HOW TO MAKE YOUR MARK ON CHINA

IN THE PURSUIT OF SUSTAINABLE HIGH GROWTH, MULTINATIONALS ARE ON THE LOOK-OUT FOR NEW MARKETS AND SEGMENTS. MANY OF THEM HAVE LANDED ON THE SAME SPOT – CHINA. **MARGARET LEUNG,** HEAD OF GREATER CHINA TREASURY SERVICES AT JPMORGAN, INVESTIGATES.

Investment in China experienced renewed vigour in 2002, stimulated by post-World Trade Organisation (WTO) private capital spending and public investment. Both imports and exports grew sharply, and China emerged as the favourite destination for foreign direct investment (FDI). The Chinese economy grew 8% during that year and fixed investment growth was as high as 17.3%.

Today, China is the sixth largest economy in the world, after the US, Japan, Germany, the UK, and France. The continuing evolution of global cost and demand patterns, coupled with the greater access to foreign markets provided by Sino-foreign joint ventures in China, re-ignited China's exports, which rose 22.3% in 2002 .

Statistics from the Ministry of Finance of China show that FDI into China totalled $82.8bn (€73.9bn) in 2002 and $30.5bn (€27.2bn) as at the end of April 2003. Many have predicted that China will soon become the world's manufacturing base. In addition, the region has attracted so much investment from within Asia that many predict there may be a new Asian trading bloc.

A survey by the Boston Consulting Group indicates that 90% of the companies in Europe, the US, and Japan have set a 'China first' strategy. According to the *ASEAN Economic Bulletin*, about 400 companies out of the Fortune 500 have made direct investments in China and accounted for more than 3,000 projects in the country. In Pudong of Shanghai alone, the total value of projects invested by foreign companies reached about $8bn. Among all the foreign investors, European-based companies accounted for 8.73% in 2002, the third largest group of foreign investors behind Hong Kong and the US.

PERSEVERANCE PAYS OFF. Patience and persistence are necessary for operating in this emerging and regulated market. Unlike the normal practice in many Western countries, corporations are required to gain multiple approvals and be in compliance with many local regulations prior to launching their operations in China. So far, Shanghai is the most pro-active Chinese city in establishing infrastructure and legislation to allow foreign companies to set up business and regional headquarters. A total of 27 corporations have gained approval to establish their own regional headquarters in Shanghai since July 2002. Six of these are European-based corporations, as listed in *Table 2*). A further 20 multinational corporations had established their regional headquarters in Beijing by August 2002. The regional headquarter status allows these corporations to better utilise their investments and share resources and operations more efficiently in China.

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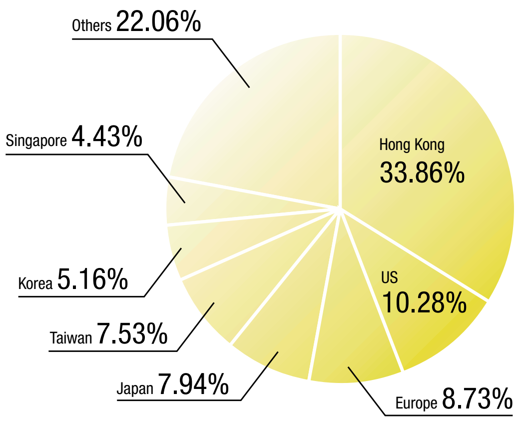
THE RACE IN CHINA: FROM FORMULA 1 TO MOTORCYCLE. European treasury centres and systems are among the most sophisticated in the world, comparable to a top high-performance Formula 1 on a racetrack. However, 'racing' in China requires the right combination of skillsets, as well as mindsets. Sometimes, the track may be too winding and narrow for a Formula 1 to deliver its best performance, and the condition is more suitable for a motorcycle instead. Understanding the landscape and planning the route are always essential in winning the business race in China.

LANDSCAPE: THE UNAVOIDABLES. China is still not totally opened to foreign banks. Treasurers must bear this in mind when searching for a domestic banking partner. So far, they have a fair chance of using one of the banking partners with whom they are more familiar in one of only nine Chinese cities (Shanghai, Shenzhen, Dalian, Tianjin, Guangzhou, Qingdao, Nanjing, Wuhan, and Zhuhai) which have been opened to foreign banks for local currency (renminbi) business in China. Fortunately, this is only a temporary constraint. With China's accession into the WTO, a schedule has been mapped out to open up the rest of its markets. By the end of 2006, all cities will be opened to foreign banks. Hence, the more sophisticated cash management services and electronic banking systems will become

▪ **Figure 1**
China: breakdown of FDI by country in 2002



Source: MOFTEC, PRC

▪ **Table 1**
Country distribution of Fortune 100 Companies (2002)

	FORTUNE 100 COMPANIES	WITH PRESENCE IN CHINA
US companies	38	19
Japanese companies	20	20
European companies	37	30
Others	5	3
Total	*100*	*72*

▪ **Table 2**
The 27 multinational corporations with approval to set up regional headquarters in Shanghai

September 2002	Alcatel, Emerson, Suntory, Mitsubishi, ExxonMobil, Fuji Film, Delphi and Honeywell
December 2002	Atlas Copco, Michellin, APP, Marubeni, Gillette, Uni-President, Henkel and Cargill
March 2003	Johnson & Johnson, Kodak, Pioneer, Kohler, Komatsu, Owens Corning, BOC Gases, CITIC Pacific and Toray
May 2003	Rhodia and YKK

fully available in China. For the time being, companies operating outside of these nine 'open' cities unavoidably still need to partner with a local bank.

To exacerbate the hurdles, there are a few other unavoidable constraints imposed on the business operations of foreign companies in China, such as:

- **Currency control:** there are clear and detailed guidelines on conversion rates, remittable amounts, and retainable foreign currencies.
- **Control in opening bank accounts:** the number of bank accounts, location of accounts, and functionality of accounts are highly regulated.
- **Control in interest rate on deposits and borrowings:** the gap between the borrowing and deposit rates can be as wide as 3% or more.

Given the limited investment channels in China, a key challenge facing treasurers is yield enhancement for idle balances, especially renminbi deposits, which are tightly regulated by the People's Bank of China (PBOC). However, treasurers should not be discouraged. Banks in China have already started to offer more innovative yield enhancement products to help companies achieve higher returns on their cash balances. It is therefore important for treasurers to constantly look out for innovative solutions with acceptable risk and return profiles in the market.

Collecting renminbi payments in China poses another big challenge for foreign corporations who sell their services and products in China, especially those dealing with with foreign banks only. The largest local bank has over 8,800 branches in the entire country. Comparatively, the top foreign banks in China have a limited number of branches, all in the single-digit realm. Therefore, avoiding the use of local banks may not be a wise strategy. Rather, a hybrid arrangement of combining a local and a foreign bank is a more favourable approach. For example, some sophisticated treasurers choose to use the extensive branch networks of local banks to facilitate collections while linking with their international banking partners to provide enhanced yields for the cash pools collected around the world.

It is worth noting that some foreign banks may offer to pick local banking partners for their clients, based on their own relationships with the local banks. Local businesses or joint venture partners may also recommend their own friendly local banking partners to the foreign partners. Therefore, the criteria for selecting a banking partner in China may not be purely a capability issue; relationship is probably the more dominating factor.

WORKING WITH THE UNKNOWN. Upon entering a new market, it is optimal to leverage on the experience of the most trusted local partners to reduce risk of uncertainties. Unfortunately, many local and foreign partners may not even know each other before the new 'marriage' is closed. In China, 'marriages' between corporations are mostly based on market expansion or cost reduction strategy. Sometimes, members of a partnership may not even be involved in the selection of 'marriage' partner. Yet, they have to live with the consequences right after the partnership is concluded. Popular unknowns that treasurers have to live with include:

- unfamiliar local team culture;
- unfamiliar banking partners;
- unknown amounts of cost reduction; and
- unknown growth prospect.

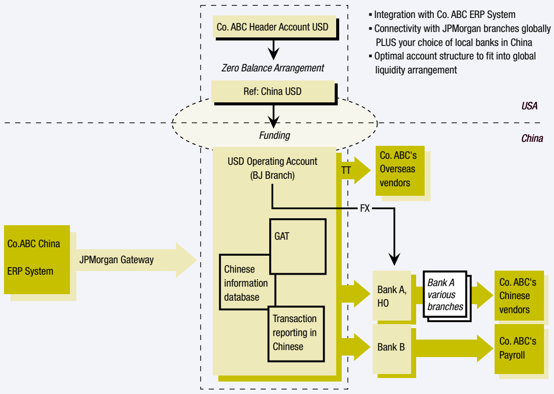
Data integrity is another challenge for foreign companies in coping with the unknowns in China. Preparing a business plan in a country with little transparency can be a very daunting task.

All of the above unknowns can be the determining factors for the business decision to stay or leave the Chinese market. If doing business in China requires a long-term growth strategy, why did some players settle for a short-term solution? The answer lies within the company's appreciation of the unknown elements, help converting a challenge of 'unknown' into a winning factor.

▪ Figure 2
3 'U's': Unavoidables, unknowns and unacceptables

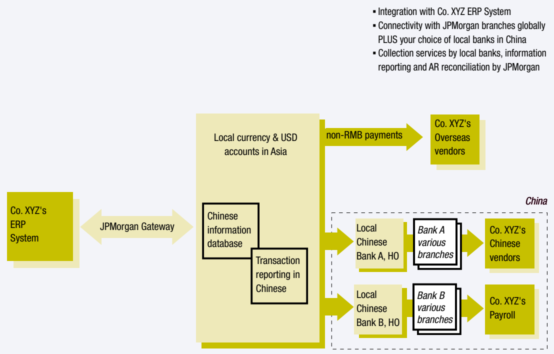
The following cases illustrate there are still a lot that can be achieved in China through prudent management of the 3 'U's'.

CASE ONE
Combining the largest local bank network with a large powerful foreign bank's infrastructure in a city where renminbi business is not opened to foreign banks.



BENEFITS:
- Accelerated and consolidated information flow.
- Centralised offshore treasury functions at locations where investment options are more abundant and flexible.
- Reduction of cash-trapped situations in a controlled country, allowing more flexibility for integrated working capital management.
- Utilisation of existing ERP system to standardise processes.
- Enhanced risk management through better transparency, centralised treasury control, and integrating the local banking system into a foreign bank's more sophisticated infrastructure.

CASE TWO
A large multinational corporation successfully integrated its enterprise resource planning (ERP) system in China through financial system integration of a large international bank.



BENEFITS:
- Connectivity with branches of a foreign bank globally as well as selected local banks in China.
- Collection services by local banks, information reporting, and accounts receivable reconciliation by a foreign bank.
- Standardisation of process and making best use of local banks' strength in renminbi processing.

Source:IBE's Illustrative Code of Business Ethics, 2003

There are various ways in managing the unknowns. In particular, it is important to install as much consistency as possible to flush out all irregularities. Direct integration with enterprise resource planning (ERP) systems can minimise the risks of manual tampering of files and execution failure. Leveraging on the expertise of an international bank to guide the local partners on system enhancements is crucial and can reduce the unknowns within the unfamiliar banking systems. Banking partners in China should be more than just a transaction processor. They should be treated as trusted partners who can help their clients build an effective platform to deal with the unknowns. Therefore, choosing banking partners should not be based on pricing and cut-off times alone. Rather, valuable experience and innovative ideas should be the decisive reasons. Partners' proven delivery capability and access to a global customer service network can also create additional values for business operations.

MANAGING THE UNACCEPTABLES IN AN ACCEPTABLE MANNER. Most large multinational corporations expanding into China may already have powerful ERP systems such as Oracle or SAP. However, including China into the same platform may not be a simple task. China is predominantly a paper-based economy with six simultaneous functioning clearing systems. The latest one is the China National Advanced Payment System (CNAPS), which was introduced by the PBOC in 1996. Currently, CNAPS is available in around 150 medium- and large-sized cities in China. Against this backdrop, deviations from standard business processes are inevitable. Treasurers must accept this fact, but be vigilant in new developments in China so that these deviations can be reduced and eliminated eventually.

WINNING IN SHORT TERM AND TRIUMPH IN LONG TERM. Most companies enter China with a long-term vision. However, many leave before the vision becomes definitive. Those who succeed are the ones who rigorously learn to navigate within the unavoidably rough landscape, and eventually find the roadmap to the achievable.

Patience and persistence are important elements for business success in China. Sometimes, it takes endless meetings with banking partners and regulators to resolve issues. Moreover, reading the 'unwritten' enhances familiarity and reduces the unknowns. Those who can read into the future direction of the market and anticipate challenges are usually more prepared and flexible. They can reap the benefits of future deregulation in a speedier manner. Hence, treasurers should possess all these attributes, as speed-to-market is crucial to treasury management in such a competitive economy.

Adopting a realistic view in this regulated market allows one to focus on what can be done rather than the unacceptables. On the other hand, tolerating the 'unacceptables' in the short term does not mean losing sight of what can be achieved in the long term. Risk management and internal control should never be compromised, but there is always more than one road to success. Managing the unacceptables in an acceptable manner is the key to long-term success in China. Through the recent global incidences, we have learned that failure of large businesses usually arises from lack of internal discipline rather than lack of business acumen. While good business is what we want to achieve, building a business over a solid foundation is required for long-term success in this vast and rapidly emerging market.

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