CHINA BUSINESS REVIEW

THE MAGAZINE OF **THE US-CHINA BUSINESS COUNCIL**

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IMAGINE CHINA

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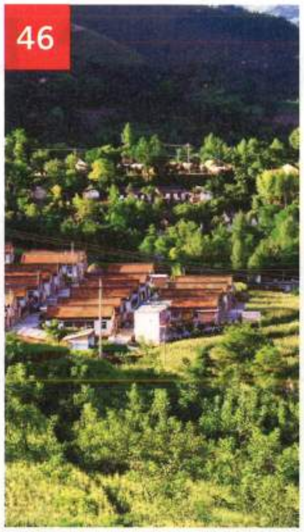

FEATURES

DEPARTMENTS

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LETTER FROM THE EDITOR

A few weeks before this quarter's *China Business Review* went to press, the Chinese government released trade data showing falling imports and slowing exports. Chinese imports dropped by 2.6 percent in August. Exports increased by 2.7 percent, higher than in July, but much lower than the double-digit growth rate China has experienced in the last decade. Analysts say these numbers are another sign of China's slowing economy.

This issue's stories on financial services focus less on how the economy is slowing, but instead show how China's shifting economy has changed the marketplace for financial services. The Brookings Institution's Eve Cary writes about how real estate developers found new sources of financing when PRC regulators tightened property lending last year. Tharon Smith, founder of the Strontium Group, writes about US and Chinese venture capital firms and how they can work together to take advantage of opportunities in the Chinese market. And Moody's President and Chief Executive Officer Raymond McDaniel talks to *CBR* about China's attempts to build a credit system and the importance of a more open financial system for the long-term strength of the economy.

This issue also features a special report on intellectual property rights (IPR), a longstanding concern for foreign companies in China. Thomas Ross, litigation partner at Marshall, Gerstein & Borun, discusses the differences between the IPR enforcement systems in the United States and China. Thomas Moga, partner at Shook, Hardy and Bacon, writes about the growth of design patents in China and foreign companies' reluctance to use them to protect their IPR.

Feature stories in this issue examine a variety of topics, including China's land reform efforts, US companies' export control risks, best practices for accessing China's government procurement market, and a survey of Chinese professionals on workplace issues.

Until our next issue, which will celebrate the US-China Business Council's 40th anniversary, check out our blog for news stories and statistics on US-China trade at cbrmagazine.tumblr.com. We always welcome reader feedback. Contact me anytime at cmnelson@uschina.org.

Christina Nelson

Christina Nelson

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CHINA CONFERENCE CALENDAR // OCTOBER 2012–JANUARY 2013

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

YANGTZE-MISSISSIPPI RIVERS FORUM

OCTOBER 11–12

Location: Wuhan, China
Organizer: Society of Transportation and Logistics, China Communications and Transportation Association, Wuhan Municipal Government, Ministry of Transportation
Contact: Chung Tam
Tel: 86-10-8580-4798
ctam@astl-china.org
www.astl-china.org

MUSIC CHINA 2012

OCTOBER 11–14

Location: Shanghai New International Expo Center
Organizer: Messe Frankfurt (HK) Ltd., Intex Shanghai Co., Ltd.
Tel: 852-2802-7728
info@hongkong.messefrankfurt.com
www.musicchina-expo.com/indexen.asp

PRIVATE BANKING CHINA 2012

OCTOBER 15–17

Location: Shanghai: Jumeirah Himalayas Hotel
Organizer: Terrapinn Pte Ltd.
Tel: 65-6222-8550
enquiry.sg@terrapinn.com
www.terrapinn.com/conference/private-banking-china/index.stm

112TH CANTON FAIR 2012

OCTOBER 15 – NOVEMBER 4

Location: Guangzhou, Guangdong: China Import and Export Fair Pazhou Complex
Organizer: China Foreign Trade Centre (Group)
Tel: 86-20-2888-8999
info@cantonfair.org.cn
www.cantonfair.org.cn/en

CHINA EDUCATION EXPO 2012

OCTOBER 20–21

Location: Beijing: China World Exhibition Hall
Organizer: Fairlink Exhibition Services Ltd, China Education Association for International Exchange
Contact: Ms. Lily Zou
Tel: 86-10-8580-0790 /0791/0792
Lily@fairlink.com.cn
www.chinaeducationexpo.com

WORLD RESOURCES FORUM 2012

OCTOBER 21–23

Location: Beijing: China National Convention Center
Organizer: World Resources Forum
Tel: 41-58-765-7400
info@worldresourcesforum.org
www.worldresourcesforum.org/WRF-2012

SHARED SERVICES & OUTSOURCING WEEK CHINA 2012

OCTOBER 23–25

Location: Shanghai
Organizer: International Quality and Productivity Center
Contact: EQ
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.ssonchina.com

CHINA RETAIL EXPO 2012

OCTOBER 23–25

Location: Shanghai World Expo Exhibition & Convention Center
Organizer: Diversified Events Hong Kong LLC
Tel: 852-3105-3970
www.divevents.com.hk

6TH CHINA INTERNATIONAL AUTO PARTS EXPO

OCTOBER 26–28

Location: Beijing: China International Exhibition Center
Organizer: China General Technology Group
Contact: Zhang Yazhu, Lan Mingxue
Tel: 86-10-68991436
zhangyazhu@exh.genertec.com.cn; lanmingxue@exh.genertec.com.cn
en.iapechina.com

19TH INTERNATIONAL CONFERENCE ON INDUSTRIAL ENGINEERING AND ENGINEERING MANAGEMENT

OCTOBER 27–29

Location: Changsha, Hunan
Organizer: IEEE
Contact: Runliang Dou
Tel: 86-22-2789-0062
ieem.19th@gmail.com
ieem2012.ieeng.org/index.html

CHINA INTERNATIONAL JEWELRY FAIR

NOVEMBER 1–5

Location: Beijing: China International Exhibition Center
Organizer: Neway International Trade Fairs Ltd.
Tel: 852-2561-5566
info@newayfairs.com
www.newayfairs.com/EN/EventFrame.asp?eventID=27

CHINA MINING 2012 CONFERENCE AND EXHIBITION

NOVEMBER 3–6

Location: Tianjin Meijiang Convention Center
Organizer: Ministry of Land & Resources and the Tianjin Municipal Government
Tel: 86-10-6446-6855
info@china-mining.org
www.china-mining.org/en

2012 CHINA (BEIJING) INTERNATIONAL WINE & SPIRITS FAIR

NOVEMBER 4–6

Location: Beijing
Organizer: China Chamber of Commerce for Import & Export of Foodstuff, Native Produce & Animal By-products
Contact: Wang Xuwei
Tel: 86-10-8710-9873
wangxuwei@cccfna.org.cn
www.vinchina.cn/en/index.asp

BIOLOGICS WORLD CHINA

2012 NOVEMBER 5–7

Location: Shanghai
Organizer: IMAPAC Pte. Ltd.
Tel: 65-6493-2093
info@imapac.com
www.imapac.com

14TH INTERNATIONAL EXHIBITION ON METRO, LIGHT RAIL TRANSIT & URBAN HIGH SPEED RAIL TRANSIT

NOVEMBER 8–11

Location: Guangzhou Jinhan Exhibition Centre
Organizer: Coastal International Exhibition Co. Ltd
Tel: 852- 2827-6766
general@coastal.com.hk
www.coastal.com.hk/metro

10TH CHINA INTERNATIONAL AUTO AIR-CONDITIONING & REFRIGERATION TECHNOLOGY EXHIBITION

NOVEMBER 8–10

Location: Shanghai World Expo Exhibition & Convention Center
Organizer: Shanghai Gehua Exhibition Service Co., Ltd.
Contact: Ms. Zhang
Tel: 86-21-3414-1312
kim.yang@gehuaexpo.com
www.autocoolexpo.com/en

2012 CHONGQING AUTO CONSUMER FESTIVAL

NOVEMBER 8–12

Location: Chongqing International Convention & Exhibition Center
Organizer: Chongqing General Chamber of Commerce
Tel: 86-23-6863-3836
service@unido-spx.org
parts.autochongqing.com/en

2012 CHINA INTERNATIONAL GREEN INNOVATIVE PRODUCTS & TECHNOLOGIES SHOW

NOVEMBER 9–11

Location: Guangzhou, Guangdong: China Import and Export Fair
Organizer: China Foreign Trade Center, China Chamber of Commerce for Import and Export of Machinery and Electronic Products
Contact: Zhou Rong
Tel: 86-10-85261628; 6559-9082
saitong@cccme.org.cn
www.cigipts.cn/en/index.aspx

CHINA INTERNATIONAL GOLD, JEWELRY AND GEM FAIR

NOVEMBER 9–12

Location: Shanghai World Expo Exhibition & Convention Center
Organizer: UBM Asia Limited
Tel: 852-2585-6179
salescjgf-hk@ubm.com
exhibitions.jewellerynetasia.com/shj

3RD MOBILE PAYMENT CHINA 2012

NOVEMBER 14–15

Location: Ramada Plaza Pudong Shanghai
Organizer: IGVision
Contact: Ms. Grace Zhu
Tel: 86-21-5161-5300
marketing@igvision.com
www.mobilepaymentchina.com

TEA & COFFEE CHINA 2012

NOVEMBER 14–16

Location: Shanghai New International Expo Center
Organizer: China International Exhibitions
Contact: Ms Becky Sun
Tel: 86-21-6209-5209
becky@chinaallworld.com
www.fhcchina.com/en/index1_13.asp

BEIJING OVERSEAS PROPERTY & INVESTMENT SHOW 2012

NOVEMBER 21–24

Location: China World Trade Center
Organizer: Beijing Jia Hua Four Seasons International Exhibition Co. Ltd.
Contact: David Wei
Tel: 86-10-824- 3031
kfwei2003@yahoo.com.cn
www.chinapropertyexpo.com/index.asp

SHANGHAI INTERNATIONAL FOOD FAIR 2012

NOVEMBER 22–24

Location: Shanghai Mart
Organizer: Shanghaimart
Contact: Jade Cheng
Tel: +86-21-2325-5312
jade.cheng@shanghaimart.com.cn
www.shanghaimart.com.cn/chinese/selfevent/2012/foodfair/index.html

8TH SHANGHAI INVESTMENT BANKING FINANCIAL EXHIBITION 2012

NOVEMBER 23–25

Location: Shanghai Everbright Convention & Exhibition Center
Organizer: Shanghai QiShun Exhibition Service Co., Ltd.
Contact: Mr. Wei Ran
Tel: 86-21-6191-4825
shqszl@163.com
shlcz.dv37.com/plus/list.php?tid=88

14TH CHINA INTERNATIONAL MOBILE PHONE INDUSTRY EXHIBITION & SEMINAR

NOVEMBER 25–27

Location: Shenzhen Convention & Exhibition Center
Organizer: Shanghai Kuozhan Exhibition Service Co.
Contact: James Tung
Tel: 86-21-6484-1883
kuozhansales@163.com
sz.mobileexpo.cn/english/index.asp

CHINA COAT 2012

NOVEMBER 28–30

Location: Guangdong: Guangzhou International Convention and Exhibition Center
Organizer: Sinostar Internationl Ltd.
Tel: 852-2865-0062
info@sinostar-intl.com.hk
www.chinacoat.net/2012/visit_en.htm

LNG TECH CHINA

DECEMBER 5–6

Location: Renaissance Beijing Capital Hotel
Organizer: International Quality & Productivity Center
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.lngtechnologychina.com

11TH SUZHOU INTERNATIONAL PRODUCTS TRADE FAIR

DECEMBER 14–17

Location: Jiangsu: Suzhou International Expo Center
Organizer: Suzhou International Expo Center
Contact: Mr. Gu
Tel: 86-512-6280-4482
guzhan@suzhouexpo.com
www.chinaexhibition.com/trade_events/1592-Agrif_China_2012_-_The_11th_Suzhou_International_Products_Trade_Fair.html

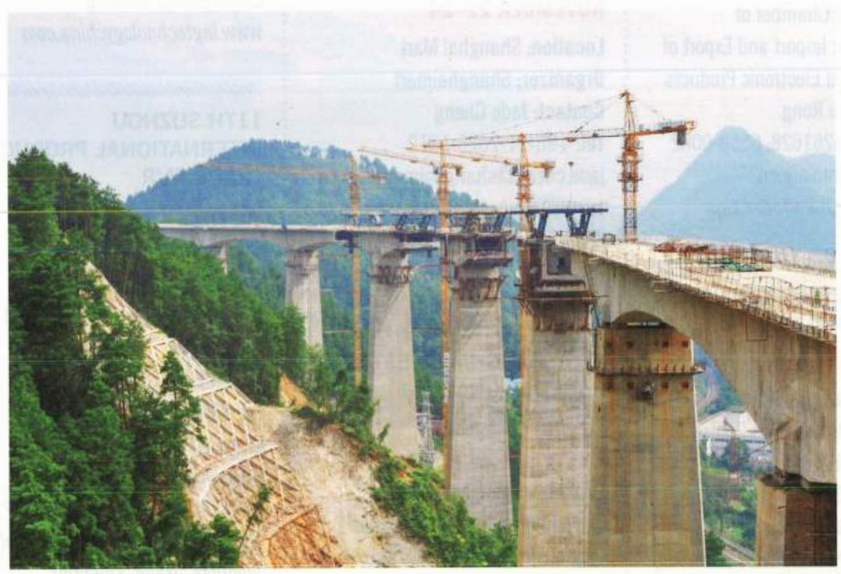
4TH ANNUAL BIO/PHARMACEUTICAL COLD CHAIN CHINA

JANUARY 16–17

Location: Beijing
Organizer: IQPC
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.pharmacoldchainchina.com

Chinese workers named **18 foreign companies** among the **50 best employers in China**, while the majority of the remaining companies were Chinese state-owned enterprises.

China Drops Slightly in Global Competitiveness Ranking



IMAGINE CHINA

China's global economic competitiveness ranking has fallen to its 2009 level, dropping this year from 26th to 29th, according to the World Economic Forum's (WEF) annual report. Although China's ranking fell, the WEF notes China's overall score "barely changed" compared to previous years.

WEF defines competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of a country."

As in past years, China scored the highest among the BRICS (Brazil, Russia, India, China, and South Africa) economies. Brazil finished the second-highest in 48th place. Areas of concern in China highlighted in the report include financial market development (54th), technological readiness (88th), and market efficiency (58th). China's ranking dropped in each of these areas. WEF calls these areas "critical for China's competitiveness." In regard to market efficiency, the report says, "insufficient domestic and foreign competition is of particular concern, as the various barriers to entry appear to be more prevalent and more important than in previous years."

China scored higher on a number of other measures, including its macroeconomic situation (11th) and health and basic education (35th). China's overall rankings were brought down somewhat by the quality of education measures, especially the quality of management schools (68th), and the disconnect between educational content and business needs (57th).

WEF also surveyed more than 14,000 executives on a number of issues, including the most problematic factors for doing business in each country. In China, the top five responses were access to financing, inflation, policy instability, inefficient government bureaucracy, and corruption.

The most globally competitive countries on the list were largely European. Switzerland topped the list followed by Singapore, Finland, Sweden, Netherlands, Germany, and the United States, which fell two spots from last year. WEF cited the lack of macroeconomic stability as the United States' greatest area of weakness.

—Ben Baden

Changes in Chinese Visa Requirements for US Travelers

In August, China made several changes to requirements for US travelers seeking Chinese business (F) and tourist (L) visas. Individuals planning to acquire business visas must now submit an invitation letter from a Chinese agency or an invitation letter issued by Chinese local government, company, or institution. This is a change from past visa requirements, which required that business travelers acquire an invitation letter from US-based offices, according to press reports. Tourists seeking L visas now must submit an invitation letter from a Chinese "duly authorized tourism unit," an invitation letter issued by a company or individual in China, or a copy of the traveler's roundtrip airline and hotel reservations.

There has been speculation that this change may align with China's leadership transition, as well as recent regulations included in the PRC Law on Entry and Exit Control. The law, which places stricter consequences on foreigners working illegally in China, will go into effect on July 1, 2013. For information on documents required for the visa application, visit www.china-embassy.org/eng/visas/adr.

—Ben Baden

New Chinese Grads Prefer Working for SOEs over Foreign Companies

Chinese firms, mostly state-owned enterprises (SOEs), outnumbered foreign companies on ChinaHR.com's annual list of the 50 best employers in China, but foreign companies are gaining ground. (ChinaHR.com is the Chinese subsidiary of Monster Worldwide, Inc., an employment search company) Chinese workers named 18 foreign companies among the 50 best employers in China, while the majority of the remaining companies were Chinese SOEs. China Mobile Communications Corp., Procter & Gamble Co., Baidu, Inc., Google Inc., and Huawei Technologies Co., Ltd. were the highest ranked companies. The number of foreign firms on the list is up from only three in 2010, but down from 2007 when they accounted for more than half of the top 50, according to *China Daily*. ChinaHR.com surveyed more than 40,000 Chinese workers, most of which were new college graduates.

—Ben Baden

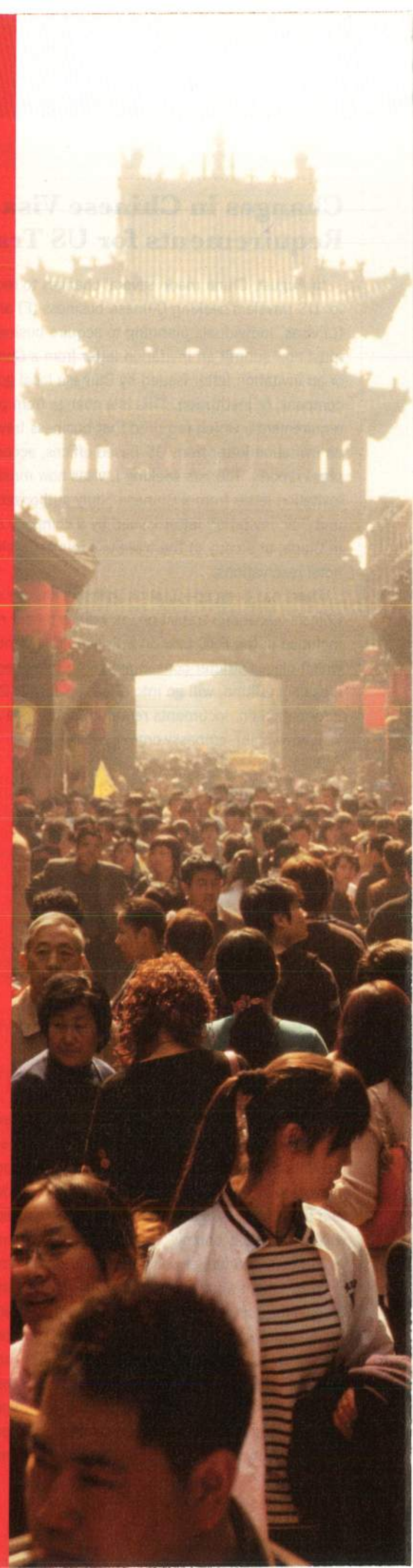
EU Chamber Report Says Patent Quality in China Overlooked

In August, the European Union Chamber of Commerce released a report examining the state of patent policy and how it affects innovation in China. Chinese officials have said that China aims to become an "innovation-oriented economy" by 2020 and a "world technological power by 2049."

While patent filings are booming in China—the government has pledged to file 2 million patents annually by 2015—the report says patent quality has been overlooked. The government has set high goals, but the authors of the report say there isn't enough being done to encourage the filing of high quality patents. "While patents are exploding in China and certain innovation is also on the rise, patent quality has not proportionately kept up and in fact the overall strength of China's actual innovation appears overhyped," the report says. For instance, the report estimates that there might be more than 2.6 million lower quality patents filed in China in 2015 alone, which is significantly more than the report's projection for high-quality patents. "This study uncovers how a network of patent-related policies, other measures, and practices in China collectively hamper both patent quality and innovation at large," the report says.

The report places a significant amount of importance on China's ability to innovate, saying China's success is important to the country's growth as well as the growth of the global economy. "The future direction of the world economy—inclusive of many businesses, consumers, and governments—to a notable extent hinges on China's ability to innovate," the report says. The report calls for different strategies to measure the strength of Chinese innovation, such as an incentive system to encourage higher patent quality.

—Ben Baden



BY **JOIE MA** AND **RYAN ONG**

New Initiatives Encourage Private Investment in Chinese Industries

This year, more than 20 PRC government agencies have released a number of new guidelines encouraging private investment in a range of economic areas and industries, including energy, healthcare, finance, transportation, and telecom. While this new round of guidelines provides no evidence that "private capital" could include foreign-owned companies, they provide important indications of the types of tools that Chinese planners could use to shift the competitive balance away from state-owned enterprises (SOEs).

GOVERNMENT, PUBLIC OPINION MIXED ON LIKELY IMPACT OF GUIDELINES

Premier Wen Jiabao has stated that implementation of these various guidelines is important for China's economic development. In July, Wen met with private enterprises in Sichuan province and called on central and local government agencies to promote projects to attract private capital into key sectors for development, including rail, city administration, public utilities, energy, telecom, education, and healthcare. Other government agencies have stated that these guidelines could have a significant impact. For example, Wang Zhigang, a senior official at the State-owned Assets Supervision and Administration Commission (SASAC), stated that this push will facilitate private capital to invest in centrally and locally controlled SOEs to enter state-controlled industries.

Despite these efforts, other observers are less confident that these implementing guidelines will have an impact. In a June 26 interview with *Caijing* magazine, China Private Enterprises Association President Bao Yujun stated that though language in the guidelines is positive, the document contains few details about how to encourage private capital investment. In addition, he expressed doubt that private companies would be interested in entering some of the targeted industries where profits may be falling, such as the troubled railway industry. In Wenzhou, Zhejiang, Zhou Dewen, head of the Small- and Medium-Sized Enterprise Promotion Association, argued that many of these guidelines appear to encode previous policies that do not address the core concerns that currently prevent private investors from gaining market access. For example, the guidelines for the energy sector do not provide crude oil importing rights to private investors, despite significant concerns raised by private enterprises earlier this year. Additionally, Zhou noted that private investors are concerned that implementation of these policies could be inconsistent.

Many analysts still question whether private companies will truly be able to set up companies to compete with SOEs in key sectors. The guidelines and statements by some government officials suggest that some policymakers may limit these reforms only to private investors making non-controlling investments in existing SOEs.

GUIDELINES COULD PROVIDE BASIS FOR EQUAL TREATMENT

Despite the lack of details, these implementing guidelines provide direction for foreign companies in many sectors that face competitive challenges from SOEs and limited market access. While most of these documents focus purely on generic "private capital" and raise questions about the participation of foreign capital, two of these guidelines—dealing with healthcare and education—specifically mention how foreign enterprises can enter into such industries.

In addition, many of the guidelines emphasized equal treatment among SOEs, private enterprises, and foreign enterprises. Wen stated during his Sichuan tour that there should be no discrimination in government procurement among SOEs, private enterprises, and foreign enterprises. Such language could provide foreign companies with stronger grounds to appeal discriminatory behavior in the future.

Ultimately, the reform of SOEs and introduction of more competition into sectors dominated by the state will be determined by the upcoming leadership transition. Major reforms in China tend to happen step-by-step, as a senior Chinese official reminded a delegation of US-China Business Council board directors during a visit to Beijing in late June.

JOIE MA (jma@uschina.org.cn) is manager of programs for the US-China Business Council (USCBC) in Shanghai, and **RYAN ONG** (ryanong@uschina.org) is director of business advisory services for USCBC in Washington, DC. This article is adapted from a report that first appeared in *China Market Intelligence*, USCBC's members-only newsletter.

WORKERS MAKE EYEGLASSES at a factory in Wenzhou, Zhejiang. In September 2011, the president of the Zhejiang Center Group, an eyeglasses maker, fled to the United States to escape a debt of ¥1.5 trillion. He later returned to China when banks agreed to more favorable repayment terms.

WANG DINGCHANG/XINHUA PRESS/CORBIS

When One Credit Door Closes, Another Opens

BY **EVE CARY**

As the Chinese government has tightened its lending policies, property developers and other enterprises have turned to private and informal lenders.

In September 2011, the president of Zhejiang Center Group Co. Ltd., the largest eyeglasses maker in China based in Wenzhou, Zhejiang, made news when he fled to the United States because he was unable to pay his company's high-interest loans. That fall, more than 100 business managers in the city, facing similar repayment and credit crunch issues, disappeared, committed suicide, or declared bankruptcy. A number of entrepreneurs in Henan and Jiangsu provinces followed suit.

These incidents occurred during a period of deep liquidity issues for businesses, particularly real estate developers, sparked by central government policies aiming to avoid a property bubble through tightened monetary policy and limited bank lending. From 2007 to 2010, home prices rose by 50 percent. There are an estimated 10 to 65 million vacant housing units as a result of speculation. Additionally, a report issued by the Agricultural Bank of China in December 2011 stated that home prices in first-tier cities would need to drop by 10 to 25 percent and home prices in second-tier cities would need to decrease by 5 to 15 percent to reach a sustainable level. In response to these high housing prices, the central government tightened bank lending from the summer of 2011 to the summer of 2012.

The central government has also encouraged banks to slow lending to real estate projects. According to the People's Bank of China (PBOC), the increase in cumulative loans related to housing projects totaled ¥1.3 trillion ($198 billion) in 2011, down 38 percent from 2010, and new loans to the property sector comprised 17.5 percent of total loans in 2011, down from 27 percent in 2010.

Local governments also became less reliable sources of financing during this period. In 2008, for example, local governments were flush with cash disbursed from the central government in a massive stimulus package. Now, local governments are facing significant pressure from the central government to enforce property development-related restrictions.

DOORS OPEN FOR DEVELOPERS

While the government has implemented these tightening measures, a number of avenues of credit (both official and unofficial) have opened or expanded for developers.

Private lending emerged as a significant player as early as 2008, including direct lending between individuals and companies, private equity funds, and underground banks, according to a PBOC report. Bank lending, according to a Citic Securities note, accounted for only 13 percent of small enterprise funding needs in 2008 (the most recent data available). Thirty-six percent of all lending came from informal lenders that year.

In response to the Wenzhou crisis, Chinese Premier Wen Jiabao announced the creation of a new "special financial zone" in Wenzhou.

Shadow banking, or underground banking, is an informal, private lending practice. Though often used by private citizens who do not qualify for loans, shadow banking is also utilized by developers in some cases. It is difficult to know the size of the industry. Estimates range from ¥2 trillion ($314 billion), according to the State Information Center, to ¥17.7 trillion ($2.8 trillion), according to China UnionPay. Underground banks often charge sky-high interest rates for loans: an estimated 14 to 70 percent.

Trust companies also play a role in shadow banking by purchasing loans from banks, taking the loans off the bank's balance sheet, and selling these loans to companies and individuals. In the first three quarters of 2011, trust companies distributed ¥322 billion ($51 billion) to property developers. Trust companies pose a number of risks to investors, including an inability to withdraw invested funds at times.

Private equity funds have also emerged as a crucial source of funding. Real estate investment funds are attractive to wealthy Chinese who would like to remain involved in the property market but face central government regulations, such as restrictions on the purchase of second and third homes. Property developers are attracted to the idea

QUICK GLANCE

- » A wave of bankruptcies in Wenzhou, Zhejiang exposed the difficulties private businesses have getting access to financing.
- » Tighter lending standards have forced businesses to look for alternative sources of funding outside of the government.
- » Underground banks often charge sky-high interest rates for loans: an estimated 14 to 70 percent.

because it allows them to keep assets and take charge of their own finances. In Shenzhen, Guangdong, there are 2,200 real estate funds, and in Tianjin there are more than 1,000. Developers such as China Overseas Land and Investment Ltd., Gemdale Corp., and Shanghai Forte Land Co., Ltd. have set up their own funds, while others, such as China Vanke Co., Ltd., have set up joint funds with their competitors. In 2011, 29 property funds raised a total of $4.1 billion, an increase from the previous year's $2.9 billion raised by 28 funds, according to consultancy Zero2IPO. Analysts expect that more than $6 billion will be raised in 2012, and they expect that number to grow by a rate of 40 to 50 percent in the next few years.

Property developers are also looking overseas for funding. Chinese developer Sino-Ocean Land Holdings, Ltd. collaborated with New York-based Kohlberg Kravis Roberts and Co. to raise a $200 million fund to invest in residential projects in China. In addition, China Overseas Land and Investment Ltd. set up a $500 million property development fund with ICBC International Holdings Ltd. and APG, a Dutch pension manager.

In early 2012, a number of major cities, including Shanghai and Beijing, started pilot Qualified Foreign Limited Partner (QFLP) programs, which allow foreign fund general partners to buy renminbi (RMB) and invest in an RMB fund (in an amount not to exceed 5 percent of the total capital of the RMB fund). This may allow the RMB fund to be more of a domestic partnership as opposed to a "foreign-invested partnership" that has a number of restrictions.

There has been a recent effort by private entrepreneurs to develop "home-grown" equity firms in China. As a result, investment by foreign funds dropped 45 percent last year, partly due to less stringent regulations for Chinese firms. Foreign investors face roadblocks by local authorities, who are not constrained by any nationwide rules governing the private-equity industry, as well as currency conversion requirements. Joint investments with domestic funds have thus become popular. According to the *Asian Venture Capital Journal*, joint investments totaled $13 billion in 2011, compared with $5.1 billion in 2010.

CENTRAL GOVERNMENT RESPONSE

Recently, the central government has introduced targeted policies aimed at loosening some aspects of mainly government lending in response to the economic slowdown of the past few months.

In response to the Wenzhou credit crisis, Chinese Premier Wen Jiabao announced at a State Council executive meeting in March 2012 the creation of a new "pilot zone" or "special financial zone" in Wenzhou. Private informal lenders will be allowed to officially operate loan companies that focus on lending to small- and medium-sized enterprises (SMEs), though this project has not gained much traction so far. Wenzhou citizens will be allowed to invest up to $3 million overseas (in non-bank entities), and small firms are now allowed to issue bonds.

Among other policy measures this year, the PBOC in February cut banks' reserve requirement ratios, freeing up an estimated ¥400 billion ($63 billion) in funds. In March 2012, the four largest state-run banks stated that they would provide more loans to "qualified" housing developers to construct "ordinary commercial housing." A number of banks have also increased lending to SMEs. These moves indicate that the central government is aware of the potential for, and consequences of, a real estate slowdown.

Recently, banks have been increasing lending to local governments. Bank loans to the real estate industry totaled ¥11.3 trillion ($1.8 trillion) in the first half of 2012, up 10.3 percent year on year. Wen has shifted his rhetoric to note that the government wants to promote investment, though Lian Ping, the chief economist for the Bank of Communications, notes that there is a still "a controlled pace of lending."

ADDITIONAL SOURCES OF FUNDING

Other less popular sources of funding have also surfaced as regulators have tightened lending in China. As of March, three property companies—Agile Property Holdings Ltd., KWG Property Holding Ltd., and Shui On Land Ltd.—issued $1.7 billion in bonds.

Peer-to-peer loans have utilized online platforms to connect lenders and borrowers, providing funds at higher rates than banks. This is often referred to as the "Wild West of lending," since the level of vetting of both borrowers and lenders varies dramatically from platform to platform, and there is little regulation.

Leasing companies have become sources for medium-term financing in that they rent equipment to businesses, allowing companies to make smaller payments and avoid taking out loans to purchase equipment.

Credit guarantee companies provide collateral that allow private firms to get loans from bigger banks.

—*Eve Cary*

During the height of the credit crunch, many small firms had to rely on increasingly unsavory lenders to service existing loans, particularly in Wenzhou.

IMAGINE CHINA

THE CREDIT CRUNCH AND DEVELOPERS

During the height of the credit crunch, many small firms had to rely on increasingly unsavory lenders to service existing loans, particularly in Wenzhou. These lenders charged such high fees that borrowers were caught in a cycle of increasingly high debts. Smaller firms often have to pay higher overall interest rates, and may not be able to survive the competition. Additionally, falling home prices and demand have reduced cash flows and made it difficult for developers to service existing loans, particularly since land is often used as collateral. Noah Wealth Management, a Chinese financial services company, estimates that ¥117.3 billion ($18.4 billion) of property trust products will be due in 2012, greatly exceeding last year's total of just over ¥47 billion ($7.4 billion).

Anton Eilers, executive director of Greater China at CBRE Residential, anticipates a round of mergers and acquisitions due to failures to meet loan payments. When larger companies take responsibility for the debts of smaller developers, debt defaults can be avoided, and smaller, weaker companies will be weeded out in favor of larger, more robust property developers.

Some developers look like they will come out of the crunch stronger than ever, including China Vanke. The company focuses on properties that have flown under Beijing's radar: smaller, first homes. Developers connected closely with local officials or with state-owned enterprise investors may also have an easier time, as they will be able to leverage their guanxi—or "relationships"—to ensure continuing loans from the state banks.

RAMIFICATIONS FOR CHINA'S FINANCIAL SYSTEM

The windows that have opened as a result of the credit crunch, and the windows of opportunity that the state is opening itself are extremely significant to China's financial system. These new policies and programs, including the rise of private equity, the Wenzhou experiment, and the loosening of capital controls, could lead to an overall evolution of the Chinese financial system.

At the National People's Congress in March, Wen called for increased access to funds, noting that "banks have yet to be able to meet those companies' needs, and there is a massive amount of idle private capital. We need to bring private finance out into the open."

Though there has been a loosening of bank lending, China is still stuck in a cycle of over-investment. In the future, there will surely be another round of tightening, leading developers to once again look to alternative funding sources.

However, there are still high legal hurdles, including inadequate legal protections for investors using these fledgling products. There are no specific regulations or laws for non-deposit lending institutions, just "guiding opinions" from the China Banking Regulatory Commission and the PBOC, and local government oversight bodies that provide general regulations and recommendations for the industry. As these new aspects of the financial system move forward, China will need to develop a regulatory infrastructure and educate investors to mitigate financial risks. Companies need a wide range of credit options to allow for longer-term investment and stable growth. Developing home-grown companies can provide a foundation for China's future economic growth.

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Rating China's Economy

The CEO of Moody's discusses China's evolving credit system, economic performance, and liberalization of the country's financial services sector.

GARY TAMIN

Moody's Corp.—a global provider of credit ratings, research, tools, and analysis of financial markets—rates and tracks debt covering more than 110 countries. Moody's opened its first office in greater China in Hong Kong in 1994, but its China-related business dates back to May 1988, when the firm's rating agency assigned China an A3 sovereign credit rating. It is now three notches higher at Aa3 with a positive outlook, making China one of Moody's highest rated sovereigns. In 2001, Moody's opened a representative office in Beijing. That office became a wholly owned subsidiary in 2003. Moody's operates two main divisions in China—Moody's Investor Service and Moody's Analytics—and has offices in Beijing, Hong Kong, Shanghai, and Shenzhen.

Moody's President and Chief Executive Officer ***Raymond W. McDaniel Jr.*** *joined Moody's in 1987 and has served as CEO since April 2005. He agreed to an interview over email with* CBR *Editor Christina Nelson about China's credit market, financial services sector, and investment environment.*

What services does Moody's provide in China?

McDaniel: China's domestic capital market is large, and the country is taking an increasingly weighty role among the community of nations. China has an important role in the broader global economy with increasing influence and reach. As a multinational institution, we are committed to providing the types of services and products that China would find useful on its path to growth, and we have adjusted to account for it.

Through Moody's Investors Service (MIS) we publish credit ratings and research on cross-border Chinese bond issuers. In practical terms, this means that the MIS Beijing office focuses its analytical activities on issuers offering bonds in overseas markets. In addition, in 2006, Moody's invested in one of China's leading domestic ratings agencies, China Chengxin International Credit Rating Co. Ltd. (CCXI), which focuses its work on companies issuing in China's domestic bond market.

Through Moody's Analytics (MA) we offer a broad suite of qualitative and quantitative solutions to help Chinese institutions manage risk. Our MA products include research, economics information, risk software, professional services, consulting, and training.

Moody's has recently made a number of investments which bolster our suite of China-related products and services. These include an investment in ChinaScope Financial, an integrated provider of China-focused analytics and business intelligence; CSI Global, a provider of financial training and certifications to global customers, including Chinese managers and executives from leading Chinese financial services institutions; and Copal Partners, a leading provider of outsourced research and analytical services.

Most people think of credit ratings when they think of Moody's. Indeed, rating the credit worthiness of issuers and debt securities is a significant part of our business, both within China and globally. But we also have extensive experience in economic analysis, research services, financial services training, and risk management.

For example, typical projects with China-based or China-focused clients include providing financial services training, enterprise risk management, and solutions for compliance with Basel III [international capital requirement] regulations, as well as assisting organizations with building their own risk management systems. Moody's also offers China custom research services through our Copal business, which provides "deep dive" research services, such as macroeconomic studies, market surveys, industry reports, company reviews, and financial analysis, including forensic examinations. These capabilities are used by supply chain managers, credit analysts, and bankers to help analyze customers, suppliers, and partners.

What changes have you seen in China's financial services and credit market over the last decade?

McDaniel: This question could be an entire interview in itself because so much has changed. Over the past decade, credit performance in the corporate sector has been very good. And, during and after the global financial crisis, China's economy demonstrated good recovery despite some weakness in residential real estate.

Since 2005, when the People's Bank of China (PBOC) introduced China's first-ever true credit-based short-term commercial paper programs, China has rapidly developed its credit market. The domestic market has become a very important funding channel for Chinese companies and financial institutions, and facilitates more transparent and more cost-effective public bond issuances. China's bond market is now the third largest in the world. Domestic bond issuances reached a record ¥7.8 trillion ($1.2 trillion) in 2011, and outstanding bond balances amounted to ¥22.1 trillion ($3.5 trillion) by the end of 2011. For perspective, the US outstanding bond market debt is about 10 times larger at $37 trillion.

What are the most common questions you get about China and its credit system?

McDaniel: Common questions revolve around China's potential approaches to credit policy. For example: "To what degree will credit in China evolve towards a managed or free market?" Or, even more specifically: "Will bond defaults be permitted?"

There are several possible approaches that China could take with regard to credit policy. First, China could follow a managed pathway similar to Japan with banks and government entities extending support to effectively insolvent companies. Or, second, China could follow a more free market approach, similar to credit in the United States, where insolvent companies generally declare bankruptcy and either liquidate or reorganize with debt repayment plans. Some would argue that there is a third, a purely Chinese model which takes a bit of both. That's essentially what the policy makers are trying to do.

Currently, there are indications that China is following a managed credit path, analogous to Japan. Based on news reports, some companies have defaulted on their bank loans, but local governments and banks then provided support to avoid public bond defaults, using public funds not only for state-owned enterprises (SOEs), but also private companies. This managed approach to credit may support social policies, but may not be ideal for a healthy bond market. Only time will tell whether a managed approach to credit becomes an enduring feature of China's capital market.

IMAGINE CHINA

China's economy has become immensely more complex in the past three decades of rapid, double-digit growth.

What is China doing to create a credit system?

McDaniel: The development of credit systems pose something of a chicken and an egg problem. What comes first, a liquid debt capital market or transparent information? Liquidity creates more information, and transparent information supports more liquid markets.

In China, both of these components are, I think, developing in tandem, but are not yet fully mature. Importantly, the government is supporting the development of a credit system with an encouraging series of regulations and policies. For example, the Qualified Foreign Institutional Investor scheme was recently revised to permit international investors to buy bonds on the interbank market.

How do investors and analysts research companies in China, and how is that different than what you would do in the United States?

McDaniel: Moody's recently surveyed 100 asset managers, hedge funds, private equity firms, and wealth managers in North America to understand how they research Chinese companies. The survey identified a couple of interesting differences. First, we learned that roughly 40 percent of investors here leverage their firm's research teams in Asia, suggesting that local knowledge contributes to a competitive advantage. Second, we learned that investors' top challenge is data quality, indicating a different stage of information maturity. Right now, investors are assuming that the credit risk of specific companies is linked to the credit risk of China itself.

How do you rate an SOE versus a private company in China?

McDaniel: Moody's ratings on China's SOEs have two key elements: their standalone credit fundamentals and the expected governmental support in a stress scenario. In assessing the standalone credit fundamentals of an SOE, we apply the relevant industry methodology, similar to a private company. However, we also assess the management oversight of the SOE by the government through its agents, SASAC [State-owned Assets Supervision and Administration Commission] and the National Audit Office. The government's oversight provides checks and balances and partially mitigates our concerns on corporate governance, an issue faced by a number of private companies in China.

SOEs also have good access to domestic bank and capital markets because of their ownership by the government, which provides them with an edge over many private companies in China.

Moody's also considers a rating uplift in view of the expected governmental support for SOEs. In assessing the support level for an SOE, we consider its strategic importance to the Chinese economy, its policy role, reputational risk to the government, and the government's track record of providing support to the SOE. This could end up with multiple notches of a rating uplift.

As a result, in Moody's rated universe, the majority of Chinese SOEs and their subsidiaries are rated at investment grade, while most of the country's private companies are rated below investment grade.

What are investors in China most worried or most enthusiastic about?

McDaniel: One top question in our customers' minds is: "Will China face a hard landing?" Obviously there is a wide range of definitions of a hard landing. At Moody's, we define it as a

The majority of Chinese SOEs and their subsidiaries are rated at investment grade, while most of the country's private companies are rated below investment grade.

permanent halving of the past decade's trend annual real growth rate within the near term; in the case of China, from 10 percent to 5 percent. The latter would, however, still be above the global growth rate. We don't believe such a scenario will materialize, and forecast growth for the next two years at 7.5 percent per year.

China's economic growth is healthy, but the economy is moving from double-digit to single-digit growth rates as the country approaches middle-income levels. This appears to be a natural economic development and is similar to Japan from 1966 to 1970 and Korea from 1986 to 1990. As with the rest of the world, the European situation is a negative drag on growth, and investors are concerned that China is the most exposed among major economies to the European slowdown.

Over the longer term, our sovereign team at MIS believes China continues to have upside potential. Once the private sector plays a larger role in the financial system, the prime engine for exports and investment in the economy would receive a big boost.

Also, the inevitable internationalization of the renminbi (RMB) and potential acceleration of financial liberalization after this fall's leadership transition creates numerous long-term opportunities.

How long could it take for the RMB to be truly an international currency? And what makes you say the potential is high for financial liberalization after the leadership transition?

McDaniel: I believe that it is likely that the RMB will trade internationally in the next 10 or 20 years. Potentially, to counteract negative public perception in the wake of recent political challenges, new leadership may be inclined to move quickly with policy reforms to demonstrate unity.

How big of a risk is China's shadow banking sector to the stability of the banking sector?

McDaniel: There are funding activities in which banks are heavily involved for facilitating certain transactions, and so they assume direct and indirect exposures. Examples are entrusted loans, bank bill acceptances, trust products, and underground lending. We estimate the size of the non-bank credit market to be about 20 percent of total bank assets, which is significant, but not high.

The non-bank funding channel grew rapidly in 2010 and the first half of 2011, but has since slowed as the authorities have stepped up oversight of the sector. We estimate that the growth of this exposure slowed to 25 percent in 2011 from 45 percent in 2010.

Nonetheless, the slowdown in economic growth has caused more borrowers in the shadow banking sector to default, based on media reports, as these borrowers had leveraged themselves up excessively and had to pay interest rates much higher than those on bank loans. Some borrowers also have bank loans.

It is difficult to quantify the risk that China's shadow banking sector poses to the stability of the banking sector due to the lack of disclosure. But based on Moody's analysis, if problem loan ratios increase to high single digits from current level of around 1 percent, the capital adequacy of most banks would still be able to meet regulatory requirements. Our analysis shows that Chinese banks are well capitalized and have a good level of cushion.

However, should problem loans increase to more than 10 percent of total loans, most of our rated banks would need to raise significant amounts of capital to meet regulatory requirements.

What other important issues is Moody's following in China?

McDaniel: Interest rate liberalization is very important for the further development of the domestic bond market and internationalization of the RMB. The PBOC released a report in February calling for significant capital account liberalization steps over the next three to five years. The governor of the PBOC, Zhou Xiaochuan, recently wrote in an article that conditions are "basically ripe" for interest rate liberalization.

We believe that interest rate liberalization will also enhance economic efficiency. China's economy has become immensely more complex in the past three decades of rapid, double-digit growth. The economy needs price signals, rather than administrative and political decisions, to ensure a more market-based and efficient allocation of capital.

Interest rate liberalization is also a key precondition for the further development of a domestic bond market and internationalization of the RMB. With liberalized interest rates, China could develop a municipal bond market. As in the United States, it would enhance the sustainability of government finances, if a diversified investor base is developed and transparency is promoted. Ultimately, it would lead to greater fiscal discipline on the part of local governments.

IMAGINE CHINA

Chinese e-commerce company **ALIBABA GROUP** (headquarters pictured above) is just one example of a successful company that received venture capital investment.

US-China Venture Capital Partnerships

BY **THARON SMITH**

US and Chinese venture capital firms can help each other access broader markets and realize higher returns on their investments.

Chinese and US enterprises are searching for ways to collaborate and build high-performing global companies, and partnerships are the next step for realizing growth and capital returns. Silicon Valley, New York, and Shanghai have served as cross-border incubators for early stage companies focused on bringing US technology to Chinese markets and vice versa. These projects are an early indication that venture capital partnerships between the United States and China will be the future driver for increased capital gains and significant investment returns.

Venture capital encourages private investment, stimulates private consumption, and supplies global public markets with viable, high-growth enterprises. Institutional limited partners and US venture capital industry investors are starting to look for new models, managers, and emerging economies for growth. At the same time, PRC government limits on investments in real estate and stock markets and a lack of alternative assets have increased investors' appetites for cross-border venture partnerships. Chinese investors are seeking growth outside their home market, and trying to make efficiency improvements domestically that would equate to higher financial and non-financial returns, such as job creation, infrastructure construction, community building opportunities, and educational and professional training improvements.

US-China cross-border venture partnerships provide a framework to bring both industries together to participate in the future economic and market growth of both countries. Although building partnerships takes time, attention to detail, openness, communication, cultural sharing, and well-defined expectations, new venture capital firms are demonstrating that these partnerships can be successful.

CHINA'S VENTURE CAPITAL INDUSTRY

Since PRC government agencies first started targeting infrastructure, technology, and science research and development (R&D) for domestic investment in the 1980s, the venture capital industry has evolved to become more popular with private and foreign investors that hope to capitalize on the growth of the Chinese market. Government-backed venture capital funds followed government agendas and invested in major infrastructure projects that allowed venture to thrive, such as technology parks, innovation centers, and laboratories. In 2011, global enterprises raised $5.9 billion in venture capital. Ernst & Young estimates that China will likely pass Europe to become the second largest venture capital hub by the end of 2012.

According to the Renaissance Capital Global IPO Review, Asia-Pacific remained the most active region for investment in the second quarter of 2012, accounting for 47 percent of deals globally. Venture capital activities in mainland China have shifted from purely infrastructure development to innovation in science, technology, and consumer products and services, and foreign firms have been increasingly involved in this new wave of investment. For example, venture capital firm IDG-Accel has invested in technology to expand the Internet and e-commerce in China. Chrysalix Energy Venture Capital, which invests in green technology, alternative energy, and environmental waste recycling, expanded its focus to China in 2011 with a $300 million fund.

The venture capital industry in China is still in the early-stages of development, and the domestic stock market remains inefficient. Participants buy and sell stocks with little knowledge or guiding practices, companies lack global standards, and governance is an ongoing concern. But the domestic Chinese venture capital industry has made improvements in areas such as legal, accounting, syndication, enforcement, sourcing, overseas public offerings, and screening of deals. Domestic Chinese venture capital firms are beginning to accommodate the government's desire for private investment in an effort to develop an entrepreneurial environment on the mainland. In addition, venture-backed company exits—by listing on China's stock markets or through domestic mergers and acquisitions (M&A)—have also been on the rise this year. M&A activity amounted to more than $6 billion as of early August, according to Thomson Reuters data, marking the highest levels of Chinese deal-making in five years. Chinese domestic stock markets have been showing signs of improvement and global stock markets have been more receptive to China-based enterprises. This means Chinese companies now have more opportunities to go public both globally and domestically.

CROSS-BORDER VENTURE PARTNERSHIPS

US venture capital investors are particularly eager to identify high-growth enterprises and emerging technologies with broad applications across markets. China's venture capital goals include turning domestic companies into global competitors, acquiring new technology, and expanding into new markets. Venture investors in both countries have overlapping goals and important lessons to share with each other. In cooperation with design centers, innovation parks, and research organizations, cross-border venture

QUICK GLANCE

- » The appetite for cross-border venture partnerships has increased due to investment restrictions in China and US investors' desire to expand to new markets.
- » US and Chinese venture capital investors can benefit from working together to share knowledge and build companies that take advantage of China's economic growth and expanding consumer market.
- » Although US-China venture partnerships can be challenging, investors can increase their chance of success by taking time to build relationships and foster open communications between partners.

partnerships can leverage resources, networks, and knowledge between various institutions.

Cross-border venture partnerships bring together US and Chinese enterprises at a relatively early stage of development to engage in activities for growth and innovation. Unlike the more common joint ventures where an investor is a passive partner in the company, venture partnerships encourage groups, companies, or corporations to jointly participate in business operations. Venture partnerships use strategic alliances and equity partnership models to facilitate cross-border deals, develop the investment relationship early, and commit to profitable, long-term goals.

Venture capital partnerships have taken several different investment forms, such as special purpose vehicles, equity joint ventures, and investment funds structured with both US and other foreign investment as limited partners such as "parallel funds." Venture capital partnerships aim to innovate by bringing together both foreign and domestic investment partners as well as forming and cultivating foreign and domestic enterprise teams to build global companies.

Challenges of partnerships

Despite the rapid growth and success of China's emerging venture economy and the experience of US-based venture investors, cross-border venture partnerships remain challenging. Political, ideological, cultural, and regulatory uncertainties in the United States and China present difficulties in cooperation and understanding. In addition, partners must consider obstacles in media misrepresentation, due diligence, accounting, rule of law, intellectual property rights, and gaps in management talent and leadership.

US venture firms that have attempted to enter the China market have not been entirely successful. Some of the top venture funds that have good reputations and track records in the United States have opened representative offices in China for the purpose of venture capital investment, but failed to cultivate long-term relationships with local officials and businesses. The most successful US funds operating in China have well-developed local partners and established track records of high performance in domestic investments and exits, demonstrating their ability to leverage local talent, make connections and invest with longer time horizons.

Building and sustaining an entrepreneurial culture in China is a difficult task. In general, China's system lacks the opportunity for first time entrepreneurs to fail and regain social acceptance to try again. This leads to hesitation and overwhelming pressure to succeed. In the United States, high-performing individuals and teams are encouraged to learn from their mistakes. Creativity, collaborative problem solving, and the process of art and design are also highly valued in the US venture capital industry. These traits and values have yet to be fully embraced in China, where issues such as fear of failure have stifled innovation in most high-tech areas.

OPPORTUNITIES

Led by the PRC government's desire to boost domestic consumption and increase investment in innovation, China has a growing need to transform domestic companies, upgrade consumption-led industries, and improve public shareholder markets. The United States has a successful history of building great companies, leading global industries, and cultivating one of the most desired stock markets in the world. Venture capitalists from the United States and China can benefit from working together to share knowledge and build companies to take advantage of economic growth and increases in domestic consumption.

US venture firms that want to develop closer ties with China can start by investing in and building high-growth and impactful enterprises with their Chinese counterparts. Several pioneers in this area include venture capital firms such as GSR Ventures, Granite Global Capital, and Qiming Ventures. These venture funds have led the way for venture partnerships, building great companies such as Alibaba.com (private), China's travel website Qunar (initial public offering scheduled for 2012), and childhood online entertainment company Taomee (listed on the New York Stock Exchange).

US venture investors interested in China should examine the needs of the domestic venture capital industry and Chinese entrepreneurs. In China, there are currently gaps in the areas of early-stage company investment, operational know-how, and creative engineering and problem solving. In the domestic venture capital industry, Chinese investors are looking for partners to create global distribution channels, marketing and branding expertise, and design and creative capabilities. Chinese venture institutions want to professionalize and equip managers for future increased expansion and growth. Foreign partners can assist Chinese domestic investment professionals grow the venture capital exit market internally and globally.

US investors can play a role in shaping China's venture industry, while also expanding their own brands and making connections to Chinese R&D institutions. US investors that want to access growing commercial technology, healthcare services, and Internet-based markets in China can provide procedural and systematic improvements and efficiency gains through advanced US technology and products. For example, US healthcare service providers and leadership development organizations are increasingly interested in providing services and evaluation practices to Chinese healthcare and financial services companies. US organizations, such as Silicon Valley Bank, are investing in the future of early stage technology and commerce companies in China that focus on the commercialization of products and services, such as online commercial sales, high-tech solutions, and mobile education to solve the current challenges of these rapidly changing Chinese industries.

In the United States, venture firms are beginning to develop innovation centers targeted toward cooperation with Chinese entrepreneurs and global markets. In several states, incubators, creative collaborations, and R&D centers are emerging with a focus on

Ernst & Young estimates that China will likely pass Europe to become the second largest venture capital hub by the end of 2012.

the Chinese market. For example, InnoSpring in Santa Clara, California, which opened earlier this year, is a venture-backed incubator designed to encourage both American and Chinese start-ups to expand beyond their home markets. With Chinese outbound investment in the United States expected to reach $3.6 billion in the first half of 2012, the United States also represents a significant market opportunity for Chinese investors.

BUILDING SUCCESSFUL PARTNERSHIPS

To increase the likelihood of success for the cross-border venture capital industry, US and Chinese government leaders have encouraged entrepreneurs to develop platforms for joint investment and cooperation between domestic and foreign players in both markets. Chinese government-backed venture capital funds are currently being encouraged to acquire foreign intellectual property and cooperate to build out domestic markets for technology such as agricultural waste-to-energy, sustainable building products, and sensitive medical devices. One of the outcomes of the 2012 US-China Strategic Economic Dialogue (S&ED) was for both countries to promote more open investment and foster financial market reform and regulatory changes to qualified foreign institutional investor programs.

Venture capital is a relationship-intensive business, especially in China. The Chinese venture landscape is built not only on relationships, but also on long-term commitments. Investors should keep in mind that it takes time to build the relationships necessary to engage domestic players. Typical Western practices that rely on legal enforcement and contractual agreements are not sufficient to succeed in China.

To build successful US-China venture partnerships, both partners should:

» Encourage entrepreneurship

Develop policies to encourage co-funding of new venture funds and emerging entrepreneurs. Implement shared value systems that support entrepreneurs and the environment in which they operate. Establish economic and financial incentives to increase cooperation at all levels of early stage company development. Encourage risk sharing and link compensation to performance.

» Balance interests

Utilize global best practices and competitive advantages to benefit the partnership, while acknowledging national frameworks, such as legal structures and policy guidelines as well as cultural and social differences. Recognize the value and importance of your partners' vision, goals, input, and contributions. Meet as often as necessary to understand the needs of the business activities and make a commitment to overcoming differences and mutual accountability. Balancing the interests of the partners does not require that the benefits of the partnership be equal, but that each partner is able to achieve identified key goals and objectives.

» Build respect

Establish good communication channels to express issues, concerns, and challenges openly. Build trust and respect through repeated interactions over longer periods of time.

» Engage policymakers

Work with both governments to improve regulatory frameworks to guide capital flows in both directions. Work alongside organizations such as the American Chamber of Commerce in China to encourage development of venture capital partnerships.

Cross-border venture partnerships are in a position to invest and develop companies in sectors such as financial services, energy, medical technologies, clean-tech, telecom, cloud- and Internet-based businesses around the world. These venture partnerships are one of the riskiest categories of investment. When actively managed, however, they are designed to produce the largest rewards.

Development of any early stage company or new investment business model is dynamic, complicated, and full of potential pitfalls. Venture partnerships between US and Chinese enterprises need to be tailored to the needs and circumstances of each organization or early-stage team. Given the complex and rapidly changing landscape of early-stage investment between the United States and China, well-connected organizations with on-the-ground experience have an advantage as venture capitalists begin to explore potential partnerships and enterprise exchange opportunities.

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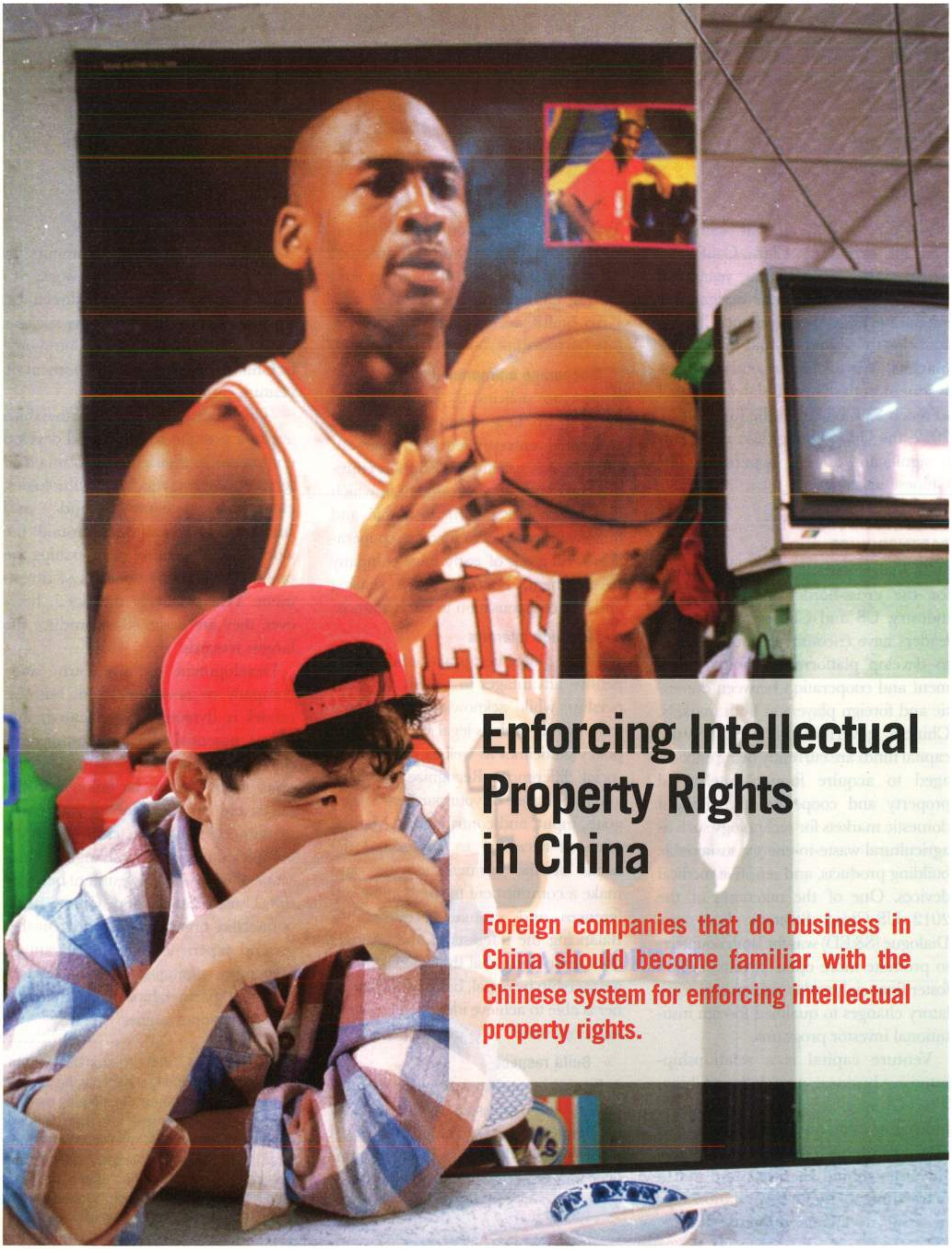
BY **THOMAS I. ROSS**



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Enforcing Intellectual Property Rights in China

Foreign companies that do business in China should become familiar with the Chinese system for enforcing intellectual property rights.

China's oft-stated reputation for being lax on protection of intellectual property rights (IPR) can deter foreign companies that want to do business in the world's second largest economy. While enforcement of copyright protection is still difficult in China, it is possible to win court cases or protection through administrative rulings in the areas of patents, trademarks, and trade secrets. But the only way for IPR holders to succeed is to familiarize themselves with China's system of enforcement.

ENFORCEMENT OF IPR IN CHINA

Civil enforcement of IPR in China is a two-track system. The first is the administrative track, whereby an IPR holder enlists the aid of a local government agency office (see p. 26). The second is the judicial track, whereby complaints are filed through the court system.

Those who take the administrative route are almost exclusively Chinese. Set up in the provinces and some cities, these local government offices operate as a quasi-judicial authority and are staffed with people who specialize in their respective areas of IP law. If they are satisfied with an IPR holder's complaint, they investigate. The authorities can issue injunctions to bring a halt to the infringement, and they can even enlist the police to assist in enforcing their orders. But agency officials do not have the authority to award monetary damages. Also, there is no established appeal procedure, so if a party is dissatisfied with the agency's decision, it has to take the case to court to change the result.

The court procedure in China is the most popular method chosen by foreign companies for IPR enforcement for two reasons. First, IPR holders based outside of China are familiar with going to court to enforce their IPR. Second, administrative proceedings in China cannot award monetary damages. The time to trial in a Chinese court is usually less than a year from the filing of the complaint. (The conventional time to trial in the United States is at least two years.) However, in China, a court case for patent infringement is usually delayed to await the result of an invalidity determination, which is not decided by the court. In China, if a patent is contended to be invalid as a defense to infringement, that determination must be made by the State Intellectual Property Office (SIPO), China's patent office, and usually takes one to two years.

Upon filing of the complaint and receiving a timely answer by the accused infringer, the court usually gives the parties a few months to submit their evidence in preparation for the trial. The court will usually forward a copy of the evidence submitted by one party to the other party, and may arrange a separate hearing to give both sides the opportunity to challenge the veracity of the evidence. The trial consists of opening statements by the parties, a court-conducted investigation of the evidence and witnesses, a debate usually under questioning by the court, and brief closing statements. After the trial, the court will issue a written decision unless the court requires further hearings.

There is no discovery procedure, as there is in the United States, whereby revealing documents are produced, and development, sales, and profit information are revealed to the lawyers for the opposing party. Therefore, actual damages for infringement are difficult to determine given the lack of information on sales numbers and profits. Statutory damages are adopted in most cases. Under the current patent and trademark statutes, the maximum amount is ¥1 million ($158,000). Because this amount is relatively insignificant and only reached in exceptional cases, IPR owners do not typically litigate in China for the purpose of recovering significant damages. Instead, they do so to secure a court injunction against further infringement.

NOTABLE CHINESE IPR CASE LESSONS

A few IPR enforcement cases in China have been widely reported and illustrate lessons for foreign companies experiencing IPR enforcement issues in China.

Patents

In 2006, the Chinese subsidiary of the French company Schneider Electric SA was sued by the Chinese company Chint Group Corp. for patent infringement in the Intermediate Court located in Chint's home city. Chint claimed that Schneider Electric had infringed on Chint's utility model patent relating to circuit breakers. In its defense, Schneider filed a patent invalidation petition with SIPO. In April 2007, SIPO affirmed the validity of the Chint utility model patent.

The Intermediate Court moved forward with the infringement case and insisted that Schneider produce certain tax information to determine the company's sales and profits on the alleged infringing products. The infringement trial was held, and in September 2007 the court found Schneider was infringing

QUICK GLANCE

- Companies can pursue administrative or judicial avenues to enforce their intellectual property rights (IPR) in China
- IPR owners do not typically litigate in China for the purpose of recovering significant damages because the damages awarded are usually small.
- Copyright infringement is one of the most significant IPR enforcement issues.

Chint's patent. The court issued an injunction against Schneider and awarded $49.2 million in damages to Chint. While on appeal, Schneider and Chint settled.

It is perhaps significant that this infringement suit was brought in Chint's home city. Because local protectionism is a concern in China (whether in a local court or agency office), foreign companies should consider preemptively bringing a suit in whatever may be considered their home court in China. For example, PRC law provides that an infringement lawsuit can be brought in the place of infringement—wherever the infringing product is sold—not just the place of defendant's domicile. PRC law permits a party accused of infringement to bring a declaratory suit in its home court seeking a judgment of non-infringement. A foreign company accused of infringement could also file an invalidity challenge with SIPO as a way of warding off a patent infringement suit.

Trademarks

Two similar trademark cases are notable for their different outcomes. The first concerns Yi Jianlian, a famous basketball star in China. A Chinese sports products company registered the trademark "Yi Jianlian" even though there was no business relationship between Yi and the company. The PRC Trademark Law says that no trademark shall prejudice another person's existing prior rights in a trade name or the right to exploit their own famous name. Yi filed a cancellation action with State Administration for Industry and Commerce (SAIC) and provided substantial evidence to establish his popularity in China before the filing date of the trademark. On that basis, SAIC ruled that Yi owned name rights, and canceled the company's trademark.

However, when former National Basketball Association superstar Michael Jordan took a similar matter to court in China, he lost. In 1998 and 1999, Qiaodan Sports, a Chinese maker of sports products, filed trademark applications for "qiaodan," which is widely recognized in China as the translation for "Jordan." Qiaodan Sports used "qiaodan" as its products trademark. A market survey conducted in Shanghai showed that 90 percent of the 400 Chinese citizens polled believed "qiaodan" was Jordan's brand. Jordan sued Qiaodan Sports for name right infringement in the People's Court of Beijing. Despite the undeniable fact that Jordan is world-renowned, the court held that "Jordan" is a common surname in the United States and therefore not sufficiently unique to create exclusive recognition for Jordan to own the name right to "qiaodan."

Jordan's lawyers have re-filed their name right infringement case, now in a different court, in Shanghai. Perhaps the lesson from Yi's case is that Jordan should have started with SAIC, the governmental agency specializing in applying the trademark law for registering and policing trademarks, in his effort to cancel Qiaodan's mark.

Copyrights

Since private party enforcement of copyright protections has not been effective, either because favorable judgments have not been forthcoming, or because infringers keep eluding punishment, copyright infringement is the most notorious of China's IPR issues. The United States and other countries even brought a World Trade Organization dispute

CHINESE AGENCIES INVOLVED IN IPR ENFORCEMENT

Administrative enforcement of IPR is unique to China. Here are the major agencies able to conduct enforcement actions.

» **State Administration for Industry and Commerce (SAIC)**

The Trademark Office, under SAIC, is located in Beijing and has authority over trademark registration and enforcement of trademark protection. SAIC can receive trademark applications and register trademarks. It also has the power to cancel a registered trademark, order that the sale of infringing items cease, order the destruction of infringing trademarks or products, impose fines, and remove machines used to produce counterfeit goods. Under the Law to Counter Unfair Competition, local AIC offices have been established in the provinces for administrative enforcement of trademark rights. The local offices address trade secret misappropriation and other unfair trade practices, such as trade libel.

» **State Intellectual Property Office (SIPO)**

SIPO at the national level serves as the patent office, which examines and issues patents. However, SIPO also oversees local IPO offices, which have authority to investigate and bring a halt to clear cases of patent infringement.

» **National Copyright Administration (NCA)**

NCA is responsible for nationwide copyright issues, including registering copyrights, investigating infringement cases, and administering foreign-related copyright issues, including developing foreign-related arbitration rules. Though administration enforcement is available, NCA encourages complainants to use the court system due to lack of personnel.

» **General Administration of Customs (GAC)**

Chinese customs regulations ban the import and export of goods that infringe on IPR. The IPR holder must proceed at the port of entry or exit where protection is sought to register its complaint. If the investigation concludes there is infringement, GAC has the authority to confiscate the goods, and may destroy the infringing goods and impose a fine.

—*Thomas Ross*

CHINT GROUP CORP. won $49.2 million in damages in 2007 from Schneider Electric, which Clint accused of infringing on its circuit breaker patent.

IMAGINE CHINA

over this matter in 2007. It seems that foreign business copyright holders have only achieved significant enforcement results when working in conjunction with Chinese law enforcement agencies as part of Chinese trade relations programs.

STRATEGIES FOR ENFORCING IPR IN CHINA

Winning is unlikely if a company does not understand the rules of the game. Here are four litigation strategies to enforce IPR in China.

Citing precedent in a non-precedential legal system

Unlike the United States, which has a common law legal system based primarily upon past judicial opinions that interpret legislation, China is a civil law country. Chinese judges make rulings based directly on statutes without regard to other court decisions. The judges make their decisions autonomously by requesting and challenging evidence, questioning the witnesses, receiving briefs and hearing arguments from legal counsel, and even consulting their own experts. Judges in China do not respond to precedent. But the Chinese Supreme People's Court (SPC) recently issued illustrative cases for reference in judging IPR disputes in the lower courts. These cases do not form a part of the law as they would under a common law system, but coming from the SPC they carry the weight of authority. Drawing the local court's attention between one's case and such illustrative cases should have a favorable effect on the ruling of the local court.

Exploit local relationships

In China, the courts are not independent of the government as in the United States. Court appointments are made by the local government, and the local government depends on local companies for employment and tax income. These relationships tie local businesses to the courts. In the United States, it is considered inappropriate for a litigant or a prospective litigant to get to know the judge to improve their likelihood of success in court. In China, however, conflict of interest is traditionally not a concern for Chinese officials. Foreign companies should try to establish contacts in the local government as well as the courts as part of doing business. Generally, the involvement of a Chinese lawyer or qualified agent to handle an IPR enforcement case in the court or before the local administrative authority will be a legal requirement. The goal for foreign companies should also be to identify local counsel with strong local relationships and a prominent reputation.

Seek an early injunction from an administrative agency

Administrative enforcement of IPR is a feature particular to China. Local authorities may not be able to hear complex or highly technical IPR cases; however, they should be able to handle simple patent, trademark, or misappropriation cases. Foreign companies should not overlook this enforcement route simply because monetary damages are not available. Damage awards in China are generally modest anyway, due to the lack of discovery and statutory award limits. Also, if the attempt at enforcement by the administrative authority fails, a company can sue the infringer in court.

Obtain utility model patents

China grants two levels of patents: invention and utility model. Invention patents are similar to utility patents in the United States. Utility model patents are different in that they are not examined, have a term of only 10 years, and can only be directed to the structure of an apparatus. Because they are quick and inexpensive to obtain and granted without substantive examination, utility model patents are often dismissed as lower quality patents vulnerable to invalidation challenges. This misperception has led many foreign companies to pay little attention to or even exclude them from their patent portfolios. However, since utility model patent applications are not substantively examined before issuance, a utility model patent holder can be in position to take infringers to court in a matter of months or up to a year from filing the patent application. As demonstrated by the Chint v. Schneider Electric case, the consequence of infringing a utility model patent is no less devastating to the accused infringer than with a regular invention patent.

Except in the area of copyright enforcement, there are procedures and remedies in China that are effective for enforcing the gamut of valid IPR. However, those procedures and remedies are China-centric, which is what foreign companies need to accept if they wish to enforce IPR in China.

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BY THOMAS T. MOGA

Obtaining and Enforcing Design Patents in China

APPLICATIONS FOR DESIGN PATENTS HAVE GROWN RAPIDLY IN CHINA IN THE LAST DECADE, BUT FOREIGN COMPANIES ARE STILL RELUCTANT TO USE DESIGN PATENTS TO PROTECT THEIR PRODUCTS.

The design patent was first introduced in China in 1985 as part of the country's first modern patent system, which also included the invention patent and the utility model patent. Design patent protection in China is established under the Patent Law and the Implementing Regulations of the Patent Law. Broadly speaking, designs patents cover new designs, shapes, patterns, or colors, which are rich in an aesthetic appeal and are fit for industrial application. Conversely, the invention patent protects technical solutions or improvements relating to products or processes, while the utility model patent covers mostly structures and shapes of mechanical structures.

Since its introduction, the design patent has been enthusiastically embraced by Chinese entities. In 2011, Chinese applicants filed for 327,565 design patent applications compared with only 188,027 filed just five years earlier. In fact, the design patent is preferred over the invention patent by Chinese applicants, accounting for 35 percent of all types of patents filed in China that year. Design patents are generally cheaper to apply for, granted faster, and contain a relatively broad scope of coverage, while the invention patent is more expensive and takes longer to process.

Foreigners in China, on the other hand, have not been so enamored, having filed just over 10,000 design patent applications in 2011, or about 11 percent of all types of patents filed by foreign applicants. This is partly the result of experiences with design patents in other countries, such as the United States, where design patent application standards are stricter than in China.

While some foreign companies are building their design patent portfolios in China, convincing others that the cost of obtaining such patents in China is justified is difficult. Many foreign companies believe that that the enforcement system in China simply does not work, that the PRC government is not truly committed to protecting intellectual property rights (IPR), and that rampant corruption at multiple levels stymies provincial and local efforts to stop counterfeiting. While much more work needs to be done to bring China's enforcement regime to a world-class level, China's intellectual property enforcement system today is vastly improved over what it once was. Assuming this trajectory continues, a design patent secured today will have a much better chance of being enforced as time goes on. While success enforcing a design patent down the road is not a sure thing, one outcome is certain—failure to obtain the design patent in China while the opportunity to do so is available will guarantee there will be no relief against future infringers in that country.

FILING PATENT APPLICATIONS

The design patent application in China is a fast, low cost way to obtain protection. The design patent application does not require substantive examination, but rather faces only an examination as to formalities in which applicant information, completeness of the application, and acceptability of the drawings are considered. No comparison with earlier designs is made, although a third party may challenge a patent after it is granted through a proceeding before the Patent Reexamination Board (PRB). Time from filing to grant varies, but generally is between three and eight months. The term of the design patents in China is 10 years from the filing date. Translation and filing fees are also minimal.

The timing of filing is also important. China is a first-to-file country, so whoever gets to the patent office first with the application generally wins. Foreign applicants can overcome this disadvantage by filing early in their home country followed by a timely filing in China. Failure to file first can result in lost design patent rights. The date of filing is also important as China is an "absolute novelty" country, meaning that the "prior design" that can be cited against the application includes "any design known to the public in this country or abroad before the date of filing." Accordingly, all applicants seeking design patent protection in China need to file a patent application somewhere in the world before the design is known publicly, either inside or outside China.

APPLICATION CHALLENGES

In the eyes of patent counsel of a major US sport shoe maker who has been "reasonably impressed" with the quality of patent examination, dealing with China's drawing practice has been the greatest challenge in obtaining design patents. In his company, harmonization of drawing practices has been difficult—and costly—to develop.

Foreign applicants frequently find that the drawings they submit to other patent offices, such as the US Patent and Trademark Office

QUICK GLANCE

» China is the most litigious country in the world in terms of intellectual property enforcement.

» Chinese companies have applied for the vast majority of design patents in China.

» China's IPR enforcement climate has improved, and foreign companies should consider applying for patents to protect their products in China.

IMAGINE CHINA

(USPTO), may not be acceptable to China's State Intellectual Property Office (SIPO) without changes, such as removing surface shading or broken lines.

Design patent applications in China also require the applicant to provide a brief description that "may be used to explain the said design as shown in the drawings or pictures." Initially, applicants worried that the written description could be used by a court to interpret the scope of the patent. However, experience has demonstrated that a general statement identifying the "essential portion" of the design as being "the shape of the product of the design" would be acceptable to SIPO.

Design patents can overlap with copyright protection in China. Currently, works of "applied art" (defined as "artistic works with utilitarian functions") are eligible for copyright protection in China, but only to foreign applicants. Products such as sneakers, tire treads, and even Lego bricks may be eligible for copyright protection in China as "works of applied art." In March 2012, the National Copyright Administration of China issued a draft of proposed amendments to China's Copyright Law, which remedies the current law by making copyright protection for works of "applied art" available to both domestic and foreign parties.

THE QUESTION OF FUNCTIONALITY

Under the Patent Law, patented designs must be distinctly different from existing designs or the combinations of the features of existing designs and must not be in conflict with the lawful rights acquired by others prior to the date of application. But there is an ongoing debate in China about how much functionality a design patent can have in China before it falls outside the scope of design protection. For example, vehicle components, including exhaust systems, have been patented as designs in China, even though these items would not receive design patent protection in the United States.

Because design patents protect designs of industrial products, most of these products have specific functions. No design patent has been invalidated by the PRB merely because it was "functional." At present, the criteria for determining the patentability of a product under design patent in China is whether or not the article is identical with or similar to any prior design. As it stands today, the system in China allows the applicant to obtain a broader scope of design patent protection than is available in most other countries.

ENFORCEMENT

China has experienced significant growth in the number of filed patent applications over the last 10 years. In 2001, 203,573 patent applications were filed, of which 60,647 were for designs. In 2011, more than 1 million patent applications were filed, of which 337,796 were for designs. Patent litigation in China has kept pace, making China today the most litigious country in the world when it comes to intellectual property enforcement. In 2001, only 1,597 infringement actions had been filed. By 2010, that number had risen to 5,700, compared with 3,605 patent infringement actions filed in the United States in the same year.

Over the past couple of years, PRC courts have witnessed noteworthy infringement actions that involved design patents, but it is still unclear how similar an accused product has to be before it is found to be infringing. In an effort to provide guidance to courts wrestling with this question, the Supreme People's Court issued an interpretation in January 2010 specifying that in determining infringement an "eye of the ordinary beholder" test will be applied to determine whether or not there is substantial similarity. This same "ordinary beholder" must undertake a "comprehensive assessment" of the overall configurations of the competing designs when determining whether or not there is sufficient identity to support a finding of infringement. However, previous court decisions suggest that treatment of identity by Chinese courts remains inconsistent and contradictory.

In 2003, Honda brought a case against Chinese auto maker Heibei Shuanghuan alleging that the Chinese automakers "Laibao S-RV" infringed its design patent for the C-RV. The case ultimately made its way to the Supreme People's Court. Honda's patent was challenged by defendant Heibei, which claimed that the C-RV design was known and was thus shown in the "prior art" before Honda applied for patent protection. The court determined that, at least with sedans, a review of the overall view of the vehicle does not help because sedans have common configurations. In such case, the "ordinary consumer" is able to distinguish between particular products by distinguishable features, such as headlamps. Certain design features were used to determine brand identity, at least with sedans.

In 2009, German company Neoplan Bus won more than $3 million in damages after bringing a design patent case against Chinese auto maker Beijing Zhongtong Xinghua. The First Intermediate People's Court of Beijing found that there had been infringement of a bus design. In ruling in favor of Neoplan, the court ignored "partial and minor" differences that did not impact the overall design of the bus. The court may have come to a different conclusion than the Honda case because a bus is a "less common article" than a sedan.

The director of intellectual property for a US-based global manufacturer of footwear and athletic apparel says he hesitates to obtain more design patents in China because of the inconsistency in court decisions and because even a slight difference between the design patent and the product results in a finding of non-infringement. He says his company enforces its trademarks in China so it does not hesitate to enforce its IPR in general, but he believes the narrow interpretation of the scope of design coverage demonstrated by the courts outweighs the value of design patents. But he says he does not have plans to ramp up his modest design patent portfolio given the unsettled state of design patent interpretation by the Chinese courts.

HOW THE SYSTEM IS FAILING

While China's patent laws today are world-class, the challenges involved in enforcement remain considerable. This fact, coupled with rampant infringement, forces many prospective foreign design patent applicants to re-consider and frequently abandon plans to file many (or any) design patent applications in China.

Patent coverage must be expanded

In China, design protection is directed to physical objects and excludes products with graphical user interface (GUI) from design patent protection. The GUIs, such as icons, menus, and pointing devices, allow humans to interact with their computers and cell phones. However, China now has the opportunity to join the majority of countries that grant design patent protection for GUIs. David Kappos, undersecretary of Commerce for Intellectual Property and director of the USPTO, stated that "design protection of GUIs is important in addressing the increasing phenomenon of migration of real objects to virtual objects, such as cell phones or laptops, or the GUI of a refrigerator to enable its remote control. There is also a need to provide more robust protection for designs in the borderless computing 'cloud.'"

Encourage more flexibility in infringement cases

A more flexible approach to interpreting the identity of a design patent would make use of the system in China more attractive to foreign applicants. It would also make the system fairer to all design patent holders who engage in infringement litigation. For example, in the United States, a product infringes a patented design when "in the eye of an ordinary observer, giving such attention as a purchaser usually gives, [the] two designs are substantially the same … the resemblance [being] such as to deceive such an observer, inducing him to purchase one supposing it to be the other." The ordinary observer is deemed to view the differences between the accused product and the patented design in the context of prior art, such that differences between the claimed design and the prior art are likely to be relevant. (However, there is no separate explicit requirement that the accused product appropriate the novelty of the patented design.)

The design patent in China is underutilized by foreign companies, but it is a valuable tool that can both protect investment and potentially halt infringement.

"Junk" patents filings must be policed

Because the system of granting design patents does not require SIPO to undertake a substantive examination, the filing of frivolous design patent applications is common. The resulting "junk" patents are either based on previously known designs or issued design patents with or without minor modifications. For example, a licensee of a design patent re-submitted the same design in his own design patent to "double" and thereby "improve" the rights of the legitimate design patent holder—all without the authorization of the licensor. To reduce the number of junk patents, China could adopt a system of substantive examination. This step would be consistent with China's push for increased domestic innovation. Other possible modifications include the requirement that an oath or declaration attesting to originality of the design be submitted with the application (currently not required) or the requirement of a SIPO-issued evaluation report prior to the filing of an infringement action. Along these lines, penalties for knowingly asserting an invalid design patent should be levied. A separate opposition proceeding should also be established for design patents.

The design patent in China is underutilized by foreign companies, but it is a valuable tool that can both protect investment and potentially halt infringement. China has taken several positive steps to improve its design patent protection, at least on paper. However, a sustained and focused effort to halt rampant counterfeiting and to overcome inadequate enforcement by broadening the scope of design patent coverage will be required if China's IP system is embraced without reservation by the international patent community.

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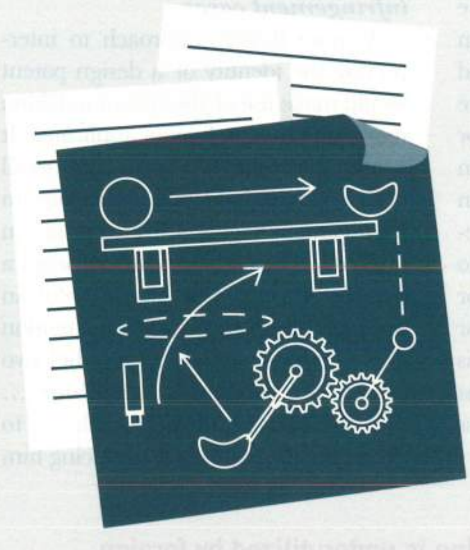
CHINA DATA // INTELLECTUAL PROPERTY IN CHINA

PATENTS



1: China became the world's top patent filer in 2011.

500,000: Number of patent applications analysts expect will be filed annually in China in 2015. The United States (400,000) is expected to file the second most annually, followed by Japan (300,000).

73: Percent of applications filed by domestic companies in China in 2010, up from 52 percent in 2006.

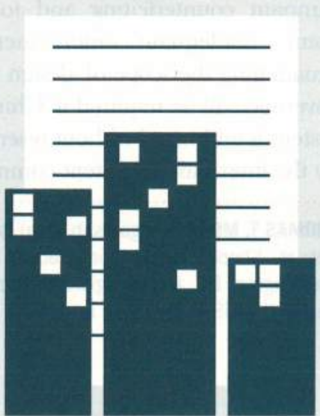
TRADEMARKS

13: Percent of all trademarks filed globally that were filed in China in 2009.

450: Percent increase in the number of trademarks registered in China from 2000 to 2009. Between 1989 and 2009, more than 550,000 trademarks were registered in China.

669,088: Number of trademarks received by China's trademark office in 2008, the most of any country, followed by the United States (294,070) and the Republic of Korea (137,461).

PATENT FILINGS ABROAD BY COMPANY



Huawei topped the list of applicants to the World Intellectual Property Organization in 2008, the first Chinese company ever to do so.

ZTE Corp. (China) filed the most patents in 2011, followed by Panasonic Corp. (Japan), Huawei Technologies Co., Ltd. (China), Sharp Corp. (Japan), and Robert Bosch Corp. (Germany).

BY THE NUMBERS

INNOVATION

$65.8 billion: Amount China invested in research and development in 2008, which was equivalent to 1.5 percent of its gross domestic product that year.

0: Number of Chinese companies on the Thomson Reuters 2011 Top 100 Global Innovators list. The most innovative companies are based in the United States (40 percent), Europe (29 percent), and Japan (27 percent).

34: China's rank as measured by the 2012 World Intellectual Property Organization Global Innovation Index.

US COMPANIES IN CHINA

From 1976 through 2011, **FIVE US COMPANIES RANKED IN THE TOP 20 TRADEMARK FILERS IN CHINA**. Johnson & Johnson ranked second with 1,877 trademarks filed followed by The Walt Disney Co. in third with 1,647. Mars Inc. ranked seventh with 1,223, General Motors Co. ranked 16th with 980, and Wal-Mart Stores Inc. ranked 20th with 893.

Sources: Thomson Reuters, World Intellectual Property Office

IMAGINE CHINA

The Export Control Risks of US-China Technology Collaboration

BY **JIAN BIN (BEN) GAO** AND **DAVID HARDIN**

As US-China trade expands to higher value goods and services, companies should carefully assess how US export control laws may affect their activities.

US-China trade has grown beyond trade in low-cost goods, and now entails more activities higher up the value chain, such as research and development (R&D), high-tech manufacturing, and Chinese investments in US firms. A consequence of this trend is the increased exchange of technology between the United States and China.

Such exchanges of technology, while often seemingly a normal part of business collaboration, create a serious risk for companies subject to stringent US laws applicable to the export of technology, which include the so called "deemed export rule." The risk of technology exchange is that a company may unknowingly release technology to China or Chinese nationals in violation of such export control laws, forcing the company to suffer the legal, financial, and reputational damage of an enforcement action brought by the US government.

QUICK GLANCE

- » Technology exchanges have become a normal business practice, but companies must pay attention to stringent US export control laws that may prohibit some of those exchanges.
- » The US arms embargo on China makes exports to China subject to more controls than exports to most other countries.
- » Companies should carefully determine the classification of items they release to Chinese companies or individuals to mitigate compliance risks.

THE US EXPORT CONTROL REGIME

The US government restricts the export of two types of items: munitions items and dual use items. Munitions items, also known as defense articles, are those that theoretically have only a military application. Dual use items are those that theoretically have both commercial and military applications.

Restrictions on the export of munitions items are administered and enforced by the Department of State, through its Directorate of Defense Trade Controls (DDTC) under the authority of the International Traffic in Arms Regulations (ITAR). The regulations contain the US Munitions List (USML), which exhaustively identifies the many classes of items considered to have only military applications. Furthermore, under the regulations, DDTC may also restrict the export of any item designed specifically for a military application, even if it is not identified on the munitions list. Any item controlled by DDTC generally requires a license for export. China is a special case because of the United States' existing arms embargo against the country; any item controlled by DDTC is generally prohibited from being exported to China.

Restrictions on the export of dual use items are administered and enforced by the Department of Commerce, through its Bureau of Industry and Security (BIS) under the authority of the Export Administration Regulations (EAR). Like the ITAR and its USML, the EAR contains the Commerce Control List (CCL), which identifies classes of items considered dual use. Each item on the CCL is subject to a certain level of control. A license may be needed from BIS to export a given item depending on the level of control and the destination country. For example, an item subject to missile technology controls would require a license for export to China, but not to Canada.

Compliance with US export controls requires a jurisdiction determination to decide whether an item is a munitions item or a dual use item. It also requires a proper classification of the item on the USML or CCL, called a classification determination. An item controlled by DDTC or identified on the CCL generally requires a license for export and is thus considered export controlled. If an item is neither controlled by DDTC nor subject to a BIS license requirement, it is still technically subject to BIS's control, but generally would not require a license and is not considered export controlled.

EXPORT OF TECHNOLOGY AND THE DEEMED EXPORT RULE

Many companies fail to recognize that export controls also apply to software and technology. The export of software and technology to China constitutes an export of technology, regardless of the nationality of the recipient in China (even if the recipient in China is a US citizen) and regardless of the form of export (whether by fax, e-mail, or manual download). The export controls that apply to the software or technology largely depend on the export controls that apply to the corresponding item. If the export of the item requires a license, then the export of any corresponding software or technology would likely require a license, even if exported independent of the item.

Complicating the matter is the deemed export rule, under which the release of software and technology to a person who is not a US citizen or US permanent resident (i.e., green card holder) is deemed to be an export to that person's country of birth or permanent residency (depending on which regulations apply). The rule applies regardless of where the release takes place and even if it takes place in the United States. "Release" is broadly defined to include visual inspection and oral exchange of information and, by DDTC's standard, may even include merely making information accessible to a non-US citizen. The release of technology to a Chinese national in the United States would therefore constitute an export of that technology to China. Combining the principle of direct technology exports explained above, if software or technology is exported to a Chinese national in Thailand, an export of the technology to both China and Thailand occurs.

COMMON BUSINESS SCENARIOS MAY CARRY EXPORT CONTROL RISKS

Many common business scenarios involving China create risks under US export controls on technology.

Manufacturing in China

Manufacturing in China may require an export license to allow Chinese workers to access US-origin, export-controlled software or technology, even if a US company owns or controls the manufacturing facility or the manufactured product will be exported to the United States exclusively. Examples include specification sheets and technical diagrams required for manufacture. Even the reliance on US-origin, export-controlled software or technology for manufacturing in China may result in the end item also becoming subject to US export control laws. In 2011, US company ArvinMeritor Inc. was fined $100,000 by BIS for, among other things, exporting technical drawings to China without the required license; the drawings related to export-controlled vehicle components and were presumably intended for manufacturing the components.

Conducting R&D in China

Like manufacturing, R&D activities in China may also require an export license if using US-origin, export-controlled software or technology. A common example is the use in China of R&D from the United States. Reliance on such software or technology for R&D may lead the outcome of such R&D, whether an item or further developed technology or software, itself to become subject to US export control laws.

Collaborating with Chinese researchers

If access to US-origin, export-controlled technology by Chinese nationals is not required for manufacturing or R&D, but collaboration involving such technology is nevertheless required, US government authorization may be required to engage in such collaboration. As a general rule, collaboration implies sharing of non-public intellectual property (IP), which serves as a red flag that authorization is required.

Selling to Chinese customers

Potential sales to Chinese customers may require an export license if, during the sales process, the customers are exposed to US-origin, export-controlled technology that goes beyond general system descriptions. Examples include presentations containing proprietary information not readily available to the public.

Supporting Chinese customers

Continued technical support of Chinese customers may require an export license if such support entails access to US-origin, export-controlled software or technology. Examples include a customer-only Intranet consisting of non-public information, such as user or repair manuals, and software updates.

Employment of Chinese nationals, which is becoming more frequent, is the most common risk scenario for companies.

Employing Chinese nationals

Employment of Chinese nationals, which is becoming more frequent, is the most common risk scenario for companies. Companies are responsible for obtaining an export license before releasing certain US-origin, export-controlled technology to any Chinese national employee, regardless of where the release takes place. As an example, BIS just recently imposed a $110,000 fine against a Singapore company, Technetics Group Singapore Pte. Ltd., for transferring export-controlled manufacturing instructions to two of the company's Chinese national employees in Singapore without the required export license.

Licensing software or technology to Chinese partners

Licensing of certain US-origin, export-controlled software or technology to Chinese companies would also require an export license. Red flags that would indicate a license requirement include arrangements in which the software or technology is proprietary or involves access to source code. As an example, DDTC and the Department of Justice (DOJ) recently fined United Technologies Corp. $75 million for its role in helping China develop a military attack helicopter; among other things, the company's Canadian subsidiary supplied the Chinese military with US-origin, export-controlled software that was modified specifically for use in that helicopter.

Engaging in corporate transactions with Chinese investors

A corporate transaction that requires Chinese nationals to conduct any due diligence or pre-acquisition review entailing US-origin, export-controlled information could require an export license. For example, due diligence that would require a review of non-public IP suggests that an export license may be required. The value of the target in a merger and acquisition scenario may be affected by export restrictions applicable to its IP assets. Chinese investors should know that US-origin, export-controlled technology may not be disclosed to Chinese nationals or transferred to China without the required license, even if a Chinese company owns the technology through acquisition of the technology's designer or manufacturer.

Visiting US companies

Visits to US companies by Chinese nationals may also require an export license if the visit would result in the release of US-origin, export-controlled technology. This is particularly true if the visit entails a tour of the assembly line for an export-controlled item, which could be viewed by the agencies as a release of technology. The requirement for a license applies in this scenario even if a Chinese company owns the US company.

SCOPE OF THE EXPORT LICENSE REQUIREMENT

Several factors may relieve companies of an export license obligation. First, generally no export license is required if the software or technology to be released to the Chinese national is not export controlled, i.e., neither controlled by DDTC nor subject to a BIS license requirement. Therefore, correct classification of software and technology is crucial for determining the applicable restrictions. The existence of a minor difference in technical characteristics can dictate whether a particular item is export controlled.

Second, for some export-controlled items, the corresponding software and technology may simply not be export controlled. In those cases, the US government has made the policy decision not to subject the software or technology to the same controls as the item. This determination also requires a careful classification review.

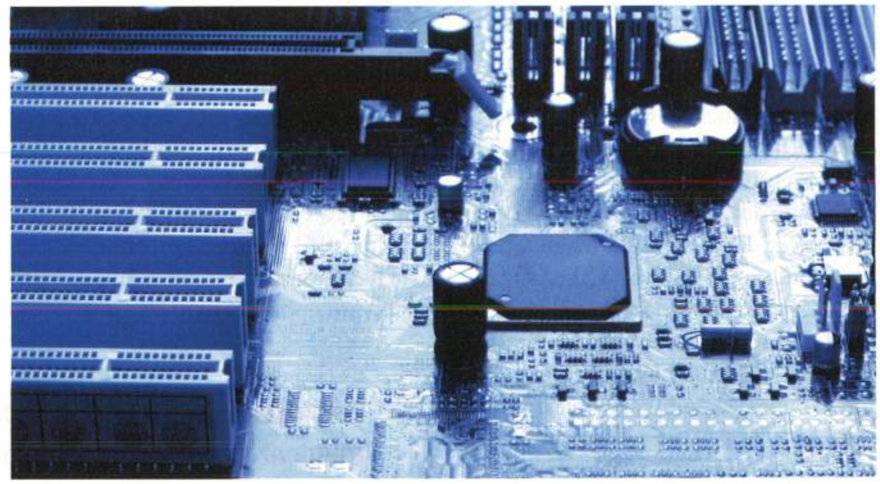
Third, technology is not export controlled if does not rise to the level of "development," "production," or "use" technology. Definitions for those terms are in the EAR and should be reviewed carefully against the technology at issue in determining whether the technology is export controlled.

Fourth, publicly available information is generally not subject to export controls. This exception is subject to many conditions, highly fact-specific, and subject to different interpretations depending on whether the software or technology is controlled by DDTC or BIS. Companies should review the regulations and the software or technology carefully before relying on this exception.

Finally, foreign nationals who have been awarded US permanent residency or refugee or asylum status are treated as US citizens under US export control laws. Thus, such nationals are not subject to the deemed export rule and may access US-origin, export-controlled software and technology without an export license.

RISKS ARE ESPECIALLY ACUTE WITH RESPECT TO CHINA

China is subject to more controls than most other countries under the US export regime. Because China is subject to a US arms embargo, the United States prohibits the export of any DDTC-controlled item, technology, or software to China. For BIS-controlled items, technology, and services, China is subject to many more controls than most countries. In addition, a "military end-use" rule applies to China that prohibits the export of various classes of items, technology, and software to China if the export is for a military end-use. Violation of those controls may lead to enforcement actions for which civil penalties may reach \$500,000 per violation and criminal penalties may reach \$1 million per violation and imprisonment.



A widely quoted 2011 report by the Office of the National Counterintelligence Executive named China as the "most active and persistent perpetrator of economic espionage" and warned that illegal technology transfer to China is a threat to US national "prosperity and security."

Export control enforcement actions have involved China more than most other countries. Based on civil and criminal export enforcement data from BIS, 36 out of 161 actions closed in 2010 and 2011 involved China, second only to Iran at 44. In contrast, only seven cases involved Russia and only three involved South Korea. Similarly, in a DOJ list of major US export enforcement, economic espionage, trade secrets, and embargo-related criminal cases, China was involved in 32 of the 141 "major" cases since 2010, tied with Iran.

The enforcement focus on China, particularly with respect to technology transfers, will likely continue, if not increase. A widely quoted 2011 report by the Office of the National Counterintelligence Executive named China as the "most active and persistent perpetrator of economic espionage" and warned that illegal technology transfer to China is a threat to US national "prosperity and security." That report represents only the latest public concern raised by the US government about Chinese theft of US-origin IP. Recent informal statements by DOJ and BIS officials confirm that the enforcement agencies have begun addressing such concerns by stepping-up prosecution of such theft through US export control laws.

Moreover, enforcement of the deemed export rule is set to intensify. In 2011, the Government Accountability Office (GAO) issued the latest in a string of reports criticizing BIS for not effectively preventing unauthorized technology releases to non-US persons in the United States. The report recommended that BIS assess compliance with the deemed export rule by reviewing a sample of existing H-1B specialty visas to "determine whether employers of the applicants should have applied for deemed export licenses." The GAO also urged BIS to "develop and implement procedures for incorporating Department of Homeland Security immigration data into its enforcement screening activities."

In February 2011, the US government began requiring US employers petitioning to hire foreign workers under H-1B, L-1, or similar visas to certify compliance with the deemed export rule. Specifically, US companies are required to certify that they have assessed the technologies that would be released to the foreign worker and determined whether an export license would be required.

Unfortunately, the US government's current effort to reform the US export control system, even if successful, is not likely to alter the status quo with respect to China. Although one of the many aims of that effort is to relax export controls on certain items, software, and technology, it proposes to do so for only select US allies and retains many of the China-specific policies and restrictions currently in effect. Existing national security concerns with respect to China are all but likely to preclude any attempt to liberalize export controls for that country.

RECOMMENDED ACTIONS

Given the above regulatory environment and the US government's security concerns related to China, companies can expect continued, intensified enforcement against unauthorized release of US technology to China, either through direct or deemed exports. US companies that possess potentially export-controlled technology and employ Chinese nationals or collaborate with Chinese parties now face greater compliance risks than ever before.

The first step in the prudent management of that risk is to assess whether and which of the company's items, technology, and software is export controlled by carefully determining the jurisdiction and classification of each. This can be accomplished by comparing your company's items, technology, and software with the classes of items, technology, and software subject to the ITAR or identified in the CCL. Depending on the company's skills, resources, and experience, help from third-party export control practitioners may be warranted.

A concurrent assessment, with the help of human resources, must identify the foreign nationals employed by the company, the potential access points for export-controlled items, technology and software, and the mechanisms required to cut off those access points absent required licenses.

Finally, where technology or deemed export risks are real, companies need to draft new or update existing export control policies that restrict access to export-controlled technologies and implement a compliance program commensurate with their risk level.

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Navigating China's Government Procurement Market

BY **JOHN LENHART** AND **KYLE SULLIVAN**

Despite progress in regulating government procurement, issues of transparency and enforcement remain problematic.

CONSTRUCTION OF PUBLIC WORKS PROJECTS—like the Bird's Nest stadium built for the Beijing Olympics—are covered under China's Tendering and Bidding Law. Analysts expect China's $180 billion public procurement market to continue to grow.

China's government procurement policies—regulations that govern how and what products can be purchased using public funds—have been a source of controversy in recent years, both for their connection to protectionist policies and their influence over China's accession to the World Trade Organization's Agreement on Government Procurement (GPA). China's public procurement market has grown 10-fold over the last 10 years to $180 billion, and analysts expect that growth to continue. While government statistics put the size of the Chinese market at less than half of the US government procurement market covered under the GPA, these statistics do not take into account the significant purchases by China's giant state-owned enterprises (SOEs).

Market access to China's public procurement market remains a vital issue for international companies that do business in China. In the summer of 2012, the US-China Business Council (USCBC) interviewed more than 20 member companies from a broad range of industries to learn more about the current realities of China's public procurement market. USCBC staff members asked a series of questions concerning the tendering and bidding process, the challenges companies face in navigating the system, and the best practices they use to overcome those challenges to sell into China's public procurement market.

Until the turn of the century, there was no legal framework at the national level to regulate government purchases. Now, a series of Chinese laws and regulations have created the public tendering and bidding process, which in most cases has improved transparency in China's public procurement market.

Despite progress, there are significant problems that continue to plague China's public procurement system, which have a negative impact on competition for international and domestic companies alike. Fractured administrative authority and dispersed markets make China's public procurement market difficult to navigate and compromise the ability of Chinese government agencies to obtain high-quality products. USCBC interviews showed, however, that there are a group of foreign companies that are successfully selling to government agencies and SOEs in China.

Unlike GPA signatory countries, which have a unified framework to govern all public procurement that occurs within their borders, China has two sets of laws that govern public procurement: the Tendering and Bidding Law (TBL), which was issued in 2000, and the Government Procurement Law (GPL), which was issued three years later. Each law is regulated by a different agency and covers different types of industries and end-users (see Figure 1).

CHINA'S DUELING PUBLIC PROCUREMENT LAWS

The TBL can be traced back to a State Council measure in the 1980s to promote competition among SOEs. The measure introduced a tendering and bidding system for construction and public works projects. Several localized systems emerged throughout China in the 1980s and early 1990s. Though these systems were successful in introducing market mechanisms and reducing corruption in government purchases related to construction projects, they also led to a fragmented system. As the deficiencies in the system became apparent, there was a push in the 1990s to create a national law that would have authority over the various local regulations. In 2000, the State Development and Planning Commission (the predecessor to today's National Development and Reform Commission) implemented the TBL. With its historic roots in the State Council's regulation on the tendering and bidding process, the TBL maintained a similar focus on construction and public works tendering, covering all projects whose value exceeds ¥500,000 ($79,400), regardless of whether the end-user was a public agency or private company.

The GPL developed separately as a result of the rampant corruption in government purchases that occurred after China's market reforms in the late 1970's. Fiscal and tax reforms of government agencies were the first steps in implementing stricter regulations on the use of public funds. By 2000, the Ministry of Finance (MOF) had developed a fuller regulatory framework for government procurement of goods and services, and MOF published a series of ministerial orders regulating purchases made by government agencies. In June 2002, the National People's Congress passed a national GPL, which omitted state-run hospitals, public schools, and social and sports organizations.

Goods and services covered under the GPL are listed in China's centralized government procurement catalogue as well as local govern-

QUICK GLANCE

- » China's public procurement market has grown 10-fold over the last 10 years to $180 billion.
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- » Issues with transparency and gaps in regulation are two of the largest issues foreign companies face.

ment procurement catalogues. The catalogues use broad terminology to cover a host of products, making it simple for any company's product to fit into the catalogue system and become eligible for purchase.

THE TENDERING AND BIDDING PROCESS

Chinese regulations clearly lay out the tendering and bidding processes, which vary slightly by end-user, the size of the bid, and the industry involved. Though the tendering and bidding process has improved since the 1990s—when a company's ability to retain a government contract was largely based on relationships—companies have varying opinions on the current state of tendering and bidding in China.

The creation of national laws governing procurement and bidding as well as a more formalized process has been a positive development that has been welcomed by many company representatives. However, many interviewees stressed that continued protectionist tendencies by local governments and a lack of rule of law undermine any progress that has been made. Unwritten quotas on the purchase of domestic products and the lack of a meaningful system to challenge unfair selection decisions make well-crafted legislation meaningless in practice, and hurt the ability of foreign companies to compete on a level playing field.

CHALLENGES

Many of the challenges in navigating China's tendering and bidding process are inter-related. General issues of government transparency contribute to other major concerns, such as price pressures and internal compliance.

Transparency

Company representatives noted improvements in transparency in China's public procurement system. Many pointed out that large SOEs and central government agencies have strong incentives to comply with regulations to maintain a good image with suppliers, international and domestic regulators, and the public at large. But transparency is still a primary issue of concern for most companies at the local and provincial level.

Transparency issues can take many forms. Multiple firms stated that under-the-table deals occur between certain end-users and suppliers that come from both China and other countries with more relaxed anti-corruption laws than the United States. Others complained of a term coined as "local branding," an off-shoot of China's indigenous innovation policies, a set of industrial policies focused on aiding Chinese companies to become internationally competitive by creating and holding their own intellectual property rights. Local branding in practice means unwritten quotas are passed down to local government agencies, requiring agencies to purchase brands that are wholly Chinese owned. The tendering and bidding system also lacks a functioning appeals system. Nearly all foreign companies said that challenging a review panel that makes the decision on who wins the bid was not practical because winning such cases are rare, and even a win might come at the cost of upsetting a future customer. Without the ability to appeal decisions, review panels and end-users have little incentive to keep detailed records of how they make a decision.

Price pressure

Chinese review panels evaluate products by price, quality, and life-cycle costs to pick the most valuable product for purchase, but company representatives say government agencies usually end up choosing products at the lowest price to meet budget targets. Multinational companies have no ability to compete in such an environment, and say they would benefit from clearer standards for calculating review criteria.

Domestic content

The lack of clearly defined domestic content regulations also continues to be a challenge for multinational compa-

fig. 1 **CHINA'S TWO GOVERNMENT PROCUREMENT LAWS**

LAW	TENDERING AND BIDDING LAW	GOVERNMENT PROCUREMENT LAW
Year released	2000	2003
Administering agency	National Development and Reform Commission	Ministry of Finance
Coverage by product	Construction of public works projects (i.e. Olympic stadium, Three Gorges Dam)	Goods and services not related to construction projects or public works (i.e. computers, cars, office materials, consulting)
Coverage by end-user	All public and private transactions that require tendering and bidding, including private business purchases, publically funded works projects, and purchases made by state-owned enterprises	All purchases of goods and services made by a direct government agency

nies. Domestic content regulations should establish a clear definition of what is considered a "Chinese product." Many foreign firms manufacture products in China, hire Chinese employees, and source many materials locally. The PRC government has yet to release domestic content regulations, however, leading some government agencies to mistakenly interpret a domestic product by the company's country of origin. MOF has stated that it will release final domestic content standards by the end of 2012, but the regulations still had not been released before this article was published.

BEST PRACTICES

Despite these problems, there are a series of best practices that companies can follow to mitigate challenges and sell successfully into the public procurement market in China.

Stakeholder outreach

Developing relationships is vital to any business endeavor, both in maintaining long-standing customers and educating potential customers about the benefits of the company's product. Practices for stakeholder relations varied among companies, but most companies adhered to several general principles:

» Engage stakeholders early and regularly

All companies noted it is critical to actively seek out and engage stakeholders to educate them on product specifications and to gain leads on possible upcoming bids (see Figure 2). For most companies, sales teams take the lead in engaging stakeholders. Suppliers either provide technical training courses to sales staff or pair them with product engineers to ensure they can speak in detail on product specifications.

» Combine research with outreach

Similar to traditional business development models, many companies pair

fig. 2 **STAKEHOLDER BREAKDOWN**

STAKEHOLDER	DESCRIPTION	IMPORTANCE TO SUPPLIER
End-user	Purchasing company or government agency	Holds ultimate decision-making power on product choice
Procurement agency	Manages the process of tendering and bidding. May be private, government affiliated, or branch of state-owned enterprise	Sets product specifications, implements bidding process, and forms review panel
Review panel	Group of technical experts from both industry and academia hired by the end-user or procurement agency to review a tender	Makes recommendations on a preferred product to the end-user; may veto decisions made by government agencies
Government procurement office	Government office affiliated with Ministry of Finance that exists at central and provincial levels	Companies must file with government procurement offices to become eligible to apply for tenders, and they must work with the office to sign contracts being awarded a bid
Design institute	Commissioned by the end-user to design large projects	Advises end-user on the project scope, types of materials, technologies, products, components, and suppliers necessary to complete the project
Key opinion leaders	Technical experts with trusted reputation in given industry	Influential in given industries and possible candidates for review panels

their sales and marketing teams to create an open channel to exchange market intelligence that sales personnel can act upon. Several companies said they have their marketing teams scouring the Internet for media articles about end-users' future investment plans or researching government policies and plans, such as China's various five-year or regional development plans. Companies combine that macro-knowledge with sales personnel's local intelligence to identify potential end-users and projects.

» Focus on key industry stakeholders

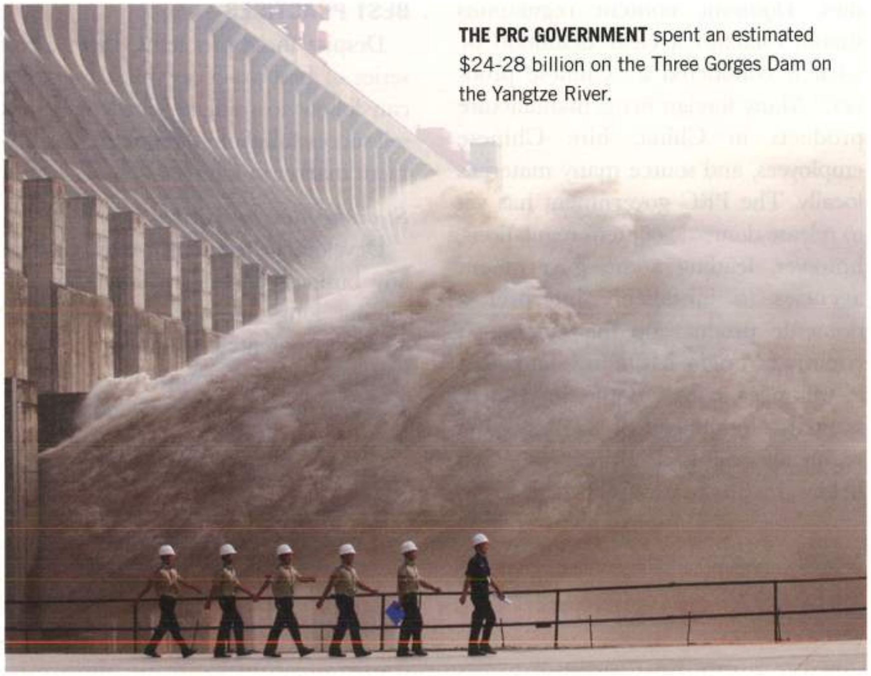
While some stakeholders are more important than others depending on a company's product or industry, some companies only target large SOEs or central government agencies, which are more likely to buy their higher-quality products. Many companies that sell products for large public works projects focus resources on outreach to design institutes, which advise the end-user on project scope, specifications, and product selection, and can influence the review panel.

» Maintain strong internal communications

Internal communications can be key to maintaining business relationships and discovering new clients in China. Internal communication can be complicated by the diverse number of offices that need to inform the sales team about potential clients, product specifications, regional markets, and internal compliance standards. As such, companies have varying methods of ensuring that sales, marketing, business development, technical, and legal teams maintain good communication, including weekly meetings, ad-hoc phone calls, and locating department heads in adjoining offices.

» Strategic partnerships with local businesses

Given the size of the Chinese government procurement market, many companies find it beneficial to engage with local companies to improve their performance in a wide array of markets. Strategic partnerships include moving products through third-party distributors, contractual partnerships with local vendors, or joint ventures with local companies. Foreign companies that work with local companies can increase local knowledge and company resources, including funding for new investments. Companies say working with distributors is particularly useful in selling to certain government agencies that exclusively buy through distributors.



THE PRC GOVERNMENT spent an estimated $24-28 billion on the Three Gorges Dam on the Yangtze River.

IMAGINE CHINA

Patient and consistent outreach to key stakeholders combined with strong internal communication and a focus on key markets can help more companies as they attempt to navigate China's public procurement market.

China has made progress over the last 20 years in creating a more structured public procurement system, but issues with transparency and gaps in regulation cannot be overlooked. Discrimination against foreign products that are locally sourced and produced continues to be an issue, both through discriminatory standards written before the tendering process begins, or through de facto quotas that force local governments to buy local products even when they would prefer to invest in a higher-quality item produced by a foreign company.

Some companies, however, continue to profit from selling into China's public procurement market. The strategies they employ will likely be even more useful as China moves to improve transparency and decrease discrimination in preparation for a legitimate accession offer to the GPA. Patient and consistent outreach to key stakeholders combined with strong internal communication and a focus on key markets can help more companies as they attempt to navigate China's public procurement market.

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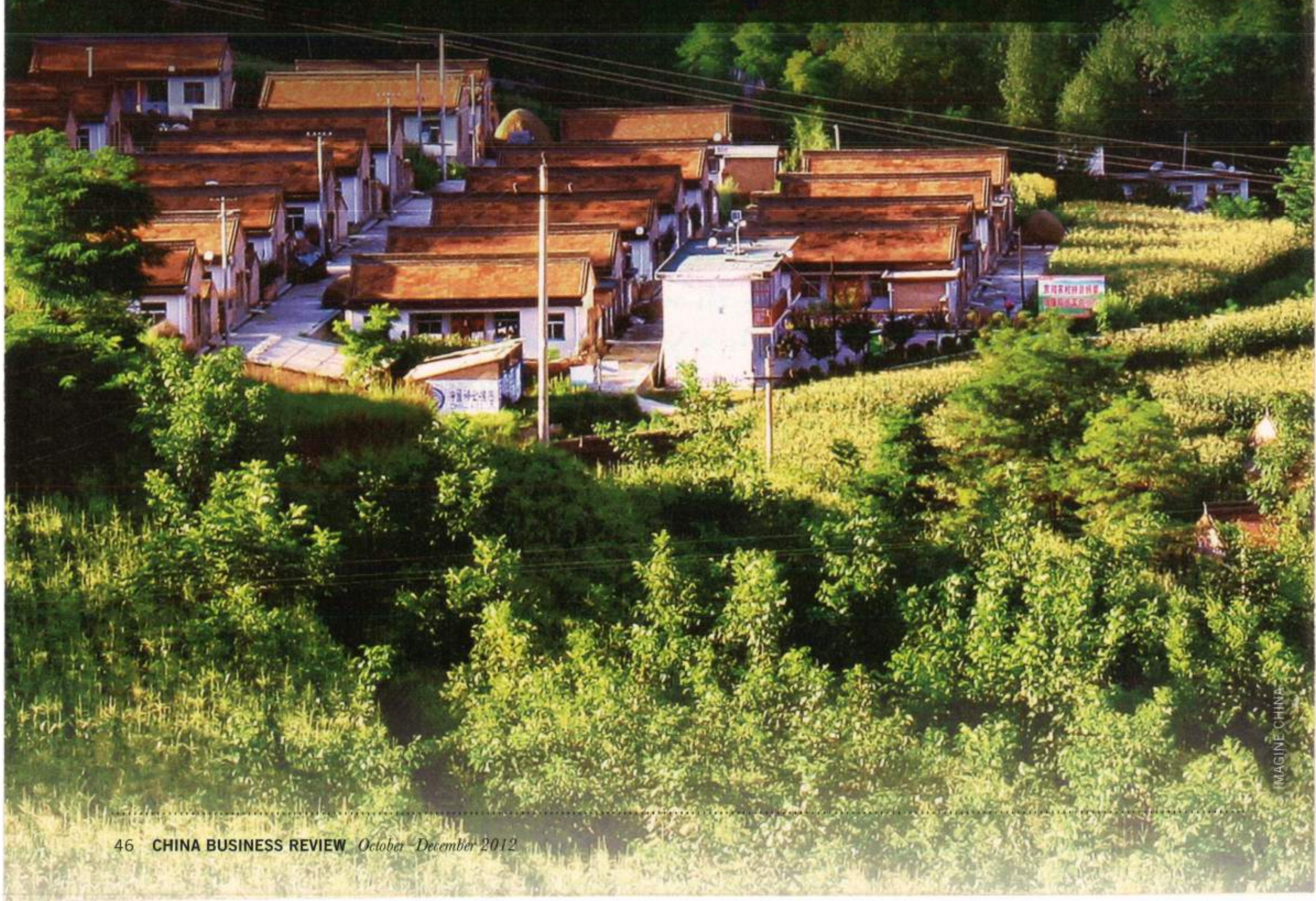
Land Reform Efforts in China

BY **ZHU KELIANG** AND **ROY PROSTERMAN**

Despite reform efforts in recent years, land seizures in China have become a growing source of social unrest.

Grievances arising from compulsory land expropriations conducted by government authorities, also known as eminent domain in the United States, are the main cause of mass protests and violent conflicts in China today, according to researchers from the China Academy of Social Sciences. While the pace of industrialization and urbanization accelerates in China, Chinese officials estimate that approximately 2 million rural residents lose their land each year. On paper, government authorities in China may expropriate land and other properties without the consent of property holders for the purpose of "public interest." Though the expropriated parties are entitled to compensation, they often do not receive market rates.



IMAGINE CHINA

A highly-publicized mass protest against local authorities' land expropriations in Wukan, Guangdong in late 2011 helped highlight this phenomenon. But the Wukan experience is not an isolated incident. The *Wall Street Journal* reported that in 2010, there were 187,000 cases of "mass incidents" involving group protest and violent confrontation with government authorities. Approximately two-thirds of these incidents were related to land grievances, mostly in rural areas.

There are strong incentives for local government authorities to continue their current practice of land expropriations. Local governments sell expropriated land to property developers, and the resulting profits and real estate development are a major source of local government revenue and GDP growth. In recent years, revenue from selling expropriated land has constituted 27 percent of the total local government budget each year. In many big cities, the proportion has reached 40-50 percent. According to the Chinese media, the total government revenue from the reported sales of expropriated land in the 120 largest cities in China reached roughly $300 billion in 2010. In addition, *Caixin* magazine reported that in 2010 local governments used land sales revenue to repay up to 40 percent of local government debt.

Because land is often expropriated cheaply from farmers, local government authorities frequently offer "free" or low-cost land as an incentive to attract investment projects. In 2009, a major automobile manufacturer, BYD Co. Ltd., agreed to invest ¥5 billion ($733 million) to build a factory with an annual production capacity of 400,000 new cars in Xi'an, Shaanxi, largely because the local government promised the company 750 acres of land. According to media reports, the local government did not follow proper regulations in the expropriation process, which triggered a series of protests by land-losing farmers. The PRC Ministry of Land and Resources later stepped in and ordered the suspension of the project. Despite this incident, such incentives are considered by government and businesses as a common and legitimate practice across China to attract big investment projects. This not only serves as additional grounds for local governments to expropriate farmers' land but also creates unfair competitive advantages among firms that have close relationships with local governments.

The following article explains how the law and practice work in China concerning compulsory land expropriations. Unless otherwise specified, all the data cited below comes from a nationwide survey conducted by Landesa, China Renmin University, and Michigan State University in the summer of 2011. The survey consisted of independent interviews of approximately 1,800 farmers in 17 agricultural provinces.

THE POLICY DILEMMA

Chinese policymakers are facing a dilemma. The central government agrees that strong and secure land property rights for farmers are key to achieving social stability and sustainable growth in the agricultural sector, but local authorities are attracted to the easy revenue generated by land sales and real estate development. The government realizes that this practice is resulting in a looming property bubble, jeopardizing the Chinese economy, and leading to social unrest.

The PRC government has recently taken actions to address the problem, such as tightening the real estate market to curb local authorities' desire and ability to expropriate farmers' land. In 2011, Chinese news sources showed that the revenue from land sales dropped by 13 percent due to the central government's tightening of the real estate market.

The central government is also in the process of amending its land expropriation law to improve both the legal regime and the government practice. Outside of Beijing, a few local authorities in Hainan and Guangdong are experimenting with new ways of carrying out land expropriation schemes so that the process can become more fair and equitable for the farmers. For example, in one pilot county in Hainan, affected farmers are allowed to organize themselves as a company to negotiate and distribute cash compensation. The company also receives a share of the developed land that can be permanently used for commercial or other for-profit purposes, which allows affected farmers to receive ongoing dividends to ensure their long-term livelihood.

However, there is great uncertainty as to how far the reforms can go. The recent economic slowdown in China has already opened up the discussion about whether the real estate market tightening measures should be loosened. Local authorities' strong

QUICK GLANCE

- » Chinese officials estimate that roughly 2 million rural residents lose their land to government land expropriations each year.
- » A 2011 survey found that the revenue generated by expropriated land is often more than 10 times the amount rural residents were compensated.
- » Despite legal reforms, China's laws on land seizures still lack compensation standards and do not clearly define "public interest."

desire to promote GDP growth, improve infrastructure, and maintain social services does not necessarily coincide with the central leadership's efforts to avoid economic missteps and assert effective political control over local jurisdictions. Consequently, news sources have reported significant hurdles and opposition to the revision of the land expropriation law, dampening the high hopes for some fundamental improvement to the law.

WHOSE LAND IS IT ANYWAY?

In China, the law provides that all farmland is owned by collectives (village communities), and collective land ownership is defined as jointly owned by all members (farmers) of a village collective. However, there is no effective system in place for farmers to exercise their ownership rights or to determine market prices of land. Instead, a few village officials, who are politically accountable to their superiors at higher levels of government, usually exercise the ownership rights on behalf of the village collective. In essence, the local officials treat the concept of collective ownership of farmland as state or national ownership, which leaves farmers with little say in situations such as land expropriations.

Instead of real ownership rights, Chinese farmers possess "use rights." China's modern land reform began with the dissolution of Soviet-style collective farms and the physical allocation of farmland to individual households for individual farming. Under the law, each farm household enjoys use rights to the allocated land, including the right to possess and farm the land freely, and to lease or assign the land on the market. The use rights last for a term of 30 years, many of which started in the late 1990s. About 77 percent of China's 200 million farm households currently have received some form of written documentation confirming their 30-year use rights.

However, their 30-year rights are not guaranteed in practice. Such rights are susceptible to many threats from local authorities and officials, restraining farmers' ability to make investments in land to increase production and income. The greatest threat to the security of farmers' land rights is compulsory land expropriations, which have caused widespread grievances and public outcry.

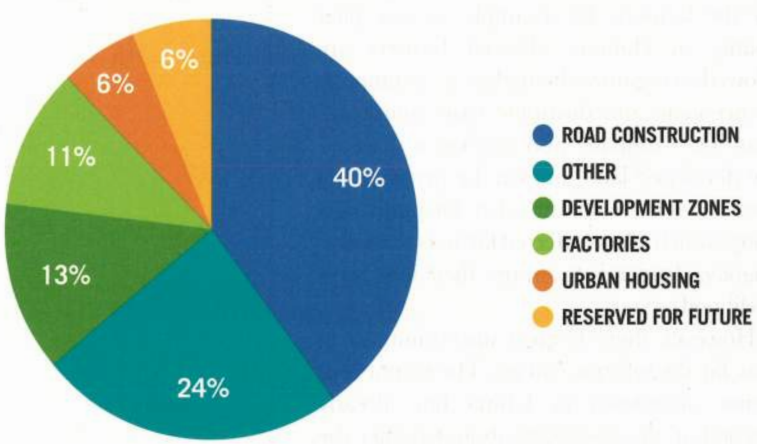
THREE CHALLENGES

Like many other countries, China's constitution and other laws allow government to expropriate land for "public interest," but in practice many land expropriations in China are for private or other for-profit interests. The definition of "public interest" in China is still unclear. The 2011 Landesa survey shows that the most common reasons for land takings include road construction, development zones, factories, urban housing, or future urban or commercial development (see Figure 1). Other than road construction, almost all remaining land projects serve private commercial interests in China. The "others" category includes some schools or irrigation projects, but also represents cases where the public is not fully informed about how the land will be used (and it is often used for commercial purposes). Based on reports of land sales in the media, it is reasonable to assume that a majority of the land expropriations generate hundreds of billions of dollars every year for local authorities.

Many land-losing farmers say compensation is grossly inadequate, according to Landesa's surveys. The law calls for "reasonable compensation" that should ensure the long-term livelihood of affected people. In reality, this objective has been seldom achieved. Although there are reports of farmers living on the fringes of Beijing or Shanghai who became overnight millionaires due to the compensation paid in land expropriations, such stories are a rarity.

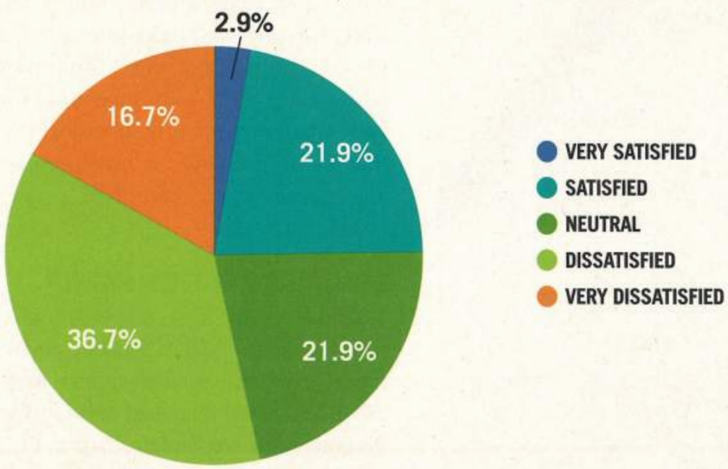
The 2011 Landesa survey shows that the average amount of compensation paid to land-losing farmers is \$17,800 per acre. For projects serving for-profit purposes, this is hardly the "fair market value," which is typically defined as what a knowledgeable, willing, and unpressured buyer would pay to a knowledgeable, willing, and unpressured seller in the market. In addition, there is still no final authority in China that determines land valuation for farmers, even though entities such as the Asian Development Bank have tried to calculate compensation and valuation for expropriated land. For a small number of cases where affected farmers knew the actual pric-

fig. 1 **REASONS FOR LAND EXPROPRIATIONS**



Source: 2011 Landesa Survey

fig. 2 SATISFACTION WITH COMPENSATION FOR EXPROPRIATED LAND



Source: 2011 Landesa Survey

Note: Figure does not add up to 100 percent because of rounding.

es at which local governments sold the land, the survey shows that local authorities sold the land for a mean price of $740,000 per acre, more than 40 times higher than the average compensation paid to farmers. Taking the median price local authorities are reported to have received, which reduces the influence of high outlying prices, the price is $190,000 per acre, still more than 10 times what the land-losing farmers received. The government authorities retain the difference as their revenue.

Compensation is the biggest complaint among affected farmers. When asked about their satisfaction with compensation for expropriated land, more than 50 percent of respondents said they were very dissatisfied or dissatisfied (see Figure 2). Compared to past surveys, respondents hold about the same level of dissatisfaction with compensation.

Overall, the total number of dissatisfied farmers is more than twice the number of those who were satisfied with their compensation. Notably, 17 percent reported that they were "very dissatisfied," nearly six times greater than the proportion of "very satisfied." This translates to roughly 670,000 people who are "very dissatisfied" every year due to land expropriations.

A third source of dissatisfaction concerns the lack of procedural fairness and transparency. Nearly half of those who were dissatisfied cited a due process issue alongside their economic loss, saying compensation was decided without any input from the farmers. Government authorities commonly make unilateral decisions on the issue of compensation and resettlement, and the Chinese court system often declines cases filed by land-losing farmers who wish to challenge the government's decisions.

IMPLICATIONS OF ONGOING REFORMS

Some regulatory reforms show promising improvements in laws on compulsory land seizures. A State Council regulation in January 2011 concerning the compulsory expropriation of urban properties allows government seizures of urban land rights and real estate only for truly "public interest projects," essentially eliminating the possibility of exercising public power to serve private, for-profit projects. This regulation also requires a court order before evictions can occur, a significant improvement to prevent procedural abuses by local governments. According to Premier Wen Jiabao's public announcement in early 2012, the amendment of the land expropriation law will be completed before the central leadership transition takes place in March 2013.

But China's land expropriation law still does not clearly and narrowly define "public interest," which would stop the government from taking household-held land use rights for commercial purposes. The current law also does not set compensation standards to allow farmers to capture more of the value generated from changing the land to non-agricultural use. The current process also lacks transparency and public participation, which prevents farmers from having a meaningful say in the process.

Granting reliable, continuing rights on the same parcels of land to farmers could help increase domestic consumption in China, one of the government's major policy goals. It could also help narrow the large urban-rural gap in per capita income, which is now roughly 3 to 1 in favor of city dwellers. If the rural population is granted land rights, they will be able to invest in the land that is their main asset, grow their wealth, and join their urban cousins as consumers of a wide range of goods and services.

Securing and protecting land property rights has significant implications for the business sector. Local governments in China often lure investors with free or cheap land; but in reality, there is no such thing as "free land." Corporate social responsibility calls for prudent considerations to ensure the affected people are treated fairly. It is also in the best interest of investors and businesses to carry out due diligence assessments as to whether the land is obtained legally and properly. Otherwise they risk having large numbers of angry farmers protesting in front of their new factories or office buildings. The reputational risk for business firms is substantial, and it must be treated with care and caution.

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Managing the Ambitions of Chinese Professionals

BY **CHRISTINE RAYNAUD**

Though compensation is important, career progression, better benefits, and a company's strategic vision are all critical factors in whether an employee takes a new job.

During the last decade, the Chinese economy grew at a spectacular rate, continuously lifting the ambitions and expectations of the Chinese workforce and creating unprecedented challenges in the areas of talent recruitment and retention. Despite slower economic growth, business and human resources professionals may face an even greater challenge in recruiting and retaining talent in 2013 and beyond than in past years.

In recent months, deteriorating global economic conditions and the challenge of moderating and redirecting China's growth path, which was driven by excessive asset investment and export activities, has affected China's economy. New government policies attempt to contain inflation and rebalance the economy towards a more sustainable path and pace in which domestic consumption is expected to play a larger role. Not all sectors have been affected in the same way. Investment, financial services, and most industrial activities have felt the pressure more than domestic-driven consumer or life sciences sectors. After a buoyant 2011, MRI China Group (MRIC) has noted some easing in the job market in 2012, with fewer opportunities, longer decision processes, and more selective, budget-conscious employers. Employees, who started 2012 with huge ambitions, have mildly adjusted their expectations but continue to ride a much stronger job market wave than their peers in North America.

STILL AN EMPLOYEE'S MARKET

At the end of 2011, 33 percent of the respondents to MRIC's talent environment survey intended to change jobs in 2012, and many managed to do so. Only 23 percent of respondents had not been approached with a job offer in the previous year. The high-compensation levels job changers received in 2011, as well as other trends specific to the China talent market, explain these trends.

- **During the 2008-09 global economic crisis, employees stayed put. Having been in the roles that they landed before or during the economic slowdown for at least three years, employees see 2012, the year of the Dragon, as a good time to consider a career move.**
- **China's rise to become the world's second largest economy has bolstered the confidence of employees at management and professional levels that China—and the Asian countries that are major business partners—is coming of age, while North America and Europe flounder.**
- **China's one-child policy, introduced in 1979, is now starting to produce profound demographic changes in China's labor market. The number of new workers in the labor force reached a tipping point in 2005, and is now steadily decreasing.**

Even though China's GDP growth has slowed from a peak of almost 15 percent, the number of job vacancies in China continues to grow. This year, wages are still expected to rise an average of 8 percent compared with 10 percent in 2011, but this average number hides circumstances where management and professional talent were demanding and obtaining raises of more than 20 percent in 2011. More than 63 percent of MRIC survey respondents received wage increases of at least 20 percent when changing jobs, and 30 percent of respondents received a raise of 40 percent or more. In today's economy, these employees still demand 10 to 20 percent salary increases, or even more for in-demand talent.

In this context, employers in China still struggle to retain good talent. Tempered economic growth and a more competitive economic environment have also forced companies to sharpen the quality of their products and services as well as improve operating efficiency. These structural changes create new talent management challenges and opportunities. The MRIC Talent Environment Report surveyed 4,962 mid- to senior-level managers across a wide range of businesses, industries, and locations. The report surveyed 3,811 individuals in mainland China, 532 in Hong Kong, 325 in Singapore, and 294 in Taiwan. Common patterns emerged from our survey albeit with some variation across sectors and seniority level.

- **Compensation remains a key retention factor, but respondents said they stay at their company because of career development opportunities, a company culture they appreciate, and a good work-life balance. Chinese professionals, including young professionals, describe a good working environment as a business with a clear vision that supports meritocracy.**
- **When changing jobs, work-life balance becomes less important than the candidate's confidence in the leadership and the strategic direction of a prospective employer.**
- **In mainland China, benefits are as critical as compensation. Salaries have increased a lot in China so employees are keen on finding tax efficient compensation packages where allowable or practiced. With good compensation in hand, good candidates now also shop for better benefits, such as leave time, a car, or medical insurance.**
- **Health care is a concern for all levels of professionals in mainland China, and senior managers in particular place great importance on such health benefits.**

LOCAL VERSUS FOREIGN EMPLOYERS

Thirty-six percent of respondents from both local and foreign companies rate career promotion opportunity as the main motivator for staying in a job. However, while 20 percent of respondents working for local companies in mainland China highlighted benefits as a key retention incentive, only 12 percent of Chinese employees at foreign companies said the same. Respondents from local companies also put stronger emphasis on leadership and strategic direction at their company than employees of foreign companies, where work-life balance and the company culture seem more important to talent retention.

Local employers have become more attractive in mainland China. Many local employers tend to be more flexible than foreign companies in the way they structure total compensation with allowances in lieu of compensation. State-owned organizations often offer subsidized housing and private employers offer stock options to their senior management. Senior managers are also attracted to local employers because strategic decisions are made here—since it's the company's headquarters and not the Asia or China office of an international company—and they have the possibility to rise to the top.

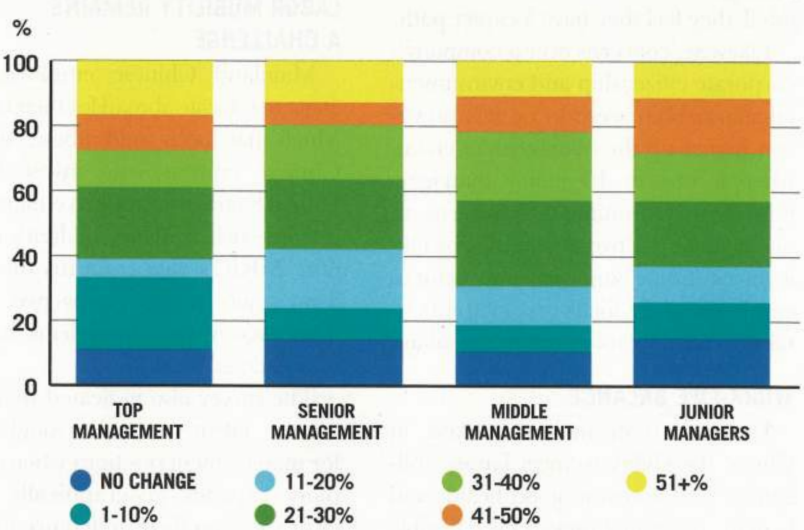
THE GENERATION GAP

There is a marked progressive difference in the importance employees in different age groups place on meritocracy, transparency, and governance. The more senior the manager, the less it is an issue. However, top executives must recognize the importance placed on such issues by their management workforce. For international employers, this means demonstrating that it is possible for a Chinese

QUICK GLANCE

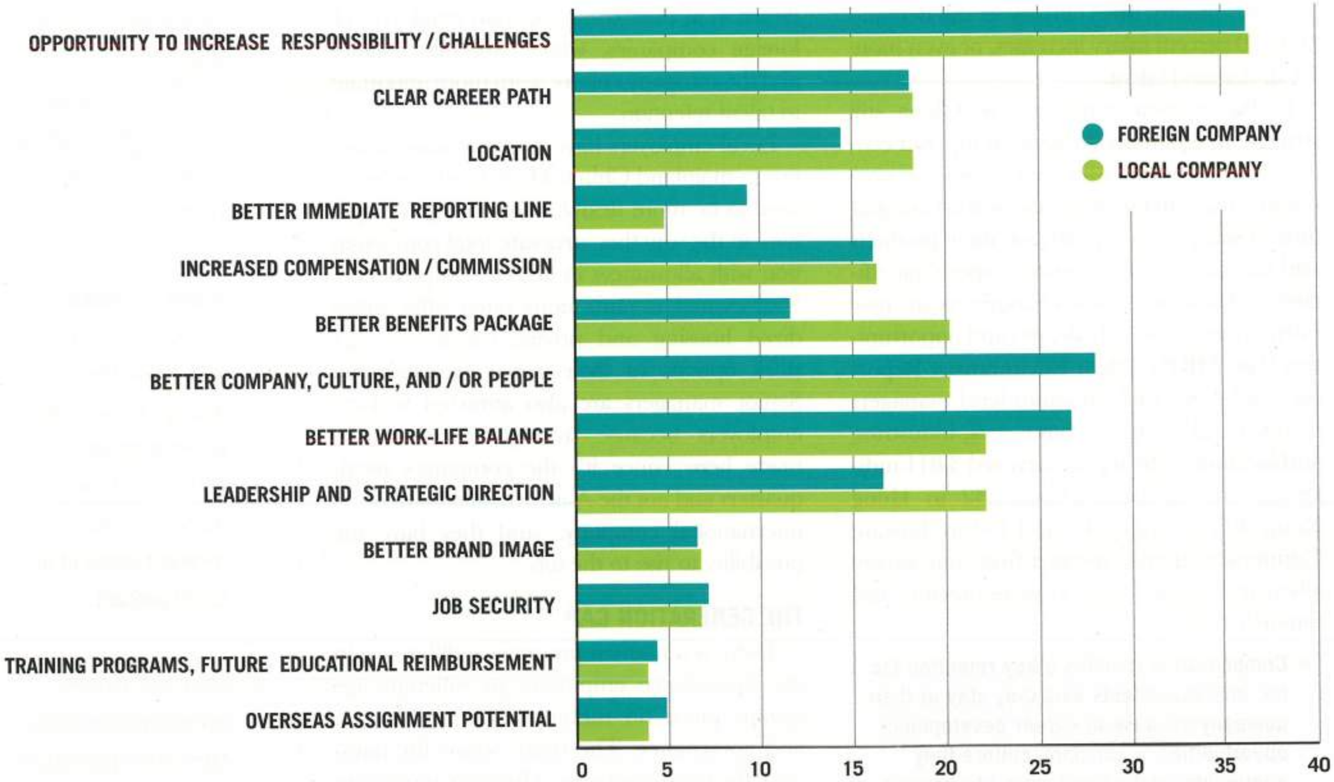
- Employees in China that stayed in their jobs during the 2008–09 economic crisis are now looking to move into new positions.
- Wages increased by 10 percent in 2011, but this average masks cases where professional employees have demanded and received raises of up to 20 percent.
- Local and foreign company employees rate career promotion opportunities as the top motivator for staying in a job.

fig. 1 **MAINLAND CHINA COMPENSATION PACKAGE INCREASE FOR JOB OFFERS ACCEPTED**



Source: MRIC

fig. 2 **MOTIVATORS TO STAY IN CURRENT JOB: MAINLAND CHINA BY COMPANY TYPE (%)**



Source: MRIC

employee to rise to the top job. For local firms, which tend to operate in a more autocratic and relationship-driven manner, it means more openness through the implementation of best practices in talent management. Young and middle managers are more likely to stay in a job if they feel they have a career path.

Likewise, concerns over a company's corporate citizenship and environmental stewardship seem to be less prevalent higher up the management chain, whereas one in 10 junior managers now rate environmental concerns as one of their top two motivators for taking a job. Some employers may want to emphasize their focus on environmental sustainability to attract young talent.

WORK-LIFE BALANCE

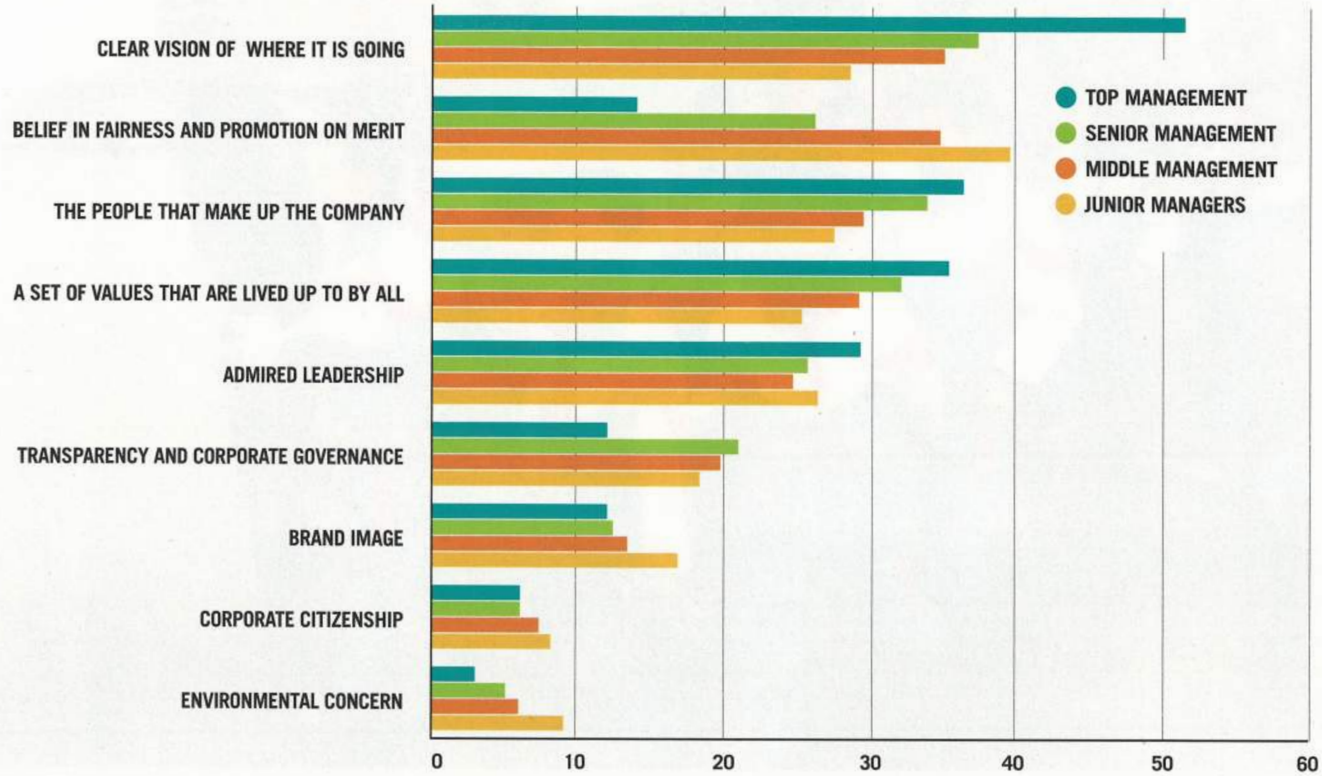
Unlike in more mature markets, in China, the ability to meet family obligations and access to good health and benefits programs prevail over flexible work schedules. While MRIC did not investigate this matter in greater detail, MRIC believes that meeting family obligations in China has to do with money—i.e. buying a house, car, or providing a good education—to support the family.

LABOR MOBILITY REMAINS A CHALLENGE

Mainland Chinese employees are eager to relocate abroad for their careers. Much has been said about wealthy Chinese citizens who invest in the United States or Europe to emigrate for reasons such as their children's education. MRIC's data confirms this trend from a job market perspective. (Note: The majority of respondents work in international firms.)

The survey also indicated that more mature talent—typically sought after for management positions when a company expands geographically—have clear views on their preference for relocation. These views typically involve an "upgrade" to a city that is perceived as offering career advancement and is more attractive as a family destination. For example, employees are willing to relocate to a city with a better quality of life and better education options for their children.

Employees in Guangzhou had the highest appetite for relocation (59 percent). However, Guangzhou respondents, many of whom are already immigrants to the city from surrounding regions, are less "internationally-minded," according to survey results, and would rather relocate to other cities in China or neighboring markets. North America and Europe are not among the top relocations for respondents from Beijing or Shanghai. Within China, respondents from Beijing were very likely to say they would relocate to Shanghai (53.2 percent) well ahead of Tianjin (17.7 percent), Qingdao (14.1 percent), and other Chinese cities, but Shanghai employees are not as likely to *fig. 3* **MOST IMPORTANT ASPECTS OF COMPANY CULTURE: MAINLAND CHINA BY MANAGEMENT LEVEL (%)**



Source: MRIC

want to move to Beijing (30 percent). Beijing's attractiveness is impacted by pollution levels, and Shanghai respondents said they felt it wasn't as easy to "blend in" in North China than in cosmopolitan Shanghai.

Overall, employees' appetite for relocation to a few mainland inland destinations seems to be increasing, compared with last year's findings. This year Suzhou, Hangzhou, Qingdao, Shenzhen, Guangzhou, Chengdu, Wuxi, Nanjing, and Tianjin were cited by more than 10 percent of mainland-born respondents. Solutions to fill talent shortages in new development areas include investing in training by municipalities and employers to groom local talent while providing incentives through talent sourcing programs for experts based in foreign and coastal cities.

RECOMMENDATIONS

Unlike in 2011 when companies' top challenge was to recruit at high speed with ultra-competitive salaries, this year's market conditions offer employers more opportunities and time to invest in talent management as their short-term needs can be balanced with longer-term thinking. Employers should:

- **Re-evaluate talent for current and future requirements**
- **Hire top talent now while there is more talent available**
- **Balance the short-term actions of performance management with long term strategies of staff engagement and career development**

Build company culture

If organizations invest in engaging their talent, performance will increase and retention will be a natural consequence. Engagement should always be a top priority. Engagement is linked to employee buy-in of the leadership, vision, and values of the company. Employees who do not engage or fit in with the company culture can be replaced. To achieve engagement and retention, career paths and perspectives must be clear inside the organization, and each employee's short- and long-term objectives and their place in the organization should also be clear.

Upgrade and develop

Identify good performers and high-potential employees inside your company as well as in the market. Benchmark your talent and develop those employees with the potential to grow into a leadership or senior expert role to meet your organization's needs in the future. Handling resource and performance management internally and recruiting externally can be an opportunity to assess and revamp people and roles to provide a new competitive advantage for the organization.

CHRISTINE RAYNAUD is the CEO of MRIC, the MRI China Group, which provides executive recruitment services across China, Hong Kong, Taiwan, and Singapore. She is based in Hong Kong.

How Safe Is China?

BY **INGRID LOMBARDO**

Visitors and foreign residents can take steps to increase safety during their stay in China.

On July 22, it rained in Beijing for 16 hours. Inadequate drainage caused flooding, which caused 57,000 people to evacuate their homes. Thirty-seven to 300 people, depending on the report, died due to drowning or building collapse. Commentators blamed China's infrastructure, saying it was either antiquated or built in a hurry in the race to modernization, for the damage and deaths. Suddenly, safety was on everybody's minds.

CET Academic Programs—a company that sends roughly 650 study abroad students to China every year—thinks a lot about safety in China. Many of the threats to American students in China are the same threats foreign residents and visitors face. In an effort to provide safety tips for tourists and business people in China, CET surveyed staff members who have lived in China for two or more years, some since the 1980s.

Everyone agreed that living in China felt relatively safe. Most interviewees felt that China was safer than the United States in terms of violent crime, but that living in China posed other risks, particularly in terms of food safety, traffic safety, and petty theft. While most colleagues reported feeling some threats—mostly minor—to health and well-being, one respondent indicated she had never had a safety issue in one and a half years living in Beijing.

FOOD SAFETY

Foreign visitors are likely to be confronted with food safety issues while in China. In a survey conducted this year, more than 80 percent of respondents in 16 major Chinese cities said food safety was one of the "most worrisome safety concerns" in China. Nine out of 11 CET staff members have reported being affected by food safety issues while living and working in China, including food poisoning from Chinese and Western restaurants. Fears about tainted cooking oil have led one staff member to cook at home frequently.

To reduce the risk from unsafe food, CET staff recommends avoiding the cheapest restaurants, such as food stands, and bars with suspicious drink specials, such as "foreigners drink free,"

IMAGINE CHINA

which is a red flag for counterfeit alcohol. Hotel buffets, where food sits out for a long time, should also be avoided. Seafood can be risky, according to one staff member who ended up with food poisoning four or five times over 10 years. Cooking at home can eliminate the risk of ingesting fake or toxic foods. Always wash fruits and vegetables before peeling, cutting, or eating.

ROAD AND TRAFFIC SAFETY

Traffic safety can be a major concern for foreigners living in China. According to a 2011 *New York Times* article, China has nearly double the number of traffic-related deaths per year compared to the United States—despite having about one-third the number of vehicles on the road. About half of CET staff members have reported issues with road or traffic safety while living and working in China. One staff member was involved in a major accident while riding his motor scooter; he and his two children were hit head-on by a bus with faulty breaks. All three suffered skull fractures. Luckily, they recovered due to the excellent medical care they received in China and the United States.

To reduce the risk of traffic accidents in China, always wear seatbelts in cars that have them and helmets on bikes or scooters. Stay alert at all times on the roads, whether driving or on foot. Visitors and expats in China may want to avoid motor scooters or overnight buses to reduce the risk of being involved in a traffic accident.

THEFT

Petty theft of items such as bicycles and wallets is one of the most common crimes in China, but visitors and business people can take steps to reduce risk of theft. Six out of 11 CET staff members reported having personal items stolen while living and working in China, including two wallets, one scooter, one bicycle, and one iPhone. Both scooter and bike were taken despite being locked. Petty theft can be prevented by keeping personal affects in front pockets instead of back pockets and never slinging bags over backs of chairs or out of sight. The taxi meter scam—when a taxi driver "forgets" to turn on a meter—can be avoided by always taking official taxis and making sure the meter is running. Bike thefts can be difficult to avoid, but residents can reduce thefts by using multiple locks or keeping their bicycles parked in sight when possible.

HEALTHCARE

Nowadays, major cities in China have expatriate hospitals with international standards; those uneasy about local medical facilities can access an international hospital in most cases. CET staff members have had diverse experiences with healthcare in China—especially when traveling outside major cities—but none reported major safety concerns with the healthcare system. CET issues each of its students a wallet-sized emergency contact card that includes the phone number for the nearest international hospital and a 24-hour English-language hotline for medical advice and hospital information throughout China. Students are instructed to keep this card with them at all times, especially while traveling. Foreign residents and visitors in China should keep similar information with them in case of a medical emergency.

POLLUTION

China's air pollution is a growing concern both among Chinese citizens and foreign residents. Two out of 11 CET staff members reported problems with pollution while living and working in China. One staff member with a preexisting sinus condition reported more frequent sinus infections in Beijing; another started developing asthma after a few years of living in Beijing. Ways to lessen its effects include avoiding outdoor exercise on the worst days, wearing a face mask, and purchasing an air filter for one's home.

OTHER SAFETY CONCERNS

Other safety concerns while living and working in China include issues related to politics, anti-foreigner sentiment, or lack of information. One staff member reported that cement and soda bottles were thrown at her during a soccer game at the Worker's Stadium. One staff member who was in China in 1999 said he felt uncomfortable after the US bombing of the Chinese embassy in Belgrade. Many people said aggressive things to him at that time. (Though the United States government says the incident was an accident, Chinese officials still say it was a "barbarian act" by the United States.) Another staff member reported a feeling of trepidation around foreigners in Beijing in August 1989 after the Tiananmen Square protests; the whole city seemed "on edge" and locals were afraid of being associated with foreigners. Staff members also reported feeling a sense of unease during the SARS outbreak in 2003, when lack of reliable information led to an abundance of rumors about the extent of the outbreak. The "100-day crackdown on illegal foreigners" in Beijing this year, when police patrolled expat and tourist areas and conducted random passport and visa checks, also led to a sense of unease.

China remains a relatively safe country, but visitors and residents should remain cautious in certain situations. It can be easy to adopt a false sense of security in China. Foreign residents and visitors should always be prepared and aware. Limit drinking while in unfamiliar settings and avoid going out alone at night. CET would also advise against taking specific safety incidents in China and applying them widely. "Life in China is generally safe as long as one is knowledgeable about potential safety issues," one staff member said. "China is not sound-bitable," another staff member noted. "Every city and population is different ...There are positive and negative themes running through everything ... Don't base your opinion on the last sensational story you heard."

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USCBC BULLETIN

EVENT WRAP-UP

UPCOMING EVENTS

SHANGHAI

WEDNESDAY, OCTOBER 31

China Operations Conference 2012

WASHINGTON, DC

THURSDAY, DECEMBER 6

USCBC Gala 2012

WEDNESDAY, JANUARY 31

Forecast 2013

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

BEIJING

AUGUST

2012 China-US Economic and Trade Cooperation Forum

The China Academy of International Trade and Economic Cooperation held a full day event with key US and PRC government, industry, academia, and media representatives to discuss US-China economic cooperation.

SEPTEMBER

Strategic and Economic Dialogue (S&ED) Implementation and the Outlook for US Firms

The American Chamber of Commerce in Shanghai and US-China Business Council (USCBC) hosted Treasury officials Sharon Yuan, acting senior coordinator for China affairs and the S&ED, and Robert Dohner, deputy assistant secretary for Asia, to discuss the implementation of S&ED outcomes and the business outlook for US firms in China.

China International Import Conference 2012

The China Council for the Promotion of International Trade held a two-day conference on China's trade policies and constraints that limit foreign imports into China. The conference featured PRC government officials from various agencies, and included a US-focused seminar in which executives from US companies participated.

Beijing Breakfast Briefing with USCBC President

USCBC President John Frisbie hosted a breakfast briefing on USCBC's latest member company survey of business and operating issues in China. Frisbie also provided an overview of the latest developments in US-China trade politics and briefed members on the organization's priorities.

SHANGHAI

JULY

Is the Economic Sky Falling? A Mid-Year Update and Forecast on China's Economy

Andy Rothman, China macro-strategist at CLSA Asia-Pacific Markets, and Barry Chen, managing director at InterChina Consulting, shared their views on China's economy. Rothman discussed China's macroeconomic outlook and its "mini stimulus," and Chen shared insights on China's sectoral growth and decline, investment, and costs.

SEPTEMBER

Department of Homeland Security (DHS) Engagement with China

DHS Deputy Secretary Jane Holl Lute talked about DHS interaction with China. Lute discussed potential cyber security cooperation, global supply chain security, standards for the transmission of advance data, intellectual property rights (IPR) enforcement, and travel and tourism facilitation.

China's Intellectual Property Environment

William Fisher, partner at Hogan Lovells International LLP, and Benjamin Bai, partner at Allen & Overy LLP, discussed policies and regulations that affect IPR in China. Fisher talked about whether these policies and regulations are preferential to Chinese companies and how to navigate these policies and regulations while protecting a company's IPR. Bai provided updates on developments in strategic emerging industries and discussed best practices for IP management.

WASHINGTON, DC

AUGUST

Joint Commission on Commerce and Trade (JCCT) Midyear Review

Claire Reade, assistant US Trade Representative for

AMBASSADOR LOCKE HIGHLIGHTS ADVANCES IN US-CHINA RELATIONS

US Ambassador to China Gary Locke spoke about the past, present, and future course of the US-China relationship at an event co-sponsored by the Carnegie Endowment for International Peace and the US-China Business Council in Washington, DC, highlighting recent accomplishments, such as increased trade and foreign investment between the world's two largest economies.

During his September 13 speech, Locke said the Asia-Pacific region is a top priority for the United States, noting that the economies of the region account for almost 60 percent of the world's GDP. "Together with our friends, partners, and allies throughout the Asia-Pacific, we hope to develop common solutions to shared problems, and leave the world a better place for our children," Locke said.

Locke highlighted recent bilateral meetings held between the United States and China, including four meetings of the Strategic and Economic Dialogue, and the fact that the presidents of both the United States and China have met 12 times over the last three years.

Locke remained optimistic about the future. "We intend to make history in our relationship with China in the 21st century," he said. For American companies operating in China, Locke said it was important to work together to guarantee a level playing field for competition with Chinese companies by establishing a more open investment climate, ending unfair currency practices, and improving the protection of intellectual property rights in China.

To highlight recent cooperation, Locke mentioned the tremendous growth of US-China trade over the past four decades. "To put this in tangible terms, in 1972 our annual bilateral trade was less than $100 million," Locke said. "Two-way investment was close to zero. Only a handful of American jobs relied on trade with China. Today, more than a billion dollars of goods and services flow between our two countries each day.

USCBC President **JOHN FRISBIE**, left, listens to US Ambassador to China **GARY LOCKE** speak at an event at the Carnegie Endowment for International Peace on September 13.

More than 800,000 American jobs depend on producing goods and services sold to China."

He went on to tout the growth of US exports to China, which surpassed $100 billion for the first time in 2011. Locke also highlighted Chinese foreign direct investment in the United States, which is on a record pace so far in 2012. More than $3 billion in deals were completed in the first half of the year. "Imagine what we can accomplish 50 or even 100 years from now if our governments, our companies, and our peoples are working together," he said.

Locke also explained efforts to streamline the visa process for Chinese citizens interested in visiting the United States. More than 1 million visa applications were processed through the United States' embassy in Beijing and its consulates in Chengdu, Guangzhou, Shanghai, and Shenyang—a 42 percent increase from a year ago. He said visitors had to wait less than eight days, on average, to get a visa appointment.

—Ben Baden

China, and Craig Allen, deputy assistant secretary of Commerce, shared the latest JCCT developments and updates from their trip to China.

Briefing on the Interagency Trade Enforcement Center (ITEC)
Brad Ward, ITEC director, discussed ITEC's activities to enforce US trade interests under international trade agreements, enforcement of domestic trade laws, and the implications for cases against Chinese trade practices.

Meeting with Zhejiang International Investment Promotion Center Delegation
USCBC held a meeting with a delegation from the Zhejiang International Investment Promotion Center to discuss recent developments in Zhejiang's export-oriented economy and the province's work in promoting strategic emerging industries.

SEPTEMBER

China's Financial Reforms
USCBC hosted a presentation with Pieter Bottelier, senior adjunct professor of China Studies at the School of Advanced International Studies at the Johns Hopkins University. Bottelier discussed the status of China's financial system, including its exchange rate and capital controls and the need to create greater consumer driven growth.

Forging US-China Relations with Ambassador Gary Locke
See above.

The Challenges of Human Resources and Government Affairs Hiring in China
Julian Ha, global sector leader of government affairs at Heidrick & Struggles, and Hongxia Liu, partner at Heidrick & Struggles, discussed China's labor market at a USCBC briefing. Ha and Liu provided insights into hiring challenges for government affairs personnel in China. USCBC Vice President Erin Ennis also presented human resources results from USCBC's recent member survey.

BY **JENNIFER SUN**

Smartphone Apps to Help Navigate Life in China

Have you ever found yourself lost in a Chinese city without a map? Unable to decipher a menu? Or just confused by prices in a market? These nine smartphone apps—available for both iPhone and Android operating systems—make finding your way around China a little bit easier.

IMAGINE CHINA

1. XE CURRENCY EXCHANGE (FREE)

This free app is useful to have anywhere in the world. Calculate renminbi conversions to make sure you're getting a good deal while bargain hunting. The app also updates live every 30 seconds and generates graphs that track exchange rates over time.

2. QINGWEN CHINESE DICTIONARY ($4.99)

With more than 80,000 entries, Qingwen is one of the largest Chinese-English, English-Chinese dictionary apps available. Just type the word in the search bar—in Chinese characters, pinyin, or English—and the best results will pop up. Qingwen also provides context and phrases to use with each word definition. Free alternatives include DianHua Dictionary and Pleco Chinese Dictionary.

3. LONELY PLANET MANDARIN PHRASEBOOK ($5.99)

While dictionaries and definitions are useful, sometimes you need to ask for the nearest restroom. Lonely Planet's Mandarin Phrasebook has more than 600 phrases to help you navigate any situation.

4. CAMDICTIONARY (FREE)

CamDictionary uses your camera to identify and translate Chinese characters. Scan the app across a newspaper or sign and watch it translate the phrase in real time.

5. EXPLORE METRO GUIDE ($1.99)

Available for Shanghai, Beijing, Guangzhou, Taipei, and Hong Kong, Explore Metro Guide offers metro maps with location services, so the user can find the closest metro stops and get directions to a destination. Be sure to have Wi-Fi or 3G enabled to use the location service.

6. WEICO (FREE)

If you use Weibo—China's Twitter—you may want to download Weico, a third-party app platform for Sina Weibo. The app is only partially-translated into English, which means users who do not read Chinese will need to be familiar with Weibo's functions to navigate the app.

7. DOUBAN.FM (FREE)

Douban is like China's version of Spotify or Pandora rolled up with Myspace's social network. A free account allows users to stream music and download up to 50 songs to listen to offline.

8. TUDOU (FREE)

China's counterpart to YouTube, Tudou offers an impressive number of English-language videos. Since YouTube is blocked in China, Tudou is one way to get a taste of trending videos in China.

9. CHINA AIR POLLUTION INDEX (FREE)

This app gives real-time measurements of the air quality in cities across China based on data released by the US Embassy in Beijing, the US Consulate in Shanghai, and the PRC Ministry of Environmental Protection.

JENNIFER SUN, an undergraduate business and economics student at the University of Pennsylvania, was a *CBR* intern during the summer of 2012.

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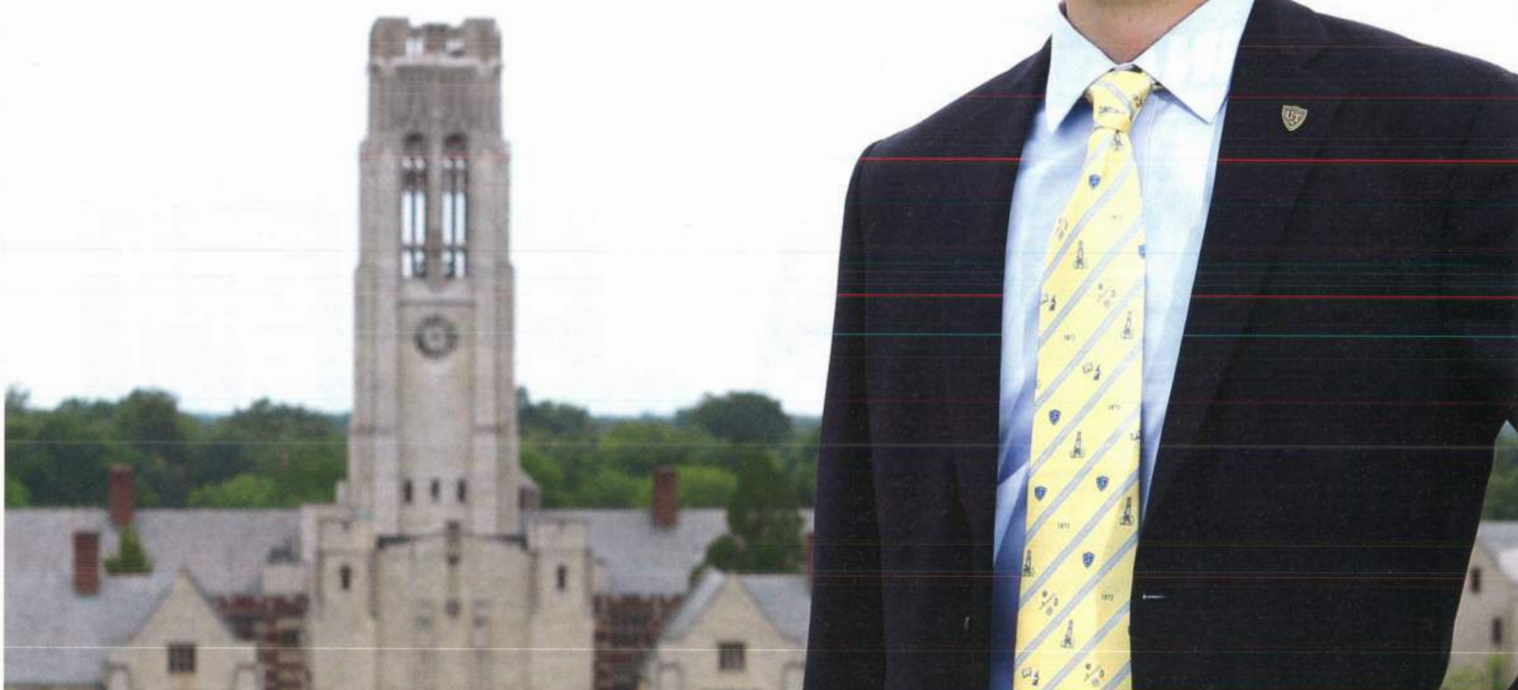

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Xinren Yu, a native of China, is just **one of the many UT success stories**. He is a 2011 UT graduate with a masters of science in electrical engineering and is now pursuing a masters of business administration in marketing.

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