

THE



# CHINA



# PARADOX

Despite risks, companies are forging ahead with expansion plans in the world's biggest market.



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**A**sk any executive who's overseen a facility in China, and you'll likely hear a common sentiment: overcoming hurdles—some predictable, some less so—comes with the territory.

Recent news events have highlighted challenges for foreign companies with China operations. Google clashed with Chinese authorities over search engine censorship; Foxconn, which employs thousands to assemble electronics, twice this spring promised double-digit wage increases in the wake of worker suicides. Meanwhile, amid China's still-hot economic growth (8.7% in 2009), skeptics worry that real-estate and stock-market bubbles could burst.

Behind the headlines, however, companies with big ambitions aren't abandoning the dragon. On the contrary, foreign direct investment in China—on track to exceed \$90 billion this year—was up 11.28% for the January–April period. U.S. companies are rapidly scaling up their China investments, with a 22% increase last year and a 37% increase for

**COMPANIES WITH BIG AMBITIONS ARE NOT ABANDONING THE DRAGON. U.S. INVESTMENTS IN CHINA THROUGH APRIL WERE UP 37% FROM THE SAME PERIOD LAST YEAR.**

January–April, according to China's Ministry of Commerce. At this rate, U.S. firms will pour \$4.3 billion into their China-based operations this year.

Why the appetite for risk? As it turns out, risks associated with China-based investments vary greatly depending on a company's goals and strategies, according to U.S.–China Business Council president John Frisbie. Business environment factors that spell trouble for certain industries can turn out to be non-issues for others. Many issues can be mitigated with strate-

gic planning. And for many who dream of growing sales exponentially, the promise of reaching China's enormous markets makes navigating the sometimes-choppy waters highly worthwhile.

"You really have to look at the particular product area or industry segment that a U.S. company is in, and that will tell you what the environment is going to be like," Frisbie says. "Some [industries] are controlled and some are not."



### **Planting Enviable Stakes**

Big names in business need little convincing of the investment opportunities in China. PepsiCo, for instance, in May announced plans to invest \$2.5 billion in China over the next three years as the beverage giant adds 10 to 12 new plants, invests in agriculture, and scales up R&D. Volkswagen has unveiled plans to put \$2.5 billion toward three new China plants that will help the German automaker reach the world's largest car market. Marriott, which plans to have 60 hotels in China by the end of 2010, aims to double its China presence by 2015.

# A MODEL OF FINANCIAL STABILITY

The Industrial and Commercial Bank of China has achieved financial strength by adhering to socially responsible goals.

**A**s the global financial crisis wrought havoc in the first quarter of 2009, Chinese banks were reporting profits down over 20% from a year earlier. One institution, however, was thriving: Industrial and Commercial Bank of China (ICBC) chalked up solid 6% quarterly earnings, even in those darkest days.

Today, ICBC's outlook is even brighter: This year's first quarter yielded an 18% year-over-year profit. This track record through adversity helps explain why ICBC has become not only the world's largest publicly traded bank by market capitalization, but also the most profitable for each of the past three years. In 2009, profits were a stunning \$18.9 billion.

For ICBC, whose products range from construction loans to credit cards, success is a matter of harmony. This principle from ancient Confucian philosophy is prioritized both in Chinese culture and in ICBC's new corporate culture handbook. In practice, harmony for ICBC means achieving financial strength by pursuing socially responsible goals in a distinctly Chinese way.

Plunging markets last year created a stage for showcasing ICBC's harmonious approach. Rather than pull back in fear or curtail lending, ICBC gave China's economy a turbo-boost in 2009 by lending more than \$160 billion through domestic branches, marking a 25% increase over 2008. The new commitments marked ICBC's largest year-over-year lending increase in its 26-year history.

This infusion of liquidity helped advance national goals; more than 60% of last year's new corporate loans went for infrastructure projects, including upgrades to China's railways, highways, and electric power grid. On the environmental

front, ICBC is helping China reach 10-year carbon emissions targets by loaning more to renewable-energy enterprises and less to carbon-intensive industries. And ICBC has made sure all sectors of Chinese society can take part in the economic resurgence by intensively lending to small businesses, farmers, and ethnic minorities in remote areas.

A harmonious vision blends business and philanthropy at ICBC. After last year's devastating Wenchuan earthquake, ICBC issued \$3.3 billion in loans to help victims rebuild homes, businesses, and infrastructure. For victims unable to borrow, ICBC issued relief gifts through its \$3.6 million charity projects.

Despite its success, ICBC isn't coasting into the future. Instead, the bank has been proactive in making acquisitions and expanding operations. This year, for instance, ICBC gained access

to markets in Thailand and Canada by acquiring Bank of East Asia (Canada) and Thailand ACL Bank. Also this year, ICBC opened a branch in Kuala Lumpur, its first in Malaysia.

Today ICBC operates globally on a scale that makes it an industry leader; it runs 162 institutions overseas, as well as more than 16,000 in China. It serves 3.6 million corporate clients as well as 216 million personal-banking customers. And it's poised to grow further; as Chinese consumers grow wealthier and more comfortable with credit, ICBC intends to provide the products and services to help them reach their goals.

For ICBC, all elements of a dynamic global bank can and should work together in harmony. As the company lives out that vision, the world is glimpsing how a leading Chinese institution interprets social responsibility in our time. For more information, visit [www.icbc.com.cn](http://www.icbc.com.cn) and [www.icbc-ltd.com](http://www.icbc-ltd.com) ●



A Dynamic Institution: the Industrial and Commercial Bank of China's headquarters in Beijing.



And U.S.-based health services provider Chindex recently announced that it plans to add more hospitals to meet rising demand for high-end medical care.

Conditions in China are fueling this new investment wave. Most American companies that have launched new investments want to establish or expand local operations in order to serve burgeoning Chinese markets, according to Frisbie. Such ambitions got a hearty boost in 2009 when China's stimulus initiative, worth nearly \$600 billion, steered most of those funds into transportation infrastructure, from roads to rail to airports.

"Though infrastructure construction, which was jump-started in 2009 and heavily geared to less-developed central and western China, may at first have a low return on capital, it will have longer-term positive implications for foreign capital," says Ting Lu, China economist for Bank of America Merrill Lynch in Hong Kong. "Foreign investors will be able to explore domestic market opportunities in those regions or relocate to take advantage of lower production costs."

Other factors are helping put Chinese markets within close reach of foreign companies. Annual economic growth at or near double-digit rates for the past decade has meant millions of Chinese have amped up their consumer spending power. Frisbie has seen market opportunities grow in recent years for suppliers to telecommunications and automotive industries in China. Plus, the country's long-term commitment to infrastructure development has led to major new contracts for U.S. firms, including an order for 300 locomotive assemblies from General Electric.

To be sure, some players face bigger obstacles than others when investing in China. Google, for instance, as an information company, found itself in the crosshairs of a government that carries on China's traditional skepticism toward information-disseminating foreigners. But Frisbie observes that a company

making building materials or soft drinks doesn't face the same scrutiny and resistance as a supplier of digital content. Thus, investment in many sectors marches on at a brisk clip.

Rising labor and real-estate costs could present challenges in a country long associated with cost advantages for manufacturing, according to Juergen Reers, an advisor to U.S. companies on China strategy and a managing partner at Roland Berger Strategy Consultants.

"Costs levels are going somewhat upward, especially in the coastal regions," Reers says. "Wages are on their way up, which is quite a normal development that had to be anticipated."



## Weighing Risk and Reward

But even rising labor costs won't necessarily discourage investment from the United States, Frisbie says. That's be-

cause most U.S. companies that invest in China aren't looking for a low-cost export platform, which would be ultra-sensitive to wage inflation. Because they're instead vying to penetrate Chinese markets, they're willing to pay more than in the past for the in-country manufacturing advantage, especially when it means reaching customers whose buying power is also on the rise.

Without a doubt, challenges persist for a range of companies with interests in China. In one mark of protectionism, government procurement practices tend to favor Chinese companies. Another sign: Companies in certain industries, such as express shipping, find they're unable to get the regulatory permission they need in order to market core products.

These obstacles rank among the agenda items for trade talks and negotiations between the world's largest economy—the U.S.—and the world's most populous nation. Even so, more than 75% of U.S. companies investing in China are able to do so in facilities they wholly own, not in joint ventures shared with Chinese partners.

At this point, American companies have a long way to go before they rival how much the rest of the world is investing in China, particularly Asian companies that have moved export manufacturing to the mainland over the past 10 to 15 years. Since 2003, U.S. investment in China has accounted for less than 5% of China's total foreign direct investment. But that number is expected to climb, even if increases are met with some ambivalence abroad.

"There is a sentiment in China [where people] believe that foreign companies are too dominant in their economy," Frisbie says. "There is that environmental view. But on the other hand, the products and services that U.S. companies provide continue to be very popular." ●



### U.S. FOREIGN DIRECT INVESTMENT IN CHINA:

2008  
\$2.9 billion

2009  
\$3.58 billion

2010 (projected)  
\$4.3 billion



### TOTAL FOREIGN DIRECT INVESTMENT IN CHINA:

2008  
\$92.4 billion

2009  
\$90 billion

2010 (projected)  
\$92.4 billion

Source: Foreign Investment Department, China Ministry of Commerce

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# A HUB OF INNOVATION

The Tianjin Economic-Technological Development Area has attracted world-class corporations looking for a launchpad into China.

**A**s foreign companies ramp up investments in China, they're increasing their exposure to one of the world's most dynamic economies. Here it is crucial, experts say, to work with officials who have sufficient authority to stand by their commitments for the long term.

"As a U.S. investor, you would like to see long-term certainty that you can stay in manufacturing in a certain region for a certain time and that you have framework conditions that are stable enough so that you can make your decisions," says Juergen Reers, a managing partner with Roland Berger Strategy Consultants who advises U.S. companies with China interests.

To build solid foundations in China, U.S. companies are investing in industrial parks run by China's central government. Among these, only one has for 12 years enjoyed top ranking from China's Ministry of Commerce, which considers such factors as operating costs and infrastructure. It's also rated number one in China by the China Knowledge consultancy. This hands-down favorite is Tianjin Economic-Technological Development Area (TEDA), an incentives-rich priority zone in China's development plan.

## Home to Leading Companies

Located in Tianjin, adjacent to northern China's largest port, TEDA is home to operations of 4,700 companies, including 76 on the *Fortune* 500 list. Occupants include PepsiCo and Coca-Cola, both of which are investing billions in China to reach growing domestic markets. PPG Industries, which employs more than 1,000 workers at TEDA, is expanding to double output capacity at its TEDA plant. And Motorola, whose Asia headquarters has been at TEDA for 18 years, has since 1988 invested nearly \$3 billion in its TEDA facilities, according to a China Knowledge analysis.

"Tianjin is the site of the largest production base of Motorola in the world," says Kao Rueybin, the chairman of Motorola China. "Mobile phones and accessories, system equipment, automotive products, and two-way radios are shipped out from here to local and global markets. Therefore, it is a key player

in Motorola's global strategy. During the relationship between Motorola and TEDA over the past 18 years, these two parties have formed a firm strategic cooperative partnership."

## Savings Without Tradeoffs

Although Tianjin is regarded as a top-tier China location, TEDA-based companies keep overhead costs down thanks to incentives such as rent subsidies for high-tech startups and funding for construction and R&D. And talent is abundant, thanks to 25 universities and more than 140 research institutes in the area.

"If you go to more remote locations, then some of the incen-



World-class: TEDA's Modern Service District is a premier business complex encompassing over one million square meters.



tives are then [offset] by additional logistics costs," Reers says.

TEDA offers advantages for anchor companies, such as Toyota, and their suppliers in industries from electronics to biotechnology. TEDA firms utilize one of China's largest cargo airports, along with recently improved railways and highways, to reach emerging markets in north and central China. A bullet train gets passengers from Tianjin to Beijing in 30 minutes.

## Latest Attraction Engine

Now TEDA is attracting such major companies as Dow Chemical, Air Liquide and others to its Nangang Industrial Zone, a 200-square-kilometer dedicated chemical industrial park under the TEDA brand. It will create a petrochemical cluster marked by perfect interaction from upstream to downstream.

As the Binhai New Area's only national economic zone, TEDA has become the region's most mature area for doing business. It's the hottest investment spot in the Asia-Pacific region. For information, visit [www.teda.gov.cn](http://www.teda.gov.cn), or call 86-22-25201111. ●