MARKETING PLANNING IN CHINA

With its current difficulties, China will continue to be hot spot in world economic activities. These problems may present risks if they are not managed well, or opportunities for more proactive MNCs to develop a competitive advantage. Despite of economic slowdown, dwindling consumer confidence, pressure of price wars, and wide department store closures, the China market is still growing, and very fast in many instances. In the 1997 National Consumer Survey conducted by Gallup China, only 25% of the residents in Beijing had air conditioners. When Gallup polled these urban residents again one year later in late 1998, ownership of this appliance grew to 51%. Likewise, electric water heater ownership in Shanghai increased from 17% to 52% over the same period, and VCD from 32% to 57%, suggesting very healthy growth rates. The emerging middle class in China – namely private-sector lawyers, artists, employees of joint-venture companies are enjoying the material amenities including cell phone, washing machines, computer, cars, and home.

While some had asked whether it was worthwhile to be in China, more have asked themselves “How can we make it worth our while to be in China?” (Kimberly Silver). As for multinational corporations, they need to develop more realistic expectations about investing in China. Keeping abreast of the long-term development goals of the Chinese economy and the evolving market environment are necessary for assessing opportunities and risks associated with China business. Streamlining operations and keeping cost under control will help MNCs improving their performance. However, localization of materials and personnel should not come at the expense of quality. They must also abide by the regulations of the Chinese government, uphold the highest ethical standards in both implementation and control, and contribute to the well being of its employees and local communities.

After the trials and tribulations in the last twenty years, foreign direct investment in China seems to be approaching the maturity stage. In this new stage of development, both sides will face new priorities and priorities. As the Chinese government attempts to rationalize its policies on foreign investment, MNCs have learned valuable lessons from their experiences in China, and need to adjust their perspectives and strategies to the largest emerging market of the world. The performance of MNCs will largely depend on their ability to adapt to the evolving economic and market environment in the People’s Republic.

Meanwhile, the old generation of MNCs in China have grown accustomed to many aspects of doing business in China. Newcomers continue to test the market with their marketing plans. Starbucks, the trendy chain of gourmet coffee shop, have just opened its shop in China. Realizing that most Chinese still prefer the copious glass jars of tea, Starbucks is focusing its effort on the 18-45 age group and aims for a broader market appeal, charging only 18 yuan ($2.17) for a 12 ounce cappuccino and 21 yuan for a chocolate-flavored coffee mocha, for below the going prices of its competitors in Beijing. The venture is expected to turn a profit in five years.

As coffee drinking is becoming a trendy activity among those enjoying rising standards of living, supply is still far short of demand. Many Chinese think of coffee as an occasional drink and a great gift item. They are not bothered by tea’s traditional dominance in China.

Any foreign companies that plan to invest in these sectors still face considerable risk. In general, the regulatory framework is “opaque,” and government powers are all too discretionary. The rules for private participation are never clear, dispute resolution procedures have not yet fully evolved, and relevant agreements may not be enforceable. Mobilizing local resources from the financial sector is blocked by systemic problems, notably the political constraints that bar access to indispensable long-term debt. National government ministries and commissions often watch for signs of excessive local enthusiasm in promoting foreign investment or any other evidence of “unhealthy” pioneering.

At a project level, foreign investors are not assured of access to foreign exchange, and tariff levels and import permit requirements cannot be predicted. Often, foreign investors cannot gain majority ownership to proposed schemes. The creditworthiness of customers is difficult to assess without independently audited financial statements, and elementary assumptions concerning fulfillment of contractual obligations by suppliers cannot be ensured.

According to a Business Week article, companies that need high returns fast probably should opt out of the China game. But as the old China fades away and gives way to the new, successes will multiply. The winners will not be
those who try endlessly to figure out what Beijing expects from them. Instead, the winners will be those with more smarts, creativity, and endurance. Many have focused on the fundamental. No longer are China's "special conditions" an excuse for tolerating years of losses. More often, the problem is just a lousy business plan. With China becoming a market economy, smart players make money by executing the basics, such as marketing, distribution, and service.

Meanwhile, some clear lessons are emerging on what divides the winners from the losers. The winners have become smarter about picking Chinese partners and increasingly are daring to go it alone. Winners avoid teaming up with stodgy state enterprises or putting too much faith in top-level 'connections' in Beijing. Instead, they search for entrepreneurial companies owned by rival ministries, local governments, or even the military. They insist on management control. They have also learned how to transfer enough technology to convince officials that they aren't there just to rip off China -- without giving their crown jewels away to new competitors. Winners resist government pressure to hand over cutting-edge technologies that could build future competitors. Instead, they transfer know-how needed to ensure their China ventures are world class, while keeping next-generation technology at home. They also aggressively fight theft of intellectual property and guard their know-how.

It is also better to keep a low profile. Western companies have also learned that rather than making grandiose, multibillion-dollar promises in the Great Hall of the People, it's far better to fly below the radar screen of Beijing's state planners with modest but profitable projects that don't attract much attention at the national level. Big, costly, and high-profile projects often get hopelessly snarled in red tape, bureaucratic turf wars, and national politics. Winners tend to avoid Beijing's radar screen by launching a series of small ventures struck with cooperative local governments.

Many multinational companies have found it much more difficult than they expected to make money in China, and with industrial overcapacity driving down prices, things are bound to get worse. Joint ventures have seen many of their working assumptions toppled: Costs are higher than anticipated, sales smaller. Local partners have turned out to be ineffectual, broke, or downright difficult to deal with. Often the foreigners did not do enough homework before plunging into the Chinese market. Many multinationals are now scrambling to adopt new China strategies. China can ill-afford to have the foreigners lose interest.

Several researchers that MNCs have suffered from their "imperialist" mindset. As they search for growth, multinational corporations will have no choice but to compete in the big emerging markets such as China, among others. But while it is still common to question how corporations will change life in those markets, Western executives would be smart to turn the question around. It is suggested that multinationals themselves will be transformed by their experience, and will have to rethink every element of their business models in order to be successful. To compete effectively, MNCs need to define the emerging middle-class markets - which are significantly different from those in the West - and determine a business model that will serve their needs. In order to compete in the big emerging markets, multinationals must reconfigure their resource base, rethink their cost structure, redesign their product development process, and challenge their assumptions about the cultural mix of their top-level managers. MNCs that recognize the need for such changes will likely reap the rewards of the post-imperialist age.

**Current Climate**

On the one hand, China continues to give a lot of incentives to attract foreign investment and make many concessions. These preferential treatment put the domestic firms at a disadvantage. The Chinese authorities learned that these policies are to be changed as they saw many Chinese firms take their funds overseas in a "double tripping" to be funneled back to China just to enjoy advantages granted to foreign operators. On the other hand, China also provided many protections and subsidies to its SOEs while putting many restraints on foreign enterprises, in hope that over time Chinese enterprises will develop the strength to compete with foreign players. In the past, many FIEs came to China to produce for export. Thus, most favored national treatment would suffice. Meanwhile, as China prepares itself for entry into the WTO and more MNCs want to explore the domestic market in China, they would push for national treatment of FIEs. Thus, China will be likely to reduce or eliminate the incentives for FIEs so that both sides can compete on a fair and equitable basis.

Chinese consumers are also likely to experience important changes in their consumption patterns. In the past, Chinese consumers have been described as relatively free in spending because they did not have many other responsibilities and financial obligations, particularly the young people, such as mortgage, car loans, and medical expenses. However, recent events in China have gradually changed people’s lives and will have a great impact on their
spending patterns. The Chinese government has largely disbanded state-subsidized housing and free health care system. From now on, young people wishing to have housing and medical protection would have to budget their income more carefully. In the looming threats of unemployment and economic downturn, they have been more cautious in spending money. They are going to budget their spending, save more money, and become more value conscious. The emerging consumer lifestyles and spending patterns would inevitably impact the manufacturers and retailers.

Retailers already felt such effect in the first year of these new policies. The year 1999 is the second one in which the Chinese government have been trying to deny or defy the existence of the an deflationary economy. While researchers at World Bank and other institution have questioned the growth rate 7.6 % in GDP reported by the Chinese government and suggested the real growth rate is perhaps lower, maybe 7.0%. Some analysts thought that figure is still too high. While economic growth and consumer spending showed real signs of slow-down in 1999, the government have adopted several measures to revive the economy and to restore consumer confidence, including large state-funded infrastructure projects, lowered lending rate by one full percentage point, and spearheaded consumer credit programs in several cities. However, these measure have done little.

Consumer credit program have emerged in China, for car and housing. However, according to a survey of 1000 people in Beijing and Shanghai in 1998, conducted by the China Business Climate Monitoring Center, 64% of the respondents were fully at fait with consumer credit and loan programs. Traditionally, Chinese shoppers were inclined only to spend within their budgets and largely paid cash. The survey revealed that 56% of people now fully accept credit as a means of buying what they want. Some people, 31% of them, were a little hesitant and only 13% of those surveyed said they would not choose the method. Among those in favor of consumer credit, nearly 50% said they would buy a house, 16% said they would use credit to buy cars and other big ticket items. And 12% of the people said they would even consider spending more than they earned with credit. Among those who would decline such credit, uncertainty about future earnings, lack of confidence, and inability to afford credit were the main reasons.

Consumer Lifestyle has undergone many changes. Urban residents in China coastal areas and major cities today maintain very diverse and active lifestyles, creating demand for new goods and services. Children transporting has been booming in Beijing – commercial school bus to transport children to and from school. Chinese in general are becoming more hard working these days. Even ailing workers choose to stay on the job during the day and go to see a doctor after dusk, forcing hospitals and clinics to stay open in the evening and longer hours, and even on the weekends.

**Strategic Options**

Despite the Asian financial crisis and economic and political uncertainty in China, a number of factors favor the prospective foreign investor in China today, from industrial reform to moves by the PRC government to loosen and streamline the foreign investment approval process.

Reduced capital inflows could also mean more favorable terms from both potential PRC partners and the government regulators who review and approve foreign-invested projects. Thus, while many foreign firms have responded to uncertainty in Asia by backing away from China investments, others are bargain hunting and positioning themselves for better economic times.

The best chance for these and other companies to make money eventually is China’s commitment to greater reform. President Jiang Zemin’s government is determined to tackle the staggering problem of China’s money-losing state sector and win entry into the WTO. Officials are weighing a range of domestic reforms that could include privatization of state-owned factories, deregulation of more financial services, and an end to state control of imports and exports. Such changes could open huge new opportunities for foreign investors.

But before the critics write off China completely, they should realize that a new, market-driven China is emerging fast. Many consumer areas, from fast foods to laundry soap to shampoo, are now wide open. Even in some tightly guarded sectors, the barriers to entry are eroding. More barriers will tumble should China reach an accord to enter the World Trade Organization, which could happen in one or two years.

(Business Week, May 26, 1997). The most basic lesson of all is that China is, slowly and fitfully, becoming more of a market economy. Gone are the days when investors focused only on getting in by hook or by crook and assumed big profits would be theirs because Chinese consumers would buy anything foreign and the government would manage the competition. That is all changing.

In light of lower than expected demand and profit, many MNCs have asked themselves whether they would want to continue investing and expanding in China. Several companies have admitted that they
made mistakes and pulled out of China. Others are still struggling with coming up coherent and meaningful China strategies. While considering future activities in China, MNCs need to consider the following questions (China Economic Times). First, how would the lack of a formidable presence in China influence the company’s competitive position in Asia and the world? Second, whether the company’s expansion in China would facilitate its operation in Asia and the world? In other words, can the company continue to use China as a production base and export to other Asian countries? Third, whether the experience in China and the results of R&D in China benefit the company’s operations in other countries? Fourth, does or should the company consider China one of the cores of its global strategy?

The biggest long-term casualty of the China convulsions, however, could be future expansion of U.S.-China joint-venture projects. Several U.S. firms already have begun to integrate their China production into their worldwide operations, using their China joint venture as a low-cost source for parts for assembly elsewhere. But this practice is unlikely to increase due to the instability in China. One U.S. company that is thinking twice about such integration is Foxboro. It had been considering moving production of some of its older product lines to its Shanghai plant. Yet, one pioneer of the concept -- McDonnell Douglas Corp. -- remains enthusiastic about it. Under a co-production agreement, the St. Louis-based aerospace giant not only has been building 25 MD-80 jetliners in Shanghai for China's internal use, but also is producing MD-80 landing gears there for the firm’s U.S. assembly line. The company is gearing up to manufacture MD-80 nose sections in China as well and has plans to add other sub-assemblies. cockpit frame in Sichuan for Boeing.

Beijing just approved a Royal Dutch/Shell Group plan to build a $4.5 billion petrochemical plant, the biggest foreign investment project in China to date. It will be built in Huizhou, a city on China’s southern coast near Daya Bay the site of the country’s largest nuclear-power plant. The project came at a time when the petrochemical industry in Asia is facing overcapacity and sagging prices. Shell dismissed those worries, saying that it remains confident of southern China’s long-term demand for its products.

**Taking Baby Steps**

New investment guidelines due out in 1999 will favor the foreign investor. The State Council guidelines, tentatively called Reform Measures for China's Investment System, are likely to reflect the government's desire to reverse declining capital inflows by streamlining the foreign-investment approval process and expanding the range of investment vehicles and scope of activities available to foreign firms. All foreign-investment approval authority, regardless of total amount invested, will ultimately be moved to the local level. Depending on the size and scope of the project, approvals may be placed in the hands of individual enterprises. The guidelines also may introduce a bidding system for foreign investment into such traditional state monopolies as coal and utilities.

If some or all of these changes come to pass, the need for reliable information about targeted Chinese firms will only increase. Much of the information about Chinese firms is best uncovered by a third party who conducts the research without revealing the foreign party's identity. This permits more candid responses from a potential partner, its customers, distributors, competitors, suppliers, and regulators. In most cases, a company that relies only on its internal resources would not be able to gain access to this type of information.

For companies bound for China for the first time, it would be reasonable to take baby steps before starting running. Prospective investors can learn more by contacting U.S. Chamber of Commerce representatives in China or by reviewing published stories in China Business Review, South China Morning Post Weekly International, Far Eastern Economic Review, and Asian Wall Street Journal, among others. Given the potential profitability of operating in China, it seems sensible to adhere to a logical sequence of gradually increased involvement, beginning with establishing trade links with one or more local urban markets. This would be followed by the establishment of limited production and distribution capacity for a narrow range of products.

While many would recommend going in alone -- by establishing wholly owned operations -- particularly for well established multinationals, it would be foolish to totally discount the tremendous benefits of a local partner. As for newcomers, learning the local requirements, running efficient operations, market development, and transfer of know-how, can take a longer time with the assistance of local know-how. For this to be effective, it makes sense to link up first with an overseas Chinese partner and then with a local partner. At a later stage, with the same or new partners, up to 15-20 markets can be targeted via local production and/or distribution and the variety of products marketed can be increased. It is unlikely this approach can be completed in less than a decade from the time a commitment is made to the China market.
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<td>1. Preparation</td>
<td>market research, assessment of demand, political risk, and financial feasibility</td>
<td>middlemen service, offshore office, representative office with a small staff</td>
<td>market research, feasibility study, and transaction cost analysis</td>
<td>advertising and promotion to create consumer need awareness and to stimulate demand</td>
<td>middlemen, expatriates training, relocation, support and performance</td>
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<td>2. Entry</td>
<td>establish beachhead operation, transfer of capital and management, ensure smooth transition</td>
<td>single local market, representative office, and the first joint venture</td>
<td>transfer of capital, equipment, technology, and personnel, business plan implementation and evaluation</td>
<td>focus on brand recognition and consumer preference, establish distribution channels,</td>
<td>expatriates &amp; bicultural/bilinguals, transfer of technical and managerial know-how</td>
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<td>3. Expansion</td>
<td>sales growth, market share, new product development, and distribution</td>
<td>expand to other regional markets, establish national headquarters, increase local partnerships</td>
<td>localize supplies and production, management initiative and motivation, and meeting competition,</td>
<td>encourage brand preference, expand distribution network, and manage channel relations</td>
<td>combination of local and expatriate management, team building, and increased training needs for locals</td>
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<td>4. Experienced</td>
<td>customer loyalty, competition, coordination and rationalization</td>
<td>expand to marginal markets, wholly owned subsidiary, and even mergers/ acquisitions</td>
<td>coordination among branches, achieve cost effectiveness, and improve post-sale service</td>
<td>sales force development, focus on consumer promotion and post-sale service</td>
<td>localization of human resources, motivation and creativity, and long-term HR development</td>
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Because doing business within China often requires the local government to be a cooperative "godfather" in any bureaucratic wrangling that may occur, the importance of a "good business climate" cannot be underestimated. While recognizing the problems associated with government input in the new venture, local government agencies still present a good source of resources, particularly in areas of new developments, which are often spearheaded and regulated by government agencies. Much depends on the entrepreneurial bent of the mayor or governor in a region and his equally critical deputies, who have substantive power over individual areas of responsibility.

**Expansion Strategies**

Others still believe that China's market potential is a question of "when" and not "if." Many multinationals had moved in and closer to monitor the local market conditions. A number of firms had moved their Asia headquarters to China, Beijing or Shanghai including Chevron. The Hong Kong and Shanghai Banking Corporation (HK) to China by the end of 1999. However, MNCs need to focus on sustainability during the expansion process. What is a strategy? Avoid the obvious option and see beyond what meets the eyes, and know what not to do?

Until a few years ago, the goal of most foreign companies' investment strategy in China was to get a foot in the door. Now many companies are well inside the door and want to restructure their investment. Restructuring investments – accomplished by either grouping joint ventures together under a Chinese holding company, mergers and acquisitions, or the expansion of equity in existing joint ventures – is increasingly a matter of operations managers in China must pay close attention to. Nova Chan of Arthur Andersen says foreign companies should bear in mind 2 things when they consider restructuring a joint venture: 1. Restructuring negotiations will be at least as complicated as those involved in establishing a new joint venture. 2. A foreign company can usually get almost everything it wants out of a restructuring - provided, that is, it is prepared to pay for it.

Several analysts have suggested that China's joint ventures will wither away. Today, the number of Chinese joint venture divorces is skyrocketing China corporate divorces play out in one of 4 scenarios: 1. Buy out locals. 2. Set up wholly-owned companies. 3. Consolidate and streamline existing JVs. 4. Pull out. For those considering divorcing their Chinese partners, foreign partners can consider the following options. The first option is to buy out locals. With corporate

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 demand for capital outstripping local supply, xenophobic China is dismantling restrictions on foreign shareholdings. "That's reducing reliance on joint ventures and the need for partners at all," says Robin Weir, senior consultant with Crosby Corporate Advisory in Beijing. American paper company Kimberly Clark, for example, recently bought out its local partner of eight years.

Or the company can set up wholly owned companies. Solely foreign-funded projects accounted for 45% of newly approved foreign investments last year; foreign companies made particular inroads in such unrestricted areas as consumer goods and industrial products. Caterpillar established a wholly owned facility in Tianjin to make undercarriage parts for Caterpillar equipment. The US-based machinery maker had learned its lesson after its three-year partnership with Shanghai Diesel ended last year with the liquidation of Caterpillar Shanghai Engine. The JV, launched in 1994 when China's economy was rocketing, banked on local customers snapping up its top-quality engines. But customers proved less discerning. The venture lost 30 million renminbi in 1996 and closed down last year.

Another option adopted by many large multinationals is to establish a holding company for their ventures in China. This option can generate great benefits. First, previously under the Chinese law, the sales force of a company can only market the products manufactured by the company, and cannot handle products made by another subsidiary of the same parent company. By establishing a holding company, the holding company can market the products of all its subsidiaries. By relieving the manufacturing subsidiaries the responsibilities of marketing, sales, and distribution, the subsidiaries can focus on the manufacturing operations. Thus, the enterprise not only can consolidate its sales and distribution operations, cut costs and lead to greater efficiency, cross-selling related products, provide better customer services, and integrate the company marketing strategies.

Forging strategic alliances with other foreign companies and even the domestic firms also offer great benefits. While these companies may compete with one another, teaming together make sense in many instances, particularly when the products and resources complete one another's. The major advantage of strategic alliance is the sharing resources in R&D and sharing costs. Each has something the other wants. Please see the information on strategic alliances in the computer industry (page), involving multinationals and Chinese firms.

As company managers consider doing business in Asia, they're looking at many more expansion opportunities than resources could...
possibly support. Even the largest companies don't have the resources to pursue all the possibilities. No MNCs in China can would consider only aggregate economic performance because urban populations live and work in distinct geographic areas. Because of China's sheer size and the enormous deficiencies in connective infrastructure and distribution networks, foreign investors and exporters to China can ill-afford to target more than 20-30 key centers - and even that would pose complex logistical challenges. Thus, choice of location would be an important factor for expansion. China's urban market is defined across 600 cities and the 15,000 statutory towns that generally lie within their sphere of influence; these, in turn, are generally located in a dozen distinct regions.

As for expanding into new geographic markets, formerly forbidden coastal cities and provinces could soon change from investment pariahs to location magnets in China. An empirical survey of the 30 Chinese regions has unveiled new options for companies seeking a combination of low costs and growing markets. The survey, which allocates 50% of each region's ranking to these 2 factors, has challenged the established maxims about investing in China. Traditional investment locations took a hammering. Beijing was ranked the 3rd best location, Guangdong was 6th, and Shanghai an incredible 13th. The regions that topped the poll were Zhejiang and Shandong. Both are nearby coastal provinces that have failed to reach anything like investment levels recorded in the big 3. However, the results seem to indicate a likely change in investment patterns into China: as the big 3 become more congested and higher in cost, companies may begin to look at neighboring regions.

Furthermore, China's most significant markets today are overwhelmingly coastal metropolitan phenomena. The emerging market economy, along with the infrastructure investments that accompany any commitment to modern economic growth, will gradually yield decentralized development benefits. Demand patterns will shift somewhat because relative prices will favor locations neglected in the past (areas rich in still price-controlled natural resources, for example). Landlocked provinces such as Sichuan, endowed with 110 million people and a decades-long commitment to urban scientific and technical education, will finally get new water, land, and air links to the coast that will open up additional markets. Even the advantages of producing in very large cities--which now yield an inverse relationship between production unit costs and sheer population size--will diminish, allowing many critical, productivity-enhancing mechanisms to operate best at a somewhat smaller local population scale.

As land and labor are priced increasingly according to market criteria, and as capital moves more easily across administrative barriers, activities and the consumer markets they spawn will move out beyond the current boundaries of China's top 20 cities. Although these factors could lead to a shift in the regional origins of urban output, the spatial outcomes of decentralization will disappoint those expecting a radical geographic reshuffle. The major changes will be found largely within each of the existing dominant regional clusters of cities and towns. Because urban growth is generally a cumulative and self-reinforcing process with long-lasting effects, once established, a local cluster of cities and towns benefits from a form of inertia. Large, multinucleated metropolitan areas, containing a disproportionate share of urban economic activity, tend to expel jobs across relatively short distances, depositing them nearby to preserve access to critical information while reducing potential transport costs. This does not mean new urban clusters are unlikely to emerge in China. Past experience suggests that successful candidates tend to undergo a "Big Bang," acquiring a critical mass of jobs in a relatively rapid surge that is clearly discernible within a decade. Such instances aside, the best predictor of future outcomes is past performance, often reaching back a century or more. Few lightly urbanized regions are likely to emerge unexpectedly as major players. Most urban output will originate in the existing, interlocked network of cities and towns that include: 1) the Yangtze Delta, centered around Shanghai, Hangzhou, and southern Jiangsu province, 2) the mid-Yangtze River region centered around Wuhan, 3) the Chongqing-Chengdu corridor in Sichuan province, 4) the Pearl River Delta, in Guangzhou province, near Hong Kong, 5) the Beijng-Tianjin-Tangshan corridor, 6) the Shenyang-Dalian corridor in Liaoning province, 7) the Yantai-Jinan-Qingdao region of Shandong province, 8) the Fuzhou-Xiannen corridor across Taiwan in Fujian province.

**Focused Strategies**

Overcapacity is driving down prices, costs are high, and sales are anorexic. In the aftermath of the Asian financial crisis, major business centers in Asia witnessed an exodus of expatriate executive from major multinationals. While other have decided to completely pull out, many others have decided to scale down and back. For products still at the early stages of product life cycle in China or firms at the beginning of the learning curve, stay put in the major cities is the course. This option would appear at least
safe, if not more promising, considering the blunders of many overzealous party-goers. Meanwhile, executives can learn from the success of a small number of foreign-Chinese joint ventures in China. Much like a successful gardener, must pay due diligence to each stage of the project.

In fact, one study of FIEs in China suggests that most of these profitable businesses to date are focused joint venturesxxv. Focused joint ventures have these characteristics: highly prescribed operations, narrow product line, and sustained commitment of partners, top down motivation of employees, and strict performance standards for local suppliers. It is these tightly managed organizations that are producing goods that need the world-class standards while keeping costs in line. The focused joint ventures are setting a needed example of behavior modifications necessary to transform sheltered production into competitive production. Each focused joint venture is intensely inflexible; it succeeds by promptly serving a clear purpose and probably has a limited life span. However, adaptability can be obtained through a series -- progression of focused joint ventures.

A foreign-funded establishment has a distinct "lean and mean" owner and a strong manager responsible for the "bottom line xxvi." Thus, many multinationals that over-expanded in China in the last two decades have opted to consolidate and streamline existing JVsxxvii. Germany's Siemens group, one of China's biggest foreign investors, invested more than $650 million between 1990 and 1997 in some 40 projects employing 15,000 people. President Ernst Behrens says consolidation will mean, among other things, cutting some of the 218 expatriates that Germany employs in China. High overhead is also forcing Shanghai Volkswagen to streamline. The company has been slashing prices on its signature Santana model in a bid to move its inventory. The joint venture, which commands a 52% share of China's sedan market, has cut its sales growth target for 1998, a move that will have widespread consequences for makers of tires, parts, and steel.

By merging joint ventures, multinationals can circumvent some pernicious government regulations. One restriction prevents JVs from selling anything other than their own product. Thus companies with several ventures often set up multiple marketing and distribution systems to serve the same customers. This is the reasoning behind Unilever's plans to merge some of its 11 joint ventures. cite Rick Yan

CONFIRM MARKETING CLAIMS xxviii

As the sales and marketing claims of a potential Chinese partner form the basis for many ventures, foreign investors have found that completely reviewing these capabilities is invaluable. For example, before moving beyond the Letter of Intent stage with a Chinese partner, a major US auto components manufacturer hired an outside consultant to conduct detailed interviews with its potential partner's key customers and primary distributors to verify the PRC firms' current revenues and projections. The Chinese company was attractive to the US firm because of sharp increases in revenues in the years preceding joint venture discussions; the US firm wished to learn the fundamentals behind this rapid growth.

While detailed interviews revealed that the potential Chinese partner's sales claims matched the purchases of its main customers, they also showed that the sharp increase in revenues was largely due to the Chinese company's willingness to win business by offering generous payment terms and settling debt through barter payment schemes. In turn, this discovery revealed high outstanding accounts receivable. Further, while past and current sales matched up, due diligence uncovered significant discrepancies between the Chinese firm's sales projections and its customers' future purchasing plans. Customers' willingness to make future purchases was based on the Chinese partner's ability to continue extending generous payment terms. Rather than differentiating itself through a superior product or service, the Chinese company had become successful by offering payment terms that the US party was not willing to assume in a joint venture.

VERIFY NATIONAL SALES NETWORKS

In addition to being fooled by less than-accurate revenue claims, foreign investors have been lured into China ventures by promises of access to national sales networks, regional sales and distribution centers, and large, established market segments based on the Chinese partner's carefully cultivated relationships. But many foreign firms with JVs predicated on the sales and distribution strength of the Chinese partner typically have been successful only after the foreign partner created its own sales and distribution infrastructure. Investigating the nature and capabilities of a Chinese firm's sales network before the joint-venture contract is signed can prevent disappointment and prepare a foreign investor for the work required to establish both a manufacturing presence and a sales and distribution infrastructure in China.

In one case, a US pharmaceuticals manufacturer, attracted by the national sales and distribution network of a potential Chinese partner,
was considering an agreement that would give the Chinese firm exclusive distribution rights for all products manufactured by the US company, including imported goods and those manufactured in China. Visits to each regional sales and distribution office, and to each of the Chinese company's major customers and distributors, revealed that the Chinese firm's national sales network actually consisted of small regional offices devoted solely to collecting receivables and working out barter and other debt-settling schemes with local customers. This discovery uncovered the virtual lack of any sales, marketing, or physical distribution capabilities outside the Chinese firm's headquarters, as well as severe accounts receivable problems. Interviews with several customers and distributors revealed that all major accounts, regardless of location, were serviced by the Chinese firm's main plant. These customers were unwilling to purchase goods from regional sales offices because of poor service and weak physical distribution infrastructure at the local level.

SCRUTINIZE MANAGEMENT'S GOALS
In addition to verifying a potential partner's actual sales revenue and distribution networks, to prevent disagreements the careful investor will look into the potential partner's management. Prior to entering into a JV, a US transportation firm requested an independent assessment of its potential partner's management, in terms of strategic direction, vision for the proposed JV, past experience, industry reputation, and overall management style. Due diligence was crucial in this case, since government regulations prevent foreign firms from taking a majority equity position in transportation services, and thus management control, of joint ventures. Third-party interviews with corporate staff, past employees, competitors, suppliers, and government officials revealed both areas of compatibility and potential conflict between the foreign and Chinese management.

DOUBLE-CHECK MARKETING PLANS
In China, market conditions can vary greatly between the time that a joint-venture contract is signed and the time that business operations commence, especially if new facilities require lengthy construction times. One US electronics firm in a JV decided to review the original marketing plan and pricing strategy on which the venture's business was based to make sure that assumptions made when the joint-venture contract was signed a year earlier still applied. A third party conducted in-depth interviews with potential customers of the venture to determine changes in purchasing criteria; perceptions of the products to be manufactured in the joint venture; competitor positioning; and the image of the newly established JV among customers. The information obtained resulted in completely revised sales and marketing plans and pricing strategy. Though downward price pressure that had developed since the contract had been signed forced the JV to extend its profit horizon, it was able to adjust the marketing plan in time and move goods to market without delay.

Foreign investors have reported that in the context of slower growth in Asia, Chinese central- and local-government officials are eager to boost foreign direct investment and reverse capital outflows. Thus, they are more flexible than usual in approving traditionally "hard-to-get" investments, such as wholly foreign-owned subsidiaries and hybrid distribution ventures. As part of industrial reform, the government is eager to shed loss-making state-owned enterprises or merge them with their more successful competitors. Economic and tax incentives are supposedly available to both Chinese and foreign investors willing to take on state-owned assets. In many instances, the government is actually willing to give these assets away to investors ready to assume the risks associated with turning around the fortunes of failing enterprises. Shares of recently formed conglomerates—the result of mergers and acquisitions—are also becoming available to foreign investors (see The CBR, July-August, 1998, p.14).

But due diligence can reveal significant discrepancies between the willingness and ability of local authorities to offer tax and other incentives to foreign investors. Before moving forward with a JV, foreign investors should investigate the likelihood that local authorities will approve the terms offered by their Chinese partner. In many cases, foreign-invested enterprises (FIEs) outside of the main coastal cities, in China's encouraged industries, or with powerful local partners are more likely to be granted special concessions.

But attractive incentives and other concessions offered by powerful local partners can be misleading. For instance, investment zones that are not approved by the State Council are not legally authorized to offer a 15 percent income tax rate, though in practice many do. Should the central government decide to crack down on these practices, foreign investors in these unsanctioned zones may be forced to pay at the standard 33 percent rate more than double the tax rate originally factored into these ventures' business plans.

Taking time to understand the experiences of other foreign investors before moving forward with a China venture can also be important. For instance, one of the most common complaints among
foreign investors in China is hidden costs. A major high technology firm operating in northern China recently reported that it was asked to pay up to 130 separate fees associated with the construction of factories and employee housing. Though these fees may be waived or reduced after negotiating with local authorities, it is important to identify and document all official and quasi-official costs, as well as strategies for reducing them, during joint-venture negotiations. Detailed interviews with other foreign investors who have worked with either the potential Chinese partner or local approval authorities can provide considerable insight into how to frame joint-venture negotiations to ensure a minimum of unexpected fees.

Due diligence may also help prevent other surprises. If thorough, in-depth interviews are conducted with as many of the Chinese partner's suppliers, customers, competitors, and local regulatory authorities as possible, then histories of fraud, corruption, or other unsavory business practices may emerge. Moreover, the best way to assess political risk to a venture, including organized crime involvement, is to understand how and why the firm was established, who the founders were, and the history of the local government to which the firm reports.

Businessperson's due diligence can be crucial to assessing the true strengths and weaknesses of a Chinese partner or other strategic alliance in China, and will become even more important as new forms of foreign investment become possible. Foreign investors who go beyond classic financial investigations at the front end of a China venture can avoid a variety of disappointments and costs, and can also take appropriate measures early on to mitigate any negative effects of rapidly changing market and regulatory environments.

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