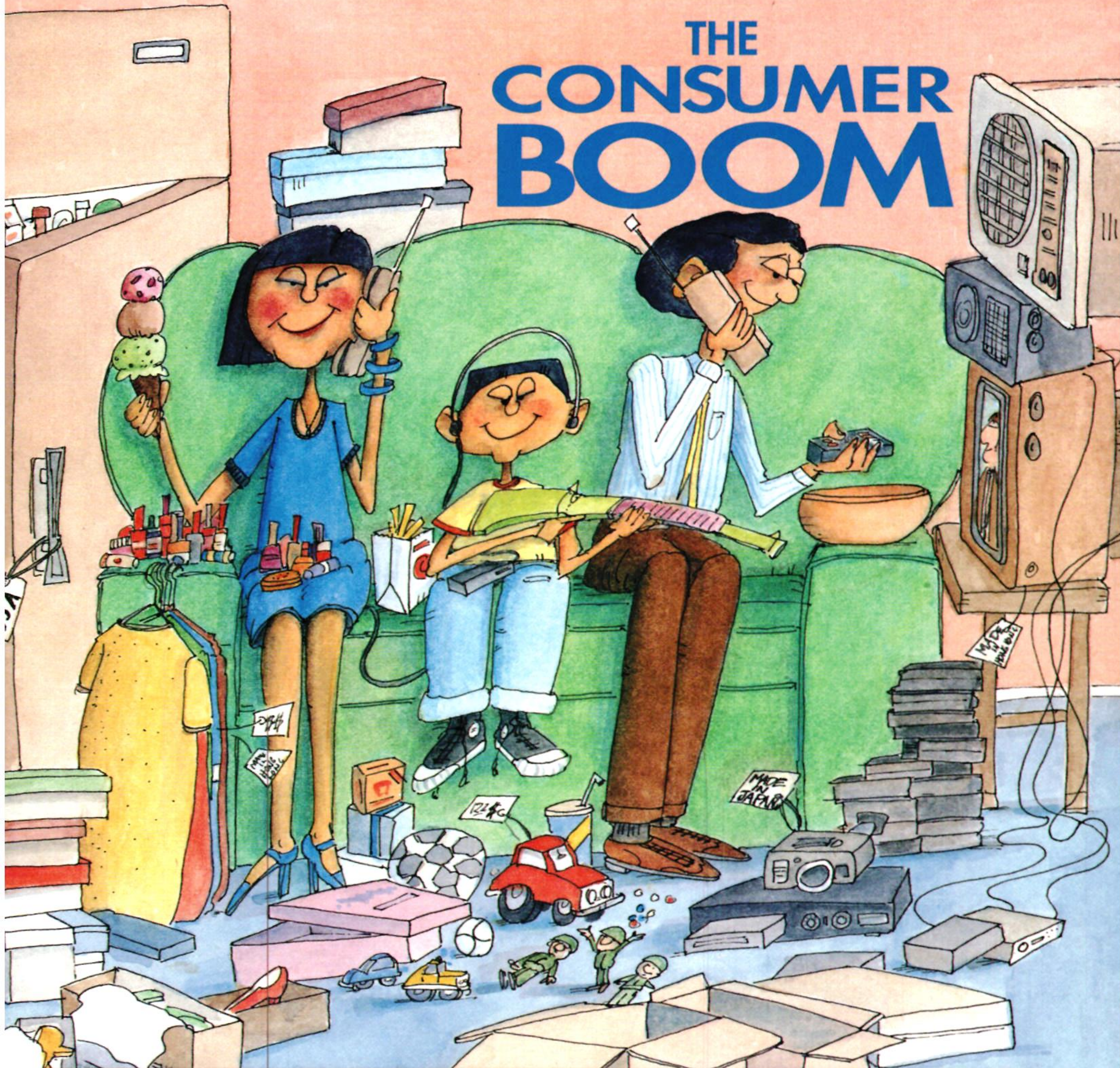
THE CHINA BUSINESS REVIEW

NOVEMBER-DECEMBER 1992 VOLUME 19, NUMBER 6

THE CONSUMER BOOM



■ 301: The happy ending ■ China's real estate revolution

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THE CHINA BUSINESS REVIEW
NOVEMBER-DECEMBER 1992 VOLUME 19, NUMBER 6
The magazine of the US-China Business Council

Features

9
301: The Successful Resolution
China's trade barriers are coming down.
Joseph Massey

TVE Exports

Year	Export earnings ($ billions)	As a % of China's total exports
1984-85	2.4	4.5
1986	4.5	14.3
1987	5.1	12.9
1988	8.0	16.8
1989	10.1	19.3
1990	13.0*	21.7
1991	18.0*	25.0

SOURCES: David Zweig
* Ministry of Agriculture

12
Reaping Rural Rewards
Foreign investors shouldn't overlook the Chinese countryside.
David Zweig

44
China's Real Estate Revolution
Land is a hot commodity in communist China.
Madelyn C. Ross and Kenneth T. Rosen

51
The Great China Land Rush
Hong Kong developers are signing big deals for big bucks.
Madelyn C. Ross and Kenneth T. Rosen

54
Gauging Investor Satisfaction
Which joint ventures in China are most profitable?
Leigh Stelzer, Ma Chunguang, and Joanna Banthin

Departments

4
Trends & Issues
Patten makes his mark, oil companies get good news, and Beijing and Washington keep busy on the legal front.

6
Letter from the President
The Council's Investment Initiative receives a warm welcome in China.

43
Council Activities
China's frenetic economic and political scenes dominate a series of West coast Council briefings.

58
China Business

61
Classified Ads

FOCUS: THE CONSUMER BOOM

18
Unlocking the Consumer Market
Future prospects for foreign companies are bright.
A report by the Hong Kong Trade Development Council

28
Cantonese Consumer Stampede
Guangdong residents can't seem to get their hands on enough foreign products.
Denny Barnes

36
Reaching the Chinese Consumer
Where to advertise for the greatest impact.
Xu Baiyi

China to Further Open Oil Exploration and Development to Foreign Firms

Officials in Beijing now appear willing to open up a number of oil-rich areas to foreign exploration. While the Chinese petroleum industry has for some time been seeking greater foreign participation in exploration and development efforts, official government approval for inland sites has been slow in coming, leaving foreign oil firms to explore (often disappointing) off-shore areas only. In September, however, the China National Petroleum Corp. (CNPC) announced that areas around existing oil fields and untapped reserves in East China would be opened to foreign company bids for exploration and development.

Although details of the bidding process for the onshore sites have not yet been released, at least one foreign firm staked its claim early on. Amoco Orient Petroleum Co. signed an agreement in May for oil exploration rights in a 1.27 million acre area of the Fuyang Basin in northern Anhui Province. Under the terms of the contract, the first by a major Western oil company for onshore exploration in China, Amoco will collect seismic data and conduct exploratory drilling. The company will have the option to extend its activities pending results of the initial data, and its Chinese partner, the China National Oil Development Corp., a CNPC unit, will have the option to acquire up to a 51 percent working interest in any commercial discovery made.

To reaffirm its interest in foreign participation in the oil sector, CNPC and the Ministry of Foreign Affairs sent a 10-member senior delegation to Europe in September to meet with a number of oil and equipment firms. Talks in Britain, Italy, Holland, and Germany focused on expanding Sino-foreign cooperation in developing China's petroleum resources. Wang Tao, CNPC president and delegation leader, reported that $300 million worth of equipment purchases were discussed, and a number of letters of intent on cooperative efforts were signed. According to Chinese sources, British Petroleum Development Ltd. and the Royal Dutch Shell Group were among the companies involved.

China further piqued the interest of foreign oil firms in September when Premier Li Peng announced to a visiting Japanese delegation that China welcomes greater foreign participation in the Tarim Basin. Located in the Xinjiang Uighur Autonomous Region, Tarim is widely thought to be one of the world's largest undeveloped oil fields, with estimated deposits of 140-200 billion barrels. To date, only minimal foreign business activity in the region has been permitted, although the Japan National Oil Corp. was allowed to conduct geological surveys of the west Tarim Basin in 1991. Though formal government approval has yet to be issued, Li's comments were seen by many in the oil industry as a strong indication that the official "hands-off" policy on Tarim would soon change.

While most foreign oil firms will be eager to bid on China's on-shore sites, new off-shore areas may also be of interest. In August, the China National Offshore Oil Corp. (CNOOC) invited foreign company bids for exploration and development in two East China Sea oil fields off of Shanghai and Wenzhou. The decision by CNOOC regarding bidding on the East China Sea sites was approved by the State Council in May and applications from over 50 foreign companies—including Chevron Corp., Exxon Corp., Texaco Inc., Mobil Corp. and Royal Dutch Shell—have reportedly already been received. Bidding on these sites will close by mid-1993, and exploration is scheduled to begin in 1994.

—Jeffrey Kao

Short Takes

President's Veto on MFN Legislation Upheld

On October 1, the Senate failed to override President Bush's September 28 veto of legislation attaching conditions to renewal of China's Most Favored Nation (MFN) trade status (*see The CBR*, July-August 1992, p.14). Though the House of Representatives voted heavily in favor of the override, the Senate vote of 59 to 40 fell short of the two-thirds majority needed. With this session of Congress now adjourned, the annual MFN debate should remain quiet until the June 1993 renewal deadline.

Foreign Law Firms Open For Business

Beijing recently gave 12 law firms permission to open the first official foreign legal offices in China. Among the 12 were four Hong Kong firms, two British firms, one French firm, and the US firm Coudert Brothers.

Despite the announcement, a number of US law firms have expressed concern that new regulations governing foreign law firms in China will constrain, rather than expand, their activities. The regulations, issued earlier this year, preclude foreign firms from conducting certain types of business in China, such as representing clients in Chinese courts.

FIEs Retain Wage Autonomy

According to a September notice released by the Beijing Labor Bureau, foreign-invested enterprises (FIEs) will continue to enjoy autonomy in setting wage levels. Though Chinese officials had hinted earlier that FIE wages would be capped at 150 percent of State enterprise wages (*see The CBR*, January-February 1991, p.8), the latest document declares that such FIEs need not get "confirmation from their department in charge and the labor bureau." It is not yet clear if other localities will adopt similar policies on FIE wages.

Chinese Firms Indicted for Textiles Fraud

After nearly two years of close scrutiny of China's textile exports (*see The CBR*, September-October 1991, p.40), US government agencies are getting their day in court. In October, the US Department of Justice indicted five individuals and two Chinese companies for evading US textile and apparel quotas. The China National Textiles Import-Export Corp., a semi-governmental corporation under the Ministry of Foreign Economic Relations and Trade (MOFERT), was charged with falsely labeling 24,000 boys acrylic jogging suits as girls apparel in 1989 in order to bypass the filled quotas for these items. China National was also charged with conspiring to mislabel Chinese-made jeans with "Made in Egypt" tags in 1990. Though indictment of a foreign government agency is rare, the US Attorney's office in New York noted that the Chinese firm is liable for prosecution because it considers itself an independent corporate entity.

The Chinese firm's US subsidiary, Chinatex America Inc., was also indicted, along with a now-defunct New Jersey trading firm, Oslo Trading Co. The individuals named in the indictments include two employees of China National, two sales managers at Chinatex, and a US citizen who was a former principal of the Oslo Trading Co. If convicted, the individuals will be subject to fines ranging from $250,000-1 million and jail terms of 5-17 years. Fines for each of the two indicted companies could go as high as $2 million.

According to the US Customs Service, this round of indictments is part of an "ongoing investigation" into alleged textile fraud by a number of Chinese companies. Neither the agency or the US Attorney's office, however, would comment on the likelihood of further indictments.

—VLW

Hong Kong Governor Rankles Beijing

On the eve of his first official visit to Beijing in late October, newly installed Hong Kong Governor Christopher Patten has already made it clear that he has definite ideas about the future course of Hong Kong's political and economic development. Patten's two-and-a-half hour address before the territory's Legislative Council (LegCo) on October 7 outlined plans for increased voting rights and public spending in the remaining years before Hong Kong reverts to Chinese control in June 1997. His proposed 21 percent increase in spending on areas such as education, housing, and the environment, however, reportedly rankled officials in Beijing.

Patten's proposal to change Hong Kong's current political system provoked an even stronger response in China. A spokesman for the Chinese Foreign Ministry said that the governor's plan to boost the number of directly elected seats in the LegCo was "inconsistent with the provisions and spirit of the Basic Law." Under Patten's plan, 20 of the 60 LegCo seats would be elected directly, an increase over the 18 seats currently elected. Another 19 seats would be decided through a new election panel made up of directly elected members of neighborhood committees, and by new "functional constituencies," which would give each voter a chance to elect a representative from his/her line of work.

The fate of Hong Kong's port and airport development (PADS) project is also likely to continue to be a heated topic of discussion between Hong Kong and China, as Patten has expressed impatience with Beijing's reservations over PADS funding. In the latest wrangling over the airport, Beijing refused Hong Kong's latest financing scheme, which proposed using the $40 billion expected to be generated from land development along the airport railway to lower projected debt. Beijing maintains that the funds belong to the Special Administrative Region Land Fund and should be handed over to China in entirety in 1997.

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Letter from the President

Chinese officials at all levels are eagerly discussing the Council's Investment Initiative following a high-level Council delegation in October.

Communicating Council Concerns

As *The China Business Review*'s final issue of 1992 goes to press, all eyes are on the imminent US election and 14th Party Congress in China. Both of these events could have a profound impact on US-China relations. Though I will refrain from speculating on the outcome of either event (we will report on these in our next issue), I do want to talk about my recent trip to China and the meetings I had with top officials there. Together with Council Chairman of the Board Jonathan M. Schofield and board members Don Sorterup of Foxboro and Alan Chien of Abacus, I met with several Chinese officials to discuss concerns of US-China Business Council member companies.

We met with Tong Zhiguang, Ministry of Foreign Economic Relations and Trade (MOFERT) vice minister, to impress upon him the importance of successfully reaching an agreement to conclude the USTR's 301 investigation—which, I am happy to say, he did (*see* p. 9). Most of our time, however, was spent on our top priority: to follow up on the Council's position paper on China's foreign investment climate. The paper was delivered to key officials in early September and appeared in the last issue of *The China Business Review* (*see* September-October 1992, p. 6).

Although scheduling was tight because of the impending Party Congress, we were able to meet with Deputy Secretary General He Chunlin, who has responsibility for foreign investment policy in the State Council. Our main purpose in meeting with He was to underscore the broad support of Council members for the paper and to emphasize that our proposals would encourage the high-tech, capital-intensive investment projects China seeks. He's response was welcome: he pointed out that all eight areas outlined in the paper are key issues from China's point of view. He agreed that improving the regulatory environment, protecting intellectual property rights, increasing the availability of foreign exchange, expanding the scope of foreign operations, and implementing other Council suggestions would enhance the investment climate and thus help China secure foreign investment in advanced technology sectors. He further noted that many recommendations from an investment position paper prepared by the Council in 1986 were in fact incorporated into the 1986 Provisions to Encourage Foreign Investment. While He

He Chunlin noted his hopes for a continuing dialogue with the Council on improving China's investment environment.

Council Chairman of the Board Jonathan M. Schofield and State Council Deputy Secretary General He Chunlin discuss investment issues at Diaoyutai, the official Chinese State compound.

stressed that China's current emphasis is to implement effectively the investment policies and regulations already in place—a point that runs throughout our paper—we are optimistic that the recommendations in our current paper will be given serious consideration by China's leadership.

In closing, He noted his hopes for a continuing dialogue with the Council on improving China's investment environment. With the delegation having laid the groundwork for frank consultation on investment issues, the Council will begin to follow up with more detailed discussions at the working level with the State Council Leading Group on Foreign Investment, the State Council Economic and Trade Office, and MOFERT. At this point, the Council's Beijing office has already received calls from a number of officials expressing appreciation for the paper and a desire to discuss it.

Throughout our meetings in Beijing, we were surprised at the lack of politicization of our discussions. We had anticipated, for example, that the Chinese would raise the issue of the F-16 fighter jet sales to Taiwan or adopt a more strident tone on MFN and 301. Yet the F-16 sale was mentioned only in passing, and we were pleased that our discussions on investment and trade issues were conducted in a constructive atmosphere.

After our meetings on the investment paper, we participated in a two-day international economic symposium sponsored by the China International Trust and Investment Corp. (CITIC). This meeting brought together over 40 high-level business leaders from the United States, Europe, and Asia. In addition to Jack Schofield and me, US participants included Maurice Greenberg of AIG, A.W. Clausen, chairman of Bank of America and former president of the World Bank, and executives from the Coca-Cola Co., Boeing Co., E.I. duPont de Nemours, Bechtel, and Eastman Kodak. Other foreign companies represented included Siemens, Philips, Samsung, Daewoo, Mitsui, Hang Seng Bank, and Swire & Sons.

Following a keynote speech by former Singapore Prime Minister Lee Kuan Yew, we met with Premier Li Peng and Communist Party General Secretary Jiang Zemin, both of whom outlined ambitious plans for the further development of China's economy. The symposium also featured a speech by Vice Premier Zhu Rongji, who, aware that many foreign companies are concerned that China's economy may be overheating, termed China's current growth as "healthy and normal." The rapid growth, Zhu said, is the result of 10 years of reforms taking effect. According to Zhu, the Chinese government is fully capable of exercising macro-economic control if overheating occurs. This latter comment echoes reports from Council sources in Beijing, who forecasted that the Party Congress would seek a slower growth target of 7-9 percent annual GNP growth.

Though the 301 negotiations are behind us and MFN has been laid to rest for another year, 1993 will no doubt bring new, potentially more difficult, challenges.

Council President Donald M. Anderson briefs US executives in Hong Kong on his China meetings.

The symposium also heard Vice Director of the State Commission on Restructuring the Economy Gao Shangquan declare categorically that China's planned economy will be phased out. "All enterprises—including large- and medium-size State enterprises—will have to go to a market basis, since we can't have some enterprises under plan while others are under the market." Gao, who is known to be on the cutting edge of the reform movement, termed this an important policy breakthrough, declaring that "the planned economy has been proven unsuccessful in China and internationally." How far and how fast China will proceed toward full marketization of its economy should become clearer after the 14th Party Congress.

After the conference, Richard Brecher, the Council's director of business advisory services, and I visited Hong Kong, where we met with member companies and addressed several business and trade associations, including the American Chamber of Commerce, the Hong Kong General Chamber of Commerce, the Hong Kong Trade Development Council, and the Hong Kong Federation of Industries. Again, much of the discussion focused on the Council's investment initiative and our Beijing meetings, though the Hong Kong audiences were eager to catch up on Washington news. We were able to discuss in detail the latest developments on China's MFN, the USTR's 301 market access negotiations, and the ramifications of the US presidential election on China policy, all of which the participants found very useful. We look forward to continued cooperation with these organizations on future matters relating to China business.

Looking back over the past year, I am pleased that trade and investment have both surged ahead, despite the political tensions in the US-China relationship. As in previous years, the Council has played an active role in keeping our members informed about the events that affect their businesses in China. I am particularly happy that, with valuable input from our member companies, we have been able to complete a number of very useful surveys on the investment climate, wages, housing, and other issues. Though the 301 negotiations are behind us and MFN has been laid to rest for another year, 1993 will no doubt bring new, potentially more difficult, challenges. We count on your continued support, and wish you all a happy and prosperous New Year.

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301: The Successful Resolution

US business will need to help USTR to ensure the agreement works

Joseph Massey

The Memorandum of Understanding (MOU) on market access signed between the United States and China on October 10 is cause for cautious celebration. A celebration because it brings, finally, a signed and binding Chinese commitment to honor the principles of the US-China bilateral trade agreement, which calls for a trade relationship based on "equality" and "mutual benefit." Though these rhetorical terms were no doubt originally inserted in the agreement at Chinese insistence, they have significance for American business, which has suffered from inequality and a highly imbalanced flow of benefits ever since we renewed trading relations with China in 1978. Once the MOU is implemented, the principles of equality and mutual benefit will be elevated from rhetoric to reality.

Our celebration should be cautious, however, because the potential positive impact of the MOU hinges on the degree to which it is implemented by Chinese authorities. The MOU contains several provisions intended to ensure that it will be implemented, such as the creation of a trade committee that will meet on an annual basis and the right of either side to request consultations. But the cooperation of US businesses in keeping the office of the US Trade Representative (USTR) fully informed about their experiences under the agreement will be a major factor in ensuring that the agreement does what it is supposed to do—give US companies access to the China market equivalent to the access Chinese firms receive in the United States.

The governments on both sides of the Pacific understand that both countries stand to gain from the 301 agreement. On the US side, our exporters will have greater access to the Chinese market, and consumers can continue to enjoy the numerous products China currently exports to the United States. On the Chinese side, consumers will have greater access to quality goods from the United States and elsewhere, at lower prices. The agreement will also foster competition in China, which will aid economic reform efforts. Moreover, Chinese firms will have better access to components and technology, as well as continued access to their most important market—the United States, which takes more than a quarter of all Chinese exports.

The potential positive impact of the MOU hinges on the degree to which it is implemented by Chinese authorities.

Transparency

The 301 market access negotiations covered four basic areas: transparency of trade-related rules and regulations, import bans and quotas, the import licensing system, and technical barriers to trade. The MOU's most fundamental achievement in terms of opening China's market falls in the transparency area.

Virtually every foreigner who has tried to do business in China has had an encounter with a bureaucrat who has explained that what the foreigner is seeking to do, or the approval he or she needs, is prohibited by an internal (*neibu*) regulation the foreigner is not permitted to see. The United States made the elimination of *neibu* regulations a key objective of the 301 negotiations, and this topic is covered in the first article of the agreement. This article requires China to regularly publish all laws, regulations, and administrative guidelines affecting or governing foreign trade, and to publish a list of all authorities that must be consulted before a particular activity can be approved. Rules not currently published must be published by October 10, 1993.

Perhaps most important, the Chinese explicitly commit themselves to issue regulations (by the same deadline) stating that state that only laws and regulations published and readily available to foreign governments and traders are enforceable. This provision is in accordance with General Agreement on Tariffs and Trade (GATT) requirements and means that foreign businesspeople obstructed by bureaucrats citing unpublished agreements can turn to the MOU for protection. If, nevertheless, an official persists in prohibiting the businessperson from carrying out his or her activities, the MOU has provisions that enable US government representatives to request a consultation.

The MOU does enable the Chinese to keep certain types of information confidential, including information that would impede law enforcement, be contrary to the public interest, or prejudice the legitimate commercial interests of Chinese enterprises. US ne-

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gotiators, however, inserted a clause in the MOU that states that such information should not include anything that would have to be disclosed under the GATT and related agreements.

It would be naive to expect that this revolutionary transformation of the way in which bureaucrats operate in China will be accepted and implemented without difficulty. The US negotiators drafted the MOU's language to be as clear, tight, and definitive as possible, but the exclusions under Article II, paragraph 1—particularly the reference allowing the Chinese to exclude information contrary to the public interest—leave a great deal of room for undesirable bureaucratic discretion and abuse.

Perhaps in anticipation of such cases, paragraph 6 of Article I commits China to create an administrative and judicial process to ensure the enforcement of the MOU's provisions. This should provide a means for foreign businesspeople to bring arbitrary, unacceptable bureaucratic interference to the Chinese government's attention. In all such cases, I strongly urge US businesses to inform the US government, as it may become necessary to invoke the consultative clauses of the agreement.

Full and good faith implementation of the transparency measures of the MOU will be a test of China's sincerity in its pledge to open its markets. Should these measures not be implemented effectively, however, the spirit of the agreement will be undermined and the United States will have no choice but to call for consultations to secure remedial action.

Import licenses

Reducing China's extensive import licensing requirements and eliminating import bans and other quantitative restrictions were the second and third objectives of US negotiatiors. These issues are addressed in Article II of the MOU, which stipulates that most such restrictions be removed according to a strict timetable. About 90 percent of all products flowing into China should be free of quantitative restrictions once all the measures are enforced.

Currently, some 572 categories of goods are subject to licensing requirements, which have been a big impediment to US exporters. According to US government estimates, about 45 percent of Chinese trade by value was subject to these licensing requirements in 1985, and the system has since been expanded. In most cases, import licenses serve to protect domestic industries, because the ministry that oversees the maunfacture of a domestic product in China is usually involved in the import approval process and has the ability to block the license. Once the MOU is implemented, only five categories of minor interest to the United States will still be subject to licensing procedures. These include rubber products, wool, and a few other goods.

Aside from import licenses, the US negotiators tackled China's extensive system of import bans and quotas. Some 234 categories of goods were subject to bans, but only 31 categories will be affected after the MOU is implemented. Similarly, the number of categories subject to quotas will drop from 52 to 10, most of which are outside the areas of primary interest to the United States.

The major area of US interest that will still be subject to quantitative restraints after full implementation of the MOU is autos and auto parts. The agreement specifically removes license requirements and quotas from a handful of auto parts categories, but all others will remain under quota. However, US joint ventures (both those in existence and those not yet established) manufacturing autos or auto components in China will not be affected by quantitative restrictions on parts or kits they use. Furthermore, such joint ventures will be permitted to import parts and kits to expand production, including expansion into new product lines. This is the one area of the market access agreement that does not apply to firms from other countries. The exclusion of third countries from this benefit can be expected to be the target of criticism from the Europeans and the Japanese.

Boon to US exports

Many of the products from which quantitative restraints are being removed are of substantial interest to US exporters. The phase-out periods for the various restrictions range from the end of this year to 1997, but the US Trade Representative estimates that approximately 75 percent of all import licenses, bans, and quotas will be completely eliminated by the end of 1994. Import barriers to items of particular US interest, including telecommunications equipment and instant cameras and films, will be lifted this year. For products for which the phase-out date is much later, the MOU calls on China to increase access each year until the barrier is completely removed.

Transparency issues also show up in the provisions regarding quantitative restrictions. Under Article II, the Chinese must publish by January 10 a list of all organizations that can authorize or approve imports, as well as the procedures for obtaining import licenses and approvals and the criteria upon which they will be approved. To prevent local and regional officials who maintain their own import regimes from undermining the agreement, the MOU stipulates that only restrictions imposed by the central government may be enforced. Localities will no doubt test Beijing in this area, and problems can be expected to arise. Article II also specifically prohibits Beijing from making technology transfer, investment in China, or the non-existence of Chinese domestic suppliers prerequisites for obtaining import licenses.

The final issue the United States pressed with the Chinese in the area of quantitative barriers was elimination of State Council Directive 56, which directs telecom authorities in China to sign contracts with three foreign suppliers of digital-switching equipment—all non-US firms. This issue is addressed in the agreement by Article II paragraph 1, which stipulates that China take appropriate steps by March to ensure that procurement of digital-switching equipment is conducted according to international bidding procedures without discrimination as to the source of the equipment or the enduser. This provision appears to be a de facto recision of Directive 56.

Standards and certification

As those of us who have negotiated with the Japanese and Europeans know, governments do not have to rely on quantitative restrictions to erect non-tariff barriers. Standards and testing requirements, the last target of the Section 301 negotiating mandate, have been increasingly used by China to block imports over the past few years. In fact, the number of products subject to standards testing and certification requirements increased by 30 percent from 1988-92 to cover nearly 150 categories of imported goods. The MOU, however, commits China to eliminate any scientifically unjustifiable restrictions by next October. The two countries will establish an expert

working group to determine which standards pass muster.

Any proposed changes in phytosanitary testing standards or certification requirements must be published in an official journal circulated to Chinese and foreigners. Reasonable time will be provided for interested persons, including foreign governments, to make comments on the proposed changes or additions. Finally, testing and certification standards for non-agricultural goods must apply equally to domestic and imported products, and must be applied uniformly throughout the country.

Other benefits

In substantial measure, the four objectives of the US 301 negotiating team have been addressed and satisfied by the new agreement. In addition, the MOU covers several other items—namely, import substitution and tariffs—that could well have become subjects of separate 301 investigations if not addressed now. As far as import substitution is concerned, Article III states that China has eliminated—as of October 10, 1992—all import substitution regulations, guidelines, and policies, and will not subject any products to such measures in the future. On tariffs, Article V requires China to reduce tariffs on a wide range of products, many of which are of significant interest to US firms. Such goods include agricultural products (fruits, nuts, prepared food stuffs, animal and vegetable oils), chemical products, iron and steel, cameras and film, confectionery, cosmetics, machinery, and electrical parts. The new tariff rates are to take effect no later than January 1, 1994.

Finally, in order to ensure that one barrier is not replaced by another, Article VII of the MOU commits China to ensure that the conditions for market access specified in the agreement are not undermined, directly or indirectly, by any other restrictions that affect imports.

The US concessions

Like every negotiation, the 301 MOU required some give and take. In return for China's agreement to further open its markets, the United States made a number of commitments to China. First, the Section 301 investigation (and the threat of compensatory tariffs against Chinese exports to the United States) has been terminated, although the US government reserves the right to monitor China's compliance with the MOU and relaunch 301 if necessary. Second, the United States made several commitments with regard to export controls: it will pursue liberalization of Coordinating Committee for Export Controls (COCOM) controls and procedures, including those governing China; it will significantly liberalize controls on telecommunications equipment and will apply these changes to China; and it will consider liberalized treatment of computer exports for civilian use, a provision which might apply to China. The computer provision would raise by 100 percent the level of sophistication of computers that would no longer need COCOM review, and would go into effect no later than 1993.

Testing and certification standards for non-agricultural goods must apply equally to domestic and imported products.

Global implications

The MOU, though a bilateral agreement, has far-reaching multilateral implications. First, almost all benefits outlined in the agreement will be extended, on a non-discriminatory basis, to all countries from which China has received Most Favored Nation (MFN) benefits. Second, the agreement calls on the United States to actively support China's accession to the GATT. (This, in turn, will permit the United States to promote the GATT's acceptance of Taiwan.) China has been seeking re-entry to the GATT since 1986, but progress has been slow, primarily due to doubts among GATT members as to the openness of the Chinese trading regime and the genuineness of Beijing's commitment to economic reform (see *The CBR*, May-June 1992, p.24). On the basis of China's commitments in the MOU, however, there should be greater confidence within the GATT that China is serious about reforming its trade regime to conform to the requirements of the GATT.

It is important to note that the convergence of China's trading system with that of the GATT was brought about not by the GATT itself, but by bilateral negotiations with the United States under US trade law. US trade laws, especially Section 301, have been frequently criticized by the GATT, other trading partners, and economists as "aggressive" and "unilateral." However, it is clear in this instance, as in so many others, that the GATT's goal of global open markets requires realistic strategies to bring it about.

In pursuing the 301 negotiations, my colleagues and I told China that the United States was committed to equalizing and balancing the trade relationship, preferably on positive terms that would expand bilateral trade. However, we also made it clear that if that outcome was not obtained, then we were prepared to equalize the benefits negatively by restricting China's access to the US market.

There can be no doubt that without such a credible lever, and without the political commitment of the entire US government and administration, the opening to the Chinese market we have been promised would not have come about.

US pressure worked because Beijing recognized that the continuation and expansion of economic reforms are in China's best interest. For reforms to succeed, China needs access to the US market and to US technology. The US threat to impose trade retaliation was significant because, if carried out, it would have set in motion a course that eventually would have locked China out of the US market and isolated it from US technology.

The desire of the Chinese leadership to acede to the GATT also made Beijing more willing to open its markets, lest it lose face by being shut out of GATT while Taiwan was accepted.

Clearly, China can control the implementation of the opening of its own market. That is why, from a US business perspective, it is critical that this process be closely monitored. This means US firms must provide the US government with accurate and up-to-date information of their experiences. If USTR can cite specific cases in which the agreement isn't being implemented, the monitoring process will be effectively serving the agreement's purpose. But for that to happen, Uncle Sam is going to have to depend in no small measure on US business. 完

Reaping Rural Rewards

China's town and village enterprises can make good investment partners

David Zweig

Town and village enterprises (TVEs) have rapidly emerged as a growing industrial force in China. TVEs—a classification which includes rural, non-agricultural, non-State enterprises collectively or privately owned—now account for almost a third of the country's industrial output, and nearly half of total industrial employment. Though the majority of the roughly 19 million TVEs currently in existence are small, family-run service businesses, the increasing numbers of export-oriented and joint-venture TVEs are having a strong impact on China's production and export levels.

For some foreign investors, the growing strength of China's TVEs raises interesting opportunities. In 1991, TVEs accounted for around $18 billion, or 25 percent, of China's total export earnings, a sharp increase over the $2.4 billion in exports registered by this sector in 1984-85 (*see* table). Products ranging from textiles to complex electronics are now being produced by these ventures.

Unleashing rural enterprise

The TVE phenomenon is a fairly recent development in China. Until the 1980s, rural factories were viewed by Beijing as a cornerstone of the "self-reliant" development of the Chinese hinterland, and as a conduit for urban technology to filter down to the countryside. In the late 1970s, after Mao's death, local governments in many regions were encouraged by Beijing to invest in new, non-State industries as a means of soaking up excess rural labor. Increased loans and tax breaks for these nascent industries helped spur rapid growth in the number of enterprises and the types of goods produced. Between 1983-88, the number of TVEs tripled, as did the number of workers employed in them. TVE expansion was especially strong in the coastal regions, particularly in Jiangsu and Zhejiang provinces, and in the suburbs of major cities.

The renewed export drive of the past two years has meant a new burst in TVE activity.

TVE Exports

Year	Export earnings ($ billions)	As a % of China's total exports
1984-85	2.4	4.5
1986	4.5	14.3
1987	5.1	12.9
1988	8.0	16.8
1989	10.1	19.3
1990	13.0*	21.7
1991	18.0*	25.0

SOURCES: David Zweig
* Ministry of Agriculture

By the mid-1980s, TVE expansion was further aided by growing support at the highest government levels, especially from then-Party Secretary Zhao Ziyang. In a 1987 speech outlining coastal development goals, Zhao called on TVEs to play a greater role in China's export drive, claiming that these enterprises had far more flexibility than State enterprises to respond to the demands of the global marketplace. Despite Zhao's ouster and temporary setbacks to economic reforms during the 1988-91 austerity campaign—when 1 million TVEs reportedly were closed—the renewed export drive of the past two years has meant a new burst in TVE activity. Strong lobbying efforts from the coastal areas and fears of massive rural unemployment also have prompted Beijing to become more tolerant of non-State enterprises. These trends, coupled with Deng Xiaoping's call for greater market activity and decentralization of foreign trade in early 1992, have sent many investors—both Chinese and foreign—looking for rural-based partners.

TVEs: a profile

Little comprehensive national-level data exists either on TVEs or on foreign investment in these enterprises. Chinese press reports note only that by the end of 1991, rural enterprises had attracted $5.85 billion in overseas funds. In addition, 60,000 TVEs engaged in export activities that year, while 7,000 were involved in joint-venture projects. In Jiangsu, over 1,000 of the province's 2,500 joint ventures were with TVEs as of April 1992; an estimated 65 percent of the joint ventures established in 1991 had TVE partners. In some cities in Jiangsu, the percentage of foreign-TVE joint ventures was even higher; nearly 80 percent of the new joint ventures formed in Nantong in 1991, for example, involved TVEs.

David Zweig, an associate professor of international politics at the Fletcher School of Law and Diplomacy at Tufts University, spent 1991-92 conducting research in China on the domestic impact of the open policy. He is the author of Agrarian Radicalism in China, *1968-1981 (Harvard University Press, 1989).*

Problems collecting data on TVEs are compounded by the fact that foreign investment trends in these enterprises vary widely from region to region. Interviews I recently conducted in Jiangsu Province, however, suggest that Hong Kong and Taiwan businesspeople supply the lion's share of foreign direct investment in TVEs. Of the 20 rural joint ventures I visited this year in Zhangjiagang and Nantong, for example, 10 were from Hong Kong, 7 from Taiwan, 2 from the United States, and 1 from Japan. Average foreign investment in these ventures was slightly over $400,000, ranging from a low of just over $100,000 to a high of over $2 million. Most were concentrated in the $110,000-750,000 range. While the majority of these ventures were involved in the manufacture of textiles, cosmetics, shoes, food products, or handicrafts, some produced higher value-added items such as valves, copper wire, surgical equipment, and electrical machinery.

The pros...

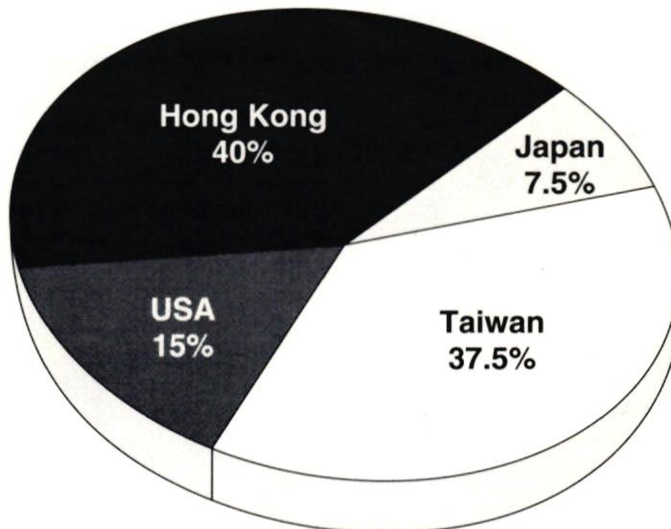
TVEs operate outside the State Plan and outside of the special zones designed to attract foreign investment. In 1988, the State Council offered export-oriented TVEs many of the preferential policies previously available only to State enterprises, including better access to cheap and stable energy supplies, technology, raw materials, and loans, as well as foreign exchange retention rights. In effect, this move was an attempt to level the playing field between State enterprises and TVEs. Currently, TVE joint ventures enjoy most of the incentives accorded to joint ventures in the Special Economic Zones and other areas, including tax holidays and the right to import components duty-free.

In addition, localities now offer a variety of perks to lure foreign investors away from the large coastal cities. In some areas in Jiangsu, citizens are rewarded with ¥1 for every ¥1,000 of foreign investment they bring in. Many locations also have given cadres specific foreign investment quotas, and have made export promotion and the establishment of new joint ventures important criteria for moving up the local political ladder.

Unlike State enterprises, TVEs fall under the control of local Party offices, local governments, or private individuals. Steering clear of the na-

PROFILE OF 20 TVE JOINT VENTURES IN JIANGSU PROVINCE, 1992

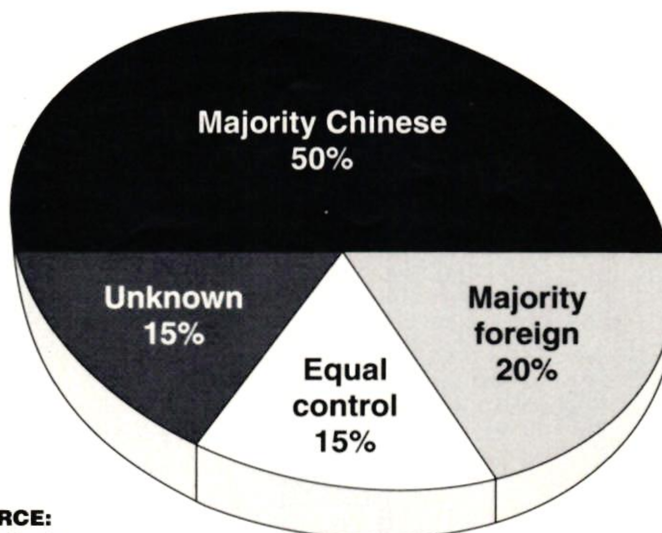
Foreign Partners



Percentage of Output to be Exported (as specified in JV contract)

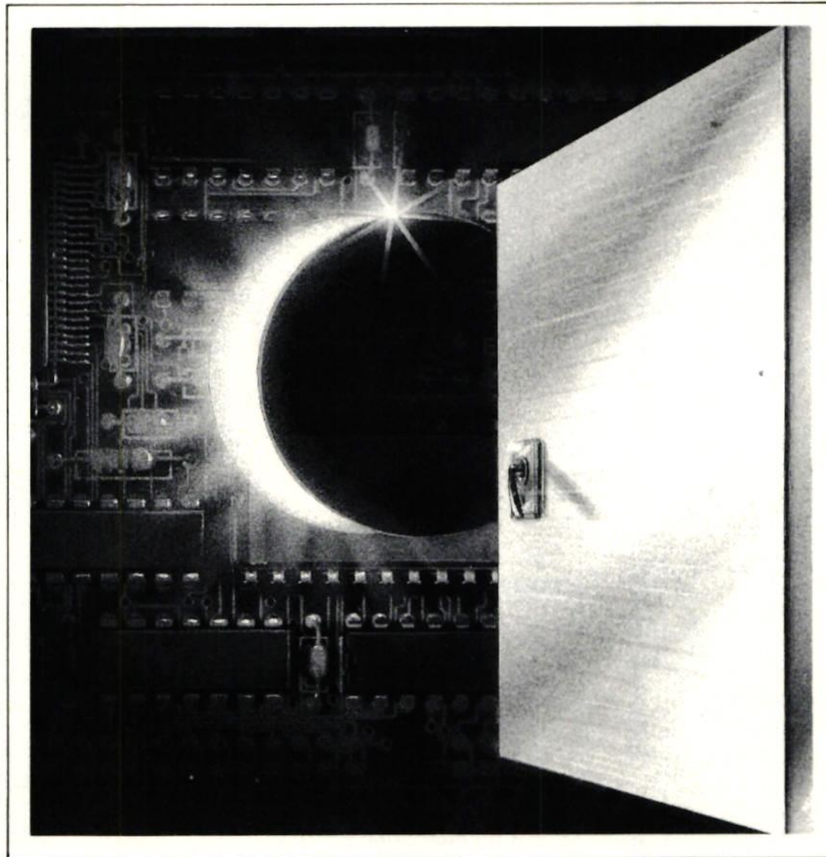
Percentage to be exported	Percentage of ventures with this obligation
90-100%	30%
70-89%	35%
50-69%	15%
25-49%	15%
0-24%	5%

Composition of Board of Directors



SOURCE: David Zweig

THE DOOR TO THE FUTURE



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tional ministries and bureaus governing foreign investment in State enterprises can have its advantages, as there may be fewer fingers in the negotiating pie. In small cities where TVEs are a key segment of the industrial sector, local officials tend to be very supportive of foreign investors. An official in Nantong's foreign investment bureau, for example, bemoaned lost opportunities in 1984-86, when rigid State-run factories undermined the municipality's efforts to enter into joint-venture agreements with Sony, Siemens, and other large foreign corporations. The city now actively courts such investors by pushing them toward potential TVE partners in the surrounding countryside.

Foreign investors exploring opportunities in TVEs may, in fact, find that village and township officials have a strong incentive to compromise and protect foreign-invested TVEs. Local Party secretaries or directors of township economic committees—the individuals who control the distribution of finances and the allocation of land and labor—are often the rural joint venture's de facto partners, and as such, stand to share in the venture's profits. Though some foreign investors might be wary of letting decisions about the venture fall prey to the personal whims of local Party bosses, in most cases the benefits of dealing with a powerful local partner outweigh the drawbacks.

Such partners often work hard to accommodate their foreign partners on issues such as labor policy, market access, and land prices. Several township Party secretaries in Jiangsu Province, for instance, reported they were able to slash land prices to lure foreign investors away from Shanghai. Foreign companies looking to sell their goods primarily within China may also find ready allies in local officials eager to see their joint venture projects corner the domestic market. In short, deals cut with local officials tend to stick, largely because these individuals have the means to ensure the venture gets what it needs at the local level to succeed.

Currently, TVE joint ventures enjoy most of the incentives accorded to joint ventures in the SEZs and other areas, including tax holidays and the right to import components duty-free.

...and cons

Perhaps the greatest problem facing foreign investors in rural enterprises is difficulty sourcing raw materials. The 1988 State Council rulings notwithstanding, TVEs still have no guaranteed access to centrally allocated resources, unlike State enterprises, which can more readily rely on ministerial intervention to ensure uninterrupted supplies of needed inputs. Despite their apparent handicap in this regard, many TVEs are able to use "back-door" connections to secure in-plan materials, a practice sharply criticized by Beijing during the 1988-91 economic retrenchment. However, in the past year or so, more raw materials have been removed from the State plan system in an effort by Beijing to rationalize prices. As a result, rural joint ventures now have far greater access to critical inputs than at anytime in the past decade.

The possibility of supply disruptions, coupled with potential energy shortages and communication bottlenecks outside of the major cities, suggests that not all of rural China is conducive to joint venture activities. But in such areas as the Pearl River Delta and southern Jiangsu Province, local governments are undertaking a wide variety of infrastructure improvements in order to facilitate foreign investment. In 1990, the city of Zhangjiagang, for example, installed over 12,000 Swedish telephones equipped with direct dial capability within China. Other cities have engaged in similar efforts to improve utilities, transportation, and communications.

Foreign exchange-balancing problems—a chronic complaint of many joint ventures in China—are also common among TVEs. Rural ventures that rely on imported materials may find themselves subject to pressure to produce for export in order to import inputs duty free. Local government partners might also prove unwilling or unable to bail out the foreign partner if exchange-balancing problems arise. While TVE joint ventures are entitled to use the foreign-exchange balancing or "swap" centers, few foreign investors can rely on these centers to meet all their needs (*see The CBR*, March-April 1992, p.14).

China's drive to export, in fact, can be problematic for potential foreign investors in the rural sector. From the Chinese viewpoint, setting up a joint venture allows the local partner to bypass the official export corporations, which typically cater to State enterprises. TVE enterprises, therefore, tend to view a joint venture as a way to improve their export performance by gaining direct access to foreign importers. Foreign companies who already have an established distribution network thus stand to profit by joining ranks with TVEs, which typically produce high-quality, low-priced goods. But foreign firms without access to ready buyers will likely have to

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rely on local or provincial foreign trade corporations to export their ventures' products. These entities, which may lack good overseas connections, tend to give TVE-produced goods low priority.

Another potential area of vulnerability for foreign partners in rural joint ventures is inadequate protection of intellectual property. While most export-oriented TVEs are involved in low-tech production of labor-intensive goods, a growing number utilize mid-level technologies obtained from their foreign partners. Generally speaking, however, many rural enterprise officials lack awareness of international standards of intellectual property protection. Some authorities may be downright ignorant of trade regulations governing protection of foreign copyrights and patents, while others may assume the laws can be bent with little chance of Beijing or the injured foreign party discovering the infraction. Officials at one textile TVE I visited in Jiangsu, for example, claimed to have registered the company's logos with the appropriate local, provincial, and national authorities, and appeared genuinely surprised to learn that the trademarks in question were illegal copies of the logos of Western sporting-goods makers.

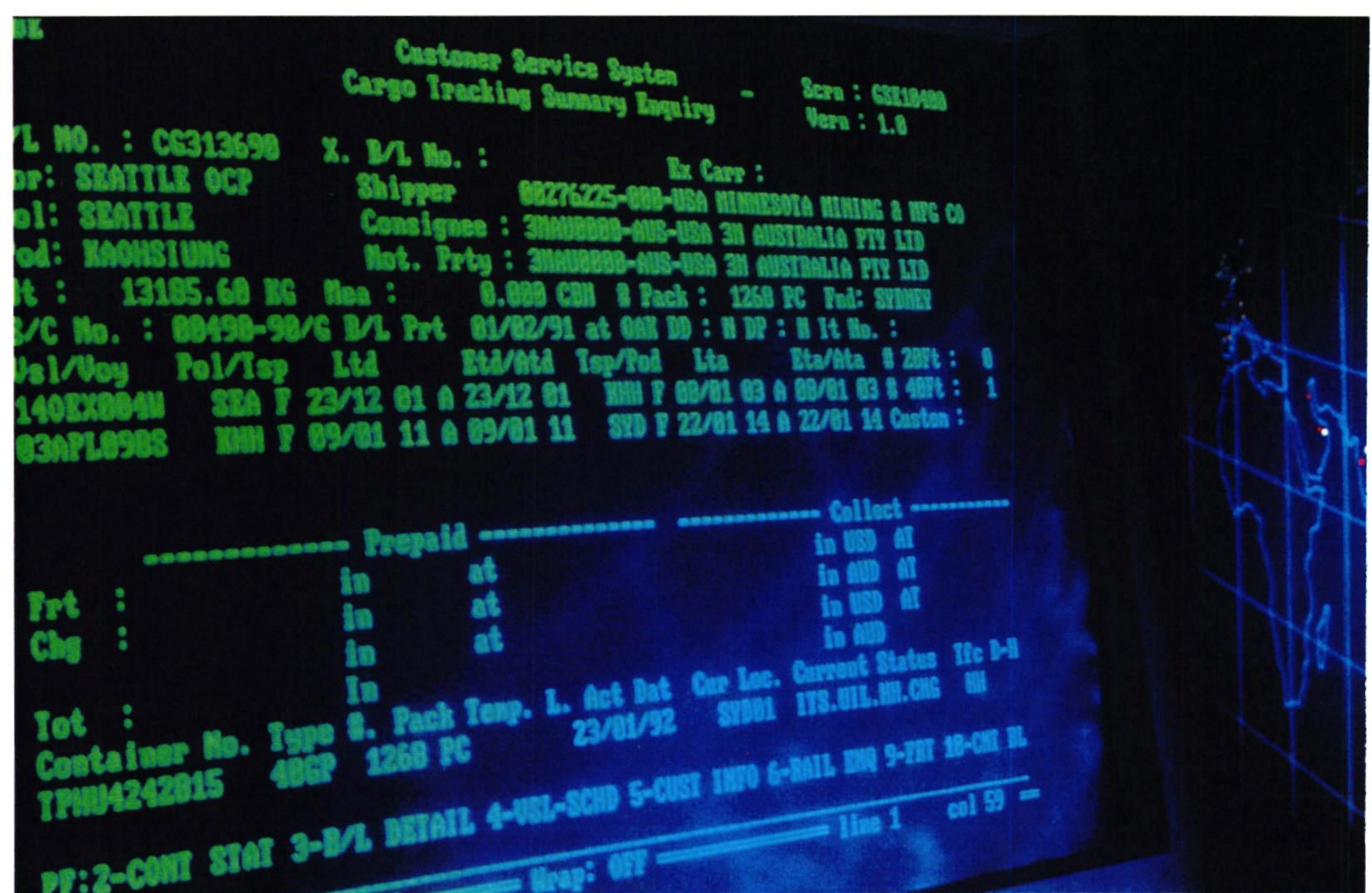
Labor and management in TVEs

Attracting skilled workers and managers is not necessarily a problem in rural joint ventures. Nationwide, local governments in 1987 forced TVEs to tighten up on management practices, in part through the introduction of a "management responsibility" system that gave managers the authority and financial incentive to increase production. Managers are generally required to meet fixed profit levels, which they then turn over to the local government. They keep a percentage (perhaps 20 percent) of the above-quota profit, which can add significantly to salary levels already as high as ¥1,000 per month. In some localities, managers who fail to meet the assigned terms are replaced.

No doubt, the Chinese partner in a rural joint venture will probably not know as much about advanced management practices as the foreign partner would like, but is generally eager to learn. A recent Nanjing University survey of 584 TVE managers indicated that over 90 percent were "willing" or "extremely willing" to participate in management training programs. My own conversations with local Jiangsu Party bosses suggest that they strongly believe that modern Western management techniques are key to earning greater profits.

Some TVEs have already implemented stricter management rules. I toured one rural joint venture, for instance, that had introduced a timeclock to check workers in and out. Another venture had instituted fines for workers caught smoking, spitting, or leaving dirty handprints on the factory's walls. Workers in this enterprise were required to arrive 15 minutes before the shift began, and could not pack up until after the final bell had sounded. While some interviews with workers indicated such management practices were far from popular, other workers seemed to welcome the challenge of increasing productivity—and the chance to earn significantly higher wages than they could be obtained by working in the fields.

As most TVEs are already quite small, foreign partners generally find that they are not burdened with surplus labor and are able to keep labor costs down. Average employment in



the factories I visited was 420 workers, considerably less than in comparable State enterprises. Six firms, in fact, each had fewer than 100 workers. Some of these joint ventures even spoke of cutting the labor force in order to boost their global competitiveness. Generally speaking, salaries in rural joint ventures are significantly less than those in urban joint ventures, and provision of worker housing is usually not an issue. Both of these factors also help keep costs down.

The most daunting labor problem for foreign investors may be keeping expatriate staff happy. Foreign managers are often less than eager to live in a rural township where few other foreigners are to be found, and even fewer Western conveniences. Some of the Taiwan managers I interviewed complained of being physically and culturally isolated at their rural ventures; one had even opened a second venture in Zhuhai to facilitate quick weekend trips home. Despite their reservations, Taiwan and Hong Kong managers tend to have fewer problems adjusting to rural life in China than do Western managers, and US investors should consider hiring them rather than Americans.

The most daunting labor problem for foreign investors may be keeping expatriate staff happy.

No turning back

With 60,000 TVEs involved in export production, there are many potential partners in rural China. Establishing a successful rural joint venture, in large part, depends on finding the right local partner with the right connections. Foreign investors should seek village or township leaders who are open-minded and relatively knowledgeable about the international market. Potential partners should also have good links with city officials, and be willing to be flexible in the negotiation process. As start-up costs can be high—even in the countryside—investors aiming to export should look for a local partner with a strong track record in producing high-quality goods.

Choosing the right locale will also be important. While infrastructure improvements throughout China continue at a fast pace, areas such as southern Jiangsu, northern Zhejiang, coastal Shandong, southern Liaoning, and the Pearl River Delta are more likely to be able to offer key transportation links. Rural ventures producing for export will be particularly dependent on rapid and reliable access to adequate port facilities.

In all likelihood, foreign investment in rural joint ventures will continue to grow at a steady pace. While the ever-shifting political winds in Beijing could well mean another attempt to rein in TVEs at some future time, the resilience shown by this sector in weathering the austerity campaign attests to the vitality and longevity of rural enterprises. Growing recognition among rural leaders that local prosperity is increasingly linked to the global economy, in turn, should further open up investment possibilities for foreign companies, who would be foolish not to give China's rural industries a careful look. 完

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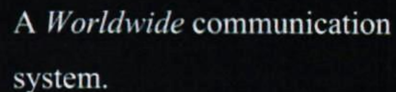


Unlocking the Consumer Market

The door to China's domestic market is opening wider all the time

Since opening its doors in 1979, China has seen tremendous economic growth and major changes in the lives of its citizens. Income levels of both urban and rural dwellers have risen sharply, giving the Chinese populace greater purchasing power than ever before. And as Chinese incomes have risen, so has foreign company interest in selling to this increasingly lucrative audience.

Income growth in China has been most marked in the rural population. Average per capita income of rural residents increased from ¥134 in 1978 to ¥630 in 1990, an increase of 370 percent. The average annual salary of urban employees rose 250 percent during the same period, from ¥615 to ¥2,140. Much of the increase in both rural and urban salaries has been due to rapidly rising wage levels across the country, but there also has been a marked increase in such non-wage income as subsidies for housing, food, and other expenses.

Not surprisingly, these rising income levels have boosted tremendously the level of expenditure of urban and rural residents. Various kinds of consumer products, including durable goods, have become popular; in 1990, total consumer sales reached ¥725 billion, an increase of nearly 500 percent over 1978 levels (*see* table). Consumer sales last year increased about 10 percent over 1990 levels. Thus far, the fastest growth in retail sales has occurred in coastal cities such as Shenzhen, Zhuhai, Xiamen, Guangzhou, Shanghai, Beijing, Hangzhou, and Dalian, where per capita GDP is up to 10 times the average nationwide urban per capita GDP of ¥2,701.

This article was adapted and excerpted from the report China's Consumer Market, *published by the Hong Kong Trade Development Council.*

1990 Sales of Consumer Goods by Region

Region	¥100 million	% change 1990/89
Total sales	7,250	3
Guangdong	668	5
Jiangsu	515	1
Sichuan	472	4
Shandong	460	7
Liaoning	421	2
Zhejiang	354	2
Shanghai	334	1
Hubei	326	2
Henan	314	1
Heilongjiang	310	3
Hebei	308	1
Hunan	295	—
Beijing	293	16
Anhui	227	1
Fujian	208	3
Jilin	199	1
Guangxi	175	3
Shaanxi	160	4
Shanxi	158	3
Jiangxi	152	—
Yunnan	146	3
Tianjin	140	4
Inner Mongolia	131	4
Xinjiang	104	6
Gansu	96	4
Guizhou	86	2
Hainan	37	1
Qinghai	29	7
Ningxia	25	6
Tibet	13	—

— = Insignificant

NOTE: The sum of the regional figures is less than the national total because some regions do not have complete statistics.

SOURCE: *Chinese Statistical Yearbook, 1990 & 1991*

The high spending power of the residents of these cities has resulted in increased demand for new products, which in turn has boosted product variety on store shelves and accelerated imports of foreign goods. Every day, tens of thousands of inland residents travel to the coastal regions to shop. Residents of Shenyang, Wuhan, Chongqing, Xian, and Chengdu are especially noted for their strong spending power.

Changing consumer tastes

As the incomes of both urban and rural residents have increased, the spending habits of China's consumers have begun to change. Though food, clothing, housing, and daily necessities continue to account for the bulk of urban expenditures—last year urban households spent 54.2 percent of their incomes on food, 13.4 percent on clothing, 28.5 percent on daily necessities, and 3.9 percent on housing—rising incomes have prompted demands for new types of products in each of these categories:

- **Food** Consumption is now dictated more by demand for quality than for quantity. Expenditures on basic foodstuffs are decreasing as a proportion of total spending, while purchases of processed foods, milk, dairy products, and other goods are increasing. Changing life styles and greater disposable incomes have enhanced the popularity of instant foods and delicatessen items, which allow consumers to spend less time on food preparation.
- **Daily necessities** Perhaps the biggest change in China's consumer spending

Perhaps the biggest change in China's consumer spending patterns is the sharp increase in sales of consumer durable goods.

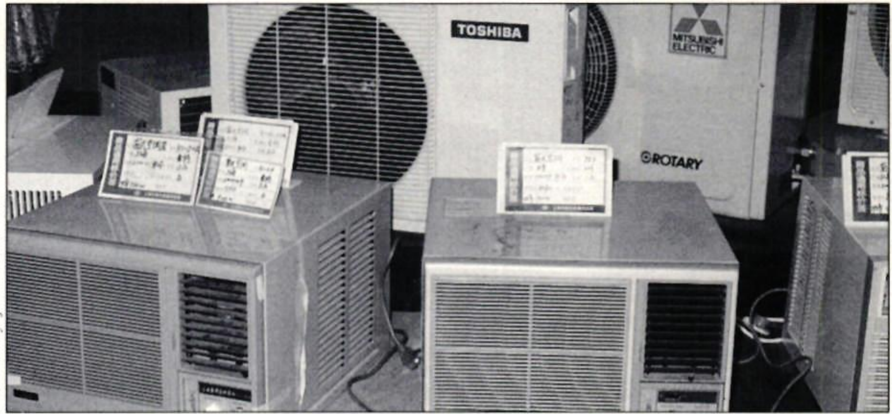
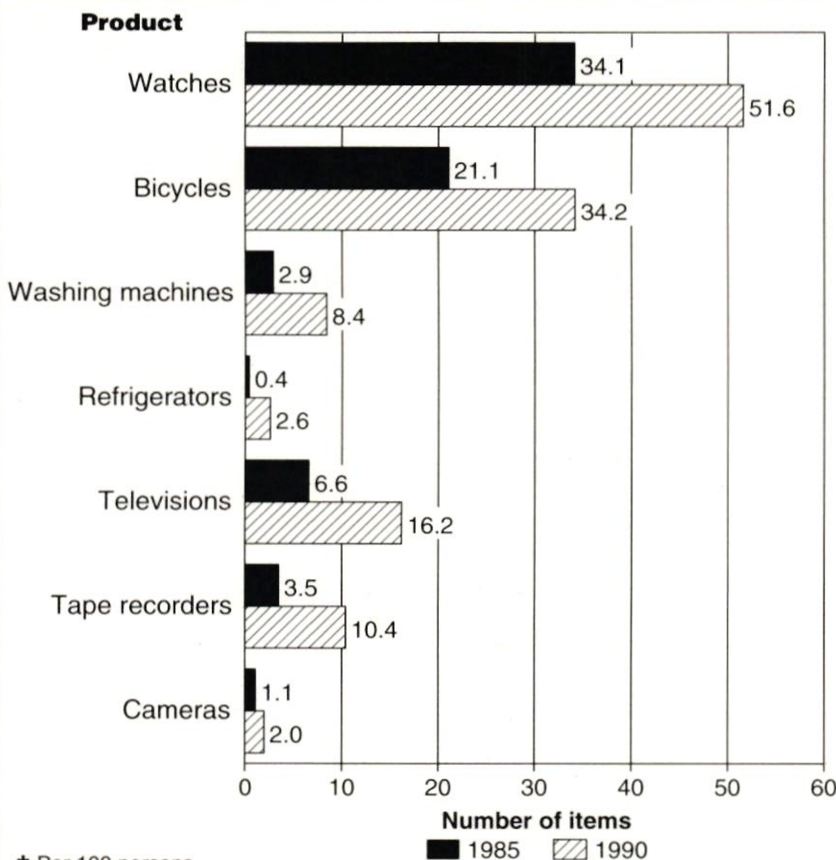


Photo courtesy of Vanessa Lide Whitcomb

Imported air conditioners can now be bought in large department stores in most major cities.

patterns is the sharp increase in sales of durable consumer goods. While basic products such as bicycles, watches, radios, and sewing machines satisfied consumer demands just a few years ago, luxury items such as color television sets, video recorders, stereo hi-fi sets, refrigerators, washing machines, air-conditioners, and microwave ovens are now much sought after (*see* chart).

• **Clothing** China's consumers are now looking for ready-made clothes, and are less interested in buying cloth to make apparel themselves. Expenditures on clothing, especially ready-to-wear apparel, have increased significantly, and it is forecast that clothing sales will increase by 50 percent over the next 10 years. These sales increasingly will be driven by global fashion trends. Already, growing numbers of Chinese consumers are looking to buy fashionable styles, designs, and fabrics; "fashion" is now key to stimulating sales and the concept of brand names is growing (*see* p.36). This phenomenon is now spreading rapidly from coastal regions to the interior.



• **Housing** Housing expenditures, which still account for a much smaller percentage of total spending than in Western countries, have nevertheless increased rapidly as consumers' disposable incomes have increased. Though many Chinese continue to live in cramped, subsidized housing, new construction and new home improvement products are upgrading the quality of China's housing. From 1978-90, for example, the average living area per person of both rural and urban residents doubled. As a result, there have been large increases in expenditures on house-related goods, including furniture, kitchenware, sanitaryware, and other amenities.

Not only are Chinese consumers buying different products, they're using them for shorter periods of time; new models are rapidly replacing older ones. For example, color television sets and stereo hi-fi equipment are replacing black-and-white televisions and basic tape recorders in many homes. As domestic production cannot meet the demand for many such goods, imports of consumer products are growing quickly.

301 eases the path for imports

What do these trends suggest for foreign producers? Clearly, the production of consumer goods in China at present cannot cope with the changes in consumer demand; the variety of domestically manufactured products is

Franchises and Fast Food

For some years already the Chinese restaurants of major fast food chains like Kentucky Fried Chicken and McDonald's have been breaking world sales records. Smaller, lesser-known restaurants have also set up shop to cater to China's increasingly affluent urban residents. In most cases, these projects have included investments on the part of the foreign company. Last spring, however, China saw the introduction of a new fast food phenomenon: a food court featuring four restaurants in one location. Moreover, the four restaurants were all franchises.

Franchising, though relatively new to China, is common in developed countries and in nearby Hong Kong, where US chains such as Wendy's, Hardees, and McDonald's have all established franchise operations. Basically, the franchisor sells the rights to its name and products to the franchisee, which runs the operation according to the franchisor's specifications and pays the parent company royalties on a regular basis. According to the International Franchise Association (IFA) in Washington, DC, the number of US franchises overseas is growing 10 percent a year. While there are no reliable statistics on the number of franchises in China, William B. Cherkasky, president of the organization, says "The IFA is very interested in China. The population is very entrepreneurial and we detect a lot of potential there."

Photo courtesy of Tony Yee

Hop Hing's "International Fast Food Town" has a prime location on Beijing's Wangfujing St.

The mastermind behind China's new franchise-studded food court is Hop Hing Fast Food Ltd., a subsidiary of Hop Hing Holdings Inc. of Hong Kong. A family-controlled public company in the edible oils business, the firm has two oil-processing factories in China. It began to diversify its business in 1991, when it acquired the Hong Kong franchise rights for Yoshinoya, a Japanese purveyor of rice dishes. Based on its success in Hong Kong, Hop Hing began to eye the largely untapped China market.

Photo courtesy of Tony Yee

Sunday is the busiest day of the week for the four franchises.

Hop Hing took the initiative to contact foreign fast food chains it thought would be interested in entering China through franchise agreements. Given Hop Hing's previous relationship with Yoshinoya, it was relatively easy to secure the China franchise rights from that company. In the United States, Hop Hing signed up three other players—California-based Carl's Jr., which specializes in hamburgers, Minneapolis-based Dairy Queen (ice cream), and Virginia-based Golden Skillet (fried chicken). Both Dairy Queen and Golden Skillet are owned by International Dairy Queen (IDQ).

These franchises have in turn been sub-franchised to the company that owns and manages the food court—the Beijing May Hing International Fast Food Development Co., Ltd. A joint venture between Hop Hing (which holds 51 percent), the Bank of China, Beijing's Dong An Group, and the Beijing Municipal Food Group, May Hing pays royalties to Hop Hing for the right to sub-franchise. The joint venture was created to take advantage of favorable tax laws and because strong Chinese partners were needed to obtain Chinese business licenses and financing.

Hop Hing and the franchisors did a year of research before opening the food court on Wangfujing, Beijing's main shopping thoroughfare, last March. Yoshinoya sent company representatives to recruit pedestrians in the Qianmen area of the city to sam-

ple the company's products; over 200 people participated over a three-day period. Since a typical Chinese fast-food lunch of rice or noodles cost about ¥2-3 at the time, Hop Hing figured the customers would be willing to pay around ¥4-5 for the Yoshinoya meals. To their surprise, however, they discovered that the test audience was willing to pay ¥7-10 per bowl—nearly double their original projections. Research for the other restaurants took less time, since some of Hop Hing's staff had previous experience selling similar foods at other fast-food chains.

Photo courtesy of Tony Yee

Small children (and their parents) are attracted to the food court's promotional giveaways and indoor play area.

The food court's target markets are children and teenagers; according to Tony Yee, market development manager of Hop Hing, the average urban Chinese couple spends up to 50 percent of its income on its one child. To attract these eager-to-spend parents, the food court features an indoor playground and weekly promotions. For instance, on Sundays, when most couples enjoy the day off from work, the food court often distributes such free gifts as baseball hats, key chains, and toys to its young customers.

Each of the restaurants receives support from its parent company in the form of training and supplies. Yoshinoya, for example, sends several representatives to China each month to conduct training and quality inspections. Each franchise must uphold the image and quality control standards of the parent company. Menus may offer fewer—but not different—items; Dairy Queen in the United States, for example, generally features some 30 products on its menu, but the Beijing store offers only a few cones and sundaes. According to IDQ Vice President of International Division Mark Lowder, however, his company plans to offer more products in China soon.

Photo courtesy of Vanessa Lide Whitcomb

Dairy Queen plans to open 40 stores in China within 10 years.

Because all of the food court franchises' products are sold in Chinese *yuan* while royalty payments must be paid in dollars, Hop Hing, like other foreign companies in China, tries to keep imports to a minimum. Currently, 10-20 percent of the four franchises' raw materials are imported, while the rest is sourced locally. Sino-foreign joint ventures provide the meat for Carl's Jr. hamburgers and bread for several of the outlets. Chicken and vegetables are sourced from Chinese suppliers, while the ice cream for Dairy Queen comes from a local Beijing dairy. Hop Hing provides ongoing training to the dairy, and also supplies a special imported emulsifier necessary to harden the outside of the soft-serve ice cream. Maintaining the rigorous quality standards of the franchisors has been difficult, maintains Yee, and occasionally additional ingredients must be imported.

Thus far, the venture—and the franchises—are doing well. According to Yee, it took just six months for the operation to become profitable. Hop Hing plans to open similar food courts in Guangzhou, Shenzhen, Shanghai, Hangzhou, and other cities in northern China. "The future for franchising in China is bright," Yee maintains. "Smaller fast food restaurants that don't want to invest in China themselves should definitely consider this option. At Hop Hing, we plan a slow but steady expansion to increase our presence in the China market."

—Pamela Baldinger
and Daniel P. Reardon

For most of the past decade, imports of consumer goods have been tightly regulated by central authorities.

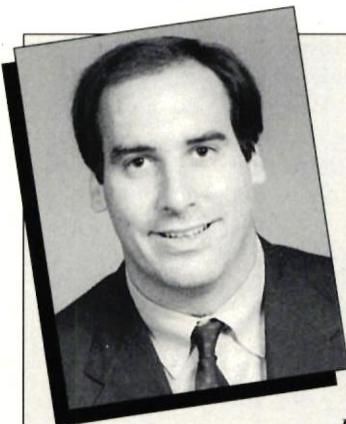
too limited and their design too old-fashioned. Even goods that are popular often cannot be produced in quantities great enough to meet demand, and there are not enough commercial retail outlets to sell them in any case. This situation bodes well for foreign consumer product makers looking to export to China or to invest in manufacturing operations there.

Photo courtesy of Vanessa Lide Whitcomb

Where emperors once ruled, foreign consumer products now hold court.

For most of the past decade, imports of consumer goods have been tightly regulated by central authorities, who prioritized hard-currency expenditures for imports of advanced technologies and equipment. Over the last few years, however, the administration of foreign trade has gradually been transferred from various industrial ministries and specialized import and export companies under the Ministry of Foreign Economic Relations and Trade (MOFERT) to the provinces, cities, and autonomous regions. Today, most foreign trade is conducted through import/export companies at these local levels. The trading companies, which operate on a commission basis, typically act as agents and look after import procedures and documentation for the enduser. Commercial enterprises are allowed to choose

Appealing to China's Snackers



Yili-Nabisco Biscuit & Food Co., a $9 million joint veture between RJR Nabisco (51 percent) and Yili Food Co. (49 percent), began production in Beijing in 1988. Yili-Nabisco General Manager C. D. Wadden recently spoke with Associate Editor Vanessa Lide Whitcomb about selling Western-style foodstuffs in China.

CBR: *What specific products does Yili-Nabisco make in China?*

Wadden: Salted crackers such as Ritz and Escort are our primary brands, along with Maria cookies. Almost all of our production is sold domestically, though we do export some of our products to neighboring markets.

CBR: *How does Nabisco attempt to establish name recognition and customer loyalty for its products?*

Wadden: We utilize all methods of marketing to build brand awareness. Product sampling, TV commercials, outdoor signs, print advertising, and a variety of promotions have been critical to our success. We hold regular in-store samplings, for example, as well as multi-city contests and other promotions.

We're always looking for new ways to enhance product visibility and distribution. In October, we began supplying Ritz crackers on Air China domestic flights. This cooperation provides us with an opportunity to increase sales volume and introduce our products to a wide range of consumers.

CBR: *How difficult has it been to distribute your goods throughout China?*

Wadden: We currently utilize the major wholesale channels in each of our key markets, and also do some direct retail sales. The wholesaler network in any country has shortcomings; wholesalers promote hundreds of products, not just your own, and transportation, storage conditions, and prompt payment can all be factors of concern. We make regular sales calls to both wholesalers and retailers to establish a relationship with our vendors, and to make sure our products are being handled and stored properly.

CBR: *Do you plan to introduce new items to the China market?*

Wadden: Several new products are planned for this year and next; we view new product introductions as integral to our future growth. Clearly, careful research in consumer preferences and trends is essential to produce "winners." It's a competitive market, though, so I can't say much more than that.

After a gruelling business journey that had taken me through five countries in two weeks, I finally succumbed to fatigue. Yet one final assignment in Beijing remained. Fortunately, my retreat into The Palace refreshed my body and soothed my soul. Its traditional charm and modern sophistication led me toward exquisite serenity like a path paved with silk.

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their own agents/trading companies according to the scope of business of the foreign trade companies involved.

Generally speaking, China has not imposed quotas on imports of consumer goods, but has restricted their import through currency controls, high tariffs (often in excess of 100 percent), and import licenses for certain items. According to the terms of the recently concluded 301 agreement between China and the United States, however, China must eliminate about 75 percent of its various import controls over the next five years (*see* p. 9). Currently, some 53 consumer items require import licenses, including such goods as confectionery, tobacco products, coffee products, videotape recorders, air conditioners, refrigerators, washing machines, radio cassette recorders, televisions, cameras, watches, automobiles, motorcycles, and computers. License requirements for several of these products, such as instant cameras and print film, air conditioners, and refrigerators, will be eliminated over the next few years.

FIEs must obtain approval from various government departments before they can sell their products domestically.

In the meantime, MOFERT will continue to handle the granting of import licenses either at the central level or through its local branches. Before imported goods can enter the country, Chinese Customs officials must examine and approve all import documents. Though currently many of the rules guiding the granting of licenses and the imposition of Customs duties are secret, the 301 Memorandum of Understanding (MOU) stipulates that they be published and made available to foreign companies by next October.

New retail opportunities

Given China's import obstacles, many foreign companies have sought to target the domestic market not by

China's Retailers Go Upmarket

If Shanghai is any indication, the retail markets in China's major cities are changing virtually overnight. The change is not so much in the number of establishments—which currently number around 120,000 in Shanghai—but in the style of the stores and the products they sell. Open-stall soda and sundry shops close down only to be replaced a week later by glass and chrome clothing boutiques selling Hong Kong-style fashions at $100 and up. Noodle and dumpling stands are being remodeled into bakeries and delis selling Italian cookies, American nuts, and Chinese-made pizza and hamburgers. And all of them seem to be doing a booming business.

According to official statistics, retail sales in Shanghai are expected to reach ¥50 billion this year, up from ¥45 billion in 1991. Imported goods are estimated to constitute between 5-10 percent of these sales. But these numbers probably undercount the true levels of retail sales and imports. Official import figures primarily reflect Shanghai's direct imports of large-ticket, luxury consumer goods such as electronics and appliances. A quick walk down most Shanghai streets, however, reveals many imports—from canned corn to socks to water purifiers—sold by small, private shops and street vendors who under-report sales to avoid taxes. Most of the imported products sold by these merchants enter China through the South, where import barriers are less rigid than in other parts of the country. Even some of Shanghai's largest department stores, which have the authority to import independently, source foreign products in South China. Sales of these goods are recorded as domestic sales, thus contributing to the undercounting of imports in Shanghai.

Photo courtesy of Vanessa Lide Whitcomb

Customers at the Shanghai No. 9 Department Store test the karaoke units. The Japanese machines, which provide musical accompaniment while the user sings into the microphone, are gaining in popularity throughout China.

Shanghai officials expect foreign access to the retail sector to grow considerably over the next several years. Yaohan, Shanghai's first joint-venture department store, has already received State Council approval, and at least two other department stores with different foreign partners will probably receive approval soon. Though these three are the only authorized foreign joint-venture retail outlets, a glance around the Jing An district, Shanghai's most prosperous commercial area, reveals many foreign joint-venture stores. Most are established as manufacturing joint ventures with retail as a sideline. In reality, however, the "manufacturing" may amount to a minimal amount of superficial processing, while the retail store constitutes the bulk of the foreign investment. Jing An officials indicate this is an excellent way to enter the retail market now; companies with such operations will be in an excellent position to take advantage of new sales opportunities when the retail market is fully opened to foreign participation.

American companies have been slow to pursue the retail market thus far, no doubt because the market has been only partially open. Both district and municipal officials in Shanghai, however, are eager to attract American retail outlets—especially American department stores.

—Rosemary Gallant.

Rosemary Gallant is an officer of the US & Foreign Commercial Service in Shanghai. The views expressed in this article are those of the author and do not necessarily repre-

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Foreign exporters have not been as successful penetrating China's consumer market as have foreign manufacturers with production facilities in China.

Photo courtesy of HKTDC

Hong Kong companies like Kwun Tee have found that establishing their own counters or sections in Chinese department stores results in strong sales.

exporting, but by investing in China. In many cases, export-processing operations that have acquired a great deal of practical knowledge about purchasing inputs in China have turned their enterprises into joint ventures. The Chinese partners of these enterprises play a key role in promoting sales in the domestic market.

Not every foreign-invested enterprise (FIE) is permitted to sell domestically, however. FIEs producing officially approved import substitutes may sell a pre-approved percentage of their output domestically, but other FIEs must obtain approval from various government departments before they can sell their products domestically.

These approvals are based upon three criteria stipulated in China's foreign investment regulations: the enterprise uses advanced technology greatly needed by China; the enterprise needs to sell on the domestic market in its early stages before it becomes competitive internationally; the investment is located in regions designated by the State for special treatment. It is not yet clear whether the import substitution provisions of the 301 MOU will also apply to foreign investments in China. If they do, FIEs that do not currently have import substitution status may find it much easier to sell their products domestically.

Except in certain cases, FIEs can handle the wholesale of their own products, but cannot trade or market other goods. Many foreign enterprises appoint agents to wholesale their products to relevant retail organizations. Products are generally sold on consignment to retailers, with the agent receiving a commission.

An increasing number of Hong Kong-invested enterprises, however, have begun to set up specialized counters in department stores that sell the products on a consignment basis. This has proven an effective marketing approach, particularly for brand-name products familiar to China's consumers. Goldlion (Far East) Ltd., for example, began using this sales method several years ago to sell ties and other menswear. Similarly, Silver Eagle Holding Ltd. sells its China-manufactured shoes in counters in Guangzhou department stores and has plans to set up similar counters in Chongqing, Beijing, and Shanghai.

The range and types of products sold by retail enterprises in China have to be approved by State commercial bureaus and other administrative departments, which categorize all products according to industry, manufacturing process, and nature of product. According to official statistics, by the end of 1990 there were over 8.7 million retail enterprises with over 20 million employees around the country. Most of these enterprises are privately owned, though the largest stores are owned by the State sector.

The State-owned enterprises consist mainly of department stores and shops under the Ministry of Commerce. These enterprises are now responsible for their own profits and losses and source their products themselves. At the end of 1990, China had 280,000 State-owned retail enterprises, which accounted for about 40 percent of all sales. Collectives and privately owned stores registered 32 percent and 19 percent of all consumer sales, respectively.

Until recently, foreign participation in the retail sector was prohibited, though the restrictions are now beginning to ease. The first officially ap-

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proved foreign joint-venture department store, to be built by Japan's Yaohan chain, is under construction in Shanghai, and several other joint-venture department stores are in the works. All of these projects are planned for the coastal area and will be allowed to sell a significant portion of imported products, provided they export an equivalent amount of Chinese goods.

Planning ahead

Generally speaking, foreign exporters have not been as successful penetrating China's consumer market as have the foreign manufacturers with production facilities in China. This is due, in part, to various import and currency barriers and in part to Beijing's emphasis on using foreign capital for industrial development. Though the successful resolution of the 301 negotiations should boost import levels, import growth will likely continue to be somewhat restrained due to foreign exchange shortages and some continuing import controls.

Companies seeking to invest, however, will probably find themselves welcomed, especially at local levels, which have generally been more open than the center to foreign participation in the domestic market. Nevertheless, foreign businesses wishing to enter China's domestic market should bargain hard for domestic sales rights when they negotiate cooperative or joint-venture projects with their partners and relevant government officials. Once such contracts are approved, it may not be possible to alter their contents.

Whether foreign companies choose to invest in or export to China, they will likely find China's consumers receptive to their products. Deng Xiaoping's exhortations early this year to expand China's economic reforms have already eased some barriers against foreign companies, and the 301 agreement should create even greater sales opportunities in the consumer sector in the future. As long as China's economy keeps growing and its reforms keep moving forward, future prospects for foreign consumer goods manufacturers should indeed be promising. 完

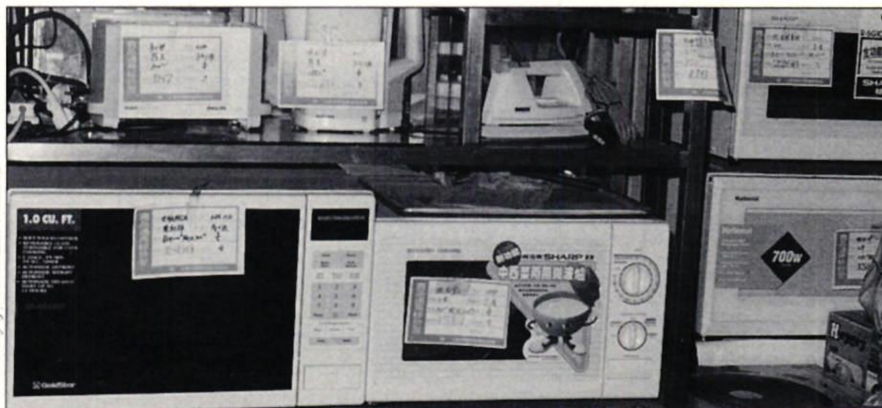

Photo courtesy of Vanessa Lide Whitcomb

Items unknown in China just a few years ago, such as microwave ovens, are increasingly demanded by China's status-seeking consumers.

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Cantonese Consumer Stampede

Guangdong's 63 million eager buyers are igniting China's consumer boom

Denny Barnes

Still holding their scissors, the Guangzhou vice mayor and US consul general both looked surprised. As the red satin ribbon fell to the floor, a stampede of Cantonese consumers surged into the first-ever American consumer products fair in China. The managers of the Guangzhou Friendship Store had predicted strong sales for the 17 US companies that participated in the spring 1992 show. But the Guangdong consumers' seemingly insatiable hunger for everything American resulted in sales three times higher than the Friendship Store's optimistic initial projections.

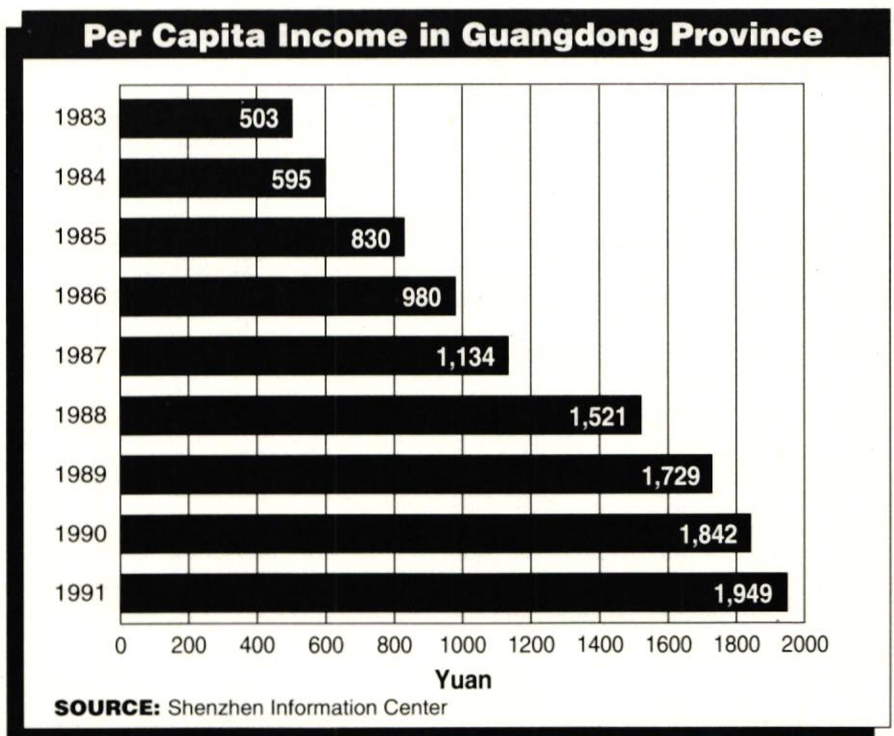
Could it be that the land of a billion consumers is finally opening its doors to foreign consumer products? The signs are everywhere. Imported goods line the shelves of Shanghai's glitzy new department stores and boutiques. Peasants in remote corners of China can be seen munching on M&Ms. Even Beijing bureaucrats, once a formless mass of blue and gray cadres, are starting to look like they've just walked out of the latest issue of *Gentlemen's Quarterly* magazine. Foreign consumer goods are in high demand—and nowhere is the trend more evident than in Guangdong Province.

Economic growth boosts consumption

Guangdong has long stood apart from other regions of China because of its proximity to Hong Kong and its ability to attract foreign investment. A glance at the statistics reveals why Deng Xiaoping praised Guangdong's economic achievements during his visit there earlier this year; the province's per capita income and savings rates are the highest in China (*see* chart). Cities such as Shenzhen, Zhuhai, Dongguan, Zhongshan, Foshan, and Guangzhou have per capita incomes far above the national average, and actual income levels throughout the Pearl River Delta may be double the official numbers,

Denny Barnes, commercial consul at the US consulate in Guangzhou, has spent the past five years in China. He is responsible for promoting American goods throughout South China.

Officially, Guangdong imported $2.5 billion worth of consumer goods last year—a 31 percent increase over 1990 figures.



As incomes have risen throughout the province...

since these figures do not reflect the large number of Hong Kong dollars circulating in Guangdong's underground economy.

Officially, Guangdong imported $2.5 billion worth of consumer goods last year—a 31 percent increase over 1990 figures (*see* p. 30). Imports in 1992 are certain to rise yet again. Retail sales of consumer products were also strong last year, reaching ¥77.7 billion ($14.3 billion at official exchange rates)—an increase of 18 percent over 1990. This spectacular performance is the result of the growing strength of the local economy and the purchasing power of the province's residents.

Cantonese yuppies

The rapid urbanization of Guangdong is another factor that has helped boost sales of consumer goods in the province. By 1991, 93 percent of Guangdong's population was living in townships and cities, compared to 23 percent for China as a whole. Concurrently, employment has been shifting from the agriculture sector to the industrial/commercial sector, where salaries tend to be higher. In 1983, for example, just 17 percent of the province's work force was employed in commerce and industry; by 1991, the figure had grown to more than 28 percent. Nationally, the number of workers employed in this sector increased by only 2 percent during the same period.

China's "baby boom" generation, which is now in its 20s, has further swollen the ranks of the new class of urban professionals. Increasingly, these young adults are employed in Guangdong's commercial sector—particularly in foreign offices and foreign-invested enterprises. Wages paid by foreign firms are typically much higher than those provided by State enterprises.

Since unmarried young adults in Guangdong usually live with their parents or in dormitory housing where inexpensive meals are provided, they tend to have few expenses. Thanks to their relatively high disposable incomes, many are quick to snap up the latest fashions—regardless of price. I recently observed a group of young office workers admiring a pair of Nike sports shoes, for example. "That's the shoe the 'Dream Team' wears," exclaimed one of them. Although a pair of the shoes cost more than the young man's monthly salary, he bought them without a second thought.

Photo courtesy of Denny Barnes

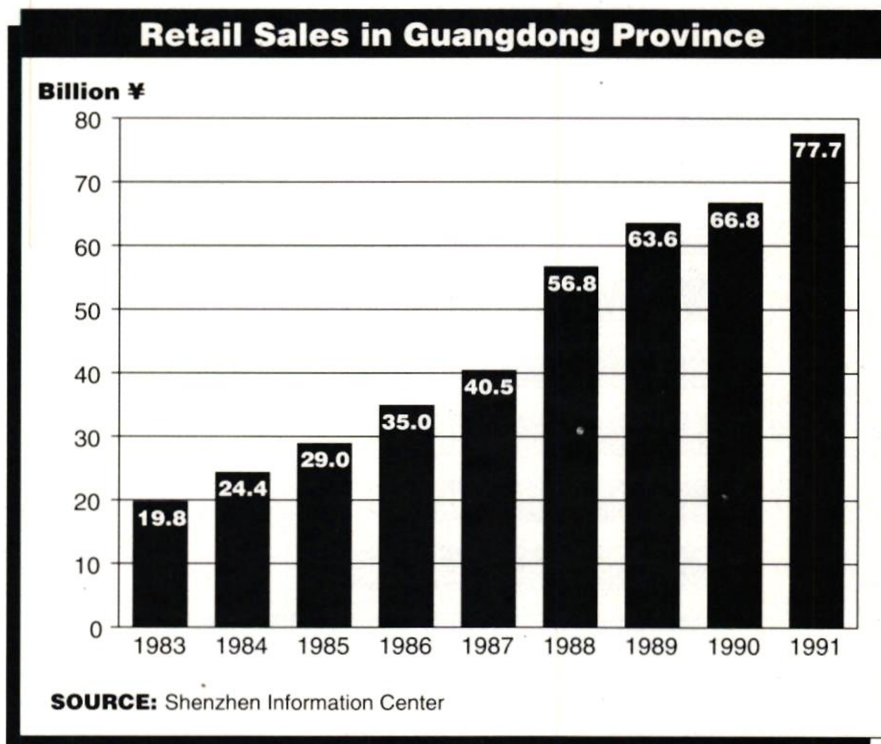
American symbols and icons are popular marketing tools in South China.

Foreign is good, American is better

Western and Chinese observers alike have commented on the way Cantonese pursue wealth with a near-religious fervor. In a culture where conspicuous consumption is a virtue, imported goods are valued as much for their symbolic value as their inherent quality. This phenomenon was never clearer than when a wealthy trader in Dongguan invited me to see his new home. He was very proud of the imported hardwood floors, bathroom fixtures, and air-conditioning system. What really impressed me, though, was the family altar in the living room. Directly under the watchful gaze of the Buddhist deity Guanyin was a 28-inch Japanese color television. Fresh-cut flowers and burning incense had been placed in front of the television. On the opposite wall, foot-high figures of the eight immortals stood on a long table flanked on each end by a Motorola cellular phone.

The foreign brands that attract most Guangdong consumers tend to be the same ones that are popular across the border in Hong Kong. Virtually every household in the Pearl River Delta has erected a towering TV antenna to tune into the latest trends—and advertisements—from Hong Kong.

If Guangdong consumers seem to think anything "foreign" is good, they appear to view anything "American" as even better. This belief is evident from the growing popularity of American symbols in Guangdong packaging and marketing efforts. For instance, Hong Kong exporters sell California pistachios in brilliant "stars and stripes" packaging. A large billboard in the



...so have retail sales.

Guangzhou Department Store features the Statue of Liberty selling ginseng tea, which the local manufacturer claims is made from roots imported from America. Teenagers strut around in new jeans with "USA" emblazoned across the hip pockets.

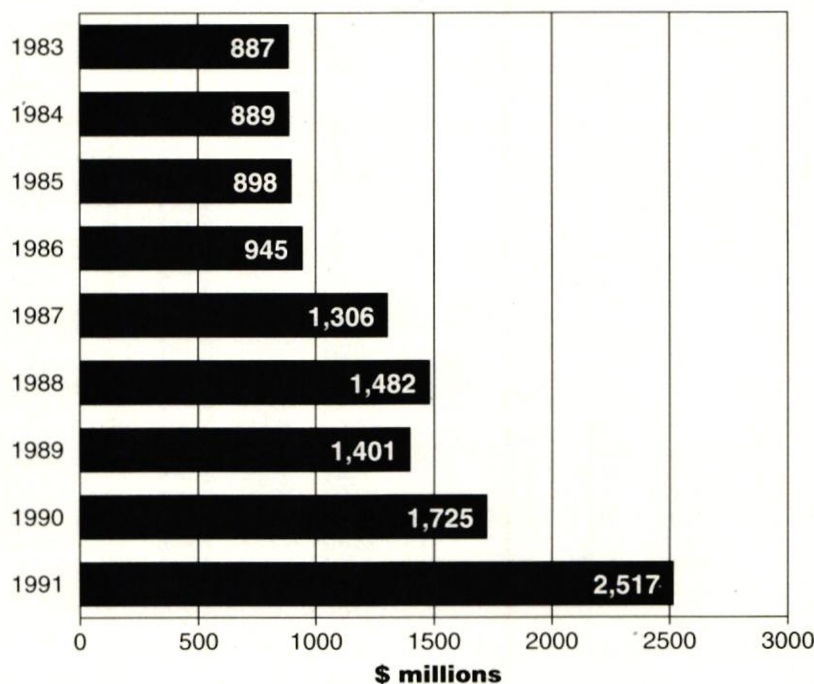
To cater to the Cantonese penchant for things foreign, markets have developed for products unknown in Guangdong even a generation ago. Honored guests are now sometimes served Western-style snack foods, such as California almonds or American potato chips, rather than traditional local delicacies. Attractively packaged snack foods and candy from the West are also considered good gifts for friends and relatives, particularly during the Chinese holidays. Tea is increasingly being replaced by soft drinks, beer, and coffee; locally produced Coke, Pepsi, Pabst beer, and Maxwell House coffee are all selling well. Food and beverage imports, which grew 44 percent in 1991, were the largest single component of the province's consumer imports last year.

In addition to food and beverages, leisure-related goods are increasingly in demand as changes in Guangdong's employment patterns provide workers with more free time. More and more of the province's residents are employed in jobs in which fixed work hours with standard holidays and vacation periods are the norm. This has led to a surge in demand for sporting goods, photographic film and supplies, videos, books, and music cassettes and compact discs.

In most homes in the province, no expense is spared in meeting the needs of the family's one child.

A growing portion of the Guangdong population's discretionary income is also spent on personal-care items. American-brand toiletries, both locally manufactured and imported, are typically several times more expensive than their Chinese counterparts. Nonetheless, Guangdong's relatively affluent consumers increasingly prefer them to domestic products. In 1991, Guangdong's imports of toiletries and cosmetics grew 41 percent to $101 million, a 10-fold increase since 1983. Even high-end perfume and cosmetics lines are now marketed in Guangdong, despite steep import duties of 150 percent.

Infant and child-oriented products are also big sellers. The combination of China's single child policy and the relatively high discretionary income typical of Guangdong residents is creating a phenomenon known as the "little emperor" syndrome. In most homes in the province, no expense is spared in meeting the needs of the family's one child. The Chinese use the phrase "4 on 1" to describe the competition among grandparents to supply the single grandchild with everything he or she wants. The market for disposable diapers, baby food, fashionable clothes, and toys, accordingly, is skyrocketing.



Importing...

The surge in Guangdong's imports is all the more noteworthy given Beijing's traditional lack of support for imports of consumer products. With the exception of stringent import licensing requirements and quotas on cigarettes and alcohol, there are few absolute prohibitions against most consumer goods now being imported by Guangdong from America. China's duty system, however, has clearly been structured to discourage consumer product imports and protect domestic industries—current duties on consumer products range from 40-180 percent.

These duties are generally assessed not according to invoice values, but according to product values assigned by Chinese Customs officials. In Guangdong, these values are based on Hong Kong prices and are compiled in tables which are updated periodically. Often, the assigned values are higher than the actual invoice value. Since the tables are classified as internal (*neibu*) documents, however, foreigners are not allowed to see them. Nor are there any official channels through which foreigners may appeal the value assigned to products they wish to market in China. A recent survey by the US consulate in Guangzhou of imported American brand-name consumer products, in fact, found that US goods in Guangdong are much more expensive than equivalent products in Hong Kong.

To avoid high import duties, a significant but undetermined quantity of the foreign goods in the Guangdong

Small Customers, Big Sales

Dallas-based Texas Instruments (TI), producer of electronic items, computers, and educational products, has been active in China for nearly 15 years. The company entered China's consumer market in December 1990, when it introduced the "English Professor," an educational aid that helps Chinese speakers learn English vocabulary, spelling, and pronunciation. The company has since introduced several other electronic educational products. Steven Ng Kwan Keung, consumer sales manager for Texas Instruments in Hong Kong, spoke to Editor Pamela Baldinger about his company's marketing strategy in China.

CBR: *What kind of market research did you conduct in China before entering the market?*

Ng: We knew that parents in China are very concerned about the examination results of their children, and suspected that they would be prepared to pay for products or services they believe can help their children get better results. Since English is included in Chinese college examinations, we thought there would be a market for the English Professor.

To test this hunch, we did market research among middle-income Chinese families whose monthly household income averaged ¥350. We found that parents in these families would be willing to pay for effective learning tools. We also hired professional consultants to craft an effective strategy for sparking interest in the product.

Photo courtesy of Steven Ng Kwan Keung

Chinese children playing with a TI computer at an in-store promotion.

CBR: *How do you approach China—as one large market? Or as several regional markets?*

Ng: We treat China as a unified market but have different goals in each province. Given China's size, we don't have the ability to promote our products everywhere at once. For now, we have chosen to focus our activities on Beijing, Shanghai, and Guangzhou, though the English Professor has been introduced in 20 provinces. We use the same advertising and promotional materials in each of these areas to provide a unified product image. By the end of August this year, we had sold 45,000 full sets (the main computer and three cartridges)of the English Professor. Each set sells for ¥666 (around $122 at current exchange rates).

This ad, from the inside of a Texas Instruments brochure, illustrates TI's theme that the English Professor can have a beneficial impact on its users' futures. The Chinese characters say "yesterday, today, and tomorrow."

CBR: *What techniques do you use to market your products?*

Ng: We use in-store promotions, direct mail, advertising, and public relations efforts. In-store promotions have been the most successful marketing tool so far. They mainly involve having salespeople demonstrate the product at the sales venue; we've discovered that the presence of these salespeople can boost sales by as much as 300 percent. As a result, department stores in Beijing, Shanghai, and Guangzhou have been providing in-store demonstrations at their own cost.

CBR: *What plans does Texas Instruments have to boost its consumer sales in China?*

Ng: China's consumer market is already huge even though foreign companies currently focus on the more developed coastal cities. This means that few companies have extended their products to more than 30 percent of the population. But if China is able to develop its interior as the government plans, the consumer market in the next 10 years will be triple or quadruple the size of the current market.

At Texas Instruments we plan to expand our marketing and distribution network into the interior and rural areas. In addition, we are working on designing products tailored specifically for the Chinese market, and are studying investment opportunities on the mainland.

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consumer market enters through unofficial and semi-official channels. While the speedboats that ply the waters between Hong Kong and Guangdong with smuggled goods are a notorious example of this type of activity, many imported goods enter via means which are not so blatantly illegal. For instance, some products arrive legitimately through duty-free channels and then leak into the general market. Most American companies usually distance themselves from these gray-market channels, however, preferring to market their consumer goods in prominent retail outlets.

Implementation of the recently concluded 301 market access negotiations, which obligate China to reduce certain tariffs, eliminate licensing requirements and quotas for most goods, and publish openly all laws and regulations dealing with trade should further open China's markets to US exporters of consumer products. Import duties on several categories of consumer goods, such as cameras, film, cosmetics, and alcoholic beverages, are being reduced, and some consumer products will no longer require licenses (*see* p. 24). Most important, China's commitment to adopt transparent, published import regulations should eliminate some of the more consternating import practices that have confronted US exporters until now, and should also enable US companies to begin marketing more consumer products directly to Guangdong distributors. This in turn may decrease US companies' reliance on Hong Kong middlemen.

...vs. local production

A number of US companies have sought relief from Guangdong's high import duties by investing in manufacturing operations in the province. Some of these ventures have been very successful; foreign-invested enterprises account for nearly a third of all enterprises in Guangdong, and produced over 28 percent of the province's total industrial output last year. Familiar household names in the United States—such as Colgate, Procter & Gamble, Kraft General Foods, Pepsi, Coca-Cola, Avon, and Heinz—are among the companies that have established joint ventures in the Pearl River Delta. Shampoo, baby cereal, toothpaste, and a wide range of other goods produced by US joint ventures in the province are now widely distributed throughout Guangdong. Though foreign companies generally have to make export commitments in their joint-venture contracts, to date, the great majority of their production is still going into the local market.

Distributing products in a highly fragmented national market with poor transportation linkages is a formidable task.

Photo courtesy of Denny Barnes

Sales of foreign photographic supplies should be aided by the 301 agreement, which stipulates that import tariffs on these products be lowered.

While most of the US investors in Guangdong have focused on the South China market, a few have attempted to create national markets for their goods. Some of the joint ventures with the longest track records, such as Procter & Gamble and H.J. Heinz Co., have successfully marketed their products throughout China, but the task of distributing products in a highly fragmented national market with poor transportation linkages is formidable. Several American manufacturers in Guangzhou have complained of lengthy delays—as much as two-and-a-half months—in booking freight on trains going north.

Even ventures looking to market their goods within the province face barriers due to transportation bottlenecks. Guangdong's infrastructure development—particularly road and rail—has not kept pace with industrial development, causing major constraints on the expansion of manufacturing activity. In 1991, industrial output in Guangdong grew 27 percent, but the amount of freight carried by rail grew only 8.2 percent. Nearly all of the province's highways and railroads are strained to the breaking point.

The increasing cost of land is another problem confronting consumer product manufacturers in Guangdong. Hong Kong speculators have driven property values up considerably (*see* p. 42), causing some potential investors to re-evaluate their investment plans.

Despite these obstacles, however, American consumer product companies continue to invest in Guangdong. The labor force is arguably the best in China, local officials are experienced in dealing with foreigners, and the close geographical and cultural ties to Hong Kong make it easy to utilize experienced Hong Kong managers and technicians.

Getting the goods out

Whether imported or made locally, consumer goods in Guangdong are generally sold through a large number of independent retail outlets, as no national or local chain stores currently exist. Even the friendship stores found in every city in China are all independent outlets. This means the manufacturer or trading company trying to sell consumer goods needs to forge links with each individual store in the province.

Before China's economic reforms were implemented in the 1980s, all wholesale and retail activities were controlled by the Ministry of Commerce in Beijing and its bureaus at the provincial, municipal, and county levels. Now, however, retailing in Guangdong has become very diffuse, and is only loosely controlled by the local bureaus. Most US companies, in fact, find the Guangdong distribution system unfathomable, and rely on the expertise of their Chinese partner, importer, or Hong Kong agent. As a result, most imported consumer products are first introduced into the local market by the major department stores in Guangzhou, such as the Guangzhou Friendship Store, the

Nanfang Department Store, the Guangzhou Department Store, and the China Foreign Trade Center Store.

Another major distribution channel for foreign consumer goods is the duty-free system. Chinese returning from living overseas are allowed to buy a fixed number of duty-free items at stores operated by the Guangdong Personnel Working Abroad Service Co. Similarly, overseas Chinese and Taiwan citizens are allowed to buy duty-free goods at the Guangdong Overseas Commodities Supply Duty Free Shop, and merchant seamen can purchase duty-free goods at a store operated by the Guangzhou Shipping Supply Co. The merchandise in all three duty-free outlets is overwhelmingly of Japanese origin, and consists largely of consumer electronics, home appliances, and motorcycles. Many of the goods that are legitimately purchased in these stores are then resold on the gray market.

Changing demographics and new investment opportunities may moderate the province's consumerism.

"Duty-free" stores are also operated in Guangdong's three Special Economic Zones—Shenzhen, Zhuhai, and Shantou. These stores take payment exclusively in Hong Kong dollars and charge less than the mainstream retail outlets, but certainly do not offer true duty-free prices. They sell a wide variety of consumer products, including many American brands of toiletries, household goods, and food items.

New distribution outlets for US consumer products may also be on the horizon. Guangdong officials announced last summer that the retail sector will be opened up to foreign participation, and negotiations are currently underway in both Guangzhou and Shenzhen to bring in foreign retailers. In Guangzhou's trendy Tianhe District, the Thai-based Chia Tai Group has begun building a huge shopping mall and office complex. In Shenzhen, 7-11 and a number of Hong Kong supermarket chains are preparing to open stores. Since there are no US department stores in Hong Kong yet, it may be some time before one comes to Guangdong. Foreign involvement in the retail sector should, however, further boost the sales of all imported consumer goods in Guangdong.

Trends and counter-trends

The Guangdong consumer product boom has been ignited by a combination of factors—rising income levels, a baby boom generation with relatively large disposable income, rapid urbanization, a growing commercial/industrial sector, and proximity to Hong Kong. This growth has been dampened only by high import duties and other import barriers. But can such growth continue?

Changing demographics and new investment opportunities may moderate the province's consumerism. China's baby boom generation may soon be more concerned about buying a home than acquiring the latest foreign products. The emergence of a private housing market and new investment opportunities, such as the embryonic stock market, are likely to absorb much of the province's disposable income.

Moreover, it is entirely possible that certain Beijing policymakers may try to temper the explosive growth in China's consumer product imports. But even a temporary market reversal is unthinkable among Guangdong's irrepressible consumers. Though the current 31 percent growth rate in imports cannot be sustained over the long term, rising incomes should keep sales of high-quality consumer goods growing at double-digit rates into the next century. The import reforms necessitated by China's desire to join the General Agreement on Tariffs and Trade (GATT) should also encourage more US consumer product companies to be players in this dynamic market.

Could it be that the age-old dream of a billion Chinese consumers buying American products is finally going to be realized? At least in Guangdong, dreams appear to come true. 完

Sales of child-oriented products, such as clay and diapers, were strong at the US consumer products fair in Guangzhou last April.

Photos courtesy of Denny Barnes

Reaching the Chinese Consumer

Where to place your ad for maximum effect

Xu Baiyi

Planning an advertising strategy to reach China's burgeoning consumer market can be a dizzying task; 1,076 newspapers, 2,197 magazines, 1,211 radio and 747 television stations all accept advertising. Nearly a quarter of a million billboards, thousands of neon signs, illuminated street signs (commonly called "light boxes"), and window displays are also available to carry your message at reasonable cost. With so many options, the selection of the right media format is essential to the success of any company's advertising campaign.

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Where to start

Major urban centers are the best places to introduce your name to the Chinese public. Given China's vast size, it is difficult to implement a nationwide marketing strategy from the outset. Instead, many foreign-invested enterprises (FIEs) have scored success by using regional media first, concentrating on large cities such as Guangzhou, Shanghai, and Beijing. After acquiring a foothold and gaining market share for their products, they then expand their sales efforts to other cities and rural areas. S.C. Johnson & Son, Inc.'s joint venture, Shanghai Johnson Ltd., for example, used such a strategy: its Agree shampoo was first introduced and advertised in Shanghai in 1988, and has now become popular nationwide.

The most effective way to create an impression on Chinese consumers is to use more than one medium. Most FIEs employ a mix of television and newspaper advertisements to reach a large audience. For instance, Shanghai Santana's successful newspaper advertising campaign uses large Chinese characters, such as *qu* (fun) to describe the experience of driving their car. The companion television spot shows a famous calligrapher writing the big characters. Similarly, as part of a promotional campaign last year, Johnson & Johnson sponsored a baby-care series on Shanghai TV and placed ads in the city's weekly TV guide and local dailies. This mix of media reinforces the advertiser's message and disseminates it more widely. Generally speaking, foreign companies are charged for advertisements in US dollars, while domestic firms and most joint ventures pay in *renminbi* (*see* chart).

Fit to print

Most foreign companies advertising in China should include at least some advertisements in newspapers. While no exact circulation figures are available, the high readership rates of Chinese newspapers make them the country's most popular advertising medium—currently, they run about $15.6 million worth of ads every year. Because of late printing and delivery times, these papers—all published by central or provincial-level governments—are not read at the breakfast table or on the way to work. Instead, most dailies are sent to offices where they circulate among quite a few people.

The titles of Chinese newspapers usually give a clear indication of their intended audience, making it easy to identify whether a publication is an appropriate advertising vehicle. Among the leading publications, *Renmin Ribao* (People's Daily), the official organ of China's Communist Party, is read by Party members and those who work in government, industrial, and commercial organizations. This paper is often the first choice for advertisers who wish to reach top decisionmakers and a national audience. Shanghai's *Jiefang Ribao* (Liberation Daily), also read by decisionmakers, is another favorite place to advertise both capital and consumer goods. Other good newspapers for advertisements include *Jingji Ribao* (Economic Daily), which is read in economic circles, and *Gongren Ribao* (Workers' Daily), which is read by over a million workers.

Evening newspapers, which are usually delivered to homes and read during leisure hours, can also be good advertising vehicles. Local and foreign consumer goods manufacturers advertise heavily in the *Xin Min Evening News*, a Shanghai publication which has about 1.5 million readers, many of whom reside in other cities. Afternoon regional newspapers provide an effective and economical way to reach specific local populations through print.

China also has newspapers that attract audiences with specific interests. *Wen Hui Bao*, read mostly by intellec-

Xu Baiyi, an advertising writer, lecturer, and consultant, has over 60 years experience in the industry. He is the author of Marketing to China: One Billion New Customers *(National Textbook Co., 1989), and has lectured as a visiting scholar at the University of Illinois and Michigan State University.*

tuals, is good for advertising cultural events. *Zhongguo Tiyu Bao* (China Sports), in contrast, caters to sports fans, while *Zhongguo Qing Nian Bao* (China Youth Gazette) is read by young people. All of these publications provide a relatively inexpensive way to reach a highly targeted audience.

Magazines are another cost-effective advertising medium for foreign companies in China. Most of the magazines that accept advertising have national circulations. Copies are sold by subscription and through retail newsstands. Most Chinese magazines clearly fall into professional, trade, or consumer categories, making it easy to identify which magazines might be effective advertising vehicles.

Another type of print ad, direct mail advertising, is still a novelty in China. Because Chinese people do not receive many fliers in the mail, they read and consider direct mail more carefully than do Westerners. The Chinese government appears open to the idea of direct mail; in 1991 the Shanghai post office launched a campaign to encourage firms to mail commercial messages. These messages can only be mailed at first class rates; they are not entitled to the cheaper bulk rates common in other countries. High international postage rates, moreover, generally make it uneconomical to send mass-mailings from overseas. The best method is to hire a local Chinese advertising agency to address wrappers and mail fliers. Currently underused, direct mail is an area with strong potential for future advertising efforts.

Mass Appeal

Dentsu, Young & Rubicam (DY&R), with its Chinese partner China International Advertising Corp. (CIAC), opened the first international joint venture advertising agency in China in 1986. Melvin Song, chief representative for the firm's Beijing office, spoke with Assistant Editor Ann Amelia Flynn about devising consumer advertising campaigns in China.

CBR: *What is the current advertising climate in China?*

Song: With the high levels of disposable income among consumers, the greater variety of products on the market, and television household penetration levels of 80 percent in some areas, advertisements are beginning to feature product differentiation. As a result, too many advertising dollars are chasing too little airtime or space.

CBR: *For what foreign or joint-venture consumer products do you handle advertising in China?*

Song: Our accounts include Mercedes-Benz and Colombian coffee (the Juan Valdez logo). Our joint-venture clients include Beijing Philips Audio; Tianjin Smith Kline & Beecham, makers of Contac and Fenbid; and Xian-Janssen Pharmaceuticals, which produces Imodium and Vermox. In the service sector, we advertise for Holiday Inn China properties.

CBR: *How do you typically devise an ad campaign?*

Song: We conduct research through focus groups, street interviews, and other methods to gain consumer insights and understand local market conditions. We then use the findings to write advertising strategies and creative work plans.

For example, when we were planning our strategy for Vermox, a de-worming product, we discovered that transformers, video games, and super-heroes were popular among Chinese children, who are the largest users of the product. We therefore developed a high-tech super-hero, "Captain Vermox" (*Anle Duizhang*) to appear in all Vermox advertising and promotional materials. He was created to alleviate fear and embarrassment in children who have worms and to convey the message that with Vermox, killing worms is easy and not a chore.

Captain Vermox

Photo courtesy of Melvin Song

CBR: *What has been the response to the Captain Vermox campaign?*

Song: The kids love Captain Vermox and sing the jingle from the TV commercials. Sales have exceeded Xian-Janssen's expectations; in the six months after the campaign was launched, over 2 million units of Vermox were sold in Beijing, Shanghai, and Guangzhou.

CBR: *Which media formats do you use and why?*

Song: It's different for each client. For example, the key markets for Colombian coffee are in Beijing, Shanghai, and Guangzhou, cities where consumers are slightly more affluent and open to Western lifestyles. Our advertisements focus on educating the consumer about quality coffee and on the superior richness of Colombian coffee, so that consumers can understand the significance of the Juan Valdez logo. In those three cities, we've advertised in local newspapers and on municipal TV and radio stations, and also on strategically located billboards. For other clients, we also utilize national media, including CCTV, People's Daily, and China Daily.

CBR: *What does the future hold for the advertising industry in China?*

Song: Already, since advertising began in China in 1979, national billings have increased 30-40 percent each year. This year's billings are estimated to reach $920 million, a 50 percent increase over the 1991 figures. Such growth has attracted more international advertising agencies to China. There's definitely great potential for future growth.

Chinese Media Advertising Rates*

Major Daily Newspapers

TITLE	CIRCULATION	DISTRIBUTION	RATE PER COLUMN/CM		
			Local Enterprise	Joint Venture	Foreign Enterprise
People's Daily *(Renmin Ribao)*	4,500,000	Nationwide	¥220	¥275	$130
Economic Daily *(Jingji Ribao)*	1,000,000	Nationwide	¥90	¥90	$60
Beijing Daily *(Beijing Ribao)*	700,000	Beijing and vicinity	¥76	¥114	$50
Wenhui Bao	970,000	Shanghai and vicinity	¥150	¥150	$50
Guangzhou Daily *(Guangzhou Ribao)*	510,000	Guangzhou and vicinity	¥125	¥150	HK$380
China Daily (in English)	150,000	Nationwide	¥50	$26	$26

Radio Stations

STATION	BROADCAST AREA	RATE FOR 30 SECONDS		
		Local Enterprise	Joint Venture	Foreign Enterprise
The Central People's Broadcasting Station Channels 1 and 2	Nationwide	¥600	¥690	$400
Beijing Radio	Beijing and vicinity	¥250	¥325	$238
Shanghai Radio	Shanghai and vicinity	¥400	¥400	$140
Guangzhou Radio (in Cantonese)	Guangzhou and vicinity	¥115	¥115	$102

Television Stations

STATION	BROADCAST AREA	DAY	RATE FOR 30 SECONDS		
			Local Enterprise	Joint Venture	Foreign Enterprise
China Central Television					
CCTV2	Nationwide	Mon-Fri	¥4,000-10,000	¥6,000-13,000	$4,000-8,000
		Sat-Sun	¥5,000-11,000	¥7,500-14,000	$5,000-9,000
CCTV8	Beijing	Mon-Sun	¥4,000	¥5,500	$3,000
Beijing Television	Beijing and vicinity				
BTV6	(no daytime advertising)	Mon-Fri	¥4,500	¥4,500	$1,600
		Sat-Sun	¥5,700	¥5,700	$2,000
BTV21		Mon-Sun	¥1,500	¥1,500	$1,000
Shanghai Television	Shanghai and vicinity				
STV8, STV 20		Mon-Fri	¥1,200-3,000	¥1,800-4,500	$500-1,800
		Sat-Sun	¥1,400-3,500	¥1,800-5,250	$500-2,160
			50% premium on holidays		20% premium on holidays
Guangdong Television	Guangdong Province				
GDTV14 (Cantonese)		Mon-Fri	¥300-2,200	¥450-3,300	HK$1,800 12,900
		Sat-Sun	¥345-2,530	¥518-3,795	HK$1,800-16,770
			15% premium Tues & Thur nights; 50% premium on holidays		30% premium on holidays
GDTV2 (Mandarin)		Mon-Fri	¥500-1,000	¥750-1,500	HK$1,800-9,100
		Sat-Sun	¥575-1,150	¥863-1,725	HK$1,800-11,830
			50% premium on holidays		30% premium on holidays

* Local enterprises and joint ventures pay in Chinese currency, except where noted. Foreign companies are charged in US dollars.

SOURCE: Saatchi & Saatchi Advertising China

New worlds. New times. World Times.

Is this simply the furled sails of a Tall Ship in the face of fresh winds, or a symbol of a world changing course and heading in a new compass direction?

Are these sailors suspended in the riggings defying the elements, or Everyman trying to adjust to the vast social and political sea changes of today?

World Times, the Boston-based global information resource, is very much part of this scene. Founded in 1978, it is owned by individuals from a dozen different countries. It is dedicated to reflecting indigenous perspectives on global issues that transcend national boundaries. Its international affairs periodical *The WorldPaper* appears monthly in 25 countries and six language editions, and serves as an early warning radar system for the new currents and landfalls ahead.

For information about subscription, advertising and corporate sponsorship of World Times' international programs, please contact:

WORLD TIMES
210 WORLD TRADE CENTER, BOSTON, MA 02210
TEL. 617.439.5400 TELEX 6817273 FAX 617.439.5415

Zhang Xuan's "Lady Kuo-Kuo and her Sisters Setting Forth on an Outing" (Tang Dynasty, 8th century), reworked in 1989 by Sanna Shao(邵[illegible]) in Hong Kong.

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In old China, travel was restricted to nobility and merchants; trips were long and arduous... and comfortable lodging was hard to find.

Today, there's a New World in Beijing, Guangzhou and Shanghai. All first class hotels where travelling business people enjoy the utmost in comfort, service and style. Convenient locations, well appointed rooms, a wide choice of business support services, recreational facilities and, without doubt, the best restaurants in town.

For fine accommodation and superb hospitality in China, look no further than New World.

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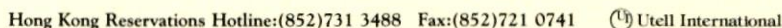
BEIJING

京廣中心
JING GUANG CENTRE
JING GUANG NEW WORLD HOTEL

SHANGHAI

上海揚子江大酒店
YANGTZE NEW WORLD HOTEL



Hong Kong Reservations Hotline:(852)731 3488 Fax:(852)721 0741 Utell International

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Television ads for similar products are often aired together so that the audience can compare claims.

On the air

Since the first television commercial aired in China in 1979, TV has assumed more and more of companies' advertising budgets and is now closing in on newspapers as the most popular advertising medium in China. Viewership has rapidly expanded—Central TV now claims an audience of 600 million for its evening news. Consequently, TV ad rates and revenues have risen steeply over the past few years. In addition to nationwide Central TV, 746 municipal and provincial television stations also accept advertising.

Television ads are generally used to establish brand recognition and highlight the special characteristics of a product to set it apart from its competition. The ads for Boeing Co., for example, have helped the company gain a reputation for safety and comfort among the Chinese population, many of whom may never even ride in a plane.

The format for television advertising in China is partially responsible for this emphasis on unique qualities. TV commercials can only be broadcast between programs when viewers are likely to switch channels, get a snack, or engage in other activities. Ads for similar products are often aired together so that the audience can compare claims. Eye-catching ads, therefore, are a must if a company's products are to stand out from its competition's.

One ploy used by advertisers to eliminate competing ads is to sponsor a program, an approach used by Shanghai Johnson & Johnson, Ltd., which backed a prime time baby-care series. The four, five-minute vignettes featured a young couple puzzling over care for their newborn infant. Each ended with a Johnson & Johnson baby-care expert dispensing advice. Aided by tie-in print ads, the series garnered much consumer attention and boosted product sales. Similarly, Marlboro sponsors programs such as "Marlboro Sports World," which display the company's logo despite a national ban on TV cigarette ads.

Television-related publications are also good advertising vehicles, as viewers often consult their local TV listings for program information. These publications have large circulations and, given their week-long lifespan, are inexpensive. For example, the 8-page Beijing tabloid *Zhongguo Dianshi Bao* (China TV Weekly) has a readership of 3 million, while its Shanghai counterpart, *Meizhou Guangbo Dianshi* (Weekly Radio Broadcasting and TV) has a circulation of 2.8 million. All together, China's 80-plus TV guides have a combined circulation of over 40 million. All accept advertising, but each one must be approached individually.

Despite the growth of the TV audience in China, radio remains a popular and important medium. Radio's broadcast area—basically the entire country—is larger than that of television, and radio programs reach consumers unable to read newspapers. Currently, around 1,200 regional and national broadcast stations accept advertising. Though radio's percentage of total advertising revenue dropped from 7.7 percent in 1983 to 4 percent in 1991, audiences are still large and ad rates remain a bargain (*see* table).

While consumer goods make up the bulk of Chinese radio ads—the Coca-Cola Co., for instance, broadcasts a 10-second message every morning before the 6:15 weather forecast on Shanghai Radio—other products can also be marketed effectively. Da An Real Estate sold all of its available apartments in two months after advertising on Shanghai Radio, though previous advertising efforts in national and overseas newspapers had yielded disappointing results. Much of the success of the campaign was attributed to being able to reach consumers relaxing at home.

Taking it to the streets

The heavy traffic and bustling crowds typical of most Chinese cities guarantee large audiences for outdoor ads such as billboards. Although it is impossible to

Chinese Outdoor Advertising Rates

Type	Rate	Minimum Rental Period
Billboards	$35-80/sq m per month	6 months
Neon signs	$60-80/sq m per month	3 years
Bus shelter*	$7,000 per shelter	1 year
Trolleys*	$10,000 for three trolleys	6 months
Light box	negotiable	negotiable

* Shanghai only

SOURCE: Xu Baiyi

Photo courtesy of Huang Yi

obtain precise data, several million people are estimated to pass through Shanghai's main thoroughfares every day. Other urban areas offer similarly heavy street traffic. This exposure, combined with low prices and the long life of billboard ads (usually six months), makes billboards the most popular mode of outdoor advertising.

Most domestic advertising agencies rent out billboards, which are often constructed in rows of 10 or more. Because billboards in China are of various sizes, paste-on posters are not usually used; instead, most billboards are hand painted. Cut-outs (portions of the ad that extend beyond the frame of the billboard), three-dimensional effects, and simple ad copy are often utilized to attract the fleeting attention of pedestrians.

In addition to large billboards, other ad sites dot downtown cities. Light boxes, which hang from buildings as shop signs, are rented out to advertisers by store owners. Pedestrian bridges and sidewalk railings in Guangzhou and Shanghai sport advertisements designed to keep product names in shoppers' heads. Arrangements for these ads can be made through almost any Chinese ad agency. Some of the most dramatic street advertisements are window displays, which are created by advertisers who rent the window space. The facade of Shanghai No. 1 Department Store, for instance, contains a row of 18 picture windows that can be leased from the store.

Consumers are beginning to rely on advertising as a guide to select commodities that satisfy their wants.

Another advertising option is plexiglass bus shelters; Coca-Cola's Sprite and Fanta, the first shelter advertisers, are still placing ads in these locations. The company credits its initial Shanghai bus shelter ads with helping boost sales in the city. Following Shanghai's lead, Beijing and Tianjin municipalities, and the provinces of Guangdong, Zhejiang, Jiangsu, and Sichuan are also introducing bus shelter ads. The local municipal planning bureau in each location generally handles advertising requests.

Photo courtesy of Xu Baiyi

This innovative billboard ad, designed by Lu Zhaohua, emphasizes the feeling of independence one gets by owning the featured product.

Advertisers not content with the shelters may want to consider advertising on the buses and trolleys themselves. Pepsi Cola International, one of the first advertisers on Shanghai's trolleys, says the novel placement of its ads on trolley fronts drummed up customer awareness, and hence, sales of Pepsi and 7-Up. Salem cigarettes and other advertisers are now also placing such ads.

Companies looking for a little more flash may want to consider neon signs, which have sprouted up in Chinese cities over the last few years. More than 60 large neon signs now light up Shanghai's skyline. As the number of skyscrapers in China's major cities increases, their roofs should be considered ideal locations for neon signs, which can be seen for miles.

Establish awareness now

A carefully planned advertising campaign does bring results. For instance, Raid insecticide's summer 1990 inaugural ad campaign used well-coordinated television and newspaper ads, billboards, neon signs, bus panels, light boxes, window displays, and posters to create a strong and immediate impact on consumers. An autumn 1991 survey of Shanghai pedestrians revealed that 92 percent of the sample knew the Raid brand name.

The growing popularity—and sophistication—of ad campaigns in China is attracting more large names in the business. Ogilvy & Mather; Dentsu, Young & Rubicam; J. Walter Thompson; and Saatchi & Saatchi have already opened offices or established joint ventures in China. They have brought the advanced technology and modern advertising and marketing techniques needed to further develop China's advertising industry. They are not without competition, however; 20 other foreign advertising firms have entered China this year, and domestic advertising agencies, such as Guangdong White Horse Advertising and Shanghai Advertising & Decorating Corp., are rapidly improving their services.

All of these firms realize this is an ideal time to advertise in China, as consumer spending is soaring (*see* p.18). China's open door policy has given many Chinese their first exposure to Western goods, and for now, interest in these goods is high. Consumers are beginning to rely on advertising as a guide to select commodities that satisfy their wants. In China, we have a saying: *xian ru wei ju*—"Whosoever comes first becomes the master." In other words, well-planned advertising today can set the stage for market dominance tomorrow. 完

我会活动 Council Activities

China Traders and Investors Gather on West Coast

"China is in the midst of a substantial economic expansion, with annual GNP growth expected to surpass 10 percent this year." This observation by Director of Business Advisory Services Richard Brecher set the stage for an in-depth analysis of China's economic and political climates and other topics at a series of West coast briefings held by the Council in September. In Seattle, Los Angeles, and San Francisco, Brecher and Council President Donald M. Anderson met with over 100 US exporters, importers, and others with a commercial interest in China.

The briefings focused on four primary areas critical to China's economic future: the political and economic environments, the current business climate, and bilateral trade issues. Brecher and Anderson noted that much of the current reform thrust in China is focused on reducing the government's role in the economy; many government bureaucrats, therefore, are less than eager to implement changes that threaten their own positions. The reformist camp, it would seem, is in no way assured of a smooth ride.

Brecher and Anderson noted that even the spectacular economic growth so far this year could mask potential problems for the Chinese leadership. Though inflation has been kept relatively low, it has begun to accelerate recently, which might prompt top leaders to slow the economy should they think inflation and spending are starting to careen out of control. Such intervention was too successful in 1988-89, when government attempts to rein in the economy ended up stifling growth altogether. Anderson concluded by noting that whatever measures it adopts, Beijing will face an uphill battle coping with the inefficient State sector, which is by far the greatest drag on the economy.

After outlining the political and economic forces shaping China, Brecher and Anderson gave highlights of foreign business activity in the country. Despite ongoing bilateral battles over China's market access practices and growing trade surplus with the United States, trade is soaring and US investors are contributing to the renewed rush of foreign investment in China. In the first quarter of 1992, US investment totaled 245 contracts valued at $340 million, more than 200 percent above total investment value for the same period of 1991. Lured in part by the economic boom and in part by Chinese promises to improve the investment climate, US companies have invested in ventures producing everything from baby food to telecom equipment. Though many of the investment-promotion policies espoused recently by Beijing are long on rhetoric and short on real reforms, US investors seem optimistic that a new policy permitting greater foreign participation in China's service industries will open the door to significant foreign investment in retail, accounting, consulting, insurance, property development, and other sectors.

Based on the large turnout and clear interest in the Council's analysis, the Council plans to hold such regional sessions more frequently. New briefings are tentatively scheduled for the spring and fall of 1993 in Chicago, Dallas, Los Angeles, San Francisco, and Seattle. "The Council is busier than ever providing technical assistance, briefings, and other advisory services," says Brecher. "These regional meetings are an effective means for addressing our membership's needs and interests."

USTR Notes 301-GATT Link

On September 24, the Council's Import Committee met with Assistant US Trade Representative Ira Wolf for a briefing on the final negotiating rounds of the office of the US Trade Representative's (USTR) 301 market access investigation. Wolf stated that his meetings in Beijing in early September with Minister Li Lanqing of the Ministry of Foreign Economic Relations and Trade (MOFERT) yielded positive indications that a final agreement would indeed be reached by the October 10 deadline. Though USTR had initially expected more political fallout from the US sale of 150 F-16 fighter jets to Taiwan in September, Wolf said there was little mention of the sale in the course of the Beijing meetings and there was no indication that the arms sale would be a factor in the final 301 agreement.

Many of Wolf's comments focused on the relationship between the 301 investigation and China's desire to enter the General Agreement on Tariffs and Trade (GATT). A successful outcome of the 301 talks, said Wolf, would "jump-start" China's accession to GATT, while failed negotiations would make the process "extremely difficult."

Though USTR, according to Wolf, realizes that China cannot dismantle its entire economic system overnight, he suggested that "Now is the time for China to liberalize." China's relatively low inflation rate, high foreign exchange reserves, and strong economic growth all point to increased liberalization of its markets, Wolf noted.

China's Real Estate Revolution

Will the latest fad become another messy lesson in capitalism?

Madelyn C. Ross and Kenneth T. Rosen

China has discovered a new natural resource in abundant supply: land. At 9.6 million sq m, China is the third-largest country in the world. With no extraction, transportation, or distribution costs, land is relatively inexpensive to bring to market, and demand for the commodity is booming.

China's leaders are eager to make the most of this potential windfall. For the short term at least, they appear to have the best of both worlds; they retain State ownership of land while permitting long-term leases to entice developers to pay for and build on the land as if it were their own. In 1991—just four short years after land-leasing experiments began on a limited basis—the "sale" and development of land around the country generated $6 billion in official revenues. This figure is expected to increase 30 percent this year, with even greater sums being earned from under-the-table deals.

Real estate acquisition and development is now the focus of feverish domestic activity as well as the target of one-third of all foreign investment in China. The value of land and property in the South and in some coastal cities has increased 50-80 percent each of the past few years, reaching levels undreamed of in China just two years ago—and comparable to rates in major international cities around the world.

What goes up must come down, however, and the way in which this new resource is managed will help determine whether it falls with a crash or moves at a more moderate pace. Real estate boom/bust cycles are common everywhere, but China's lack of laws and experience with which to govern this commodity magnify the dangers. As China's cadres begin to climb the learning curve in the real estate sector, the costs of miscalculation and mismanagement grow with each new project.

In 1991—just four short years after land-leasing experiments began on a limited basis—the "sale" and development of land around the country generated $6 billion in official revenues.

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Where it all began

Shenzhen and the surrounding Pearl River Delta of Guangdong Province have been the laboratory of land-use reforms and the birthplace of the real estate revolution. As one of China's first four Special Economic Zones (SEZs), Shenzhen had the flexibility to experiment with land reform and strike innovative deals with foreign firms. The city pioneered China's first transfer of land-use rights to an overseas investor in 1987 and has been at the forefront of the country's real estate dealings ever since.

The key factors in Guangdong, as with real estate booms elsewhere in the world, have been growing population and rising incomes. Massive in-migration is taking place throughout the Delta; Shenzhen's population has soared from just 30,000 people in 1978 to more than 2.5 million today, while the province as a whole now hosts an estimated 3-4 million workers from other parts of China.

These people are being drawn by factory jobs and entrepreneurial opportunities in the region's flourishing export sector. Many of the workers, particularly those who are self-employed in the rapidly growing private sector or who work in collectives or foreign-invested enterprises, do not qualify for the low-cost, subsidized housing available to employees of State-owned enterprises. But these workers' higher incomes (three times the national average) and the fact that many are looking for a safe place to invest their growing savings have helped create China's first real hous-

ing market, as well as markets for related commercial and recreational facilities. Domestic companies in need of housing for their employees are also becoming a major source of demand for residential properties.

The Hong Kong connection

Proximity to Hong Kong is another major factor in the region's booming property market. Hong Kong investors alone have created some 3 million export-oriented jobs in the province, helping to boost Guangdong's exports to $13.6 billion last year—almost 20 percent of China's total. The region's economy is one of the fastest growing in the world: spurred by foreign investment, industrial output has increased more than 20 percent for each of the past five years.

In addition to helping create jobs and wealth in the region, Hong Kong has fueled South China's real estate boom in a more direct way—through the growing demand of its own residents for housing in China. Fleeing the territory's sky-high land and housing prices, Hong Kong residents increasingly are purchasing retirement homes in China. Many are also buying apartments for relatives or for business purposes, while some hope merely to resell quickly for large gains. Hong Kong Chinese made up an estimated 60-70 percent of the property purchasers in the Pearl River Delta until recently, when local demand began to catch up. In 1992, Hong Kong residents are expected to buy at least 30,000 residential units in the Delta—approximately the same number of new units that will be purchased in Hong Kong during the same period.

Property north of the border is still a bargain for Hong Kong investors, who face local housing prices of up to HK$4,000 ($500)/sq ft. Top Shenzhen prices are still less than a third of that, although prime property there has jumped from HK$400/sq ft in 1988 to HK$1,200/sq ft this year (about $150/sq ft at current exchange rates). Prices in the provincial capital of Guangzhou are not far behind, in the $125/sq ft range. Meanwhile, anticipation of improved transportation networks, particularly the Shenzhen-Guangzhou superhighway to be completed late next year, is creating mini-building booms and escalating real estate prices in smaller cities throughout the province.

Hong Kong residents are expected to buy at least 30,000 residential units in the Pearl River Delta this year—approximately the same number of new units that will be purchased in Hong Kong during the same period.

Photo courtesy of Andrew Ness, Tian An China Investments Co., Ltd.

Property prices in Shenzhen, which abuts Hong Kong, are soaring.

Beijing and Shanghai try their hand

The property market outside the Pearl River Delta is also coming to life, as the "get-rich-quick" potential of real estate ventures sparks the interest of local governments around the country. Eager to replicate South China's success, they are courting foreign land developers to help upgrade basic infrastructure, renovate deteriorating urban areas, and build showcase commercial development projects in their own cities. In recent months, as prices in the South China property market have continued to rise and rumors of saturation and overbuilding have spread, other regions of the country have seen a dramatic increase in interest from foreign developers.

Beijing and Shanghai have been the focus of most of the deals struck outside Guangdong to date, and prices for top properties there are reaching levels as high as those in Guangzhou and Shenzhen. Shanghai has been the most successful in promoting its real estate, both in the old city and in the Pudong New Area to the east. The municipality claims to have signed leasing deals with foreign developers for 100 tracts of land—worth a total of $1.4 billion—in the first eight months of this year alone. This figure includes large projects recently announced by most of the major Hong Kong developers active in China (*see* list).

Beijing municipality has also signed a number of high-profile deals with major Hong Kong developers. In a spate of activity in June of this year, city officials announced projects with Hong Kong's Cheung Kong, Kerry Properties, and Sun Hung Kai Properties.

New demand from domestic sources

Although Beijing and Shanghai don't have the same level of demand from Hong Kong purchasers as do cities in South China, they do have built-in demand from large resident foreign populations. In the short term, developers are relying on foreigners to purchase their top residential and commercial spaces. But many developers also see strong potential in the local market. Chronic under-investment in urban housing has fostered huge pent-up demand for residential units, while the country's

nascent housing reforms are raising rents and encouraging those able to do so to purchase their own homes.

In addition, State enterprises in many cities are buying new properties on the outskirts of town, relocating their employees there and selling off rights to coveted downtown locations. Rapid economic growth has also increased consumer spending power and demand for commercial space, another long-neglected sector. Students returning from abroad and an emerging entrepreneurial class will contribute to local demand for real estate in major urban areas.

Such demand from the domestic market contrasts sharply with the mid-1980s, when foreign firms built hotels and office buildings catering almost entirely to foreigners in major cities and tourism centers throughout China. A glut of competitive projects and the disappearance of foreigners from China following Tiananmen left many of these projects nursing large debts and low occupancy rates (*see The CBR*, November-December 1990, p.18). Renewed demand from the foreign community, coupled with the long-term needs of the Chinese population, however, appears likely to yield a market more stable than the one that existed during the last round of major foreign building activity in the 1980s.

Regional competition heats up

Although they have smaller foreign constituencies, other towns and cities throughout China are counting on a combination of geographical location and economic potential to heat up their property markets. As foreign investors move into China in ever-increasing numbers, the cities to which they flock (often those with successful economic and technological development zones) are also beginning to see foreign interest in land development, from industrial parks to residential and commercial projects.

A few localities are trying to lure developers with special incentives, including tax breaks and discounted land prices. Hainan Province, for instance, has attracted a number of real estate projects in this way. Several unlikely areas have also attracted large projects by courting overseas Chinese tycoons with a soft spot for their native Chinese villages. One Hong Kong developer plans to build almost 800 apartments in the little-known town of Penglai in Shandong Province, regardless of profitability, in order to do something useful for his hometown. But for now, most foreign developers braving China's fledgling real estate market are likely to stick to locations with the greatest foreign demand and the most local money, in order to assure the quickest returns.

A top priority of Shenzhen and other local governments is to improve the land-lease system in order to raise the revenues collected from land-leasing and development activities.

The government steps in

Thus far, China's real estate boom has occurred with little prompting or supervision from Beijing. And until recently, the government has made only half-hearted attempts to regulate the market for fear of stemming the flow of money into China. But that attitude is changing as officials become increasingly concerned about the dangers of an unfettered building boom.

Recent evidence of the government's mounting interest in the real estate situation came in October, when Vice Premier Zhu Rongji was quoted as expressing concern about overheated real estate activity and questioned whether the market could support the number of luxury villas being built. At an August real estate conference convened in Zhuhai by the State Council, Vice Premier Zou Jiahua indicated that the government's first priority is to improve "macro-management" of the country's real estate sector through a vaguely outlined "Five-Point Unified Policy" to control the planning, purchasing, development, management, and sale of land in China.

The country already has a few real estate laws on the books, including two 1990 regulations that set basic guidelines for foreign investment in real estate and the transfer of land-use rights (*see The CBR*, March-April 1991, p. 12). It now remains for Beijing to flesh out these laws, however. A number of measures are under consideration by the State Council and the Ministry of Construction, including national regulations on land-leasing and housing prices, as well as more specific guidelines detailing foreign involvement in real estate.

The foreign investment guidelines are expected to provide incentives for foreign developers to undertake projects that match national priorities, including improvement of infrastructure and development of high-technology industrial zones in China's coastal cities. Beijing may also take concrete steps to encourage a two-tiered residential market, one for domestic and one for foreign buyers, and may encourage foreign developers to focus on luxury projects for foreigners. Some local governments have already mandated that a certain percentage of low-cost, low-rent housing be built in their jurisdictions, in order to avoid a surfeit of luxury units. Shenzhen, for example, plans to release 480,000 sq m of land for residential development in 1992, but only 120,00 sq m, one fourth of that supply, will be open to foreign purchasers.

Local land-lease controls

While national regulations have been appearing slowly, localities have been struggling to cut down on profiteering and speculation in their own real estate markets on an ad hoc basis. South China, as the first and most active center of real estate activity, is the farthest along in efforts to regulate the market. As has been the case in other sectors in the past, regulations issued by Shenzhen and other cities in the Delta will probably foreshadow the regulatory efforts of the national government.

A top priority of Shenzhen and other local governments is to improve the land-lease system in order to raise the revenues collected from land-leasing and development activities. Beijing calculates that localities around the country are losing about ¥10 billion($1.8 billion) each year through unreported or undervalued transactions.

Currently, most land-lease deals around the country are contractual ventures in which a Chinese party transfers land-use rights to a foreign

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A Sample of 1992 Foreign Inves

BEIJING

Robert Kuok (Kerry Properties Ltd.) (HK) in June announced plans to build a $300 million office, residential, and commercial development on 484,000 sq ft near Beijing's main railroad station. The project, a joint venture with a Beijing real estate development company, is expected to be completed by 1996.

New World Development Co. (HK) in July announced plans to build a $90 million department store on a 60,000 sq ft site in the Xidan district of Beijing. Joint venture partner China Electricity is providing the land.

Sun Hung Kai Properties (HK) in June announced plans for a $255 million renovation of the Dongan market on Wangfujing Street in Beijing. A 50-year contract has been signed with Dongan Market Commercial Group.

FUJIAN

Emperor International Holdings (HK) in May announced plans to spend about $40 million to develop a 126,000 sq ft, 5-block residential and shopping area in Xiamen through a wholly owned subsidiary.

Far East Consortium International (HK) in July reportedly formed a joint venture with Xiamen Commercial External Trade Corp. to develop two properties. Far East will invest $20 million to construct two 21-story buildings on a 104,000 sq ft site and will contribute $10 million for two additional 14-story residential buildings on a 68,000 sq ft site. The buildings are scheduled for completion by late 1994.

Paliburg International (China Trend) (HK) in July announced plans to develop three Xiamen residential and commercial projects with a total floor area of more than 1 million sq ft. Paliburg will own 75 percent of one project and 100 percent of the other two.

GUANGDONG

Applied International Holdings (HK) in May formed a 50-50 joint venture with the Huiyang government to develop a 15 million sq ft commercial/residential complex on a 6 million sq ft site in Huiyang.

Burlingame International (HK) in July signed a joint-venture contract with Sen Sang Development to develop three residential blocks with more than 400 units in Zhongshan. Burlingame will pay $2.6 million for the 100,000 sq ft site and contribute $7.8 million for its development.

Cheung Kong (HK) in June signed a letter of intent to develop the 35 sq km island of Jiangao, near Panyu, into a "fantasy island" amusement park with a residential complex, resort, and industrial facilities. The project will be a joint venture with the Panyu government.

China Overseas Land and Investment (HK/PRC) in August announced plans to develop a 100,000 sq ft site into a residential and retail complex in Nanshan, Shenzhen. The $24 million project is to be constructed through a 50-50 joint venture with the Nanshan district government, which is providing the land.

Chia Tai Group (Thailand) in July announced a 50-50 joint venture with Shenzhen Special Economic Zone Development Co. to build residential, commercial, shopping, and hotel facilities on a 2.4 sq km site in the SEZ. The initial phase involves development of 300,000 sq m of residential and commercial property.

Henderson Land (HK) in May signed a letter of intent to build a $131 million retail, commercial, and residential project on a 100,000 sq ft site in Guangzhou.

Hongkong Macau Holdings (Macao) in May announced plans to acquire six factory buildings on a 200,000 sq ft site in the Haizhu district of Guangzhou to convert to residential use. The firm's Chinese partner is Guangzhou Lianxing Agriculture, Industry, and Business General Co.

New World Development Co. (HK) in May announced plans to build 30-40 blocks of two- and three-story homes and recreational, cultural, and commercial facilities on Er Sha Island, Guangzhou. The approximately $250 million project, a joint venture with Guangzhou City Construction and Development Corp., is expected to be completed by 1997.

Tak Sing Alliance Holdings (HK) in June announced that it will develop a 3 million sq ft site in Da Ling Shan, Dongguan, into a $2.5 million residential, commercial, and industrial complex that includes a golf course. Tak Sing owns 70 percent of the project, a Chinese partner holds 20 percent, and a private HK firm owns the remaining 10 percent.

Styland Holdings (HK) in August announced it will enter into a joint-venture arrangement with local authorities to build a residential and commercial development on an 800,000 sq ft site in Zhongshan. Styland will initially invest $1 million and plans to pre-sell units.

Wui Kam International Investment Co. (HK) in March announced a joint venture with China Huadian Real Estate Corp. to develop a $67 million world-class resort. The project covers 1,646 acres in Bao An, Shenzhen, and will include recreational facilities, hunting grounds, and 200 cottages.

HAINAN

Kumagai Gumi Hong Kong (subsidiary of Japanese firm) in March signed a 70-year lease to develop 30 sq km in Yangpu. The project involves development of industrial land with some residential, commercial, hotel, and port construction. The investment for the first phase is $650 million, while total investment is estimated at $2.3 billion.

Sun Hung Kai Properties (HK) in September announced plans to develop up to 10 sq km of land in Sanya.

nent in China's Real Estate Sector

The first phase is a $50 million, 400-acre resort with a luxury hotel and marine recreational facilities in Yalong Bay. The consortium Sun Chung Kin Development, equally owned by Sun Hung Kai Properties (HK), Haikou Trust and Consultancy Co. (China), and CIL Group (HK), will undertake the project. Total investment for all phases of the project is estimated at approximately $900 million.

SHANDONG

Allied Group (HK) in August announced plans for a $180 million residential/commercial development on 74 acres in Yantai. The project is scheduled for completion by 1999.

Young Shing Investment Co. Ltd. (HK) in August announced plans to invest $12.6 million to construct 67 residential buildings, including 784 apartments, on 42,000 sq m through TS (Penglai) Property Development Co. Ltd., a joint venture with Penglai Chemical and Light Industry Corp.

SHANGHAI

Cheung Kong (HK) this summer announced it will take a 10 percent interest in a five-member consortium that will construct a $131 million commercial development with trade, finance, leisure, and residential facilities on 14 acres in Pudong. The project is to be completed by 1998 and the consortium has rights to the site for 50 years.

Hang Lung Development Co. (HK) in August announced that a wholly owned subsidiary and two Shanghai partners paid $2.6 million for land-use rights to build high-quality residential units on a 9,400 sq m site in the old city.

Henderson Land (HK), New World Development Co. (HK), and **Sun Hung Kai Properties (HK)** in July signed a letter of intent to contribute construction costs for a $450 million, 3 million sq ft "cultural square" to include entertainment, shopping, office, and residential facilities on a 550,000 sq ft site in the Luwan district. The three-company Hong Kong consortium owns 50 percent of the joint venture set up to develop the property. The venture's Chinese partner, the Shanghai Cultural Bureau, will provide the land.

Hongkong Tianming Investment Co. Ltd. in April announced plans to establish a joint venture with Shanghai State Farms to build the 30-story Huadou office building in the Lujiazai area of Pudong. The $37.5 million project is slated for completion by late 1995. Hongkong Tianming owns 25 percent of the 50-year joint venture.

New World Development Co. (HK) in August announced a joint-venture agreement with the China Construction Bank and Shanghai Real Estate Co. to build a multi-purpose finance and trade building covering 8,250 sq m in the Lujiazui area of Pudong. New World is responsible for construction, including $5 million in initial costs. The Chinese partner is supplying the land.

Pacific Concord (HK) in July signed a contract to build 30 residential and commercial blocks on a 500,000 sq ft site on Nanjing Road. Plans include an 80-story skyscraper and a 250,000 sq ft department store. Pacific Concord (40 percent) and partner Shanghai Xin Jin An Real Estate Corp. (60 percent) will set up the Concord Jin An Real Estate Corp. joint venture to undertake the project. The venture will pay land-lease costs of $116 million, while total project costs are estimated at $307 million.

Shanghai Industrial Co. Ltd. (HK) in May signed a contract to renovate 10 acres in the city's Putuo district. The development includes apartments, offices, hotels, and entertainment facilities. Shanghai Real Estate Development Co., a joint venture between Shanghai Industrial and Putuo District Urban Construction Corp., expects to invest $108 million in the project.

Success Plan Co. Ltd. (HK) in June announced plans to develop 28,000 sq m on Caobao Road into a complex of luxury apartments, offices, recreation facilities, conference centers and supermarkets called the "Shenfu Zone." Success Plan and Shanghai Longfu Industrial Corp. have established the Shanghai Huaxia Success Plan Co. joint venture and have obtained a $12.9 million, 50-year lease. The joint venture plans to invest $200 million, including $90 million for the first stage.

SICHUAN

Sea Holding and Chesterfield Co. and two other Hong Kong companies in July signed a contract with Huaqiao (Overseas Chinese) Housing Development to form a joint venture to develop a $170 million commercial and residential area in Chengdu. The project, "China Overseas Exchange Square," is to be completed in 1996. The Hong Kong partners own 80 percent of the joint venture.

TIANJIN

Innovative International (HK) in May finalized plans to develop a luxury residential, commercial, and shopping complex with car-park facilities on a 126,717 sq ft site on Fu Shau Lane. Innovative International owns 55 percent of Tianjin Hechuan Construction Development Co., a joint venture with the Tianjin Heping District Construction Development Co. The joint venture will pay approximately $8.5 million for a 50-year land lease.

Tian An China Investments Co., Ltd. (HK) in May announced plans to form a joint venture with a Tianjin development company to develop an apartment complex on 3,172 sq m in the downtown area. The joint venture signed a 70-year land-lease contract.

ZHEJIANG

Pacific Land Construction Corp. (HK) in May announced plans to acquire a 50-year lease on 1.3 sq km in Ningbo. The first phase includes development of 250,000 sq m in the Beilun Industrial Zone. Total investment in the project is expected to be $13 million.

Compiled by Madelyn C. Ross and Kenneth T. Rosen. This list is based on published reports that for the most part have not been independently verified.

partner, who shoulders most of the construction costs. The deal may be submitted for approval to local authorities after the fact, giving the local government a relatively passive role in determining land use and prices. In some cases, foreign parties have acquired local land-use rights directly from a Chinese individual or group claiming to possess those rights. If not already approved for lease to an overseas buyer, such inside deals, which often involve very low transfer prices, are illegal, and investors risk government intervention later on. The State Land Administration's local bureaus are now trying to collect back payments from undervalued or unreported transactions, although they are unlikely to be able to stop such sweetheart deals entirely.

To prevent future losses, Beijing is promoting the transfer of land-use rights though competitive bidding auctions to keep prices at market levels and ensure that State and local governments collect their share of the revenues owed from each transaction. Shenzhen proposed this summer that all local land deals be handled through competitive bidding, but this process may not be viable in less mature real estate markets where the level of demand is not high enough to make such tenders feasible.

Stopping speculation

Another immediate problem in the Pearl River Delta is that overseas speculators are buying up many units solely for short-term gain, leading to inflated prices and a possible collapse of the market. Local governments in South China have already tested a variety of ways to slow speculation, but have found enforcement of such measures difficult. Shenzhen, for example, has tried to control the pre-sale of units which have not yet been built. The city has mandated that developers spend at least 25 percent of construction costs before selling a property, and has required buyers of partially constructed units to wait until the property is completed before they themselves resell. These and other similar regulations have been routinely ignored, however. A measure with more promise may be Shenzhen's plan to bring supply closer to demand by increasing the amount of land released for residential development this year to 480,000 sq m, 180,000 sq m more than the amount released 1991.

Chinese officials seem aware that too much government intervention could suffocate real estate activity.

Shenzhen and several other cities in Guangdong have also tried to institute a capital gains tax to curb speculation, but until now enforcement has been lax and only a fraction of the revenues owed to the government have been paid. The tax, moreover, is often based on prices substantially lower than current market value, and the government plans to raise its assessments accordingly. To achieve its goal of deterring short-term speculators, the capital gains tax ideally should be applied to short-term gains only, and should not penalize gains on long-term investments. It remains to be seen if efforts underway to improve local tax systems will be successful.

Photo courtesy of Madelyn C. Ross

Towns and cities along the Shenzhen-Guangzhou superhighway have found their real estate growing in value even though the road has not yet opened.

This past summer, Shenzhen launched a rigorous new campaign to register and regulate all companies engaged in property development in the SEZ. Among other things, the law requires all developers to have a current operating license and to undergo an annual financial and business review. The rigor with which the campaign is being pursued has already begun to slow the pace of development activity and has earned Shenzhen a reputation as one of the best-regulated property markets in China.

The central government has also begun to take a much firmer stand on land management. In October, both Minister of Construction Hou Jie and Vice Premier Zhu Rongji issued the strongest national warnings to date on controlling speculation and land profiteering. Hou announced that China will begin to withdraw leases on land if contractors do not begin construction within two years, and hinted that other steps will be taken to cool overheated real estate markets.

A tricky balancing act

Chinese officials seem aware that too much government intervention could suffocate real estate activity, and that they should rely on market adjustments as much as possible. The director of the Ministry of Construction's real estate department noted in August that his department would try to use tax rates, land-leasing prices, and profit-distribution rates rather than compulsory administrative measures to guide domestic and foreign real estate companies. But in areas where illegal activity is already rampant such measures may be too late, and stricter administrative measures, such as limiting the number of firms involved in real estate development, may be needed to bring the market back under control. China's lack of experience with real estate and often overzealous bureaucracy will make the already difficult task of guiding this sector without scaring away potential investors even harder.

If properly managed, however, a vibrant real estate market could prove to be a boon for the Chinese government as well as for developers and citizens. The government would be able to turn a once-ignored asset into a money-maker that employs numerous people and generates funds for basic construction, urban renewal, and infrastructure in the process. The leadership would be able to offer better housing and other facilities to much of the population while absorbing ex-

cess liquidity and expending little of the government's own funds.

But the problems in realizing this scenario may be just beginning. Housing reforms have already run into difficulty getting citizens to accept the idea of paying for something they have long taken for granted. For the real estate revolution to spread across the country and have long-term staying power, the basic relationship between Chinese citizens and property will have to change—something which is likely to happen only over many years.

Housing reforms have already run into difficulty getting citizens to accept the idea of paying for something they have long taken for granted.

For its part, China will have to prove its ability to sustain long-term ownership rights and allow a healthy secondary market to operate. Continued government tolerance and ideological flexibility are also key prerequisites. If the government proceeds carefully, it may succeed in allowing the basic features of a private real estate market to operate without relinquishing ultimate State ownership of the land, but this is unlikely to be a stable long-term solution. Instead, assuming China continues to move toward a more market-oriented economic system, certain segments of the real estate market, such as housing, may eventually become fully privatized. Perhaps the only certainty at this early stage is that managing China's newest commodity will be much harder than bringing it to market.

Hong Kong developers lead the way

The Great China Land Rush

Madelyn C. Ross and Kenneth T. Rosen

Despite unanswered questions about the long-term viability of China's emerging real estate market, developers have been signing up for projects in China at a frantic pace all year. Many see a window of opportunity that may disappear within a few years and are eager to gain access to land-use rights now—while good deals are still easy to find.

Least daunted by the uncertainties of China's real estate market, Hong Kong firms heavily dominate the market. They know China relatively well, and are not deterred by the concept of long-term leases rather than outright ownership, since all land in Hong Kong is nominally owned by the British crown. Already, most of the territory's developers have announced Chinese land deals or their intent to get involved in the China market(*see* p. 48). Some firms have issued special shares just to raise funds to invest in China, while others are taking their money out of real estate projects in the United States and Europe to buy Chinese land.

By late 1992, Hong Kong firms had gained the rights to perhaps as much as 200 million sq ft of land in China, although only a small fraction of this land is under active development. Hong Kong estimates put the amount of Hong Kong money going into mainland property projects between HK$12-20 billion this year ($1.5-2.5 billion).

Hong Kong manufacturers with existing facilities in China were among the first to get involved in Chinese real estate.

The lure of China

For many Hong Kong companies, land development is merely a logical (and lucrative) adjunct to their other activities in China. Ironically, it was not developers, but Hong Kong manufacturers with existing facilities in China who were among the first to get involved in Chinese real estate. These industrial firms found they could use their connections with local Chinese authorities to obtain land cheaply; in many cases, the property is adjacent to or near their factories. Such real estate projects tend to be located in areas such as Huiyang, Dongguan, and other towns throughout Guangdong Province that are home to many small, Hong Kong-run factories. Because real estate is just a sideline interest, these companies generally keep their projects small and look for quick resale profits.

Hong Kong property developers, more recent entrants to the market, are finding that investing in real estate north of the border makes good business sense for them, too, although for very different reasons. Because undeveloped land in Hong Kong is rare and expensive, these firms are eager to get hold of land in China now, while prices are still low. They are generally not in a rush to develop it, and in fact some see advantages to waiting for the market to mature. Their projects are usually located in major cities and tend to be longer-term, larger, and more ambitious than those of the manufacturers.

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While most Hong Kong firms are eager to sign one or two lucrative land deals in China, few have been willing to make China the focus of their attention. An important exception is Tian An China Investments Co., which struck its first two land deals in Shenzhen in 1988. The company has gradually shifted emphasis from development of industrial estates to residential and commercial units, which now account for 50 percent of the firm's total land reserves. Its geographical base has also broadened from an initial emphasis on Guangdong and Xiamen to cities of the Yangtze River Delta and northward to Tianjin. Currently, the value of Tian An's 32 million sq ft in China is skyrocketing, and its completed projects are selling well. In the past 18 months, Tian An has sold over 1 million sq ft of industrial space and nearly 500,000 sq ft of commercial and residential property. As one of the few Hong Kong firms specializing in China real estate, Tian An now finds itself in a lucrative niche and many institutional investors consider the firm's stock an important part of their Asian portfolios.

A number of Hong Kong developers are involved in both real estate and major infrastructure projects in China, and expect real estate ventures to help generate cash for their longer-term projects. For example, New World Development Co., one of the territory's major property developers, has one of the largest land banks in China (expected to reach 40-50 million sq ft by the end of this year), as well as a diverse project portfolio, ranging from power plants and highways to department stores and housing complexes. These projects are spread throughout the country, although those in and around Guangzhou form the core of the firm's capital investment in China.

A few developers have begun to combine infrastructure and real estate projects into single "mega-projects." For example, in June, Hong Kong's Wharf Holdings signed letters of intent for a massive project located in the inland metropolis of Wuhan. The project's goal is to help the city regain its industrial pre-eminence and enhance its role as a key gateway to China's interior. Wharf plans to construct an inland container port near the city and develop up to 25 sq km of land, which could include construction of tunnels, power plants, hotels, and industrial estates.

The number and scope of Chinese real estate deals must be viewed with some skepticism.

Several of the other Hong Kong firms that focus on China land projects are actually Hong Kong subsidiaries of mainland firms. China Overseas Land and Investment, for instance, is a wholly owned subsidiary of the State Council's China State Construction Engineering Corp., which has invested in some 20 properties in Shenzhen, Shanghai, and Hong Kong. In August, China Overseas won the tender for a major residential/retail development in Shenzhen, and also announced plans to establish an office in Guangzhou to pursue more opportunities in the province. Like China Overseas, other Chinese companies have found that investing in their own country through a Hong Kong subsidiary allows them to take advantage of the preferential treatment China gives to foreign investors.

Less than meets the eye

Though the roll call of Chinese real estate projects lengthens daily, the number and scope of these deals must be viewed with some skepticism. Many of the heralded deals will never actually come to fruition; some are merely premature announcements by local authorities eager to show how much investment their city has attracted, or by investors hoping to help cement a deal. A number of deals are still in the letter-of-intent phase, with the toughest and most detailed negotiations yet to come. Some will no doubt be denied final approval by the Chinese government or stymied by government requirements down the road. And, once their plans do get off the drawing board, many firms are likely to find financing difficult to obtain.

Projects planned in several distinct phases also bloat the real estate figures, as later phases may be abandoned or scaled back if initial results do not meet expectations. The timeframe of some of the Hong Kong developers' mega-projects, for instance, is easily 20 years, making current investment projections extremely unreliable. Several Hong Kong developers have already indicated that they expect to build only about half of the projects they have on paper. Yet, even if half of these projects are never realized, the impact of the those that do go forward will transform the skyline of many cities in China and contribute to the rapid economic integration of Hong Kong and China.

Looking ahead

China's real estate market is likely to continue to be dominated by Hong Kong firms for the next few years, although China's own 3,000-plus developers will offer increasingly stiff competition. Domestic developers continue to gain rapidly in number and ability, and are increasingly able to compete with foreign developers. Construction Minister Hou Jie recently announced that China will take steps to "create conditions for fair competition" between domestic and foreign developers, which will further stimulate the activities of domestic firms.

The other major players are likely to be a growing number of Asian real estate developers, who will focus on cities where they have regional, economic, or family ties. A number of wealthy overseas Chinese—from Taiwan, Thailand, Malaysia, and Indonesia—with personal interests in China have already become active in real estate projects. South Korean and Japanese firms are also signing a growing number of real estate deals in northern cities, where they have strong regional ties.

The involvement of US and European firms in China's real estate sector will remain limited. Their activities are likely to continue to focus on foreign-oriented projects, in which Western firms have greater familiarity and expertise. Although a number of Western companies have expressed interest in developing real estate in China, the legal and logistical complexities and relatively long time periods involved will probably keep most of them out of the market.

But for Hong Kong firms, the opening of China's vast undeveloped land reserves presents a historic opportunity to extend the boundaries of their real estate activities northward. As long as demand continues to grow and land continues to be offered on favorable terms, this opportunity will be too good to ignore. 完

AMCHAM'S CHINA BOOKS

China Commercial Relations Directory

A bilingual, English-Chinese directory, published biennially. This year includes 119 companies. Also includes "statistical anatomy of China" in the form of 18 charts or listings reprinted with permission of leading research publications on China. A "China Travel" chapter which gives information on getting visas, transport connections. American business contacts in the country, and foreign exhibitions calendar. Now in its eight edition. List price: HK$215/US$34 (HK$175/US$29 for AmCham members).

PRC Business Firms in Hong Kong and Macau

A guide to over 400 firms compiled by a team of US government staff members and business people active in China.

Banking & Finance, Insurance, Oil Companies, Shipping Agents, Travel Services, Publishing and News Media: *Geographic* listings show company connections to national, provincial, urban and Special Economic Zone corporations of China. Also *Parent/Holdings firms* guide. *Products & Services* index and *Chinese-language* company names appendices: essays surveying nature and history of Chinese corporate presence in Hong Kong and Macau; US Commerce Department and Hong Kong Trade Development Council review economic impact and trends of Hong Kong/Macau/China connection. List price: HK$265/US$41 (HK$215/US$34 for AmCham members).

Hong Kong Connection — Doing Business in Guangdong Province

Comprehensive introduction to how business works and where to get help on the ground in Guangzhou. Special Economic Zones and so-called "Open Areas" like deltas of the three major rivers in the province — the Pearl, Han and Jian. First book in English to offer a simple, straightforward and inexpensive introduction to business conditions in the province based on first-hand research. List price: HK$215/US$34 (HK$175/US$29 for AmCham members).

AMCHAM'S HONG KONG BOOKS

American Foods and Beverages in Hong Kong

American Foods and Beverages in Hong Kong is a directory of over 200 importers, supplemented with chapters describing the American presence in Hong Kong's food business and giving tips on how best to enter this growing market. Published in cooperation with the US Foreign Agricultural Service (FAS) in Hong Kong. First edition. List price: HK$165/US$28 (HK$135/US$24 for AmCham members).

Returning to Hong Kong — A Home Employment Resource Guide for Graduates of Overseas Universities

A guide to jobs for almost 6,000 graduating Hong Kong students returning from overseas. Distributed free to graduating Hong Kong students at American, Australian, United Kingdom and Canadian universities in cooperation with the Institute of International Education (IIE), British Council and International Development Program in Australia. List Price: HK$195/US$32 (HK$165/US$28 for AmCham members).

AmCham Members Directory 1991/92

Over 500-page book contains four major sections, including a guide to over 600 American private or government organizations concerned with US business development in Asia-Pacific. Lists 2,425 members from 1,074 companies. List price: HK$1,220/US$169 (HK$820/US$124 for members).

* * * * * * * * *

The American Chamber of Commerce in Hong Kong
Room 1030, Swire House, Chater Road,
Central, Hong Kong.
Tel: 526 0165 Fax: 810 1289
Tlx: 83664 AMCC HX
Mail Address: GPO Box 355, Hong Kong.

Who's Who in Hong Kong Communications

312-page book with four major categories: "Who's Who in Hong Kong Communications" carries extended paid listings of 115 companies, providing 65 categories of products & services. "Communications in the Hong Kong Context" includes 11 articles reviewing themes in advertising, public relations, publishing, desktop publishing equipment, and printing. "Professional Support in Hong Kong" includes a miscellany of 10 different lists/key documents. "Quick Contact File" is a telephone finders' guide to about 4,400 companies in Hong Kong, divided into 36 categories. List price: HK$215/US$40 (HK$175/US$35 for AmCham members).

Doing Business in Today's Hong Kong

A compendium of investment analyses covering the key sectors of Hong Kong's export-led economy, authored by active and successful executives in the territory's commercial life. Written by businessmen for businessmen, the authors of which are drawn from the membership of Hong Kong's largest grouping of foreign investors — The American Chamber of Commerce. List price: HK$245/US$44 (HK$195/US$38 for AmCham members).

Hong Kong Electronics Handbook/Directory

Hong Kong Electronics Handbook/Directory is divided into three major sections. The first introduces the manufacturing side of the industry with articles from people who know it.

"Sourcing guide" directory of 133 electronics companies describes their products and services, indicates if they do original equipment manufacturing (OEM), describes the nature of their manufacturing in China if any, and names their subsidiaries in Hong Kong, China and the region.

The last section of the book is a guide to Hong Kong's electronics services sector. It includes 10 different articles by authors active in each sector covered. List price: HK$215/US$34 (HK$175/US$29 for AmCham members).

Establishing an Office in Hong Kong

An annual service book which features Hong Kong context reviews of business services as varied as freight forwarding, law and architectural consulting. First-reference book for newcomers. Text material divided into 17 brief chapters intended to raise the right questions and offer the best references supported by six appendices with referrals to key organizations. AmCham business contacts and other sources. Five maps. List price: HK$195/US$32 (HK$165/US$28 for AmCham members).

Hong Kong's Training Services 1991

Extended profiles of 33 major training providers in Hong Kong and nine major types of training surveyed, also described are 17 educational institutions and seven "in-house" programs run by specific companies or organizations. List price: HK$175/US$28 (HK$145/US$25 for AmCham members).

Living in Hong Kong

The guide for newcomers to the region. First published in 1973. Divided into 15 chapters covering topics as Living and Health, Communications Services, Legal Information, Schools, Leisure Activities and even a chapter on the best way to leave. List price: HK$215/US$40 (HK$175/US$35 for AmCham members).

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Gauging Investor Satisfaction

A new survey reveals Shanghai and Shenzhen are home to China's most profitable US joint ventures

Leigh Stelzer, Ma Chunguang, and Joanna Banthin

When buying a house, a key real estate maxim is to consider "location, location, location." For US investors looking to set up a business in China, the same advice seems to apply. According to a 1991 survey we conducted of 306 senior executives in charge of overseeing US investment projects in China, ventures in certain areas are far more likely to be deemed successful in the eyes of the US partner.

Our survey sought to identify the five-year average rate of return on investment (ROI) for each of the joint ventures. Most of the ventures surveyed involve relatively modest investments; over half are capitalized at less than $5 million. And most are indeed making money; 60 percent reported a five-year average ROI of 10 percent or higher. Nearly a third reported an ROI equal to, or exceeding, 18 percent. While such returns would be considered minimal by venture capitalists in the United States, the overall average ROI of 11.6 percent is quite respectable for China-based operations. Only 12 percent of the sampled firms appear to be losing money.

Our questions also asked respondents to indicate whether their China ventures have met, fallen short of, or exceeded corporate expectations. Not surprisingly, investor satisfaction levels tend to parallel ROI results. Nearly two-thirds of the surveyed companies claimed their ventures in China are meeting or exceeding expectations. The remaining third, however, noted that their joint ventures have failed to meet expectations. Those reporting less-than-desired results were also more likely to agree that inadequate local financing, unmotivated workers, and lack of management personnel pose significant problems in China. In contrast, those reporting that their ventures are meeting or exceeding investor expectations tended to downgrade the importance of such factors.

Most US joint ventures in China are indeed making money.

Choosing a locale

Cross-tabulations of survey data suggest that location, type of product, intended market, and length of operation all affect the success of joint ventures in China. The results of our survey, which examined joint ventures in 33 different areas in China, suggest that location is one of the strongest factors influencing the performance of these enterprises.

Ventures situated in the major urban centers of Beijing and Shanghai, or in one of the five Special Economic Zones (SEZs), seem to fare better than those in Tianjin or other areas. Executives with projects in Shanghai and Shenzhen reported the best results; average ROI for US joint ventures in Shanghai was 16.2 percent, the highest reported in the survey, while average ROI for US ventures in Shenzhen was 13.6 percent. Moreover, few executives of ventures located in Shanghai—only 7 percent—complained that their projects had yielded below-expected results. These findings suggest that Shanghai's long tradition as a commercial and manufacturing center contributes toward a healthy business environment for US investment.

Of the SEZs, Shenzhen stood out as providing both the highest returns and the greatest degree of investor satisfaction. Those with joint ventures in other SEZs reported average ROI reached only 11.4 percent, compared with 13.6 percent for Shenzhen-based ventures. Nearly half of the respondents with ventures in Shenzhen reported that their expectations have

Leigh Stelzer, an associate professor at the W. Paul Stillman School of Business at Seton Hall University, taught at the University of International Business and Economics (UIBE) in Beijing in 1986, 1988, and 1992. Ma Chunguang is dean of the UIBE department of international business management. Joanna Banthin, a Sino-US trade and international business consultant, is director of Capitol Research Associates in Maplewood, New Jersey.

been exceeded, while only 30 percent of the ventures located in the other SEZs reported similar results.

Nevertheless, the relatively high overall level of satisfaction indicates that the 10-year SEZ experiment has successfully provided a hospitable base for foreign investment (*see The CBR*, November-December 1991, p. 14). Tax incentives, access to domestic markets, faster infrastructure development, and the freedom to wield greater managerial authority have enhanced the attractiveness of the SEZs and the ability of US investments there to thrive.

Respondents from elsewhere in China reported varying degrees of satisfaction with their ventures. Those with joint ventures in China's 14 open coastal cities reported somewhat lower returns on investment (10.9 percent), though there was less correlation between ROI and investor expectations than was noted in the data from SEZ joint ventures. Of the 40 coastal-city ventures surveyed—a group excluding Shanghai and the SEZs—42 percent stated that their expectations are being met or exceeded. This finding could, however, reflect the fact that many of these ventures are fairly new, and therefore optimistic about future growth. Or, it is possible that US investors in these relatively untested waters simply had lower expectations from the start.

Ventures situated in the major urban centers of Beijing and Shanghai, or in one of the five SEZs, seem to fare better than those in Tianjin or other areas.

Tabulations of survey data from Beijing and Tianjin—municipalities which, like Shanghai, fall directly under the supervision of the State Council—indicate that respondents with ventures in these cities probably had high expectations to begin with. In Beijing, despite an average ROI of 13.2 percent, about a third of the investors are less than satisfied with the performance of their ventures. Respondents from Tianjin ventures are also somewhat dissatisfied with their investments, and reported the lowest ROI (8.1 percent) of all areas surveyed. As only a small percentage of our survey sample was based in Tianjin, however, these figures may be less than truly representative.

About one-quarter of our respondents reported on more than one venture. In cases where responses reflect experiences in two or more different regions, the tabulations again suggest that investors with at least one venture in Shanghai or Shenzhen are the most satisfied. The 15 respondents with ventures in Beijing and another locale are also quite optimistic, though the location of the second venture seems to be key—11 of the 15 have second ventures in either Shanghai or Shenzhen. The 26 investors with ventures in Tianjin and another locale had an average ROI significantly higher—10.5 percent—than that of investors with ventures in Tianjin alone.

Overall, the survey results suggest that the inland cities appear to have been the most disappointing area for US investors. Average ROI in these locations is only 10.1 percent, lower than the average coastal or SEZ rate. Moreover, 49 percent of the executives reporting on inland investment projects responded that their joint ventures have not met expectations. Most likely, these results reflect the wider range of problems faced by foreign investors in the inland areas, including less well-developed infrastructure and uneven access to raw materials and transportation networks.

Age and output

Another key determinant in the level of satisfaction of the investors we surveyed is the target market of their

US Joint Venture Performance

Location of joint venture	Average return on investment (ROI) (%)	% responding "above expected results"	% responding "below expected results"
Shanghai	16.2	43	7
Beijing	13.2	29	32
Guangzhou	13.3	29	0
Shenzhen	13.6	49	36
Other SEZs	11.4	30	30
Coastal cities	10.9	42	32
Inland cities	10.1	33	49
Tianjin	8.5	35	35

Type of production	Average ROI (%)	% responding "above expected results"	% responding "below expected results"
High-tech	13.4	38	24
Export-oriented	11.1	40	43
Both high-tech and export-oriented	15.4	58	16
Domestic market	12.3	34	33
Import substitution	8.7	23	45

Start-up year	Average ROI (%)	% responding "above expected results"	% responding "below expected results"
1981-83	14.6	66	16
1984	12.7	37	28
1985	12.4	32	24
1986	9.9	21	48
1987-88	9.6	30	44
1989-91	8.4	13	27

SOURCE: *Authors' 1991 survey*

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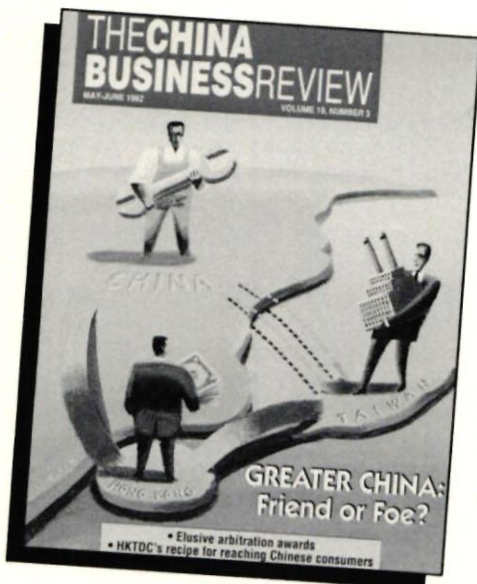

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ventures' output. Products manufactured by joint ventures in China tend to fall into four broad categories: high-technology, export-oriented, domestic-oriented, and import substitution goods. Survey respondents often reported an overlap; for instance, several ventures in the survey produce high-tech goods destined for export markets. When survey results are tabulated by production type, the high-tech/export producers tend to show the highest ROI (15.4 percent) and the highest number (58 percent) of respondents indicating that the venture has produced higher-than-expected returns. Those that produce import substitutes have the lowest return (8.7 percent) and are least satisfied (45 percent of these respondents indicated that the results have been below expectations), perhaps reflecting the higher priority given by central authorities to export-oriented ventures. However, ventures producing solely for export reported the next lowest ROI (11.1 percent), a result which could reflect our survey's large number of food-processing joint ventures, which are known for low profit margins.

If the same survey were to be conducted today, the responses would likely be quite different, given China's rapidly changing investment environment. For example, ventures producing for the domestic market reported a 12.3 percent average ROI in our survey, which should be considered a good return given Beijing's traditional reluctance to grant foreign companies direct access to China's many consumers (*see* p. 18). As this reluctance is now fading, however, ventures producing goods for the domestic consumer market are probably now enjoying much greater profits.

Our data also revealed a strong correlation between ROI and venture age. The highest ROI rates—14.6 percent—were recorded by the 50 ventures which began producing in 1981-83. The newer ventures had lower rates of ROI; the lowest rates were reported for projects begun in 1989-90. While such results are to be expected—patience in China is as much a necessity as it is a virtue—they do not suggest that the investment climate has deteriorated. On the contrary, investors in China today will likely face far fewer difficulties than did the pioneers. The strong performance of the earliest joint ventures, in fact, should be seen as a positive reflection on the long-term strategies adopted by many US companies in China; over the long haul, good results appear to be the norm.

The results obtained by examining satisfaction levels according to venture age dovetail with those obtained by looking at location. Fully 60 percent

The strong performance of the earliest joint ventures should be seen as a positive reflection on the long-term strategies adopted by many US companies in China.

of the ventures which became operational in 1981-83 are located in Shanghai and Shenzhen—the first locales empowered to offer preferential terms to foreign investors. Over a third of the joint ventures in the inland cities, in contrast, were initiated in 1987-88. As the inland areas gain more experience with foreign investors, ROI and investor satisfaction levels there will likely increase.

Summing it up

Our survey indicates that despite the vagaries of China's business climate, Sino-US joint ventures are faring quite well. Returns on investment are growing at a moderate pace. However, prospective investors examining China for the first time, or those who already have investments up and running, should pay careful attention to location when looking at potential investment sites. Respondents with ventures in Shanghai, Beijing, and the SEZs consistently reported results superior to those of respondents with projects in other areas. Though other factors also influence the success of foreign investments in China, location is clearly one of the most important. 完

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中外貿易

China Business

Windy Zou

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

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

SALES AND INVESTMENT THROUGH
September 15, 1992

Foreign party/Chinese party
Arrangement, value, and date reported

Agricultural Technology

China's Imports

Denmark United Milling System (Denmark)/Inner Mongolia Autonomous Region
Will sell equipment to a corn starch mill, financed by a Danish government loan. $5.14 million. 8/92.

Other

Asian Development Bank
Will provide a $55 million loan and an $800,000 grant to fund a tropical crops development project in Guangdong Province. 8/92.

UN World Food Program/Ministry of Agriculture
Signed agreements for soil and water conservation projects in Shanxi Province. Will also supply 78,830 tons of wheat worth $12.2 million. 8/92.

World Bank
Will provide a soft loan to a Sichuan agriculture development project which involves expanding environmental protection, irrigation capability, and poverty alleviation efforts. $174 million. 7/92.

Abbreviations used throughout text: BOC: Bank of China; CAAC: Civil Aviation Administration of China; CAIEC: China National Automotive Import-Export Corp.; CATIC: China National Aero-Technology Import-Export Corp.; CCTV: China Central Television; CEIEC: China Electronic Import-Export Corp., CEROILFOODS: China National Cereals, Oil, and Foodstuffs Import-Export Corp.; CHINALIGHT: China National Light Industrial Products Import-Export Corp.; CHINAPACK: China National Packaging Import-Export Corp.; CHINATEX: China National Textiles Import-Export Corp.; CHINATUHSU: China National Native Produce and Byproducts Import-Export Corp.; CITIC: China International Trust and Investment Corp.; CITS: China International Travel Service; CMC: China National Machinery Import-Export Corp.; CNCCC: China National Chemical Construction Co., CNOOC: China National Offshore Oil Corp., CTIEC: China National Technical Import-Export Corp.; ETDZ: Economic Technological Development Zone; ICBC: Industrial and Commercial Bank of China; INSTRIMPEX: China National Instruments Import-Export Corp.; MLI: Ministry of Light Industry; MMEI: Ministry of Machinery and Electronics Industry; MOE: Ministry of Energy; MOTI: Ministry of Textile Industry; MPT: Ministry of Posts and Telecommunications; NA: Not Available; NDSTIC: National Defense, Science, Technology, and Industry Commission; NORINCO: China North Industries Corp.; SEZ: Special Economic Zone; SINOCHEM: China National Chemicals Import-Export Corp.; SINOPEC: China National Petrochemical Corp.; SINOTRANS: China National Foreign Trade Transportation Corp.; SITCO: Shanghai Investment and Trust Corp.; SPC: State Planning Commission.

Banking and Finance

China's Imports

NCR (Japan)/People's Construction Bank of China
Will sell 121 ATMs and 14 NCR System 3000 computers. $9 million. 7/92.

Investments in China

NA (HK, Macao)/ NA (Hainan)
Will set up a trust and insurance corporation with ownership based on shareholding. $60 million registered capital. 8/92.

Banque Nationale de Paris (France)/ICBC Shanghai
Established the International Bank of Paris and Shanghai joint venture. $60 million. 7/92.

Other

Societe Generale (France)
Will open a branch office in Guangzhou. 9/92.

Korea Exchange Bank
Opened a representative office in Beijing. 7/92

Chemicals, Petrochemicals, and Related Equipment

China's Imports

Toyo Engineering Corp. and Mitsui Engineering & Shipbuilding Co. Ltd. (Japan)/China National Technical Import-Export Corp. and China Petrochemical International Corp.
Will sell polyethylene and polypropylene equipment to the Guangzhou Ethylene Project for the production of synthetic fiber and plastic products. $120 million. 8/92.

JGC Group, Marubeni, Mitsui (Japan) and Stone & Webster Inc. (US)/Sinopec
Won a contract with other companies to supply equipment and technology to build a 300,000 tpy ethylene plant in Maoming, Guangdong Province. $228 million. 8/92.

Investments in China

Praxair Inc., a subsidiary of Union Carbide (US) /Beijing Oxygen Plant
Will form a 1,500 ton-per-day joint-venture oxygen and nitrogen plant, Beijing Praxair Inc. (US:50% - PRC:50%). 8/92.

NA (US)/Changyi County, Shandong Province
Will establish an ethyl alcohol joint venture to produce waterless ethanol, furfural, and acetic acid for export. $170 million. 7/92.

Other

Japan
Provided export credits for the construction of the Shanghai Gaoqiao Petrochemical and Acrylic Acid Factory, which will have an annual production capacity of 30,000 tonnes of acrylic acid and ester. $33.6 million. 6/92.

ICI (UK), Ciba-Geigy (Switzerland), and Topsoe (Denmark)/Ministry of Chemical Industry
Signed long-term cooperation agreements on new product development, technical exchanges, personnel training, and trade. 7/92.

Construction Materials

Investments in China

Hong Kong China Resources (Holdings) Co. Ltd. (HK)/Shanghai Yaohua Glass Works, Beijing Zhongbei Glass Industrial Corp., Shanghai Trust Consultancy Corp., and BOC
Will establish the Sunshine Coated Glass Co. Ltd. joint venture to produce international-standard coated and reinforced glass using US equipment. $13.63 million. 7/92.

Other

Denmark
Will provide a grant to engage the service of foreign experts in a cement project in Inner Mongolia. $500,000. 8/92.

Consumer Goods

Investments in China

Gillette Co. (US)/Shanghai Razor Blade Factory
Signed an agreement to form the Gillette Shanghai Ltd. joint venture to make blades and razors. $59 million. (US:50% - PRC:50%). 8/92.

Inchcape Pacific Ltd. (HK), a subsidiary of Inchcape PLC (UK)
Will set up a wholly owned trading company to market consumer products, industrial equipment, and office products in the Waigaoqiao zone of Pudong. 8/92.

Singer Co. NV (US)/Shanghai Yah Chong Sewing Machine Co.
Will establish the 50-year Singer (Shanghai) Sewing Machine Co. joint venture with an annual production volume of 400,000 units. $20 million. (US:70% - PRC:30%). 8/92.

JVC (Japan)/Shanghai Gaoguang Electronics and Appliance Co. Ltd.
Established the Shanghai JVC Appliance Co. Ltd. joint venture to produce hi-tech electronic products such as large-screen color television sets. (Japan:55% - PRC: 45%). $12.5 million. 8/92.

Samsung Electronic Co. Ltd. (South Korea)/Tianjin Telecommunications and Broadcasting Co.
Established the Tianjin Samsung Electronics Co. to produce 600,000 VCRs annually. (S. Korea:50% - PRC:50%). $60 million. 7/92.

Carrier Co. (USA)/NA
Established the Tian Carrier Air Conditioning Equipment Co. joint venture. (USA:51% - PRC:49%). $10 million. 7/92.

Electronics and Computer Software

China's Imports

Digital Equipment Corp. (USA)/Jinan First Machine Tool Works
Will sell computer integrated manufacturing hardware and technology. $2.5 million. 7/92.

Investments in China

Silicon Graphics (US)/NA
Will join with five partners to manufacture the Iris Indigo workstation. 9/92.

AsiaGraphics Ltd. (HK)/China Venturetech investment Corp.
Established the Asia Computer Technology Co. Ltd. joint venture to develop multimedia software. (PRC:65% - HK:35%). $1 million. 7/92.

Toshiba Co. Ltd. (Japan)/Hangzhou Machinery and Electrical Appliances Development General Co.
Established the Hangzhi Machinery and Electrical Appliances Co. Ltd. joint venture to develop and produce parts, components, and software for Toshiba products. (Japan:78% - PRC:22%). ¥1.75 billion (US$13.78 million). 6/92.

Food and Food Processing

Investments in China

NA (US)/Laizhou (Shandong)
Will establish a joint venture to produce beer and other beverages for export. $18.2 million. 8/92.

Other

Snow Brand Milk Products Co. (Japan)
Will open a Hongkong subsidiary aimed at supplying the China market. 9/92.

Chia Tai International Investment Co. Ltd. of Chia Tai Group (Thailand)/ Ministry of Agriculture
Provided grants to three major agricultural universities to build chicken-breeding development centers. $2.75 million. 7/92.

Foreign Assistance

UNDP
Will provide a grant for modernizing the General Administration of Customs. $1 million. 8/92.

World Bank
Provided grant to improve elementary education in China's poorer provinces. $110 million. 7/92.

ADB
Provided a grant to help sponsor the Northwest China International Economic & Technological Cooperation Symposium in Xian. $100,000. 7/92.

Military Equipment

China's Imports

Russia/NA
Sold 12 SU-27 fighter jets and will deliver 12 more planes in November. 8/92.

Petroleum, Natural Gas, and Related Equipment

China's Imports

Daelim Engineering Co. Ltd. (South Korea)/Sinopec
Will sell a 25,000 tpy polystyrene facility to the Daqing General Petrochemical Works in Heilongjiang Province. 7/92.

Pharmaceuticals

Other

World Bank
Provided loans to fund a vaccine project in Shanghai. $22 million. 7/92.

Power Plants

China's Imports

Voith Hydro Inc. (US) and Elin Co. (Australia)/China National Technical Import-Export Corp.
Will sell water pumping and turbine units, electric motors, and monitoring systems to the Beijing Ming Tombs Water Pumping and Energy Storage Station, with financing from Japanese government loans. 7/92.

Other

Canada and a Belgian bank/NA
Provided a $23 million loan to finance construction of the 57,000 kw Gaotan Hydrostation in Hunan Province. 8/92.

China's Exports

NA/Iran
Will sell a 300 mw nuclear power station. 9/92.

Property Management and Development

Investments in China

Kumagai Gumi HK (Japan)/Hainan
Will develop 30 sq km of land in the Yangpu Economic Development Zone. $2.3 billion. 8/92.

Tak Sing Alliance Holdings (HK)/NA
Formed a joint venture to develop a residential, commercial, and industrial complex in Dongguan, Guangdong. $200 million. 8/92.

Shun Tak Holdings (HK)/Guangzhou municipal government
Will build a golf course and residential development in Baiyun Shan. $700 million. 8/92.

Shun Tak Holdings (HK), Sociedade de Tourismo e Diversoes de Macau/NA
Will develop two Zhuhai residential and commercial complexes. $78 million. 8/92.

New World Development Co. Ltd. (HK)/People's Construction Bank of China
Established the Shanghai New World Construction (Group) Co. Ltd. joint venture to build, sell, and rent houses and provide investment services to real estate businesses. (HK:40% - PRC:60%). $30 million. 8/92.

Allied Group Ltd. (HK)/China Yacht Club
Will establish a joint venture to develop holiday resorts in such areas as the Golden Stone Beach in Dalian. $30 million. 8/92.

NA (US)/NA
Will establish the Shanghai International Yacht Club in the Dianshanhu Scenic Zone. $4.9 million. 8/92.

Ships and Shipping

Investments in China

Hutchison Whampoa Ltd. (HK)/Shanghai Port Authority
Will establish the Shanghai Container Terminal Ltd. joint venture, which will be able to handle 1.6 million TEUs by 1995. $1.09 million. 9/92.

US West Trading Co. (US)/Shanhaiguan Bridge Beam Plant
Established a container joint venture in Hebei Province with an annual output of 48,000 folding containers. (US:22.8% - PRC:77.2%). $6.56 million. 7/92.

Telecommunications

China's Imports

AT&T (US)/Ningxia Hui Autonomous Region Import-Export Corp.
Will supply mobile telephone systems. $3.3 million. 8/92.

Northern Telecom (Canada)/NA
Will supply equipment to ChinaPac, China's data communications network. $9 million. 8/92.

Sprint International (US)/Guangdong Province and Ministry of Railways
Will provide four Telemail-brand electronic messaging systems and one packet-switched data network. $12.4 million. 8/92.

AT&T of Shanghai Ltd. (USA)/Beijing Telecommunications Bureau
Will sell fiber-optics telecommunications equipment. $13 million. 7/92.

Investments in China

LM Ericsson AB (Sweden)/Nanjing Radio Factory (Jiangsu)
Will establish a joint venture with annual production capacity of 50 sets of radio-telephone exchanges and 2,500 channels of base station equipment. $14.7 million. (Sweden:55% - PRC:45%). 9/92.

Other

Switzerland/BOC, Jiangxi Province branch
Extended an $18 million mixed loan to Nanchang City Telecommunications Bureau to procure program-controlled digital telephone exchanges, trunk optical cables, and subscriber cables for 80,000 program-controlled telephones from Switzerland.

Transportation

China's Imports

British Aerospace PLC(UK)/China Aviation Supplies Corp., a subsidiary of CAAC
Will sell eight 146-300 short- to medium- range jets. $200 million. 8/92.

General Motors, Chrysler, Ford/China
Sold more than $130 million worth of vehicles, parts, and components. Ford sold 3,010 vehicles and parts for $32 million. GM sold 2,708 vehicles and parts for $49 million. Chrysler sold vehicles and components for $68 million. 8/92.

McDonnell Douglas Corp. (US)/China National Aerotechnology Import-Export Corp.
Will sell 17 MD-80T trunkliners, 20 MD-90T trunkliners, and 3 MD-82 models. $1.2 billion. 6/92.

Fokker Corp. (Netherlands)/China National Aviation Equipment Corp.
Will sell 10 Fokker 100 planes. $300 million. 5/92.

Rolls Royce (UK)/CAAC
Will sell 13 Rolls Royce engines to power 13 Boeing-757 airplanes to be delivered between 1993-97. $184 million. 5/92.

Investments in China

Lufthansa German Airlines (Germany)/Air China
Established the Beijing Aircraft Maintenance Center joint venture to repair and maintain Air China's aircraft fleet. (Germany:40% - PRC:60%). $218 million. 6/92

Honda Motor Corp. (Japan)/NA
Will establish a motorcycle production joint venture in Guangzhou. (Japan:35% -PRC:65%) $77.6 million. 5/92.

Other

Dokken Engineering Co. (US)/Shanghai Tunnel Engineering Co.
Will construct the first stage of a circular elevated highway in Shanghai under a World Bank project. $60 million. 8/92.

ADB
Will provide a loan to help finance the construction of a 75-km, four-lane highway in Liaoning Province. $50 million. 7/92.

ADB
Provided a technical assistance grant for a 480-km, single-track railway linking Changping, Shantou, and Meizhou in Guangdong Province. $200 million. 6/92.

World Bank
Will provide loan to finance a highway project in Zhejiang Province. $220 million. 5/92.

Miscellaneous

China's Trade and Investment Abroad

Hainan Global Science & Technology Enterprise/ People's Government of Haiphong City (Vietnam)
Will establish a joint venture to help Vietnam set up its first Special Economic Zone. 8/92.

China/Tanzania
Signed an economic and technological cooperation agreement to provide a 5-year, interest-free loan worth $9.1 million and general materials worth $360,000. 8/92.

China/Zambia
Will donate $191,000 worth of goods to help Zambia combat drought. 8/92.

Other

Israel/China
Signed a trade agreement that should double Israel's exports to China within a year. 8/92.

Russia/NA
Will allow Chinese workers to be employed in Russian enterprises and will set up economic and technological cooperation sites along the Sino-Russian border. 8/92.

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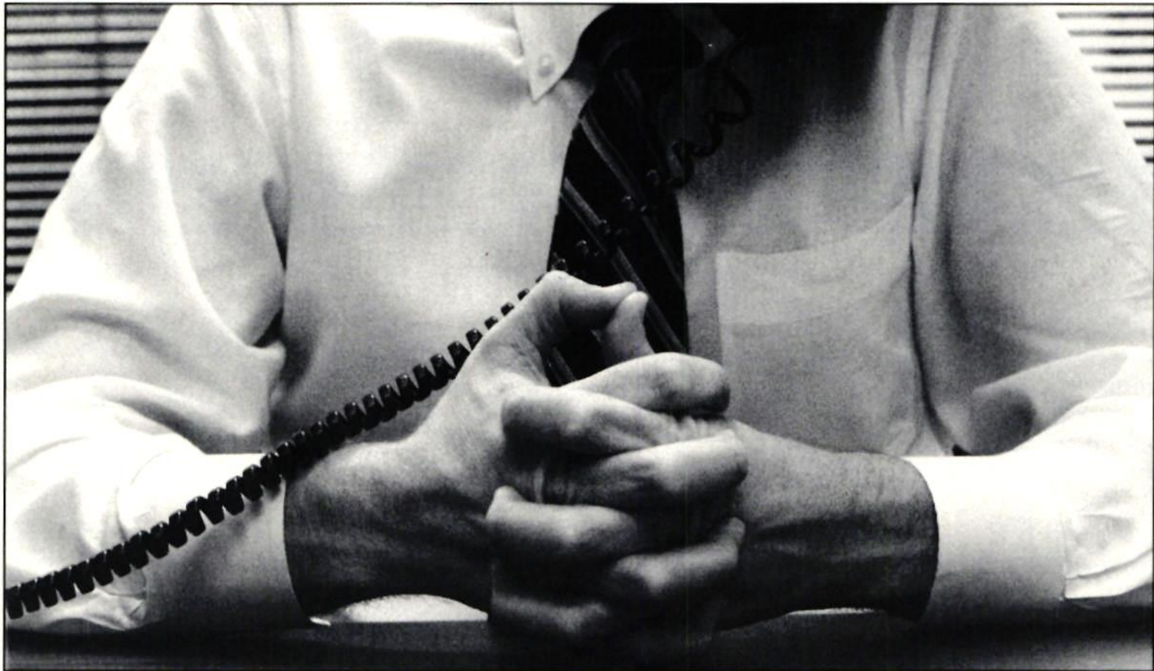

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