CHAPTER ONE

China's Three Primary Growth Drivers

待文王而兴者,	*Dai wen wang er xing zhe,*
凡民也。	*fan min ye.*
若夫豪杰之士,	*Nuo fu hao jie zhi shi,*
虽无文王犹兴。	*sui wu wen wang you xing.*

"The common people wait for Emperor Wen to come and uplift them. But the truly outstanding will uplift themselves, even if Emperor Wen doesn't appear." — Mencius

What are the forces behind China's growth, now and in the future? There are three, what many call the primary drivers of economic growth: Exporting, foreign direct investment, and domestic market consumption. Of these, trade and investment are the most important at present.

China has built its economy on exports, much as other Asian tigers or dragons did before it, relying on its mammoth quantities of labor to make it the low-cost leader. Next in importance comes foreign direct investment (FDI). A well-known relationship in international trade is that foreign direct investment usually follows exports and, by this logic, based on the huge amount of FDI coming from the US, a lot of products should have been imported into China from there, too. The theory goes that a company in the United States starts exporting its products to China and eventually decides it would be

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

easier to just make a factory in China and sell directly in the local market, thereby avoiding all the hassle of shipping, customs duties, and so on. In China, though, it may be said that few companies ever succeeded in exporting to China that didn't set up a major investment of some kind in the country first, rather than later. There are three main reasons why this relationship is the opposite of what we might expect according to standard trade theory.

First, products built abroad and sold in China as is would probably not be entirely suitable for the Chinese market, and too expensive for much of the population, whose per capita income is far below that of the US even though China's economy is the fourth largest in the world after the US, Japan and Germany (if PPP (purchasing power parity) is taken into account, China has the second strongest economy in the world today).

Second, it is a rare product that could not be found in China already, or readily copied and sold at a much lower price than the authentic item.

Third, prior to China's becoming part of the WTO in 2001, many of China's markets had high tariff and non-tariff barriers to overcome. So, as a result, a foreign company wanting to sell its products to China would usually be better off setting up a company, factory or assembly facility there and importing things for its own use, finishing them in China and then selling them domestically or, often, just re-exporting them.

China turned the whole model on its head, as did globalization when it was no longer necessary to worry about where one's factory was so long as it was in the lowest-cost location possible, and so it is that most things sold in China are made in China, and if foreign companies want to sell there they have to invest. Foreign direct investment in China has grown to be the biggest in the world in several years of the last half-decade.

While exports and FDI are China's two most important drivers, they also point to a strategic weakness which is that China is depending on outside markets and investors to help it develop. That is where the third driver comes in — the domestic market.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

It is true that any economy is driven by investment, exports and consumption, but in this context investment means not only FDI but domestic investment by businesses as well, and if China's FDI has been high, domestic investment has been higher, so much so that the Chinese government is afraid of overheating in the economy due to too much investment and has made efforts to slow investments down by instructing the big five banks (Industrial & Commercial Bank of China, Bank of China, Bank of Communications, China Construction Bank, and Agricultural Bank of China) to tighten lending criteria, raising interest rates and so on. Nevertheless, China's GDP still grew at the fastest rate of growth in more than 10 years — 11.9 percent in 2007. What's different this time is that the contribution of investment, 4.3 percent, was slightly lower than the contribution from domestic consumption, 4.4 percent.* It is too soon to say this is a trend, but it does lend support to the idea that domestic consumption will be the most important driver of future economic growth as incomes grow and retail spending increases as people find themselves with more wealth.

The mythical one billion customers dream aside, China's domestic market is quite simply going to be the biggest in the world — it is just a matter of time. In 2007, consumption was just under 40 percent of China's total GDP growth, and in terms of the total GDP expenditure, personal consumption was approximately 36 percent for 2006 (the latest year data is available). Although half of the US's consumption expenditure (about 70 percent), these two statistics refute the common idea that China's economy is driven by exports alone. Though still low compared to many developed countries, the growing influence of consumption on the Chinese economy is an important driver.

Many say China will be the world's largest market by 2050, but if China continues to grow at the 11 percent plus pace of the last several years, it could be much sooner. Year by year China steadily marches

*These figures are based on the NBS's first announcement of GDP growth of 11.4 percent, which it later revised to 11.9 percent after more data became available.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

up in the economic rankings and will eventually challenge the US for the title of world's biggest market. The importance of this for China's development is that, with a strong domestic market, China can effectively reach critical mass and continue developing on its own — a popular theory at the moment that is called decoupling.

To decouple means to be able to develop independently, despite potential problems in other countries or even in a global recession. The decoupling idea flies in the face of globalization's idea that our world is now interconnected and interdependent. Another way to put it is to say the international race to the bottom, where companies continually seek low-cost labor and abandon one country's factories for another's as tax holidays run out, may be at an end in China because its market potential is so large and companies will have to stay there in order to be successful. China is becoming the *de facto* low-cost mass producer and simultaneously the world's largest market, effectively forcing multinational companies to have a permanent home rather than remain as some kind of disembodied transnational entity: The lure of the Chinese market in the future is drawing them back to earth. Thus, while the domestic market consumption driver is the third most important now, it is *the* most important in the future, both to the Chinese economy and to your business venture in China.

Let's look at each of these drivers in more detail.

Exports from AIGO to ZTE

AIGO is the English name for one of China's electronics manufacturers, famous for products such as MP3 players, while ZTE is a mobile phone and telecom hardware manufacturer that may one day rival larger and more famous firms such as Ericsson or Siemens. AIGO is better known outside of China as an OEM, an Original Equipment Manufacturer — basically, a manufacturer that produces for bigger companies on contract. That is probably why you've never heard of companies such as AIGO outside of China, but they are a key part of China's US$1.2 trillion in exports.[1]

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

In 2007, China's largest trading partners were the EU, the US, and Japan, with US$356 billion, US$302 billion, and US$236 billion respectively in total trade. The total trade surplus (the amount by which exports exceed imports) is large again in 2007, about US$262 billion, adding to China's US$1.76 trillion in currency reserves in April 2008, and may increase by about US$300 billion in 2008 according to the Chinese Academy of Social Sciences.[2] The global interconnectedness that results from trade shows no signs of slowing China down. Even if one of China's biggest customers, the US, enters a prolonged economic correction or recession, it is optimistically thought that this would in fact increase many low-priced Chinese exports even more — an idea that could be moot if high oil prices increase transportation costs for low-priced goods.

Shoes out, dollars in

Despite the Chinese *yuan*'s[†] appreciation against the dollar and other major currencies in the past two years, China's exports continued to grow by about 25 percent in 2007, and are predicted to grow by about 19 percent in 2008.[3] Since the RMB peg to the dollar was scrapped in 2005 in favor of an unspecified basket of currencies and trading band rather than a fixed rate, the currency has been appreciating slowly but steadily, going from approximately 8.27 then to about 7.0 at the time of writing. If one believes American senators, this glacial pace is the crux of the trade imbalance between the US and China, but fast appreciation or revaluation has been ruled out by the central bank of China so that its exporters, one of the lynchpin drivers of the economy, have time to adjust to a new high-RMB environment, as well as to provide time to improve structural problems in the economy such as the wealth divide or labor laws.

[†]The Chinese currency, as mentioned earlier, can be referred to as the *yuan* or the *renminbi* (RMB for short), the people's money. Outside of China, it is usually quoted as the *yuan*, while inside China *yuan* is often used to quote prices, as in "This book is 30 *yuan*." Colloquially, it is called a *kuai*, a piece, kind of like saying "30 pieces," while *renminbi* is used for formal references to money, such as *renminbi duilu*, the exchange rate for the RMB.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

The exporters have upgraded production with more efficient machinery and many have focused on innovation as the key to remaining competitive. Compared to 1990, when China classified about 7 percent of its exports as "high-tech," that export ratio is now above 37 percent. Even China's most traditional of industries, silk production, is moving into such non-traditional areas as the production of artificial skin using silk proteins, costing 1/10th of similar products abroad thanks to China's low cost of labor and favorable, even ideal, environment for harvesting silk.[4]

An overdependence on exports is a worry for China, but putting all its eggs in one US-based basket is even more troublesome. The EU's trade with China is technically bigger, but it is not homogenous given the EU's vastly different national markets, so the US is still the single biggest market. From China's perspective, a decrease in US consumer spending could actually help mitigate the US$163 billion trade surplus (or $260 billion trade deficit, if you follow the US perspective, a very different number because of the way the two countries calculate trade[5]), but no exporter in China wants to see a US slowdown. On a macro level, the Chinese government has felt threatened by its bilateral trade dependence on the US, so has sought to hedge its bets by increasing trade with the EU and Japan. Trade with the latter is especially evident in just the last several years as Japan's economy started to recover, many believe due to the strength of trade with China. In 2008, China was also moving forward with a proposal to join the OECD, the organization for 30 of the world's market economies, among an increasing expansion of the grouping which also includes the other BRIC countries — Brazil, Russia, and India.

China's trade with other Asian nations has also increased and it is a major player in turning ASEAN, the Association of South-East Asian Nations, into the world's biggest trading bloc when China joins. A China-led ASEAN free trade zone is still some time off, but ASEAN will in the future be a major balancing force against other multilateral trading blocs such as the (now fragmenting) North

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

American Free Trade Agreement and the EU.[6] These trends should insulate China somewhat if its largest trading partner, the US, stops importing as much. Yet, the present interconnectedness of trade and globalization as a stabilizing force is important to China's continued development through exporting.

China's impact on the world

Thirty years ago, few would have predicted the extraordinary impact that China has on the global business environment today. Japan looked ascendant, the US and UK were mired in an economic downturn and ideological war with the Soviet Union, and China was mostly closed to outsiders and seemed unlikely to emerge. Yet from the time of Napoleon, who is thought to have once said that China would make the world tremble when it awoke, people have been aware of China's incredible potential, but few would have predicted it could happen so quickly, making the previous rise of Asian economies like Japan, Korea, and Taiwan seem slow in comparison.

Shanghai's Bund Then and Now

Stepping out of the Jean Georges Shanghai restaurant in Wai Tan No. 3 (Bund No. 3), I felt suddenly awakened from Michael Graves' modern design of warm interior colors and romantic lighting, by the noisy bright car lights on the Shanghai streets. How funny it was that Kevin, Marie and Michael, who came halfway across the world to dine with me and my wife, could have the same menu at the New York Jean Georges in Columbus Circle just blocks away from their apartments.

We walked toward the walkway along the Bund, passing the Giorgio Armani store downstairs from the restaurant which displayed almost the same fashion as their stores in New York, London or Hong Kong. The only difference was the 60 percent higher price tags. Strolling along

(*Continued*)

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

the walkway following the river, it has been a typical after-dinner walk for many visitors, not only digesting the foie gras and caviar, but also orienting the travelers' sense of time.

On one side of the river, we see the classic buildings in a mixture of architectures such as German Gothic, French Renaissance, Art Deco and others. The Bund started in the 19th century as a collection of buildings supporting the colonial settlements of the English and other countries, and it later become the financial street to the foreign trading houses and banks in the 19th and early 20th centuries, continuing to develop until the mid-1930s when war with Japan broke out and then civil war within China, after which it was turned over to government use. The now fully restored and preserved buildings are artistically lighted at night, displaying their 200 years of history to the foreigners visiting now. Time stops here as you can almost see the Shanghainese and foreign traders and bankers still interacting in the HSBC Building, the Customs House, the Shanghai Club, the Peace Hotel and on the busy streets.

On the other bank of the Huangpu River, one sees quite the opposite: the new Shanghai, gateway to modern China. There is the 88-storey pagoda-inspired Jin Mao Tower housing the Grand Hyatt Hotel, the 468 meter Oriental Pearl Tower, Bank of China, HSBC, and Citigroup buildings, rows of modern skyscrapers that illuminate half of the city with their giant television screens displaying advertising to the tens of thousands wandering the Bund. The new office buildings on the eastern shore of the Huangpu River are almost all related to finance, as the area, called Luijiazui, is China's first and only finance development zone created by the government to promote modernization of China's financial system.

Contrasting with the classic buildings of romantic and memorable Shanghai, the new side of Shanghai extends its earnest invitation to the foreigners to join the fast growth which began only 20 years ago.

Memory brings me back to the summer of 1984 when I first came to Shanghai. After settling in the hotel, I was dragged by my excited wife to the Bund that she had heard so much about from her Shanghainese

(*Continued*)

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

father. When the Russian-made taxi reached the Bund, the dark and quiet streets made us wonder if it was the wrong stop. Strolling along all these unlighted dark buildings on the quiet unpaved sidewalk didn't live up to the bustling and lively image of the Bund as described by Natalie's father who lived in Shanghai before 1950 and worked in the Bank of China building on the Bund.

Needless to say, the stroll was not an exciting one. In fact, I had to constantly encourage Natalie to finish the walk. But that did not mean we could return to our hotel; we still needed transportation, as back then a taxi needed to be ordered as there were very few available and which were only occasionally ordered by the foreigners who could afford them anyway. We had to walk all the way back to the Peace Hotel on the Bund and persuaded the porter there to order a taxi for us at the "late hour" of 9 p.m. on Friday night.

— *JKY*

Billion Dollars a Week: Foreign Investment

How important is foreign investment to China? Since 1978, China has received more than US$2.11 trillion in foreign direct investment. In total, more than 286,000 foreign-funded companies have been set up in China in the past 30 years, with 37,000 companies set up in 2007 alone.[7] Some 480 of the world's top 500 companies are doing business inside China.[8] In 2007, China received a record-setting US$74.7 billion in FDI,[‡] pretty good for a former Communist country: Deng Xiaoping would be proud, Mao Zedong would be apoplectic.

[‡]Or US$83 billion in total, if financial portfolio investments in real estate, stocks and so on are included. The amount of portfolio investment as a component of the total is relatively low because China still restricts many kinds of foreign investment in mainland stocks and real estate. Therefore, unlike many developed countries that allow access to their capital markets, most foreign investment in China is non-portfolio investments and used for things such as building factories, providing capital for joint or wholly-owned ventures and so on.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

In the 1980s, the joint venture was the preferred model for entry into China, in fact often the only model according to Chinese government regulations designed to ease the economy into capitalism and transfer technology and know-how in the Chinese companies, but these cooperative partnerships were often anything but mutually beneficial, leading to many problems. The 2007 case of France's Danone suing their joint venture partner, China's Wahaha Group, and vice versa, is only the latest and most public spat, but it is indicative of the end of the age of joint ventures in China. Today, the preferred model is a Wholly-Owned Foreign Enterprise (or WOFE for short, a "woofy," though the official term is WFOE, possibly because that sounds more dignified), which gives total control to the owner of the business and no surprises such as showing up to work one day to find your joint venture partner has fled with all the equipment and managers.

Back in the 1980s on the half-empty flights to China, most of the passengers were Taiwanese and Hong Kongese. Any foreigners to be seen were most likely their customers traveling with them to visit suppliers or conduct business. In the 1990s, companies started to come to establish their own factories. Some companies may even have been making money, but repatriation of profits was a problem due to China's currency controls and the idea that profits should be reinvested in the state.

Now, companies come to China for sourcing and outsourcing, and China has become a base of operations for many firms that have relocated their Asia headquarters from places like Singapore and Hong Kong to Shanghai and Beijing. The most favorable areas for investment in China, according to a World Bank report in 2006, are the south-east coastal provinces, consisting of the so-called Yangtze River Delta provinces of Jiangsu, Zhejiang, and Shanghai; the Pearl River Delta province of Guangdong (near Hong Kong and Macau) whose capital is Guangzhou and also includes Shenzhen, Dongguan, and Zhuhai, all special economic development zones; and the province of Fujian near Taiwan.[9] The worst are in the

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

north-west: Shanxi, Sha'anxi, Inner Mongolia, Xinjiang and others, and it is there where you hear about worker exploitation, coal-mining disasters, and social unrest. The current hope of the Chinese government is to slow down development in the better-off areas and shift investment to places like Sichuan and Chongqing, and central provinces such as Anhui.

The influx of FDI creates a need for not only manufacturing facilities, for which funds are typically applied, but increasingly for services. Relocated multinational headquarters have come to expect certain things of any location where they have significant operations: Accounting, legal, auditing and due diligence, human resources, even consulting and investment banking. All of these point to an urgent need for professional services and, therefore, services FDI.

The next wave of FDI in China is related to services, of which China's developing economy needs more, especially in its more developed eastern cities such as Shanghai or Beijing.

It is not just professional services that are growing the services-based FDI; it is also entertainment and dining: Restaurant chains such as Pizza Hut and KFC now dot the streets of China's budding metropolises. In fact, the entire service sector in China, including education, retail, and healthcare, is growing rapidly. In just the first half of 2007 alone, FDI in the service industry totaled nearly US$14 billion, a 58 percent rise over the same period in 2006 and representing more than 43 percent of the total FDI during that time. Clearly the foreign-invested service industry in China is growing, and the Chinese government is allowing more openness in the sector both as part of its WTO entry commitments (which are by now nearly complete) as well as accelerating the opening of other industries such as logistics that will bring in foreign know-how that China desperately needs to keep its development apace.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

At the time of writing, FDI continued to pour into China, much of it thought to be *hot money*, funds entering in order to take advantage of the appreciation of the RMB. In the first quarter of 2008, for example, FDI was up 61 percent year-on-year, with US$27 billion in investments from overseas, according to China's Ministry of Commerce.[10]

In terms of the government's preferred FDI at present, polluting, energy-intensive, and labor-intensive businesses in the already developed areas of China are out; high-tech and service industry investments in the cities, and any investments in the underdeveloped western parts of China, are in.

Big Numbers in Future China

Big trends come with big numbers, and China is a country of more than a billion in population, so it's only fitting to have some other amazing statistics. Some of these numbers may be termed irrational exuberance, while other data are just a sign of how much things have changed. Here are some of the bigger numbers:

US$3.5 trillion: The reported size of China's GDP in 2007 (RMB24.66 trillion), making it the world's 3rd largest single-country economy after the United States and Japan, in a virtual tie with Germany for 3rd place depending on the exchange rate. If inflation-adjusted GDP is used (i.e., taking PPP into consideration, the cost of living being significantly lower in China), China's economic size leaves Germany and even Japan far behind, becoming second only to the USA.[11]

US$2 trillion: The value of China's exports and imports in 2007, continuing a pattern of 20 percent plus growth for six years running.

US$2.1 trillion: The total amount of foreign investment China has received since 1978.

US$1 trillion: The approximate market capitalization of PetroChina on November 5, 2007, China's largest oil company, making it the world's first trillion dollar company, double the valuation of rival Exxon yet with only one-half of the profits.

(*Continued*)

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

547 million: The number of mobile phone users in China by the end of 2007.

592 billion: The number of text messages those subscriptions sent in 2007, generating US$8.4 billion in revenues.

5 billion: The number of text messages (SMS or short messages) that Chinese sent on a single day — the 2008 Chinese Lunar New Year — to wish each other prosperity, happiness, or to just check if people like them enough to reply. One-day windfall for the telecom operators: US$70 million. This busiest greetings day of the year is about three times the average number of SMSs sent *each day* in China — 1.6 billion.

Hungry Hippo: China's 1.3 Billion Consumers

According to the Boston Consulting Group, China will be the world's number two consumer market as early as 2015, surpassing Japan and Germany.[12] By the World Bank's estimate, this has already happened in terms of PPP-adjusted economic size. China has undergone a series of stages in the development of its consumer attitudes and behaviors which is distinctly different from the consumption patterns of most Western countries, owing to China's unique economic situation. If this can be put into the framework of Maslow's hierarchy of needs, the Chinese consumers in the cities have long ago moved beyond survival needs and are purchasing often for esteem. Young people in the cities desire the latest brand clothing or newest iPod, older consumers want a better car or a bigger house. In the countryside, a different class of consumers exists who are probably looking for security and stability, the second level of Maslow's hierarchy, but are quickly catching up. There is clearly a divided market in China of more affluent city dwellers and poorer countryside peasants. Nevertheless, the modern consumer in China has gone through several stages that are interesting to note for sociological understanding.

The first generation of consumers, now aged 60–80, and consuming prior to the opening of China to market reform in 1978,

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

aspired to purchase the "three rounds and one sound," the so-called "old four": Wristwatch, bicycle, sewing machine, and radio. At this time, China still had strict foreign currency controls, limited imports, and the items in question needed to be paid for not only in their cash value but also by having the right to purchase them using a quota ticket system.

The next generation, at the dawn of China's open-door policy of the 1980s, saw the rise of the "new four things": Washing machine, refrigerator, TV, and camera. Consumer behavior in this period started to include comparison shopping and bargain hunting as people were more free to spend money and competition was heating up. There was no way of stopping the insatiable demand in the cities, and by 1998 there were more than 100 televisions, 91 washing machines and 76 refrigerators for every 100 residents.[13] Penetration rates for goods such as air conditioners, home computers, and mobile phones were still relatively low. These formed the basis for the next generation of consumers of the China Century starting in 2000.

This is the so-called esteem need of Maslow's hierarchy: Urban Chinese consumers have now entered a period of consumption based on quality of life and are quickly adopting the same characteristics that motivate Western consumers: Aspiration purchasing, emotional purchasing, buying for technical benefits, buying based on quality rather than price, choosing status symbols and brands suitable to their incomes, and so on. While the past growth in the consumer market was largely driven by a need for basic goods during the previous stages, the new Chinese consumers are able to buy anything and everything that a global market provides (their country is the one making them, after all). There are growing domestic industries in automotive, construction, and white goods that provide high quality domestic alternatives usually at a lower price than the imported or foreign-branded or even foreign-produced China products.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

In fact, new urban Chinese consumer attitudes can often be called brand conscious rather than price conscious: A famous and established brand is a guarantee of quality, safety and effectiveness. As increasing standards of living push up the need for more living space, better cars, more fashionable clothes, and the newest technology in mobile phones and computing, the companies that want to reach these consumers' wallets must now think about differentiation and unique value propositions to consumers. One study found that it is no longer enough to simply sell a product as is, or sell it in the same way as in another foreign country; it requires a selling approach that takes Chinese consumer attitudes and behaviors into account.[14] This is a process we call *Sinofication*, modifying Western products and services to have Chinese characteristics. Some of the world's largest companies are catching on to this idea and enjoying increased success in China as a result.

Another sea change in the way Chinese consumers are being seen by MNCs is as increasingly heterogeneous. Frankly speaking, the Chinese consumers were always so, but for many years after China's initial opening post-1978, the "Chinese Market" idea of a homogeneous consumer prevailed with some minor attempts at segmentation such as targeting the "Little Emperor" children of one-child families. Furthermore, attention was focused on the so-called first tier cities such as Shanghai, Guangzhou, and Beijing, where purchasing power was highest. In the last five years, tier two cities were targeted. Now, with China's new rich being found all over, the relative maturity of the first and second tier markets makes them difficult to compete in. The next frontier in the Olympic Decade is the third, fourth, fifth tier and beyond.

While these cities are more numerous and geographically fragmented, the third to fifth tier cities have more than double the population of the first two tiers, approximately 234 million people versus about 118 milion, representing 43 percent of GDP versus 34 percent, and annual salaries about half of the upper tiers.[15] The urbanization

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

rate in these cities is also high and consumption is growing quickly as these millions of strivers see the better lives and better products in Shanghai or Beijing and want the same.

Multinationals that want to access these new markets have to follow localization strategies for their China business operations: Localize their people, processes, and products to produce more suitable items for Chinese consumer tastes. In regard to these lower tier cities in particular, the MNCs must also improve their distribution and supply chains in order to more effectively compete against local Chinese competitors already in the hearts and back-pockets of retailers. For many manufacturers, this may mean strategies that they are not familiar or comfortable with in other countries: Television shopping, manufacturer-owned stores, creating low-price versions of their product suitable for the local market, and so on.

Primary Growth Drivers

China's primary growth drivers are exports, foreign direct investment, and the developing consumer market. Of these, exports and FDI have historically been most important, while in the future, the growth of the consumer market is critical to China's continued development:

1. Exporting from China is still a viable business opportunity. China's exports are still growing dramatically — 25 percent in 2007. This shows there are still opportunities to operate export-oriented businesses in China. This includes sourcing, contract manufacturing (OEM), assembly or even full production as a JV or WOFE company inside China. Better late than never!
2. The trends within FDI are towards cleaner capital-intensive high-tech manufacturing in the cities, low-tech labor-intensive manufacturing in the western parts of China, and service industry investments just about anywhere but especially welcomed in the cities and in certain industries such as logistics where support is needed to bring China's quality of service up to international standards.

(*Continued*)

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html

3. China's domestic market is growing very quickly, and consumers are buying quality goods for their social esteem value. Especially in the big cities, brand-conscious consumers look at quality and brand, not price, as primary decision criteria (but they'll still ask for a discount!), and consumers should be properly segmented according to standard marketing characteristics for the best results selling into China's domestic markets.

China's three primary growth drivers continue.

SUPERTRENDS OF FUTURE CHINA - Billion Dollar Business Opportunities for China's Olympic Decade
© World Scientific Publishing Co. Pte. Ltd.
http://www.worldscibooks.com/eastasianstudies/6847.html