



# SELLER'S MARKET

Once upon a time, foreign companies set up shop in China to save on production costs. These days, they have their eyes on the Chinese consumers themselves

If sometime soon you book a nonstop flight to Beijing, bring along a copy of Angus Maddison's *Chinese Economic Performance in the Long Run*. This seminal work by the late British economist will set you straight on China's putative rise to sudden economic prominence. Maddison applied his econometric tools to

the year A.D. 1 and found China's share of aggregate global GDP dwarfed that of the Roman Empire. The Asian giant, it turns out, is enjoying a return to economic-superpower status. In the process, the People's Republic of China both beckons and perplexes the American newcomer who hopes to leverage the world's most revved-up economy.

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ILLUSTRATIONS BY ERIK MAUSSER

Since enacting reforms in the late 1970s and entering the World Trade Organization in 2001, China has been an economic dynamo. Its expansion has been unchecked even by worldwide recession in 2009 (when China recorded 8.7 percent GDP growth) and 2010 (when GDP grew 10.1 percent). The country's economy is more than 90 times bigger than when Deng Xiaoping dropped hard-line Communist policies in favor of free-market activity. Within that growth spurt there has been maturation, as first agriculture and then manufacturing shrunk as a percentage of GDP activity. At the same time, the labor market has experienced supply pressures (or at least imbalances) regionally and by industry.

Of course, labor-force behavior that disrupts the profit model for simpler kinds of manufacturing is part of something else—more acquisitive consumer behavior by an emerging middle class. In fact, most foreign companies that set up operations in China nowadays are looking for access to the Chinese market rather than cheap labor. Longtime participants in this marketplace all cite headaches and pitfalls of conducting business there, but China's growth more than offsets those negatives. When battle-tested businesspeople and policymakers craft advice for newer entrants, two themes dominate: Be patient and expect inherent contradictions in the business landscape.

One incongruity involves the activity and pronouncements from China's central and provincial governments. In their attempts to gain operating licenses or start construction projects, Western companies often find local authorities contradicting official Beijing edicts. That's to be expected. "The mountain is high and the Emperor is far away," goes a hoary Chinese saying, referring to geographical limits on China's centralized control of commerce and development. According to Jean-Luc Butel, Executive Vice President and Group President, International of medical technology company Medtronic, one critical area that requires the government's quick attention is consumer health needs.

"Non-communicable, chronic diseases like diabetes and heart failure account for more than 80 percent of deaths due to all diseases in China," says Butel. "This challenge demands industry-government collaboration and innovative ideas."



Medtronic innovates in a robust but deliberate manner well suited to this environment. In Beijing last August, it opened the world's first patient care center that educates patients on medical technology and what it can do. With the growth of chronic disease and limited patient-physician interaction, Medtronic identified the need to act and address both issues by partnering with the health authorities and a cardiovascular professional society. "In China, any major undertaking by a foreign company takes careful preparation," says Butel. "Especially now, I hear of U.S. and European companies saying, 'We've got to get something done in China, that's where the growth is.' If those companies try to move at a fast pace and leave details of their agreements and partnerships to be figured out later, they are guaranteed to regret it."

Among Medtronic's vital building blocks for selling in China are its joint venture with a local device company, Weigao. The venture allowed Medtronic entry to key parts of the healthcare segment in China and to leverage the local knowledge of its partner to help drive local business strategies fully realize the market opportunity.

**"Made-in-the-USA has enormous appeal to the rising Chinese middle class."**

—Gary Locke



Such local knowledge plays well in China. For example, the American fast-food giant KFC is seen by Chinese consumers as a paragon of meat freshness and hygienic food preparation. China's population knows about American standards, and KFC, by virtue of its penetration, owns a good portion of that imprimatur.

One reason American companies now hurry to begin activities in China is the inherent advantage that comes with being a Western brand.

"Made-in-the-USA has enormous appeal to the rising Chinese middle class," says Gary Locke, U.S. Secretary of Commerce and the only Chinese-American to have served as governor of a U.S. state (Washington). "In 2010 alone, U.S. exports to China grew by 32 percent." In Locke's view, the statistics and rhetoric surrounding U.S.–China trade relations are difficult to follow without running into confusion or outdated beliefs. John Frisbie, president of the US–China Business Council, is a strong proponent of the value of facts over truisms. "In the first quarter of 2011, China ran a global trade deficit," Frisbie points out. "You have to go back to 2004 to find the last time that happened. With the U.S., bilaterally they still ran a large surplus, but globally they imported more than they exported. They will revert to a global surplus the rest of this year, but probably at a reduced level versus before. It may be that China is indeed starting to sustainably boost domestic demand."

This change in balance of imports and exports is part of a plan to advance to a more mature stage for both the economy and the society, observers contend. "The Chinese government wants to rebalance its economic profile through increased consumer spending internally, and, via that process, to lower its trade imbalance with the U.S.," says Locke. "As the Chinese middle class expands, there's a stronger interest in Western culture and Western goods—that augurs well for us."

Critics of China's currency valuation policy have had evidence on their side, but are dishing out rhetoric at odds with current facts and figures, says Frisbie. "There's growing recognition by the Chinese government," he says, "that the exchange rate is a tool to help control inflation. China imports energy, commodities and food, and



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# IT's Alive!

The Liangjiang International Cloud Computing Center is going to be, well, huge

From Hainan Island up through Hong Kong and Shanghai to Beijing, China's coastal crescent has seen most of the country's growth. Aware that economic activity tilted eastward, Beijing planners have long crafted ambitious plans for the central and western sectors. John Frisbie, president of the US-China Business Council, returned from a recent gathering with a relevant comment.

"I was in a roundtable conference with 60 or 70 executives of global corporations," Frisbie says, "and they reported on ramped-up activity far from the coastal centers. China's third- and fourth-tier cities are beginning to be targets of sales growth for multinationals." Thus, American businesses that feel left behind may wish to focus inland, on Henan, Hunan, Shanxi and Chongqing. The latter, pronounced "chong-ching" and poised at China's geographical center, is home to bustling manufacturing, sundry corporate outposts (Ford, Walmart, Honeywell, IBM, Microsoft) and, in development, a financial center and cloud computing center of mammoth proportions. Like most large-scale undertakings in China's interior, the



Chongqing Data Industrial Campus, in the Liangjiang New Area, follows a master plan and offers inducements to foreign companies that invest or set up shop there. Incentives include a reduced enterprise income tax rate of 15 percent through 2020 for companies operating in "encouraged industries."

The initial footprint of the Liangjiang International Cloud Computing Center is planned at 135 acres, with a gross floor area in the compound of 2.07 million square meters. Huang Qifan, the mayor of Chongqing Municipality, calls the project "a key step toward building the largest data processing center in Asia." Envisioned over time is a development area of 2,471 acres for cloud computing that would house 200,000 servers and routers. It will initially provide IT infrastructure for the governments and enterprises of Chongqing and other regions of Southwest China, then expand to become a service outsourcing platform. ●

a stronger exchange helps control those price pressures." On that basis, a continued hands-off approach to the currency is likely; the government's target for price inflation is said to be in the range of 4 to 4.5 percent.

A common excuse for delaying entry into China has been concern about placing intellectual property at risk due to factors in the legal system and the industrial culture. It's been observed that, during a long run of success in China, Japanese auto companies take pains to withhold the most valuable technology from the vehicles shipped there. Especially as three-dimensional scanning technology has made it possible to reverse-engineer high-tech products, exporters have feared infringement and piracy. Frisbie, a veteran of two decades in-country, says the problem remains a top concern—especially for software and movie producers—but is showing slow improvement overall.

"We annually survey our members on many questions," Frisbie says. "Consistently, each year more companies say that aspect of China commerce is getting better. Foreign companies can use Chinese courts more effectively to seek redress. But if the government wants China to become an innovative economy, they have to get much better at protecting IP. Their own domestic companies increasingly demand this, too."

Factories mushrooming across China are a natural sign of economic growth, but they obscure the progress of service businesses. Nicholas C. Walsh, Vice Chairman

and Chief Distribution Officer of Chartis, is part of the less visible but deep foray of Western firms filling these needs. "As a company that traces its roots to China decades ago, we have been privileged to witness China's astounding growth," says Walsh, "and to see the services sector playing an increasingly important role in that development." When a company like Chartis makes strides in China, it naturally contributes to better safeguards, efficien-



cies and support for industry in general. "Infrastructure, large-scale development projects, manufacturing, trade and exports are all facilitated, if not made possible, by business and financial services," notes Walsh. "Additionally, a globally competitive services sector encourages high-level efficiency and ultimately better products and prices for consumers."

Like any late-industrializing nation, China must clean its smokestack emissions from the day each smokestack goes up.

Observers of U.S.-China diplomacy see particular promise in the combined need for leadership in environmental sustainability. "We're the two leading producers of greenhouse gas emissions," says Commerce Secretary Locke, "and history will judge both America and China on how we address that issue." That's the liability side of the question, but Locke sees an asset as well. "There's a reason why President Obama included \$100 billion in funding for clean energy research in the Recovery and Reinvestment Act," Locke says. "This is an area where American technology has excelled and can continue to excel. We need to make our policy more specific regarding R&D tax credits, and that will happen."

For the U.S. and China to make common cause on environmental protection would bode well across many fronts, including technology sharing for reduced dependence on fossil fuels. This will require leadership from younger entrepreneurs and policymakers in both countries.

"China encourages and welcomes American cultural institutions and commercial enterprises to actively engage in and support the cultural exchanges between China and the United States," says H.E. Mme. Zhao Shaohua, Vice Minister of Culture, People's Republic of China. "Together we can help bring about increased understanding and deeper friendship between our two peoples." ●

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## Global Development Strategy Chongqing, Conduit between China and the West

### 全球发展趋势 重庆实践的价值

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In the 20th century, China's economy was driven by the development of its coastal areas. However, more recently, the central government has been pushing its 'go west' reform program, and as the gateway to China's western region, Chongqing is sure to thrive from its yet unexploited opportunities.

The 'Liangjiang New Area' in Chongqing will play a critical role in narrowing the income gap between the eastern and western regions of China. 'Liangjiang New Area' is built to meet the increasing demand from the manufacturing, technological innovation, trade, and financial industries in China's western region, as well as direct investment from abroad.

Chongqing Municipality has taken the lead in organizing the first ever international forum in the 'Liangjiang New Area'. This event will gather prominent thought leaders and industry experts from around the world to discuss the unique opportunities that this area can offer.

The Liangjiang Forum is endorsed and supported by the Ministry of Commerce of the P.R. China, the China Council for Promotion of International Trade (CCPIT), the World Trade Centre Association Hong Kong, Bloomberg Businessweek and Tsinghua University.

#### Confirmed speakers include:

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Mr. Stephen Roach, Chairman, Morgan Stanley Asia  
Mr. Gerhard Schroeder, Former German Chancellor  
Mr. Henry Chan, Executive Director, Li & Fung Group  
Mr. Jacky Chan, CEO, AIA Hong Kong and Macau

For speaking opportunity, please contact  
**Mr Harry Li**  
Mobile: +86-13601378439  
Tel: +86-10-66497550  
hli83@bloomberg.net

For info on registration, please contact  
**Mr Paul Yang**  
Mobile: +86-13910696020  
Tel: +86-10-64627321  
yangp@ruderfinnasia.com

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