websites—has put digitally empowered consumers in the driver's seat and changed the game for marketers and media alike. It is also clear that the revolution has spread beyond the developed world. The same upending of the traditional relationships between marketer and consumer, professional and amateur, and authority and the average person on the street is happening in China, too.

In China, however, the revolution has followed a somewhat different trajectory than in the developed world. Some of the major topographic features of the social media landscape—such as the challenge to mainstream news from web-based media—may feel familiar at first blush, but a closer examination reveals contours shaped by a distinct Chinese Internet culture. As the Internet assumes a more central role in Chinese cultural and commercial life, understanding this landscape—with all of its perils, pitfalls, and possibilities—is vital to running almost any business in China today.

### China's Internet culture

Observers have noted that China's Internet is more "entertainment superhighway" than "information superhighway"—

a fair characterization, given the time Chinese Internet users typically devote to MP3 downloads, chatting with friends, playing online games, and watching online videos (see p.32). Perhaps their focus on entertainment is attributable in part to the PRC government's well-known censorship policies, which often render news and political reporting formulaic, staid, and not reliably objective. And yet, for all the frivolous distraction and political redaction, the Internet has developed into China's first real public sphere—a space, in this case virtual, where a huge range of ideas can be and are openly expressed. China's legions of Internet users, now numbering over a quarter-billion and growing fast, are also growing more vocal, strident, and conscious of the power they wield. Though censors may limit what is said online, anyone who "listens in" on Chinese cyberspace will likely be moved by the heated debates, candid criticism, and bold attempts to "push the envelope." (Visitors to Chinese cyberspace will also likely be struck by the often vicious and puerile tone of the invective and by the utter lack of self-restraint exhibited by Chinese netizens.)

For all its shortcomings, China's Internet has become the crucible of the nation's contemporary culture, where new language is created, new literary talent finds voice, and new musical phenomena are born. It is the place where a brand may be elevated to greatness by the web's marvelous power to amplify good word-of-mouth. But it is also the place where a brand may encounter the destructive force that China's netizens seem to unleash so capriciously.

## Quick Glance

Companies should

- Use the Internet to monitor relevant discussions and engage consumers;
- Be aware that creating and maintaining a blog takes enormous time and resources—and comes with risks; and
- Engage consumers transparently.

## Weighing Internet tools

The surging popularity of social media is at the heart of the consumer revolution in China, just as it has been in the United States. That does not, however, mean that US brands should engage social media in the same way when in the China market.

### Blogs

When companies begin to devise social media strategies, they often first consider monitoring or setting up blogs. Generally, companies want to learn what is being said about their brands in cyberspace, perhaps to identify the real influencers for outreach or to allay the concerns of dissatisfied customers. More ambitious companies want to do more than monitor blogs. They want to start blogs of their own, believing a blog would be a good way to connect with customers, encourage their feedback and engagement, and give the company a human face. Though these are excellent motivations, blogs are often the wrong place for companies in China to learn what China's netizens are saying about a brand (see p.30). For example, at the time of this writing, the most popular blog in China was from a stock market analyst with a stock-picking algorithm and a book to sell. The next most popular blogs were from "blogging celebrities," such as movie stars, writers, and singers. China does not have many bloggers who have gained fame as bloggers: no one like Markos Moulitsas Zúniga, founder of the left-wing *Daily Kos* blog, or even like celebrity-gossip blogger Perez Hilton (the pen name of Mario Armando Lavandeira, Jr.). Most Chinese blogs are little more than online diaries, and of these, the vast majority do not have enough of a regular readership to be of much concern to most companies.

That does not mean that crises for foreign-invested enterprises (FIEs) never originate with blogs. For example, in 2007 a Chinese Central Television English-language news reporter named Rui Chengang launched a personal, and ultimately successful, blog-based crusade to oust Starbucks from the Forbidden City in Beijing. But this case is an exception, and tracking blogs for mentions of a company is simple enough using free tools, such as Google Alerts. A company can easily set up that service to deliver daily, or more frequent, e-mail alerts for any mention of the company, its brand, or its top officers in mainstream online media and in most blogs. Companies that have not been using such a service should start using one now.

### Bulletin board systems

The real place where conversations about brands occur on the Chinese Internet is in bulletin board systems (BBSs), which are online forums where people can post, usually anonymously, threaded messages about any topic. Sam Flemming, an expatriate American who is the co-founder and CEO of CIC Data, LLC, an Internet word-of-mouth research and consulting firm in Shanghai, has preached the value of tracking consumer opinions on BBSs for years. Used less frequently in the English-language Internet, BBSs are extremely popular in China, where they have attained a surprising level of sophistication.

Of China's roughly 1.5 million commercial websites, about 80 percent have a BBS attached to them, and ordinarily these are among the liveliest and most frequently visited parts of a site. Tens of millions of messages are posted to them daily, and about one third of Chinese netizens routinely post on a BBS, according to the China Internet Network Information Center. Some BBSs, like the influential forum Tianya, are regarded as more highbrow—the place to go if your tastes run to politics or literature. Other BBSs are rowdy free-for-alls with no semblance of civility. And on the million or more other forums, companies can find conversations about their company, brand, and competitors. Ordinary Chinese consumers air grievances every day about shoddy construction by cheap real estate developers or poor service by some appliance manufacturer, while others sing praises of the car, smart phone, or athletic shoes they just bought.

Social media has made life difficult for many companies regardless of geography. Mistakes made by anyone in any organization—a surly customer service representative or an errant employee caught in some misdeed—can rebound with disproportionate vehemence. Though it is said that in space no one can hear you scream, in cyberspace the screams of an unhappy customer are heard and can be amplified, widely and quickly disseminated, and instantly brought to the attention of traditional media. Everything breaks online these days. Last year's scandal surrounding Chinese dairy company Sanlu Group, with its melamine-tainted infant formula, broke publicly after a September 11 posting on the Tianya forum.

## Tips for foreign companies

**Address public relations problems swiftly**

News about FIEs in China spreads fast. As Jim McGregor described in his book *One Billion Customers*, foreign companies in China are operating in a "free fire zone," where local media, new or traditional, often feel little compunction about targeting FIEs. Quick reaction is absolutely essential. Flemming points out two cases in which difference in response time mattered a lot.

In 2006, a customer discovered that the personal computer he had ordered was shipped with a slightly different processor than the one advertised. Because the foreign computer company moved slowly to address his grievance, the customer's one negative post snowballed into a colossal

> Blogs are often the wrong place to learn what China's netizens are saying about a brand.

## To Blog or Not to Blog?

A corporate blog, done well, can be a valuable resource for improving visibility, engaging customers, and building good will for the corporation. But companies should carefully consider the risks and responsibilities of creating and maintaining a blog—it is not something to be undertaken lightly. Some useful points to consider:

■ **Set goals** First, each company needs a clear idea of what it wants to get out of blogging. Keeping up with the Joneses is not an acceptable goal. Jeremiah Owyang, San Francisco-based senior analyst in social computing for Forrester Research, Inc., recently told of a company that wanted to begin blogging because their competitors had begun doing so. "What's your goal?" Owyang asked them. "Thought leadership," they replied, the irony apparently lost on them.

■ **Be sure that the company is ready** Take a good, hard look at the company. Is it ready to brave the waters of social media, Chinese or otherwise? If the company cannot confidently say that it has an internal culture of transparency and is sufficiently thick-skinned to take public criticism, it should not bother with a blog but should stick to listening.

■ **Staff the blog appropriately** Senior management must understand the level of talent and commitment required to make a corporate blog a success. Someone needs to take editorial ownership of the blog, and that individual should be a good, natural writer in a position senior enough to have a credible voice and responsible enough to adhere to the company's code of conduct for its blog, which must be spelled out clearly. Recognize that quality blogging takes time—not just the time it takes to post, but also the time to read voraciously and stay current with other blogs on the topic the company intends to address. The company will not help its brand image if it cannot spare the time to read up and tap out a few good, engaging blog posts a week.

■ **Promote the blog** Just building a blog is no assurance that an audience will come. Unless the company deliberately promotes the blog, it will be ignored and will serve no purpose. Companies should optimize the blog for search engines and link generously to other related blogs. The Internet provides heaps of literature that can give pointers on how to optimize and promote a blog.

Finally, companies should realize that they will not recognize an immediate payoff from blogging. Search engine optimization and link-swaps will carry a blog only so far. It will take time for the blog to gain a real readership. Companies should consider the blog as part of their long-term efforts in industry thought leadership, in profile-raising, or whatever other goals that have been set.

*—Kaiser Kuo*

headache for the company, earning the incident the nickname "Processorgate." Bad publicity continued for weeks, until the company offered refunds under the threat of a class-action lawsuit. Eventually, the company's reputation in China recovered, but a faster response to the problem would have prevented much of the negative publicity.

In contrast, Christian Dior reacted with admirable alacrity to a major potential crisis. Last spring, when company spokeswoman Sharon Stone suggested at the Cannes film festival that the May 2008 earthquake in Sichuan was karmic retribution for Beijing "not being nice" to her friend, the Dalai Lama, BBSs in China lit up instantly with righteous indignation. Dior was quick to drop Stone from all of its China marketing and issue a statement of apology from her. As a result, Dior escaped unscathed.

On the Chinese Internet, conversations about brands occur in bulletin board systems.

**Monitor online discussions**

Listening to online conversation is vital for companies. Tools to monitor relevant discussions offer a valuable barometer that no company operating in China should be without. Fortunately, a growing number of companies operating in China offer such tracking tools. Generally, the process involves "crawling" BBSs, blogs, and other social media with search spiders and processing relevant results with semantic algorithms of varying complexity. The algorithms assess individual posts and assign a value according to the intensity of the positive or negative sentiment expressed. Purveyors of these tools will then notify clients about actual or potential crises—either in real-time, via a dashboard (a set of read-outs that allow a client to monitor what the trackers are seeing), or in periodic reports—flag recurring issues in online posts, and offer possible ways to respond to problems and opportunities and to manage the client's online reputation.

**Engage consumers transparently**

Many companies want to do more than track online comments about their brands. They want to engage real online communities of people who are fans of the company's brand and who will offer honest, constructive advice. Though engaging with a commenter or a blogger is trickier than monitoring comments, the rules of engagement through social media, such as blogs, generally apply in any Internet market. The key is to engage transparently. Company representatives must always identify themselves and their corporate affiliation clearly, and treat the commenter with respect and professional courtesy no matter what kind of vituperation they might encounter. A company rep should never assume that he or she can post anonymously.

Like too many other things in China, online forums are often adulterated for commercial gain. "Astroturfing" —a tactic used by some companies to create the appearance of grassroots consumer enthusiasm through BBS, blogs, or other social media—is common. Unscrupulous competitors will often use social media to launch smear campaigns. Companies should be careful about agencies that claim they can protect brands by handling negative comments. One common practice is to bury a negative comment about a client by flooding a BBS thread with mildly positive, neutral, or even totally unrelated comments using multiple identities that appear to come from different machines in different parts of the country. The negative comment moves so far down the thread that most people reading the thread will not find it. This dishonest practice does not address real problems; it only sweeps them under the rug. On the bright side, Internet users are growing more aware of this sort of dishonest practice, and smarter Internet users simply know to take it all with a grain of salt.

## Keep up with trends—but be safe

The swift rise of the Internet in China in recent years has caught some companies by surprise. With news and rumor traveling fast in cyberspace, companies must monitor what commenters are saying about them and their products. Even more important, companies must be ready to respond quickly to any complaints or negative comments that appear, as failure to do so can seriously damage a company's reputation.

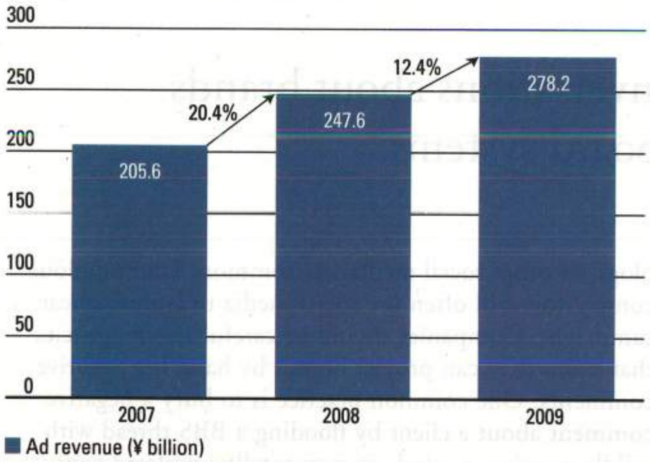
Companies can also use the Internet to engage customers and market products in new ways, but they should be ready to commit the resources necessary to do the job well. Again, all such channels must be carefully monitored for signs of dissatisfaction among potential customers and the general public. Finally, companies must be as transparent as possible when engaging potential customers. In short, companies should take advantage of the opportunities this new medium offers but be on the sharp lookout for potential pitfalls. 完

*Kaiser Kuo is the group director of Digital Strategy at Ogilvy & Mather Advertising, China.*

# China's Ad Spendin

**Despite economic uncertainty, advertising in China is expected to grow next year.**

**China's Advertising Market, 2007–09**




Note: The 2009 growth figure was projected in late November 2008.
Source: Nielsen Media Research

**Pharmaceuticals top the list of China's unique mix of ad spending categories.**

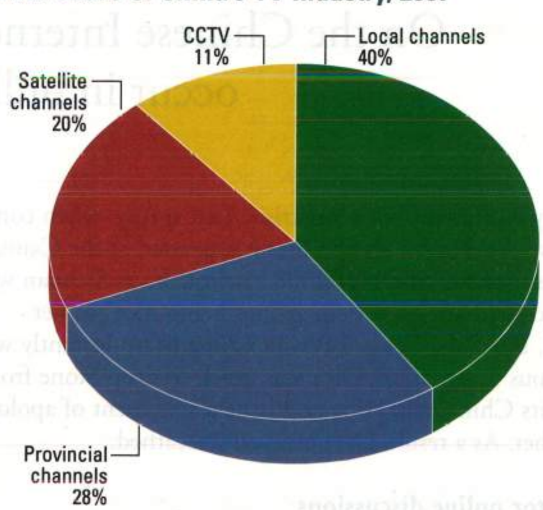
**TV Ad Spending by Category, 2007**

| Category | $ million | Year-on-year change (%) |
|---|---|---|
| Pharmaceuticals and health products | 3,932.3 | 17.8 |
| Toiletries | 3,336.8 | 5.6 |
| Beverages | 1,729.5 | 29.6 |
| Business, industry, and agriculture | 1,311.3 | -11.5 |
| Foodstuffs | 1,033.3 | 26.0 |
| Telecom | 811.7 | 20.5 |
| Household | 777.3 | 34.8 |
| Retail and services | 703.4 | 34.2 |
| Automotives | 549.0 | 33.7 |
| Clothing and accessories | 491.2 | 15.8 |
| Entertainment and media | 412.8 | 34.4 |
| Electrical appliances and audiovisual products | 334.1 | 15.3 |
| Government, social, and political organizations | 287.7 | 24.8 |
| Computers and accessories | 225.5 | 32.1 |
| Property | 214.1 | 12.6 |
| Leisure | 198.7 | 128.2 |
| Finance, investment, and banking | 160.4 | 46.1 |
| Miscellaneous | 80.1 | -2.1 |
| Tobacco and accessories | 20.7 | -10.0 |
| Office equipment and supplies | 19.9 | -70.7 |

Source: Nielsen Media Research

**China's TV market is dominated by China Central Television (CCTV) and about 30 satellite channels, but local and provincial channels collectively have the biggest market share.**

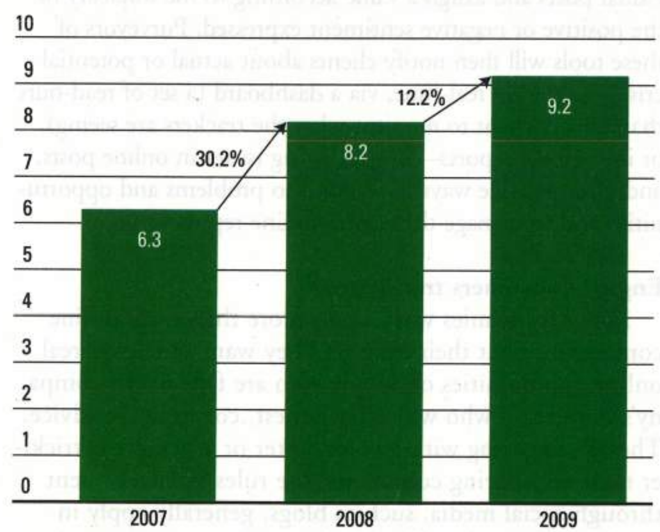
**Market Share of China's TV Industry, 2007**




Note: Percentages do not add up to 100 percent because of rounding.
Source: *South China Morning Post*

**CCTV ad sales will grow rapidly despite China's slowing GDP growth.**

**CCTV Ad Revenue, 2007–09 (¥ billion)**




Note: The 2009 figure is the amount sold at auction for 2009 CCTV advertising in November 2008. Ad sales in 2008 grew by 30 percent largely because of Olympics-related advertising.
Source: *South China Morning Post* and *The New Express*

# orecast Not So Grim

## China's Internet users have various reasons for surfing the web...

As of June 2008, China had **253 million netizens,** making it the country with the **most Internet users.**

### Internet Application Use Rate and Number of Users

| Internet application | | % | Users (millions) |
|---|---|---|---|
| Basic Internet application | Instant messaging | 77.2 | 195.4 |
| | Search engine | 69.2 | 175.1 |
| | E-mail | 62.6 | 158.4 |
| Network media | Online news | 81.5 | 206.2 |
| | Blog/personal space | 42.3 | 107.1 |
| Digital entertainment | Online music | 84.5 | 213.7 |
| | Online video | 71.0 | 179.6 |
| | Online gaming | 58.3 | 147.5 |
| E-commerce | Online shopping | 25.0 | 63.3 |
| | Online payment | 22.5 | 57.0 |
| Online community | Forum/BBS access | 38.8 | 98.2 |
| | Publishing posters on forum/BBS | 23.4 | 59.3 |
| Others | Online banking | 23.4 | 59.3 |
| | Online education | 18.5 | 46.7 |
| | Online stock/fund transaction | 16.9 | 42.9 |
| | Online job hunting | 14.9 | 37.8 |

Note: BBS = bulletin board system
Source: China Internet Network Information Center

## US advertisers spent about 15 times more on online advertising than China in 2007...

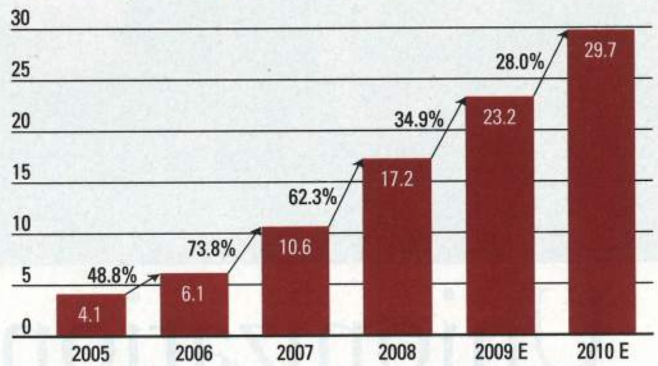
### United States vs. Chinese Online Advertising, 2007

| | $ billion |
|---|---|
| United States | 22.5 |
| China | 1.48 |

Source: iResearch Inc.

## ...but for China's online advertising market, the sky is the limit.

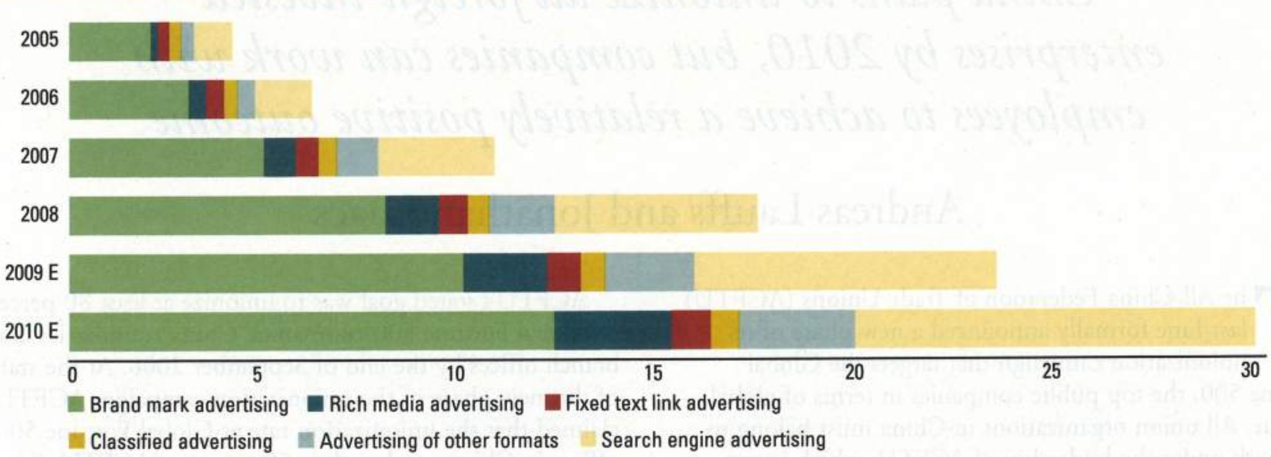
### Online Advertising (¥ billion), 2005-10




Note: E = estimate
Source: iResearch Inc.

## ...and online advertisers have a variety of tools in their arsenal.

### China Online Advertising Market Size Forecast (¥ billion), 2005-10




Note: E = estimate
Source: iResearch Inc.

China Foto Press

# Unionization Drive Leaves Room for Compromise

*China plans to unionize all foreign-invested enterprises by 2010, but companies can work with employees to achieve a relatively positive outcome*

Andreas Lauffs and Jonathan Isaacs

The All-China Federation of Trade Unions (ACFTU) last June formally announced a new phase of its unionization campaign that targets the Global Fortune 500, the top public companies in terms of global revenue. All union organizations in China must belong to and work under the leadership of ACFTU, which is controlled by the Chinese Communist Party (CCP).

ACFTU's stated goal was to unionize at least 80 percent of Global Fortune 500 companies' China subsidiaries and branch offices by the end of September 2008. At the start of this new phase of the unionization campaign, ACFTU claimed that the unionization rate at Global Fortune 500 offices in China was less than 50 percent. (ACFTU did not disclose the exact figure.) In early October, an ACFTU official in charge of union organization, Wang Ying, announced that 82 percent of Global Fortune 500 company offices in the PRC had been unionized. She also announced that ACFTU's ultimate goal was to unionize 100 percent of all foreign-invested enterprises (not just Global Fortune 500 subsidiaries) by the end of 2009.

Perhaps recognizing that many foreign companies have complex corporate structures in China, ACFTU has also announced a new policy of allowing subsidiaries with multiple branch offices to "centralize" their union structure. (Previously, ACFTU required each branch office of a company to have its own union.) Though ACFTU still insists that each branch office have some type of union representation, it now allows companies to have a union in their head office to supervise and lead the union representatives in each of the branch offices.

## Now what?

Though companies in China cannot prevent ACFTU officials from organizing employees or employees from organizing or joining a union themselves, companies are not legally required to establish unions. ACFTU is controlled by the CCP but is not a government ministry with direct administrative enforcement powers. Thus, it has been using a number of strategies to pressure companies to unionize, such as

■ Threatening to expose companies in the media as being noncompliant with PRC law or as refusing to allow its employees to unionize. Companies that have noncompliant employment practices may be more vulnerable in this respect, though even companies that comply with the letter of the law have been named by ACFTU in the media as being noncompliant. For example, the PRC state-run media in 2007 published articles in which ACFTU accused McDonald's Corp. and Yum Brands Inc.'s Kentucky Fried Chicken and Pizza Hut chain restaurants of violating PRC labor laws when, in fact, the labor bureaus never confirmed violations.

■ Trying to convince local government bureaus with legal enforcement power over companies to exert pressure on companies in their jurisdiction. For example, the approval authorities in Shanghai refused to allow Wal-Mart to establish any stores in the city unless it agreed to establish unions in its stores, according to the *21st Century Business Herald*, a Chinese business publication.

■ Directly approaching company employees and trying to convince them to join ACFTU and organize a union in their company. If ACFTU decides to approach employees directly, the company cannot obstruct such efforts. This was, in fact, the method used to establish the first union in a Wal-Mart store in July 2006 in Fujian.

### Quick Glance

■ The All-China Federation of Trade Unions (ACFTU) is seeking to unionize all foreign-invested enterprises by the end of 2009.

■ To pressure companies into unionizing, ACFTU has relied on various tactics, including threatening to expose "noncompliance" in the media.

■ Despite the high unionization goals, company unions still lack independence and the ability to significantly represent workers' interests.

In addition, there is always the risk that some disgruntled employees may decide on their own to approach ACFTU about establishing a union. As employees in China become increasingly aware of their rights and less willing to tolerate perceived mistreatment, there is a greater risk that employees who harbor grievances against their companies will try to use unions to push their views on the company.

## If a company decides to set up a union—what next?

Most companies would prefer not to have a union established in their PRC subsidiaries, but until mid-October of 2008 unionization appeared to be unavoidable for many. Since then, probably in response to the global economic crisis, ACFTU has significantly slowed its campaign. Still, the worst case scenario for a company would be if a union led by hostile employees was established without any company influence; in some cases, such employees may even refuse to listen to upper-level ACFTU branches—or the government—in their dealings with the company. Several FIEs in this situation have experienced major disruptions to their operations.

Though unions are given significant powers under the law and could seriously disrupt a company's operations, companies can still try to influence the process of union establishment and improve the odds of the company management and the union developing a friendly and cooperative relationship.

The exact procedures for establishing a company union are not described in the PRC Labor Union Law or in any other law or regulation. ACFTU has established its own general guidelines for how a company's union should be established, with detailed procedures set by local ACFTU branches across China. Though some details in the procedures may vary from city to city, the general process is as follows:

■ The first few employees to join ACFTU form an initial "preparatory team" (*choujian xiaozu* or *choubei xiaozu*) to lead the union establishment process.

■ This preparatory team tries to recruit as many employees in the company as possible to join the union.

■ The employees who have signed up to join the union elect the union committee members, including union chair and vice chair.

■ The election results and application for establishment are submitted for approval to the "upper-level" branch of ACFTU (the district-level or street-level ACFTU branch with supervisory authority over unions established in that district or neighborhood).

In various ways, the union establishment process allows companies to try to influence who is on the union committee, the leadership body that ultimately runs the company union's daily affairs and represents the company union (and ultimately all employees) in its dealings with the company. For example, if a company decides to cooperate in the establishment of a union, it can choose who will make up the initial preparatory team. Local ACFTU branches have generally been quite flexible in accepting a company's choices. Through the preparatory team, the company can create the candidate list for the union committee. In addition, the preparatory team can decide whom to recruit as the first company union members prior to the election of the union committee, allowing the company to determine the voting body that will elect the union committee.

To ensure that the union committee represents employees' rights and interests, the national ACFTU recently issued regulations that restrict eligibility for the union committee and chair. Under these regulations, top company administrators (senior management, for example) and their relatives may not serve on the union committee. In addition, foreign nationals and human resources directors may not serve as union chair.

In practice, enforcement of these restrictions has been inconsistent, and local ACFTU branches have much discretion in determining how to interpret them. For example, some local ACFTU branches allow management to serve on the union committee, excluding only the company's general manager and deputy general manager.

In addition, though the Labor Union Law requires companies to contribute 2 percent of their total payroll to the company union as union fees, some local ACFTU branches have offered to give companies a "discount" on union fees if they cooperate on union establishment. This raises the question of whether the PRC government really views unions as organizations meant to robustly defend employees' rights and interests or primarily as mechanisms to ensure stability in labor relations as part of China's effort to create a "harmonious society." Contradictory public statements on this issue result in confusion for companies about how to respond to the unionization campaign.

For now, local ACFTU branches are mainly concerned about fulfilling their quotas for establishing company unions and are often willing to compromise on the issues of concern for companies. In this respect, they resemble government bureaucrats trying to meet minimum target goals set at the national level rather than union organizers committed to representing employees' best interests. There are, however, some signs that company unions may be encouraged to play a more aggressive role in the future.

For now, local ACFTU branches are mainly concerned about fulfilling their quotas for establishing company unions and are often willing to compromise on the issues of concern for companies.

## What does the future hold?

Unfortunately, there is no crystal ball for predicting how company unions will act in the future. Moreover, the PRC government is not known for transparency and openness, particularly in its long-term strategic goals, and different parts of the government may have different or contradictory visions of China's future direction in general and of PRC labor relations in particular.

Though stability is certainly an overriding goal of the government, company unions will not always be docile and cooperative with management. At some point, the government may decide that it would be beneficial for social stability if unions were to start playing a more robust role in representing employees' interests. For example, ACFTU has openly proclaimed that once the unionization drive is over, the next step will be to promote collective bargaining in companies, with a particular stress on collective wage bargaining. This makes sense from the PRC government's perspective in light of rising living costs and the growing disparity in wealth between rich and poor. The conclusion of collective bargaining agreements in many Wal-Mart stores has been consistently heralded in the state-controlled media as a sign of things to come. The main focus of the Wal-Mart store agreements has been to establish minimum wage levels for all employees and to guarantee a certain percentage annual wage increase. Agreements were negotiated on a store-by-store basis for the first few stores, but Wal-Mart China later negotiated collective bargaining agreements under an umbrella agreement.

In addition, many local governments have recently publicized nonbinding general policy goals to promote collective wage bargaining. National regulations require companies to engage in collective bargaining if requested to do so by a union or by an employee representative elected by the employees in a company that has no union. (In practice, collective bargaining almost never occurs if the company has no union.) An exception is made if the company has a "justifiable reason" for not engaging in collective bargaining, though the law does not define "justifiable reason." The Tianjin CCP and Municipal Government have gone a step further: In a September 2008 regulation, they appear to impose minimum and maximum wage increases on all companies.

Companies have 20 days to respond to the union or employee representative's request for bargaining, according to Article 32 of the Collective Contract Provisions of May 2004. Most provinces and major cities have their own corresponding collective bargaining regulations, however, many of which require companies to respond to the request for bargaining within a shorter period of time. In practice, the local regulations usually take precedence if there is a conflict.

The Shenzhen implementing regulations for the national Labor Union Law, the most publicized set of local regulations dealing with union issues and collective bargaining, were recently amended and took effect August 1, 2008. The amendments seem to reflect the growing influence of, or at least greater governmental support for, ACFTU policy. For example, though the national regulation requires a union committee to be established when the company union has 25 or more members, the Shenzhen regulations set a lower threshold of 25 employees, regardless of whether they are union members. The Shenzhen regulations also put into law ACFTU's policy of restricting eligibility for the union chair or union committee members.

Unlike the national Labor Union Law, the Shenzhen regulations define what exactly is meant by "obstructing" union establishment: not only coercive or retaliatory action taken against employees but also refusal of the company's senior management to discuss union establishment with an upper-level ACFTU branch.

The Shenzhen regulations diverge from the national law on the union's role during a work stoppage. The national law requires unions to play a mediating role and to encourage employees to return to work as soon as possible, whereas the Shenzhen regulations contain no such provisions and simply state that the union represents the employees in bargaining with the company if a work stoppage occurs.

Though the government's overarching goal in labor relations is stability, it seems to realize that, to achieve this goal, unions will need to be a genuine force for employee protection.

The Shenzhen regulations seem to reflect a better understanding of how unions work in other countries by using a translation of the term "collective bargaining" (*jiti tanpan*) that is more accurate than the term used in the national regulations, *jiti xieshang*, which is better translated as "collective consultations." "Collective consultation" connotes the idea of "just talking," whereas "collective bargaining" connotes a give-and-take negotiation between two parties, union and management, that may have opposing views.

In short, though the central government's overarching goal in labor relations is stability, it also seems to realize that unions will need to be a genuine force for employee protection to help achieve this goal. The government, however, shows no sign that it wishes to allow ACFTU or company unions to act as independent unions do in other countries. The interesting development to watch, therefore, is the extent to which ACFTU and the government allow company unions to truly represent workers' rights and interests. 完

***Andreas Lauffs** is the head of Baker & McKenzie's Employment Law Group for Greater China. **Jonathan Isaacs** is an associate in that group.*

China Foto Press

# Understanding China's Middle Class

*Targeting key segments of China's diverse and rapidly emerging middle class will be crucial as household incomes rise*

Allison Cui and Kheehong Song

Gone are the days when companies looked at China as a monolithic land of 1 billion potential customers. Companies are now focusing on how to capture small segments of China's giant market, and none of these segments is as attractive or as full of potential as the country's rapidly growing—and multifaceted—middle class. As China's economy continues to grow, more people will migrate to China's booming metropolises to find better-paying jobs. These working consumers, once among the country's poorest, will steadily climb the income ladder and join the new middle class. Companies that can effectively understand the composition and needs of this diverse group will be positioned to reap massive rewards.

## Why the middle class?

Though many foreign companies have remarked on the importance of China's middle class as a consumer segment, few realize just how dramatic its ascendance is. From 1995 to 2005, the population of China's middle class—defined here as households with annual incomes ranging from

$6,000 to $25,000—grew from close to zero in 1995 to an estimated 87 million in 2005, according to MasterCard Worldwide, Asia Pacific. China's middle class will jump to 340 million by 2016 (see Figure 1). The purchasing power—disposable income minus savings—of China's middle class is also growing. In 2006, around 39 percent of urban households were middle class (see Figure 2). By 2016, that percentage will likely rise to 60 percent. At present, the middle class accounts for 27 percent of China's total urban disposable income. By 2015, that percentage is expected to rise to more than 40 percent (see Figure 3). Considering its swelling numbers, purchasing power, and trajectory, China's middle class presents marketing opportunities that companies cannot afford to miss.

## What does it mean to be middle class?

Different types of companies have different concepts of exactly what it means to be middle class in China. For example, HSBC Holdings plc and Deutsche Bank AG have used income to differentiate the middle class from the affluent and laboring classes in China. From an investment bank's perspective, using income level as the defining criterion makes sense. But simply judging a group by income is far from sufficient for marketers of consumer goods. Such marketers trying to reach the middle class have to know more than their salaries: They must know what makes middle class consumers tick.

Income plays a powerful role in most purchasing decisions for any consumer segment, but other elements play a role that is sometimes greater than income. When products are relatively inexpensive, income has little influence on a consumer's decisionmaking process. Deciding to buy chocolate, for example, depends significantly more on consumers' emotion and shopping experience—a store's ambience, for example—than it does on how much money they make. Using income as the only indicator of spending habits allows much information to slip through the cracks. In addition, income is a difficult variable to act upon, in part because the data on income in China tends to be either unavailable or unreliable. Thus, companies must find meaningful alternatives to predict what consumers can afford and what they are willing to pay for certain goods and services. Studies by the Monitor Group indicate that scores of non-income-related hooks—including age, the stage in a consumer's career, and location of purchase—influence purchase decisions.

The Chinese badminton industry is a good example. Most Chinese school kids who play badminton do so in an outdoor playground with a group of friends, wear non-professional badminton sportswear, and purchase a relatively inexpensive racket in a sports stadium or shop near school. Professionals and businesspeople, however, usually play badminton in indoor badminton clubs, gyms, or stadiums. One of the major reasons they play badminton is to make friends or develop business relationships. They are aware of racket brands and wear professional sportswear to display social status.

The differences between school kids and professionals are mainly due to their disparate life stages and buying power. If a sports equipment and apparel company understands the differences between these two segments, it will use varying products and prices to target them through different channels. Nonetheless, even within the professional segments, consumers exhibit distinct buying behavior based on their occupation and level of career development. For example, engineers usually exhibit different buying behavior from marketing professionals, and senior managers may not care as much about brands as junior managers, who tend to buy famous brands to show their emerging social status.

### Quick Glance

- China's middle class, defined here as those earning $6,000 to $25,000, will increase from 87 million in 2005 to 340 million in 2016.
- Several non-income-related hooks, such as age, the stage in a consumer's career, and location of purchase, influence purchase decisions for China's middle class consumers.
- Monitor identified six subsegments within China's middle class, each with its own unique needs and consumption patterns.

## Purchasing power and how the middle class buys

Of all the challenges that the middle class presents to marketers, understanding the specific needs and purchasing power of the group is of utmost importance. Though middle class consumers have rising purchasing power and are increasingly willing to pay more for higher quality, brand names, and differentiated features, they are still price sensitive. Recognizing differences in behavior within middle class segments is essential to success in the Chinese marketplace.

When Inter IKEA Systems B.V. first entered China in 1998, its strategy was to offer stylish furniture at premium prices. The strategy was a flop. Middle class customers filled IKEA's stores to look around but bought less than expected.

In the last few years, however, IKEA has repositioned itself as a brand targeting segments with annual household incomes above ¥40,000 ($5,857). Thanks to achievements in localization, the company has been able to cut prices by an average of 54 percent in more than 1,000 categories since 2005. IKEA broke the bottleneck and succeeded in China because it recognized that middle class consumers wanted and would pay for high-quality products, but not at the same premiums as the affluent class.

## Meet the middle class

China's relatively new middle class consists of a rapidly shifting, diverse population. At present, China's lower middle class accounts for 44 percent of the total middle class. As the middle class matures, however, the number of people in the upper middle class—households that earn $12,000 to $25,000—will spike dramatically. Companies must prepare for the different shopping behaviors of each sub-segment within the middle class. Lower middle class shoppers, for example, tend to buy top-tier products that can display their wealth and status. These middle class consumers sometimes spend a large portion of their income on expensive goods. By contrast, upper middle class shoppers, who are more experienced with different types of brands, will seek out relatively high-quality products without paying as much attention to brands or will pick out products that merely reflect personal tastes.

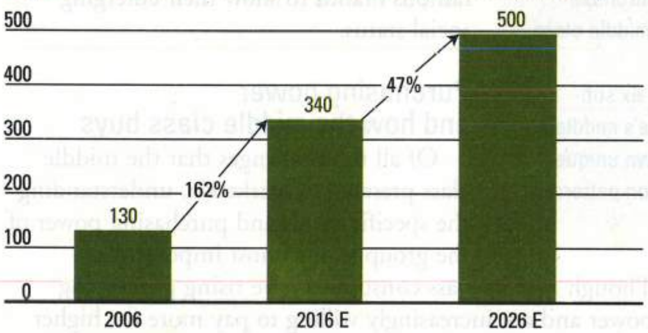
To differentiate customer segments, Monitor Group has used "action segmentation," a market analysis strategy that draws on statistical data from a customer survey with several thousand samples and wide coverage. This methodology identifies multiple consumer segments to help companies address core organizational issues, achieve a well-designed marketing mix, reach growth targets, and more effectively engage their market. In the case of China's middle class, Monitor focused on purchasing behavior and demographic features, rather than income, as the key measures for understanding the middle class.

In one case, Monitor examined the correlation between consumer occupation and purchasing decisions within the tourism industry, the results of which allowed companies to customize their tourist packages more effectively. Monitor found three distinct segments of Chinese tourists: business, leisure, and backpacking travelers. Business travelers have fairly stable travel schedules throughout the year. They are reimbursed for some expenses and tend to spend more than leisure travelers. Leisure travelers enjoy sightseeing and recreational activities and tend to be more cost-conscious and self-organized. Chinese backpackers are willing to spend more and care most about uniqueness and experience. They want more personalized services, such as global positioning systems and specially trained tour guides. Unlike US backpackers, they have money and time and backpack mainly to be fashionable and gain new experiences.

In another case, an examination of the different levels of daily exercise among men and women revealed that although men tend to exercise at a more or less constant rate throughout their lives, women exercise less after marriage and still less after having children. This information helped sportswear companies identify which demographic segments were most profitable to target.

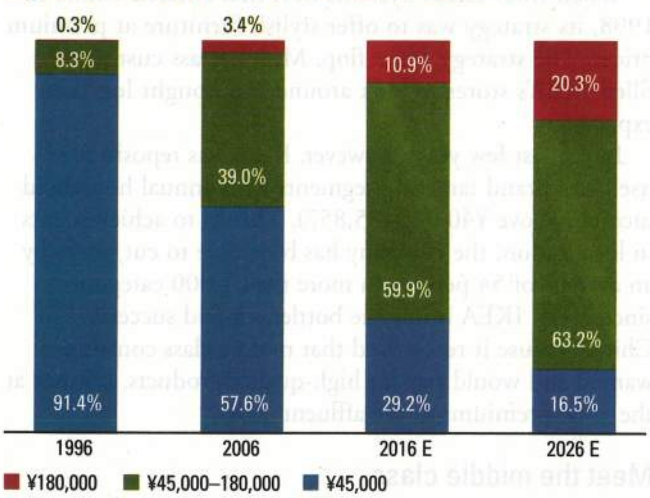
Applying the action segmentation methodology to the Chinese middle class, Monitor identified six sub-segments within the group, each with its own unique needs and

**Figure 1: China's Middle Class Consumers (million)**



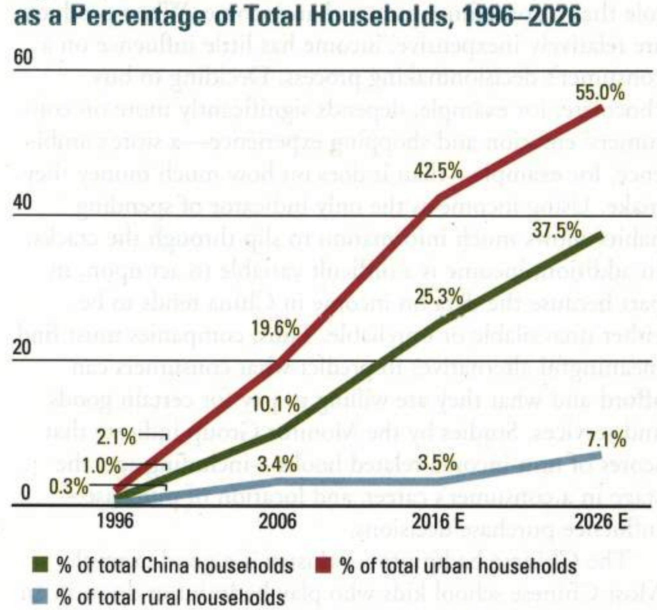

Note: E = estimate
Sources: Global Demographics, PRC State Council Development Research Center (DRC), and Monitor Group

**Figure 2: Urban Household Income in China**




Note: Unadjusted for inflation; E = estimate
Sources: PRC National Bureau of Statistics, Monitor, and Global Demographics

**Figure 3: Middle Class Consumer Households as a Percentage of Total Households, 1996–2026**




Note: E = estimate
Sources: Global Demographics, DRC, and Monitor

consumption patterns. These include Early Heavy Buyers, the Smarts, the Quality-Oriented, Trend Followers, Driven Businesspeople, and Value Seekers.

To serve the specific needs of China's diverse middle class, companies must understand the desires of these six sub-segments and learn how to reach them. Early Heavy Buyers are energetic consumers, consisting primarily of professionals in tertiary industries and junior managers at multinational corporations. They tend to be young and well-educated, with an interest in and exposure to the world outside China. As consumers, they are early adopters of the latest products and aggressively seek out fashion that can help them stand out from their peers. Because they serve as trendsetters, members of this group actively search for information online and share that information with peers. They predominantly make purchases online or by mail order and have a high willingness to spend, especially on discretionary goods such as fashion items and lifestyle products and services. This group of trendsetters stands out from Trend Followers, who attempt to emulate Early Heavy Buyers in certain ways but approach purchasing decisions differently. Trend Followers tend to be junior white-collar workers and civil servants who have some leisure time and a stable salary but are new to the middle class and have less room for discretionary spending. They are less well-informed than Early Heavy Buyers and consequently place more emphasis on the shopping experience. They are also more price sensitive. Though Early Heavy Buyers may be more concerned with being the first to get a new product, Trend Followers will wait for discounts and tend to take advantage of promotions.

Like Trend Followers, Value Seekers are usually junior white collar office workers or government employees. As their incomes rise, they increasingly demand better quality and service, but remain sensitive to price. Though they purchase some goods from relatively inexpensive luxury brands to help show their status, they remain more concerned about value than other middle class segments. Trend Followers may choose products that are in fashion, while Value Seekers tend to look for the best quality-to-price ratio regardless of how popular the item may be at the time.

The final three—the Smarts, the Quality-Oriented, and Driven Businesspeople—tend to be older and to have been in the middle class longer. The Smarts are usually more sophisticated shoppers who prefer to buy from specialty stores and boutiques instead of major outlets. They regularly order business and fashion magazines to stay on top of trends but also rely on word of mouth.

Like the Smarts, Driven Businesspeople are willing to pay premiums for convenience. Driven Businesspeople are relatively wealthy and lead extremely busy lives. They do not have much time to gather information and compare different brands or clothes, but they have higher purchasing power. They usually trust friends' recommendations, develop brand preferences before they buy, and are not price sensitive. They are experienced consumers with high degrees of brand loyalty, especially in fashion. For this group, product and service quality are much more important than price. The Quality-Oriented share much in common with the Smarts and Driven Businesspeople but tend to have more leisure time. More than either of those groups, family is a priority for the Quality-Oriented and has a strong influence on their purchasing decisions. For example, large markets and department stores that carry a range of products

*Continued on p.54*

## Case Study: Foreign-Invested Beer Company

A client from the beer industry approached Monitor Group in 2005 for help identifying and marketing to new consumer segments. The client, a European beer brand with operations in China, had been relatively successful in attracting one segment of the middle class—Early Heavy Buyers. The client's products were popular in entertainment venues, including bars, clubs, and concert halls, but were less successful in other venues, such as restaurants and places where business meetings are held.

Applying the action segmentation methodology, Monitor analyzed customer buying behavior and customer segmentation based on a large consumer survey that included 1,142 consumers in 11 cities across China. The analysis identified 12 distinct consumer segments with varying profitability and strategic importance to the client. The study found that senior managers drink foreign premium brand beer and that their favorite places to drink were restaurants and entertainment venues. In addition, survey results showed that sales of the client's brand were highly correlated with sales venue—highest in high-end entertainment and premium restaurants, where Driven Businesspeople tend to develop their business and social networks, and relatively high in low-end entertainment, where the Smarts go to have fun.

Monitor developed strategies to reach the most important and potentially profitable consumer segments: Driven Businesspeople and Smarts. For the Driven Businesspeople, the company had to focus on winning more customers. For the Smarts, the key was capturing spillover clients from advertising primarily directed at Driven Businesspeople.

By reinterpreting its market and changing the ways it reached customers, the company was able to focus on the consumer groups that offered the highest levels of profitability and simultaneously attract segments that had previously been unresponsive.

*—Allison Cui and Kheehong Song*

# Pillar of the West

## A leader in China's western development faces tough challenges

David Lammie

Chongqing's rise to prominence can be traced back to the middle of the twentieth century. From 1937 to 1945, when Japanese troops occupied Nanjing, Jiangsu (China's capital at the time), the mountainous city of Chongqing was regarded as a safe haven and chosen as the capital of the Guomindang government. Despite heavy bombing by the Japanese, Chongqing's population tripled during World War II and many important institutions and industries were relocated there, laying the foundations for the city's industrial power base. China's future paramount leader, Deng Xiaoping, was the city's first mayor after the People's Republic of China was founded in 1949.

Today, Chongqing is the most important industrial and commercial city in southwestern China. It covers 82,400 sq km—more than Beijing, Shanghai, and Tianjin combined—and has a population of 32 million, though only 6.6 million live in the city proper. Between 2002 and 2007, Chongqing's economy grew 12.6 percent annually, hitting ¥411.2 billion ($60.2 billion) in 2007. Foreign trade expanded 36 percent in 2007 to reach $7.4 billion, of which exports comprised $4.51 billion.


### Manufacturing base

Chongqing's strength lies in heavy industry and a growing multinational corporation (MNC) presence, which has developed rapidly in recent years. Many military factories, set up after 1949 for strategic security, have been converted to civilian use. Attracted by lower costs, a number of prominent domestic appliance manufacturers whose production was previously concentrated in coastal provinces—including Haier Co., Ltd., Midea Group, and TCL International Electrical Co., Ltd.—have recently set up operations there. Government-designated "pillar" sectors, which include the auto, chemical, and pharmaceutical industries, are being consolidated and stripped of old state-owned enterprise functions, such as providing housing and schools for employees. Major export items include motorcycles, autos, auto parts, chemicals, pharmaceuticals, agricultural products, and light industrial goods.

■ **Autos** Chongqing is China's third-largest center of motor vehicle production and the largest for motorcycles. In 2007, it had an annual output capacity of 1 million automobiles and 8.6 million motorcycles.

Chongqing-based ChangAn Automobile Group Co., Ltd. is China's largest producer of minivans and its fourth-biggest automaker. In 2007, the group sold 857,700 vehicles, 23 percent more than in 2006, and its revenues jumped 30 percent to ¥58.1 billion ($8.5 billion). ChangAn also has important joint ventures with Ford Motor Co. and Suzuki Motor Corp. ChangAn Ford Mazda Automobile Co., Ltd., which has an annual capacity of

250,000 units, makes several car models, including the Ford Mondeo sedan, Ford Focus compact hatchback, Ford S-MAX sports utility vehicle, and Mazda 3 and Volvo S40 compact sedans. (The company prefers to assemble Ford models from Europe, rather than the United States, because their fuel economy and safety performance are more closely aligned to Chinese requirements.)

In 2005, Cummins Inc. established a joint venture with Chongqing Automotive Engine Plant, which makes diesel engines for a variety of industrial applications. It employed roughly 1,420 workers and produced 12,000 engines in 2007. In August 2008, Fiat Automobiles SpA announced it would build a new engine plant in the municipality with an annual capacity of 100,000 units.

■ **Heavy industry** Chongqing is home to China's largest aluminum processing plant, operated by Southwest Aluminum Industry Group Co., Ltd. Completed in 2005, the facility has an annual capacity of 300,000 tons of high-grade aluminum and aluminum alloy products. ABB Chongqing Transformer Co., Ltd., a joint venture between ABB Ltd. and Chongqing Transformer Works, supplies large substations, power plants, and hydropower stations to China and overseas. It is ABB's largest transformer plant worldwide.

■ **Chemicals** The local chemicals sector is founded on extensive supplies of natural gas. Yangtze River Acetyls Co., a joint venture between China Petroleum & Chemical Corp. and BP plc, is the largest acetic acid plant in China. Its current annual capacity of 350,000 tons is set to rise to 1 million tons when construction of a new, ¥3.5 billion ($513 million) plant is completed.

■ **Banking and finance** Chongqing is home to more than 300 financial institutions. ABN AMRO Bank N.V., Allied Commercial Bank, Bank of East Asia, Ltd., Bank of Nova Scotia, HSBC Holdings plc, and Standard Chartered Bank all have Chongqing branch offices. Great Eastern Life Insurance Co. Ltd., Liberty Mutual Insurance Co., and Metropolitan Life Insurance Co. all have a presence in the city. Boston-based Liberty Mutual has its China headquarters in Chongqing and was one of the first foreign insurers to establish a presence in western China when it opened a property and accident insurance branch in the city in 2004. It began selling car insurance the following year.

■ **Retail** Carrefour Group and Wal-Mart Stores, Inc. each have three stores in Chongqing. Metro Group of Germany has opened the largest supermarket in western China in the city's downtown area, along with membership shopping centers in the Chongqing Economic and Technological Development Zone.

## Logistics hub

Cost and complexity of transporting freight are probably the biggest challenges facing manufacturers in Chongqing. A 2007 study conducted by Dezan Shira & Associates, a China-based business advisory and tax practice, found that the land and labor costs of establishing an export-oriented manufacturing business in a wealthy coastal city, such as Shanghai, were 40–60 percent higher than in the interior. Yet the cost advantages for inland cities can be outweighed by the difficulties of transporting components and finished products to and from coastal ports.

New investment initiatives, however, are beginning to remove transport barriers. Construction of the Three Gorges Dam has slashed river journey times between the city and Shanghai. A nonstop container service on the 2,500 km route currently takes as little as five days. Deeper water levels in the reservoir also yield benefits. Companies such as Yangtze River Acetyls can operate bigger vessels to and from the city, reducing costs.

Located further upstream than any other significant port on the Yangzi, Chongqing has a huge catchment area and is today the major transshipment point for outbound freight originating in the Southwest. Anticipating a surge

### A Leader in China's Western Development

The city of Chongqing was removed from Sichuan Province in 1997 to become the first non-coastal municipality under the direct control of the central government, a move that made the city the focus of national efforts to develop its western regions under the "Great Western Development Strategy." (The Great Western Development Strategy, launched in 2000, aims to promote growth in western and central China to reduce wealth disparities between inland areas and coastal provinces through massive spending on infrastructure and tax incentives to attract investment.) Local officials hope that rising land and labor costs in the coastal regions, coupled with improved transport connections to the interior, will persuade foreign manufacturers to consider Chongqing a viable investment destination.

Two developments in 2007 underline the city's importance in national affairs. In June, Chongqing and Chengdu were selected by the PRC State Council as pilot cities to deliver coordinated urban and rural planning. Spearheading a national program, the two cities have been given a relatively free rein to design and implement policies that promote social and economic cohesion. Then, in November, Bo Xilai, former Minister of Commerce and political heavyweight, was appointed the city's Chinese Communist Party Secretary.

Chongqing has also become the center for coordinating the resettlement of residents from the Three Gorges Dam project. More than 1 million people have been forced to move because of rising water levels along the Yangzi River due to the dam's construction, and another 4 million will be encouraged to resettle under Chongqing's 2007–20 Urban and Rural Development Plan.

*—David Lammie*

in throughput as a result of shorter river journey times to the coast, Chongqing will invest ¥15 billion ($2.2 billion) in river port expansion and is building the most modern container terminal on the upper Yangzi. On November 25, 2008, the PRC State Council approved Chongqing's application to give Cuntan Harbor bonded port status.

In addition, the municipal government intends to improve its railway infrastructure. It plans to spend ¥13.8 billion ($2 billion) on railways to connect Chongqing's major Yangzi port terminals. Chongqing's railfreight container station will be enlarged to include a container logistics park that will be able to handle 810,000 twenty-foot equivalent units and 1.4 million tons of express cargo each year by 2015. The Shanghai-Wuhan-Chongqing-Chengdu high-speed railway is expected to begin operating in 2012. When the entire project is completed, the travel time between Chongqing and Shanghai will be more than halved, to about 10 hours. Construction of a high-speed rail line between Chongqing and Lanzhou, capital of Gansu, started in September 2008.

Infrastructure within the city has improved as well. Opened in 2005, Chongqing's monorail system consists of 13.5 km of track and 14 stations. It is China's first straddle-type monorail and has a capacity of some 200 million passenger journeys a year.

Chongqing has also earmarked significant funds to improve the road network. The city currently has a 75 km ring road, and existing expressways connect Chongqing with Guizhou and the Sichuan cities of Chengdu, Linshui, Suining, and Wusheng. In the five years following 2006, the local government has pledged to spend ¥44 billion ($6.4 billion) on road construction and improvements to ensure that all villages have paved access to highways at the county and municipal levels. A total of 2,000 km of expressways and 6,000 km of highways linking the city with other key centers will be built. Eventually, the city will have two ring roads—the 75 km road and a second 186 km peripheral expressway—and eight radial expressways will link Chongqing with major cities in Sichuan, Guizhou, and Hubei. More than 20 bridges span the Yangzi and Jialing rivers in Chongqing, and several more are scheduled to be built across the Yangzi by 2010.

Chongqing is set to become western China's largest civil aviation hub and plans to build a network of four airports across the municipality. With a current capacity of 7 million passengers annually, Chongqing Jiangbei International Airport is undergoing a third phase of expansion that is expected to raise its capacity to 25 million passengers a year. The municipal government also plans to increase its air cargo capacity fivefold by 2010.

## Business environment

At the end of 2007, Chongqing was home to 4,451 foreign-invested enterprises (FIEs), with cumulative investment of $19.8 billion. The city had 93 Global Fortune 500 enterprises and its utilized foreign investment jumped 56 percent to $1.09 billion in 2007.

Like other inland cities, however, Chongqing has been unable to keep up with the booming coastal areas in terms of economic development. As a result of weak supply chains and a lack of skilled workers, investment and income levels remain well below those of major coastal cities, such as Shanghai and Tianjin. As an established industrial center, Chongqing has a growing base of companies able to supply new investors. The efficiency of these local suppliers can fall below the expectations of foreign firms, however, and certain components can be hard to find.

Chongqing also faces stiff competition from neighboring cities, especially Chengdu, the capital of Sichuan. Until 1997, Chongqing remained somewhat in the shadow of its local rival. As the provincial capital, Chengdu received more attention and greater investment in fixed

## Chongqing at a Glance

### By the Numbers

| | 2007 | % change over 2006 |
|---|---|---|
| Population | 32.4 million | 1.2 |
| Total GDP | $60.2 billion | 15.6 |
| Fixed-asset investment | $46.3 billion | 28.9 |
| Value-added industrial output | $18.1 billion | 46.0 |
| Consumer price index (%) | 104.7 | NA |
| Government revenue | $11.6 billion | 48.9 |
| Utilized foreign direct investment | $1.1 billion | 56.0 |
| Total trade | $7.4 billion | 36.1 |
| Exports | $4.5 billion | 34.5 |
| Imports | $2.9 billion | 38.7 |

Note: NA = not applicable
Source: Statistical Information of Chongqing (www.cqtj.gov.cn)

### Government Contacts

**Chongqing City Government**
www.cq.gov.cn

**Chinese Communist Party Secretary**: Bo Xilai
**Mayor**: Wang Hongju

**Vice Mayors**: Huang Qifan, Ma Zhengqi, Tong Xiaoping, Xie Xiaojun, Zhou Mubing, Tan Qiwei, Liu Xuepu, and Ling Yueming

**Chongqing Municipal Government, Foreign Affairs Office**
33 Sixin Road, Yuzhong Qu, Chongqing 400015
86-23-6385-0104
http://english.cq.gov.cn

**Chongqing Promotion and Service Center for Foreign Investment**
www.investincq.com

assets, such as transport infrastructure. It also attracted much greater foreign investment, and many MNCs regarded Chengdu as the natural home for establishing regional operations in southwestern China (see the *CBR*, November–December 2008, p.46). To this day, Chengdu boasts more FIEs, especially in the high-tech sector, though in October 2008 Chongqing secured what will be its largest foreign high-tech investment when Hewlett Packard Co. announced it would build a computer plant by 2010 to make desktop computers and laptops.

In addition to supply chain, power, and pollution problems, investors often cite several other shortcomings that make establishing an FIE in Chongqing difficult. These include high levels of corruption, shifting government policies, and few professionals with Western experience. And though factory labor tends to be relatively inexpensive and plentiful, skilled staff are harder to find and can be difficult to lure away from Beijing or Shanghai. There are fewer accounting, consulting, engineering, insurance, and legal professionals than in the big coastal cities, and fewer still who have experience working with MNCs, making these services more costly in Chongqing. Relocation often requires paying a premium in terms of salary and benefits.

Despite investment in transportation infrastructure, Chongqing's lengthy and unpredictable supply chains present **serious difficulties for manufacturers.**

Despite investment in transportation infrastructure, Chongqing's lengthy and unpredictable supply chains present serious difficulties for manufacturers. Power supply has long been a problem. Though the local government has invested heavily in the construction of power sources and urban power grids, and the region is rich in hydropower resources, low water levels caused by drought and increasing demand often lead to power restrictions. According to a Reuters report, Chongqing joined more than a dozen Chinese provinces to ration power in July, as declining coal stocks curbed electricity generation while hot weather boosted demand. Dependency on coal has polluted the air and generated health concerns. The precipitous hills that surround the city exacerbate this problem—acid rain, winter smog, and summertime humidity can make Chongqing an uncomfortable place to live in.

**Chongqing Development and Reform Commission**
www.cqdpc.gov.cn

**Chongqing Administration for Industry and Commerce**
www.cqgs12315.cn

**Chongqing Foreign Trade and Economic Relations Commission**
www.ft.cq.cn

**Chongqing Commerce Commission**
http://wsy.cq.gov.cn

### Major Development Zones

**Chongqing Economic and Technological Development Zone**
www.cetz.com

**Chongqing Chemical Industry Park**
www.cccip.cn

### In good hands

The task of addressing these challenges falls to Chongqing's Chinese Communist Party Secretary Bo Xilai. Most foreign observers believe he has the right experience, political authority, and international profile to turn things around (see p.43). His presence should also reassure foreign investors who remember his time as mayor of Dalian, Liaoning, in the 1990s, when the coastal city enjoyed a period of phenomenal growth and a marked improvement in its physical environment. According to a Western consultant who has recently worked in southwestern China, Bo's main tasks will be to develop public infrastructure, simplify investment procedures, enforce the labor law, and, perhaps most important, balance environmental concerns with development.

During 2008, city officials made a series of trips to foreign countries and coastal cities to promote investment in Chongqing. It is too soon to say whether these trips have been successful, and the much-needed improvements and reforms that have been initiated will still take several years to bear fruit. Initial signs are promising, however, and a number of MNC executives have explored the city as an investment option. But to what extent their interest will be converted into firm investment commitments in the future remains to be seen, especially against the backdrop of a global economic downturn. 完

***David Lammie** is a director of Yangtze Transport Ltd., publisher of* Yangtze Transport 2008, *and organizer of the Yangtze Business Network Conference in Shanghai.*


Courtesy of Pacific Trade International, Inc.

# Pacific Trade International, Inc.

## *A small candle company finds glowing success on both sides of the Pacific*

Virginia A. Hulme

Founded in 1994 by wife-and-husband team Mei Xu and David Wang, Pacific Trade International, Inc. (PTI) has grown from a makeshift candle lab in a basement in Annapolis, Maryland, to a thriving company with revenue from US wholesale operations of about $60 million in 2007. PTI partly owns three Asian manufacturing operations and in 2007 had sales of $20 million in Europe, $2 million in China, and $10 million in Australia, the Middle East, South Africa and South America combined.

### Early days

As a recent graduate in New York in the early 1990s, Xu spent a lot of time window shopping. She liked the sleek, modern styles of designers like Donna Karan and Calvin Klein, but noticed that home furnishings and décor were dominated by traditional, ornate styles. Spotting an opportunity, she and her husband, an engineer by training, decided to "leap into the sea"—they quit their day jobs and set up their own company.

At first, they were not sure what product to sell, but in 1994, a trade show in North Carolina—where they won orders for $90,000 worth of candles from small stores—made the decision easy. Inspired by the natural beauty of the Chesapeake Bay near their home in Maryland, the couple created the Chesapeake Bay Candle brand. That same year, PTI received its first order from a major US retailer, Kirkland's, Inc.

Xu knew that she had to offer new designs to keep customers coming back, but suppliers were unwilling to produce small custom orders. She turned to her Hangzhou-based sister, Li Xu, and proposed that they set up a factory to make candles of their own design. "Setting up the factory turned out to be a strategic decision, leading PTI to become the vertical company it is today—incorporating production, design, and research and development," says Mei Xu. Since then, PTI's product line has expanded to include more than 2,000 varieties of candles and accessories, including scented candles, reed diffusers, room sprays, and scented beads.

## Importance of affordable design

Design lies at the heart of PTI's success. Ever since she was a girl, Mei Xu has been interested in fashion and design. She seems to prefer clean lines and contemporary looks—a style evident in her company's designs today. Many of her team's designs are inspired by nature, with colors and textures that reflect the natural world.

Xu takes pride in the fact that PTI provides well-designed, high-quality products at an affordable price. As she puts it, "When I look back at our success, it's really about style, scent, and ambience—it's the collection of all three. It brings great satisfaction to all of us that we manage to bring great designs, great quality, and great styles to a lot of people. We probably have reached millions of families in the United States, Europe, and China with the type of design that is usually priced higher than most of the middle class can afford." Xu says that design can help a company distinguish itself and make a connection with customers: "Design is a tool that companies can use to differentiate themselves and make a connection with consumers on an emotional level. Part of the reason for the iPod's success is because it gives people a sense of aspiration, of owning something well done. They like to use it, and it becomes emotionally important to them. That's what Chesapeake Bay is striving for. We pay close attention to the glass, the fragrance, the ribbon, the packaging we use in each product. Because through that detail, you tell a story, evoke the feelings you want your consumers to experience."

Xu notes that one of the reasons that PTI has vibrant partnerships with both Target and Kohl's after more than a decade is because these companies value what PTI brings to the table: good design at reasonable, but not rock bottom, prices.

### A nose for profit

Consumers may not always burn a pretty candle, leaving it to be admired year round. But because scented candles release their fragrance through burning, customers burn the candles—and come back for more. (According to the National Candle Association, fragrance is the most important attribute for candle consumers.) As scented candles gained in popularity in the mid-1990s, PTI explored making them. There were two major problems, however. First, no one in China made scented candles at that time, and Xu herself did not know how to make them. Second, the fragranced oil needed to make scented candles was not produced in China, but in Europe and the United States. Though others questioned whether PTI could import fragranced oil to China, make scented candles, and export them to other parts of the world while still offering products at a reasonable price, the company decided to try it.

In 1995, Mei Xu found someone to teach her team how to make fragranced candles, and then went home to try it, using soup cans for molds. Little did she know she had forgotten to add a chemical that was necessary to make the candle wax blend smoothly with the fragranced oil. As a result, the candles came out not one uniform color, but with a snowflake effect. The unintended snowflake effect gave the candles a beautiful handmade look and distinguished Chesapeake Bay Candles from those of other vendors. They were a hit with buyers and soon appeared on the shelves of stores such as Bloomingdale's Inc. and Nordstrom Inc.

### Global inspiration

Mei Xu and her team constantly update their products with new textures, new shades of color, and new scent combinations—apples and ginger, or lavender with iris, for instance—and often travel to Europe, Asia, and around the United States for inspiration. Earlier in her career, Xu had worked as a consultant for the World Bank in Beijing. During that time, her work not only took her to countries such as India, Mongolia, and Bangladesh but introduced her to colleagues from around the world. This exposure to different places and people is highly valued at PTI, where designs reflect elements from around the globe.

## From candles to home accessories

To handle growing demand and keep its product lines fresh, PTI opened a design center in Rockville, Maryland, in 1995 and a design and sourcing center in Shanghai in 2006 and began working with third-party distribution centers in California and Minnesota in 1997. In 1995, PTI established a joint venture in China, and now partly owns factories in Hangzhou, China, and in Haiphong, Vietnam. PTI also opened a showroom and sourcing center in Hong Kong in 2002. The company now employs nearly 2,000 people, most of whom work in the factories in China and Vietnam.

**Quick Glance**

- Founded as a small, home-based business in 1994, Pacific Trade International, Inc. has grown into a company with global revenue of roughly $92 million in 2007.
- China's retail market is highly fragmented.
- The sleek modern designs of Chesapeake Bay Candle and Blissliving Home are finding success in both the United States and China.

In 2005, Mei Xu launched Blissliving Home as a separate US company and brand focusing on luxurious, upscale bedding. Blissliving Home owns the worldwide brand license to the Blissliving Home brand and products and partially owns Blissliving Home Fashion Products (Hangzhou) Co. Ltd., which distributes products in China. Blissliving Home focuses on bedding but also sells candles and other accessories for the home. Both Blissliving Home and PTI may soon expand their product lines to include towels, bathroom accessories, and bedroom furniture.

## Selling in China

China's retail market tends to be skewed toward the top and the bottom. According to Mei Xu, most consumers are either looking for a bargain or want to show their status with an expensive purchase. PTI's and Blissliving Home's customers in China are mostly young people in their 20s who have not yet bought a home and are reluctant to spend a lot of money on decorating a rental unit. Many products, especially those in the Blissliving Home line, are priced beyond their means. In contrast, the brand's US customers, who range in age from roughly 20 to 60, can afford the products. Moreover, US consumers of all ages seem to appreciate contemporary designs, while older Chinese consumers tend to prefer more traditional designs. As a result, PTI and Blissliving Home are caught in the middle of the market, in terms of price and consumer preferences.

Though China's consumer market is growing as the country develops, its retail landscape is still highly fragmented. Unlike in the United States, where a few chains operate nationwide, each city in China has its own major department store. Most department stores lease space to vendors to set up boutiques within the store. Each vendor has its own inventory and fixtures, but payment goes through the department store. The department store usually sets a sales goal for each vendor and keeps a portion of sales revenue. Demand for retail space inside department stores has been so strong in recent years that at some stores vendors wait as long as five years for floor space, according to Xu.

Only a few Chinese stores have a nationwide presence. For instance, China's second-largest retailer, Shanghai-based Bailian Group Co., Ltd., which is owned in part by the Shanghai government, owns 14 department stores in Shanghai and three in other provinces. Bailian is also developing malls in major Chinese cities. Even when dealing with Bailian, vendors must negotiate separately with each store. This stands in sharp contrast to how vendors work with major retailers in the United States, where a vendor negotiates with a single buyer to have its product placed in stores nationwide.

Another retail option in China is, of course, freestanding stores. The problem with this channel, according to Mei Xu, is that pedestrian shopping in China focuses on food and fashion, not home décor. Most people are out for a meal or a haircut, or are browsing for clothes, and are not thinking about home décor. As a result, Blissliving Home's

> Though China's consumer market is growing as the country develops, its retail landscape is still highly fragmented.

## Global sourcing

In 1994, PTI regarded China primarily as a manufacturing base and sourced items from the United States and Europe. Now, PTI sources and designs in China, though some inputs are sourced from other countries. Palm oil for candles may come from Malaysia and Indonesia, while fragranced oil is imported from Europe and the United States. Wicks and dyes are imported from Germany, as was the Hangzhou facility's most expensive machine—the tea-light machine. The Blissliving Home line incorporates high-end cloth from around the world—Italian cotton and silk, Egyptian cotton, Indian silk, and Turkish cotton toweling—which is then made into sheets, duvet covers, pillowcases, and other items in China.

## US sales take off

By 1996, PTI was shipping product worth \$5–\$6 million each year. In 1997, the company began working with Target Corp., and sales skyrocketed. That year, sales hit \$8.4 million, nearly three times the goal Target had set for PTI products. That same year, Kohl's contacted PTI and began selling Chesapeake Bay Candle products. In the United States, Chesapeake Bay products are sold through major retailers, such as Fred Meyer, Inc.; Inter IKEA Systems B.V.; JC Penney Corp., Inc.; Kohl's Corp.; Pier 1 Imports, Inc.; and Target. In 2008, the company launched the Chesapeake Bay Signature Collection, sold direct on the Internet and by catalogue, as well as in boutique stores. Chesapeake Bay products are also sold in Europe and Australia through Carrefour SA, IKEA, Marks & Spencer Group plc, and Target Australia Pty Ltd.

Blissliving Home products are sold directly through freestanding boutiques and in department stores in China. In the United States and Canada, Blissliving Home products are sold online, through catalogues, and in boutiques and specialty stores.

freestanding stores did not do very well.

Now Blissliving Home is experimenting with malls, which operate like US malls in that each store is individually owned. In China, malls are often devoted to a particular product, as Chinese consumers like to compare the quality and price of several products before buying. Blissliving Home's first choice for placement of its products is a mall devoted to softer furnishings, such as bedding and curtains. "Furniture malls"—malls full of stores dedicated to home repair and decoration—are the next choice. (Most new housing units in China are sold as empty shells, without flooring, lighting, or bathroom or kitchen fixtures, so one-stop places to buy these items are popular.) Blissliving Home now has a presence in 15 traditional malls and 5 home furnishing malls. Including these outlets, the company directly owns four stores in Beijing, three in Shanghai, and three in Hangzhou and has 20 franchises in cities across China.

Courtesy of PTI

Blissliving Home also sells wholesale to companies who use candles as gifts or as employee incentives. The company is also working with hotels in the United States, such as St. Regis and W Hotels, which use its candles and bedding. The company hopes to place its products in more hotels and introduce them to spas.

## Eco-friendly practices

Since the days when she worked as a World Bank consultant on water and sanitation projects, Mei Xu has been concerned about the environment, and her companies strive to use environmentally friendly practices whenever possible. They constantly seek ways to use less packaging and more recycled materials and encourage consumers to do the same. In its candles, PTI uses natural ingredients when possible. In 2008, it introduced a line of candles made largely of soy and palm oil instead of paraffin-based wax and plans to use more soy blends in future. The company is also working to eliminate acetate from its packaging.

The Blissliving Home line also incorporates eco-friendly practices when possible. Many of its products are made of organic cotton, and currently three collections are Oeko-Tex certified, meaning that the raw materials and chemicals used in production do not harm the environment or human health.

Xu explains further: "We look for partners in Europe and Asia that can produce organic products and eco-friendly dye—I'm not saying organic, because it's difficult to make high-quality organic dye—but eco-friendly dye that minimizes risk to the environment. We do have organic bedding, but we can't dye it. Instead, we use embroidery to decorate it, but so far it has not been very successful because of the lack of color. Color is essential to our business, so our next initiative is to find a partner with the technology who can meet our schedule demands.

In general, our company will adopt more technology and work with more vendors that are innovative in the environmental area to introduce sound and marketable products. That's very important. It's one thing to stay green, but it's another to bring quality products. You don't want bedding that will change color every time you wash it. That's not quality. We're trying to strike a balance, and we aim to bring the best environmental standards and technology to our candle and bedding products."

## Consumption boom

Though the current economic climate poses a challenge, over the longer term, China's economic development and the rise of its middle class is fueling a consumption boom that bodes well for makers of consumer products. In addition, the growing sophistication of China's middle class—gained through exposure to different ideas, styles, and fashions through better education, the Internet, and travel—also augur well for the sleek designs of Chesapeake Bay Candle and Blissliving Home. 完

***Virginia A. Hulme** is editor of the* CBR.

## Sales and Investment

September 16–November 15, 2008

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

*Compiled by Nicholas Chu*

### Accounting

OTHER

**China-Biotics, Inc. (Shanghai)**
Hired KPMG Advisory (China) Ltd., a unit of Netherlands-based KPMG, to assist it in complying with the financial reporting and controls requirements of Sarbanes-Oxley Act Section 404. 10/08.

**ShengdaTech, Inc. (Shandong)**
Selected Netherlands-based KPMG as its independent auditor. 11/08.

### Advertising, Marketing & Public Relations

CHINA'S IMPORTS

**UTStarcom Inc. (US)**
Signed agreement with Best Tone Information Service Corp. Ltd., a wholly owned subsidiary of Beijing-based China Telecom, to deploy a video information distribution network in Hunan. 10/08.

### Architecture, Construction & Engineering

CHINA'S EXPORTS

**CBMI Construction Co., Ltd., a unit of Sinoma International Engineering Co., Ltd. (Beijing)**
Won contract from Azerbaijan-based Garadagh Cement OJSC to build a cement clinker production line with daily production capacity of 4,000 tons. $218 million. 10/08.

**China Wuyi Co., Ltd. (Fujian)**
Won bid to expand a highway connecting two cities in Kenya. $109.2 million. 09/08.

CHINA'S INVESTMENTS ABROAD

**Changsha Zoomlion Industry Science and Technology Development Co. Ltd. (Hunan)**
Signed puchase agreement to acquire 60% stake in Italy-based Compagnia Italiana Forme Acciaio SpA, a construction machinery producer. $205 million. 09/08.

INVESTMENTS IN CHINA

**Suez Environment (France)**
Signed two agreements with Chongqing Water Group for a drinking water concession project in Chongqing and for an industrial water and wastewater concession project in the Changshou Chemical Industry Park. 09/08.

### Automotive

INVESTMENTS IN CHINA

**Affinia Acquisition LLC, a wholly owned subsidiary of Affinia Group Holdings Inc. and an affiliate of Affinia Group Inc. (US)**
Acquired Shandong-based Longkou Haimeng Machining Co., Ltd., a brake drum and rotor manufacturer, by purchasing 85% of the shares of HBM Investment Ltd. 11/08.

**BASF SE (Germany)**
Will build a plant in Shanghai to manufacture automotive spring aids made of Cellasto for 5 million vehicles per year. 10/08.

**Charter Automotive, a division of Charter Manufacturing, Co., Inc. (US)**
Opened a manufacturing, warehouse, and distribution center in Wuhu, Anhui. 09/08.

**Kumho Tires Co., Inc. (US)**
Opened a 90,000 sq ft plant with annual capacity of 300,000 tires in Nanjing, Jiangsu. $100 million. 11/08.

**MidAmerican Energy Holdings Co., a subsidiary of Berkshire Hathaway Inc. (US)**
Will purchase 225 million shares of Guangdong-based BYD Co., Ltd. to acquire 10% stake. $230 million. 09/08.

**Mitsubishi Motors Corp., Mitsubishi Corp. (Japan)**
Will form JV, Mitsubishi Motor Sales (China) Co., to import and sell Mitsubishi vehicles in Shanghai. $31 million. 10/08.

**Sichuan FAW Toyota Motor Co., a JV between Japan-based Toyota Motor Co. and Jilin-based China FAW Group Corp.**
Will build a plant with annual production capacity of 100,000 Toyota Corollas in Changchun, Jilin. $583.8 million. 10/08.

### Aviation/Aerospace

OTHER

**Airbus SAS (France)**
Signed MOU on safety cooperation with Beijing-based CAAC. 09/08.

**Aircraft Maintenance and Engineering Corp., a JV between Deutsche Lufthansa AG (Germany) and Air China Ltd. (Beijing)**
Signed overhaul agreement with Air-India Express to conduct safety checks on nine Boeing 737-800 aircraft. 09/08.

### Banking & Finance

CHINA'S INVESTMENTS ABROAD

**BOC (Beijing)**
Will acquire 20% stake in France-based La Compagnie Financiere Edmond de Rothschild. $340 million. 09/08.

**China Investment Corp. (Beijing)**
Will raise its stake in US-based the Blackstone Group LP from 9.9% to 12.5% by purchasing shares on the open market. 10/08.

**ICBC (Beijing)**
Opened a subsidiary bank, ICBC Middle East, in Dubai. 10/08.

INVESTMENTS IN CHINA

**F&C Asset Management plc (UK)/Hua Xia Bank (Beijing)**
Will form JV fund management company in China. 10/08.

**Intel Capital, a unit of Intel Corp. (US)**
Will invest in three Chinese firms, Shenzhen-based Trony Solar Holdings Co., a solar energy equipment manufacturer; Jilin-based NP Holdings Ltd., an electricity storage specialist; and Beijing-based Viewhigh Technologies Ltd., a healthcare software firm. 11/08.

**Invesco WL Ross, a unit of Invesco Ltd. (US)/Huaneng Capital Services, a subsidiary of China Huaneng Group (Beijing)**
Formed JV to pursue private equity investment opportunities in China's power generation sector. (US:50%-PRC:50%). 09/08.

OTHER

**Apax Partners LLP (UK)**
Will open an office in Shanghai to enter China market. 11/08.

**China UnionPay (Shanghai)**
Signed strategic MOU with UK-based HSBC Holdings plc to explore Asia-Pacific markets. 10/08.

**Dalian Commodity Exchange (Liaoning)**
Signed MOU with US-based NYSE Euronext, Inc. to develop futures and options markets in the two countries and internationally. 11/08.

**HSBC Bank (China) Co., Ltd., a unit of HSBC Holdings plc (UK)**
Opened a branch in Zhengzhou, Henan. 10/08.

**Shanghai Stock Exchange**
Signed MOU with Tel Aviv Stock Exchange to enhance cooperation and establish an exchange of delegations. 11/08.

**Standard Chartered Bank (China) Ltd., a subsidiary of Standard Chartered plc (UK)**
Signed strategic cooperation agreement with Beijing-based China Communications Construction Co., Ltd. to provide financial services. 09/08.

**Zhengzhou Commodity Exchange (Henan)**
Signed MOU with US-based NYSE Euronext, Inc. to develop futures and options markets and establish a long-term partnership. 11/08.

## Chemicals, Petrochemicals & Related Equipment

### CHINA'S IMPORTS

**Dow Epoxy, a unit of Dow Chemical Co. (US)**
Signed 10-year raw materials supply agreements with Shanghai Tian Yuan Huasheng Chemical Co., Ltd., a wholly owned subsidiary of Shanghai Chlor-Alkali Chemical Co., Ltd., for two proposed plants in Shanghai. $400 million. 10/08.

### CHINA'S INVESTMENTS ABROAD

**Sinopec (Beijing)**
Signed deal to acquire Canada-based Tanganyika Oil Co., Ltd. $2 billion. 09/08.

### INVESTMENTS IN CHINA

**ContiTech AG, a division of Continental AG (Germany)**
Will build a production plant in Changshu, Jiangsu. $38.2 million. 10/08.

**Israel Chemicals Ltd.**
Signed cooperative agreement with Sichuan Provincial People's Government to establish a phosphate chemical base in Leshan, Sichuan. $350 million. 10/08.

**Linde Gas (Hong Kong) Ltd., a wholly owned subsidiary of the Linde Group (Germany)/Sinopec Fujian Petrochemical Co., Ltd., a subsidiary of Sinopec (Beijing)**
Formed JV, Fujian Linde-FPCL Gases Co., Ltd., to produce and distribute nitrogen, oxygen, and argon in Quanzhou, Fujian. (Germany:50%-PRC:50%). $127 million. 09/08.

**OXEA GmbH (Germany)/ Chengxing Industrial Group (Jiangsu)**
Will form JV to build a plant for the production of amines and other chemicals in Changzhou Yangzi River Chemical Industrial Park. 09/08.

**PPG Industries (US)**
Acquired automotive refinish coatings business of the Bonny Coating-Made Co., Ltd., in Guangzhou, Guangdong. 09/08.

**Thai Rubber Group/Sinochem International Co., Ltd., a subsidiary of Sinochem Corp. (Beijing)**
Will form JV to build a latex plant with annual capacity of 30,000 tons in Hainan. (Thailand:35%-PRC:65%). $21.9 million. 10/08.

**The Blackstone Group LP (US)**
Acquired 20% stake in China National Bluestar Group Corp., a subsidiary of Beijing-based China National Chemical Corp. $600 million. 10/08.

## Distribution, Logistics & Related Services

### INVESTMENTS IN CHINA

**Agility Global Integrated Logistics (Kuwait)**
Signed deal to acquire Baisui United Logistics (Shanghai) Co., a provider of freight forwarding services. $50.5 million. 09/08.

## Electronics, Hardware & Software

### CHINA'S INVESTMENTS ABROAD

**VanceInfo Technologies Inc. (Beijing)**
Signed definitive agreement to acquire US-based Wireless Info Tech Ltd., a mobile testing and application development services provider. 09/08.

### INVESTMENTS IN CHINA

**Hewlett-Packard Co. (US)**
Will build a 20,000 sq m facility in Chongqing to manufacture personal computers for Chinese consumers. 10/08.

**IBM Corp. (US)**
Acquired 20% of Intelligent Transportation Systems, a unit of Shandong-based Hisense Group. 10/08.

**Microsoft Corp. (US)**
Will invest in staffing and resources for R&D in China over the next three years. $1 billion. 11/08.

**MTS Systems Corp. (US)**
Acquired the assets of Guangdong-based SANS Group. $43.6 million. 10/08.

**Siemens Automation and Drives Group, a unit of Siemens AG (Germany)**
Acquired Zhejiang-based Shanghai APT Co., Ltd., a low-voltage control component manufacturer. 09/08.

**Vmware, Inc. (US)**
Will more than double its R&D staff in China within 18 months. 11/08.

### OTHER

**China Security & Surveillance Technology, Inc. (Guangdong)**
Signed partnership MOU with India-based CMS Computers Ltd. to explore security and surveillance business opportunities in India. 11/08.

**Draka Holding NV (the Netherlands)**
Signed agreement with Beijing-based China Telecom and Wuhan Yangtze Communications

Abbreviations used throughout text: ABC: Agricultural Bank of China; ADB: Asian Development Bank; ASEAN: Association of Southeast Asian Nations; ATM: automated teller machine; AVIC I and II: China Aviation Industry Corp. I and II; BOC: Bank of China; CAAC: Civil Aviation Administration of China; CATV: cable television; CBRC: China Banking Regulatory Commision; CCB: China Construction Bank; CCTV: China Central Television; CDB: China Development Bank; CDMA: code division multiple access; CEIEC: China National Electronics Import and Export Corp.; China Mobile: China Mobile Communications Corp.; China Netcom: China Netcom Corp. Ltd.; China Railcom: China Railway Communications Co., Ltd.; China Telecom: China Telecommunications Group Corp.; China Unicom: China United Telecommunications Corp.; CIRC: China Insurance Regulatory Commission; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CNOOC: China National Offshore Oil Corp.; CNPC: China National Petroleum Corp.; COFCO: China National Cereals, Oils, and Foodstuffs Import and Export Corp.; COSCO: China Ocean Shipping Co.; CSRC: China Securities Regulatory Commission; DSL: digital subscriber line; ETDZ: economic and technological development zone; GSM: global system for mobile communication; GPS: global positioning system: ICBC: Industrial and Commercial Bank of China; IP: Internet protocol; IT: information technology; JV: joint venture; LNG: liquefied natural gas; LOI: Letter of intent; MIIT: Ministry of Industry and Information Technology; MOFCOM: Ministry of Commerce; MOU: memorandum of understanding; NA: not available; NDRC: National Development and Reform Commission; NORINCO: China North Industries Corp.; PAS: personal access system; PBOC: People's Bank of China; PetroChina: PetroChina Co., Ltd.; RMB: renminbi; R&D: research and development; SARFT: State Administration of Radio, Film, and Television; SASAC: State Assets Supervision and Administration Commission; SEZ: special economic zone; Sinopec: China Petroleum & Chemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; UNDP: United Nations Development Program; SME: small and medium-sized enterprise; Wi-Fi: wireless fidelity; WFOE: wholly foreign-owned enterprise.

Industry Group to extend the Yangtze Optical Fibre and Cable Co., Ltd. JV until May 2028. (The Netherlands:37.5%-PRC:62.5%). 10/08.

## Energy & Electric Power

CHINA'S INVESTMENTS ABROAD

**China Guangdong Nuclear Power Co.**
Will acquire a 49% stake in Canada-based UraMin Inc. from France-based Areva SA. 10/08.

**Government of the PRC**
Signed agreement with the Government of Pakistan to help build two nuclear power plants with total capacity of 680 MW. 10/08.

**Shandong Electric Power Construction Co. III, a subsidiary of Shandong Electric Power Construction Corp.**
Signed deal with Jordan-based Samra Electric Power Generating Co. to install a gas-powered generator unit with annual capacity of 100 MW. 09/08.

INVESTMENTS IN CHINA

**Areva SA (France)/China Guangdong Nuclear Power Co.**
Will form JV to design and build second- and third-generation nuclear reactors in China and eventually abroad. (France:45%-PRC:55%). 10/08.

**Areva SA (France)/Shanghai Electric Group**
Signed partnership agreement to build two transformer manufacturing sites in Wuhan, Hubei, and Shanghai. 09/08.

## Environmental Equipment & Technology

CHINA'S EXPORTS

**ET Solar Group Corp. (Jiangsu)**
Signed sales contract with Italy-based Helios Technology to supply a total of 15 MW photovoltaic modules. 10/08.

**LDK Solar Co., Ltd. (Jiangxi)**
Signed seven-year contract to supply 70 MW of multicrystalline solar wafers to Italy-based Helios Technology. 10/08.

CHINA'S IMPORTS

**ABB Ltd. (Switzerland)**
Signed contract with Jiangxi-based LDK Solar Co., Ltd. to provide management services, electronic systems, and equipment. $36 million. 09/08.

## Food & Food Processing

CHINA'S IMPORTS

**Gamma Pharmaceuticals Inc. (US)**
Signed contracts with three distribution companies in China to supply its Brilliant Choice Vitamins in Shandong, Zhejiang, and Beijing. 09/08.

CHINA'S INVESTMENTS ABROAD

**Good Life China Corp. (Beijing)**
Will acquire Canada-based Fun Energy Foods Inc. 10/08.

INVESTMENTS IN CHINA

**Krispy Kreme Doughnuts, Inc. (US)**
Signed franchise agreement with KKD Lotte Holdings Co., Ltd., a unit of South Korea-based Lotte Group, to develop about 35 Krispy Kreme retail locations in Beijing, Shanghai, and Tianjin over the next 4-5 years. 10/08.

**Nestle SA (Switzerland)**
Established a R&D center in Zhongguancun Environmental Protection Park, Beijing, its second one in China. $10.3 million. 11/08.

**PepsiCo, Inc. (US)**
Will invest in a variety of capital programs to expand manufacturing capacity in China, particularly in central and western areas, over the next 4 years. $1 billion. 11/08.

## Human Resources

INVESTMENTS IN CHINA

**Coatings AG, a division of BASF SE (Germany)**
Opened a training center in Shanghai to meet the increasing demand for automotive spray painting professionals and body shop staff. 09/08.

## Insurance

INVESTMENTS IN CHINA

**Taiwan Life Insurance Co., Ltd./Xiamen C&D Inc. (Fujian)**
Won approval to form life insurance JV, King Dragon Life Insurance Co., Ltd., in Fujian (Taiwan:50%-PRC:50%). 10/08.

OTHER

**Aegon-CNOOC Life Insurance Co., a 50-50 JV between Aegon NV (the Netherlands) and CNOOC (Beijing)**
Won CIRC approval to open a branch in Tianjin. 10/08.

## Internet/E-Commerce

INVESTMENTS IN CHINA

**Nielsen Online, a service of the Nielsen Co. (US)/ChinaRank, a unit of Beijing Zhongqian Wangrun Information Technology Co., Ltd.**
Will form JV to develop and deliver Internet measurement and analysis services in China. 10/08.

## Media, Publishing & Entertainment

CHINA'S INVESTMENTS ABROAD

**Hurray! Holding Co., Ltd. (Beijing)**
Signed agreement to acquire 61.1% stake in Taiwan-based Seed Music Group Ltd. $3 million. 09/08.

INVESTMENTS IN CHINA

**a-Peer Holding Group (US)/ Shanghai Synergy Culture and Entertainment Group, a subsidiary of Shanghai Media & Entertainment Group**
Will form digital music JV, a-Peer Synergy Shanghai Culture and Technology Co., to expand opportunities in the Chinese music market. 09/08.

**National Basketball Association, Anschutz Entertainment Group, Inc., a wholly owned subsidiary of the Anschutz Company (US)**
Formed JV to design and develop multipurpose arenas in major Chinese cities. 10/08.

## Medical Equipment & Devices

CHINA'S IMPORTS

**Chindex International, Inc. (US)**
Won contract to be main supplier for whole-body, color ultrasound systems to the People's Liberation Army hospital system for 2008 procurement program. 09/08.

**Shanghai Universal Biotech Co.**
Signed agreement to become the exclusive distributor for an enzyme manufactured by Japan-based Carna Biosciences, Inc. 10/08.

INVESTMENTS IN CHINA

**NeoStem, Inc. (US)**
Will acquire China Biopharmaceuticals Holdings, Inc. 11/08.

## Metals, Minerals & Mining

CHINA'S EXPORTS

**China Minmetals Corp. (Beijing)**
Signed contract to construct a rail and structural steel mill for Russia-based Mechel OAO. $300 million. 10/08.

CHINA'S IMPORTS

**Siemens VAI Metals Technologies, a unit of Siemens AG (Germany)**
Will supply Tianjin Tiantie Metallurgical Group Steel Plate Ltd. Co. with turnkey process equipment for a new continuous annealing line. 11/08.

**Siemens VAI Metals Technologies, a unit of Siemens AG (Germany)**
Won five orders from five Chinese steel producers to install dry-type dedusting systems at their plants. $37.6 million. 09/08.

# China Business

CHINA'S INVESTMENTS ABROAD

**Kailuan Clean Coal Co., Ltd. (Hebei)**
Signed agreement with Canadian Dehua Mines Group, a unit of Canadian Dehua International, to form JV to develop the Gething coal mine in Canada. (Canada:51%-PRC:49%). 09/08.

**Sinosteel Corp. (Beijing)**
Won Australian government approval to acquire 49.9% stake in Murchison Metals Ltd., an Austrialian iron ore prospector. 09/08.

INVESTMENTS IN CHINA

**Himadri Global Investment Ltd., a wholly owned subsidiary of Himadri Chemicals and Industries Ltd. (India)**
Signed agreement with a Chinese company to form JV to take over a coal tar distillation plant in Xiaoyi, Shanxi. (India:90%-PRC:10%). 09/08.

**Midas Holdings Ltd. (Singapore)/Aluminum Corp. of China Ltd. (Beijing), Northeast Light Alloy Co., Ltd., a subsidiary of Aluminum Corp. of China Ltd.**
Signed LOI to form JV to manufacture thick aluminum alloy plates and sheets. (Singapore:35%-PRC:65%). 10/08.

**Peabody Energy (US)**
Signed agreement with Inner Mongolia-based Jitong Railway Group Ltd. Co., the Government of Inner Mongolia, and the Administration Office of Xilinguole Region to explore a surface mine and develop a downstream coal gasification facility. 10/08.

**Siemens VAI Metals Technologies, a unit of Siemens AG (Germany)**
Will construct a new 5 m plate rolling mill for Hunan Valin Xiangtan Iron & Steel Co., Ltd., a subsidiary of Hunan Valin Iron & Steel Group Co., Ltd. 10/08.

OTHER

**Tube City IMS, LLC (US)**
Signed strategic cooperation agreement with Beijing-based Sinosteel Corp. 10/08.

## Petroleum, Natural Gas & Related Equipment

CHINA'S IMPORTS

**ODIM ASA (Norway)**
Won contract to supply Hebei-based BGP Inc. with two equipment packages for an offshore drilling vessel. $5.2 million. 10/08.

**ODIM ASA (Norway)**
Won contract to supply Zhejiang Shipyard, a subsidiary of Shanghai-based Sinopacific Shipbuilding Group, with two advanced deepwater cranes. $14.1 million. 10/08.

CHINA'S INVESTMENTS ABROAD

**CNPC (Beijing)**
Signed deal with the Government of Iraq to help develop the al-Ahdab oil field in eastern Iraq. $2.9 billion. 11/08.

**CNPC (Beijing)/Uzbekneftegaz (Uzbekistan)**
Signed agreement to jointly develop an oilfield in Uzbekistan. 10/08.

INVESTMENTS IN CHINA

**OAO Rosneft Oil Co. (Russia)/PetroChina (Beijing)**
Will sign agreement to form JV to build a refinery with annual capacity of 15 million metric tons in Tianjin. $8.8 million. 09/08.

## Rail

INVESTMENTS IN CHINA

**General Electric (China) Ltd., a subsidiary of General Electric Co. (US)/CSR Qishuyan**

**Locomotive and Rolling Stock Co., Ltd., a subsidiary of China South Locomotive and Rolling Stock Industry (Group) Corp. (Beijing)**
Signed supplementary LOI to form JV to produce, assemble, test, and sell diesel engines with an annual capacity of 650 units. (US:50%-PRC:50%). $90 million. 09/08.

### Real Estate

OTHER

**AMB Property Corp. (US)**
Pre-leased 139,000 sq ft at its port development in Ningbo, Zhejiang, to US-based Globe Express Service Co., Ltd. 10/08.

**AMB Property Corp. (US)**
Pre-leased 128,000 sq ft at its port development in Ningbo, Zhejiang, to Ningbo Ruiyuan Logistics Co. 10/08.

**ProLogis (US)**
Leased 174,000 sq ft of industrial distribution space in Shanghai to Shanghai Linghua Logistics Co., Ltd., a subsidiary of Japan-based Mitsubishi Logistics Corp. 10/08.

**ProLogis (US)**
Leased 192,000 sq ft of industrial distribution space in Shanghai to US-based Parker Hannifin Corp. 09/08.

**ProLogis (US)**
Leased 266,000 sq ft of industrial distribution space in Hangzhou, Zhejiang, to Shandong-based Joyoung Co., Ltd., a home appliance manufacturer. 09/08.

### Real Estate & Land

INVESTMENTS IN CHINA

**Abu Dhabi Investment House (UAE)/Shanghai Construction (Asia) Co., Ltd.**
Signed MOU to form JV to acquire 16 real estate projects in China. (UAE:50%-PRC:50%). $6 billion. 09/08.

**Pramerica Real Estate Investors, a unit of Prudential Financial, Inc. (US), Minmetals Land Ltd. (Hong Kong)**
Will form JV to invest in a housing project in Nanjing, Jiangsu. $146 million. 09/08.

### Telecommunications

CHINA'S EXPORTS

**China Great Wall Industry Corp. (Beijing)**
Will build and launch a telecom satellite for Pakistan. 10/08.

**Telestone Technologies Corp. Ltd. (Beijing)**
Won contracts from Vietnam Posts and Telecommunications Group and its subsidiary, Vietnam Telecom Services Co., to supply two indoor coverage programs. 09/08.

CHINA'S IMPORTS

**Alcatel Shanghai Bell, a subsidiary of Alcatel-Lucent; Thales Rail Signalling Solutions Inc., a unit of Thales SA (France)/Shanghai Automation Instrumentation Co.**
Won contracts from Shanghai Shentong Group Co. to provide communications systems for Shanghai's new metro Line 11. $76 million. 09/08.

**RADCOM Ltd. (Israel)**
Selected by a Chinese mobile operator to monitor and troubleshoot wireless softswitching. 09/08.

**Trapeze Networks, a subsidiary of Belden Inc. (US)**
Will deploy more than 3,000 access points for the Hangzhou Wi-Fi Metropolitan Area Network project in Zhejiang. 09/08.

INVESTMENTS IN CHINA

**Trapeze Networks, a subsidiary of Belden Inc. (US)**
Will open a R&D center in Hangzhou, Zhejiang. 10/08.

### Tourism & Hotels

INVESTMENTS IN CHINA

**Actis Capital LLP (UK), Warburg Pincus LLC (US)**
Will invest in Guangzhou-based 7 Days Inn to expand its national hotel network and strengthen its capital structure. $65 million. 10/08.

OTHER

**InterContinental Hotels Group plc (UK)**
Signed deals to manage two new hotels, InterContinental Wuhan and Holiday Inn Wuhan New City, in Wuhan, Hubei. 09/08.

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MARKETING

# Understanding China's Middle Class

*Continued from page 41*

important to a family are the major purchasing channels for the Quality-Oriented, and television is their dominant information resource for new products.

Monitor helped a sportswear client target two of the six middle class segments—Driven Businesspeople and Value Seekers—by understanding different buying habits. To better target Driven Businesspeople, Monitor recommended that its client market products in mid-range to high-end gyms and fitness clubs, where many businesspeople usually go, to develop brand awareness and attract customers. Monitor also recommended that its client place mid-to-high-end products in department stores and flagship shops, where Driven Businesspeople usually go to buy sportswear. By contrast, to target Value Seekers, Monitor recommended that the client become more aware of Value Seekers' tendency to spend time comparing products, shopping at hypermarkets, and buying less expensive products.

## What it means for your business

There is no denying the enormous benefit that companies can gain from a better understanding of China's emerging middle class. Marketing effectively to any group of middle class consumers requires an understanding of the needs of specific segments and the recognition of which segments provide the greatest potential profitability for a particular product. 完

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# A New US Embassy—and a Chance to Look Back and to the Future

Lydia R. Goldfine

US Embassy in Beijing

Just in time for the 30th anniversary of US-China diplomatic relations, and reflecting the growing importance of US-China relations, the new US Embassy in Beijing and new PRC Embassy in Washington, DC, both opened in 2008.

The Beijing Embassy Compound was dedicated on August 8, 2008—the opening day of the Beijing Olympics. The embassy is the second-largest overseas construction project in the history of the US Department of State and will host about 1,000 employees. Located on a 10-acre site, the embassy consists of five buildings: an eight-story main chancery; an adjacent three-story atrium office building; a marine security guard quarters; a consular building; and a parking, utility, and ancillary guard structure. The buildings represent modern American architecture, yet the embassy compound is rooted in traditional Chinese forms. The buildings are connected by narrow, bamboo-lined walkways and are linked by a series of landscaped gardens.

For members of the embassy community who have served multiple tours in Beijing, the closing of the old US chancery and other embassy buildings in the heart of the city evokes many memories. Executive Director of the Department of Energy's China Office Marco DiCapua, who served his first tour in Beijing from 1993 to 1997, remembers the feel of the old chancery. "The embassy was a period piece. It was reminiscent of the architecture that belongs to the first stage of the US-China relationship.... It was at times as dirty as it was challenging.... But the possibilities were endless concerning the US-China relationship."

Defense Attaché General Charles W. Hooper first served in Beijing as a foreign area officer in 1979. He too remembers the character of the old embassy buildings and its neighborhood. "We got to know the old chancery building really well, all its nuances, like elevators that didn't work, the ambassador's office, and the tree-lined streets. It was comforting walking up to those old buildings, seeing the US flag and knowing what great things had happened there. There was little art, nor was there much history ... you couldn't show off in that building. You worked in that building. We did some of our best work in that creaky, craggy, building."

The real institutional memory comes from locally employed staff (LES). Yang Gengqi, the embassy's Print Shop supervisor who has worked in the Public Affairs Office for 29 years, remembers parties at *Yi Ban* [No. 1 Office]—the ambassador's residence and the original embassy in Beijing. "Every year the American staff would put on a Christmas party for the LES, and in the spring the LES would throw a Chinese New Year party for the Americans. All the people joined together to make dumplings and decorate the program room." Yang, like many embassy staff, is still warming to the new space. "My office was a place for business exchange. It was small and comfortable. There was a window and a garden. Here it is like a big company." Yang also noted the parallel growth in the US-China relationship and the size of the US embassy: "We worked in the first building to start the relationship, we met the first ambassador. We are a part of the beginning of the China-US relationship. At first, everything was very small. We've seen everything develop into a huge relationship. After one or two years ... we will love this new building, too."

With such a significant change in the work environment, it is not surprising that staff have mixed emotions. DiCapua suggests "the transformation is as radical as any taking place in China today. For many LES members, it is like going from the *hutong* to the high-rise ... for the first time, they'll be working very closely with a lot of Americans. It used to be a lot of little provinces—*Yi Ban, Er Ban, San Ban* [Offices 1, 2, and 3]—all separated. Now we are all together in one big family."

Deputy Economic Section Chief Robert W. Forden, now stationed in Beijing for the third time, said "the new building demonstrates the US commitment; it illustrates how the two countries have moved toward recognizing that this relationship may be their single most important relationship this century. The new building symbolizes strength, and it is a good expression of not only who we are but also the importance of this relationship."

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