

INTRODUCTION

China, the Land of Mystery: The Good, the Bad, and the Ugly

China has always been thought of as part of the mysterious Orient. When Richard Nixon arrived in China in 1972 and disembarked from Air Force One, Premier Zhou Enlai was there to greet him. Nixon was said to remark, "So we've arrived in the land of mystery, Premier Zhou." Zhou responded, "It may be mysterious to you, Mr. President, but it is not to us." Perhaps apocryphal, this story still gets to the heart of the matter: People in the West are often unsure what is behind the curtain of China.

There are many ideas, beliefs, and stories about China which, to those outside the country, may seem mysterious and difficult to understand, but not to people, including the Chinese themselves, who live and do business in China every day. To them, China is ultimately just China. There is no ancient Chinese secret, though there are many things one can learn from China's trends, and opportunities still to be had for the forward-thinking.

Historically, foreigners have been coming to China from elsewhere for centuries seeking knowledge, fortunes, and adventure.

One of the first documented accounts was a young Italian boy, traveling with his family eastward in search of trade, who arrived at the capital, Beijing, in 1275 A.D. There he stayed for nearly two decades, extending his skills as a linguist and was made a courtier by the then reigning *khan* of the Yuan Dynasty.

Twenty years later, the boy returned to Europe a man, bringing exotic knowledge and inventions from the mighty Mongol Empire. *Cathay*, as it was called then, was unknown to most. So, when his thoughts were recorded into a book recounting tales of strange customs, magnificent treasures, geographic descriptions unparalleled at the time, even cannibalism, heroism, and adventure, it became a best-seller which remained popular for decades after his death.¹

The man whose name is synonymous with exploration is well-known to all as Marco Polo. His influence on people at that time was great and served to build interest in the wonders of China. His meticulously detailed geographic information guided the likes of Columbus on his journeys, and the Marco Polo name today lives on to great effect as the moniker for a famous bridge near Beijing, even a popular bakery chain from Taiwan.

In the centuries following Marco Polo's first magical, terrifying and awe-inspiring impressions of China in his book, other travelers would continue to seek Cathay, writing about a country of *kowtows* and *sing-song* girls, the place where a certain kind of porcelain (which Westerners eponymously named china) was invented, the source of much of the world's tea, up until its somewhat dramatic closing in 1949. Before that China had already undergone several cycles of isolationism and exploration, and it is now once again open (for business) and the journey eastward to find its riches has started once again. This is the *meng ya*, 萌芽, the seed that is to grow in the Chinese Century only now just beginning.

Thomas Friedman's *The World is Flat* credited Columbus with starting "Globalization 1.0". For this book, which is not so much about globalization as it is about being prepared for China-related change and making the most out of China opportunities, we shall honor the first great traveler who came from the west to the east, Marco Polo, as the one who inspired and ignited the passion to take a chance and go to China for the possibilities it offered.

Journey to the East

In October 2007, six new direct flights from the US to China were announced, and under a May 2007 agreement, the total number of direct flights via US carriers alone will increase to 23 a week by 2012.² This figure does not include the Chinese carriers that fly to the US, and it is of course only a fraction of the total flights to and from China to non-US destinations. Boeing estimates that China will need more than 3,400 new large-bodied aircraft for a total fleet of 4,460 by 2026.³ New infrastructure had to be built, and China will create about 97 new airports throughout the country at a cost of approximately US\$62 billion, giving it a total of 244 airports by 2020, with 13 of those airports capable of handling more than 30 million passengers per year each, according to an announcement from China's Civil Aviation authority in January 2008.

Large volumes of air traffic into and within China are one major indicator of several trends: Increasing globalization in politics and the economy, non-stop business opportunities, leisure travel, and urbanization.

China's new airports are among the largest in the world, many built in the last decade and several, including Shanghai's Pudong International Airport, already constructing additional runways to handle increased volumes of air traffic. Compare this to the early 1980s, when China had few international flights, near-deserted international airports like Shanghai's *Hong Qiao* International Airport which had no tow-carts or luggage belts so bags were tossed to passengers from the back of a truck, and if you saw any foreigners on a plane bound for China, they would likely be Hong Kongese, Taiwanese, or guests of the same going to see their mainland Chinese factory.

The increasing flights to and from China and the expansion of China's domestic air carriers mean that there will be far more people coming into China from abroad to the point where today, foreign carriers are courting the Chinese firms for partnerships even after attempts at M&A or joint ventures failed, as with a failed investment by Singapore Airlines into China Eastern Airlines in 2007. Simply put, every air carrier wants to make inroads into China because of the huge growth in air travel both inwards and outwards.

Arriving on a jet plane, don't know if they'll go back again

Where do all these passengers come from? According to 2004 statistics, the majority of travelers to Shanghai were from Japan, Hong Kong, the United States, France, Germany, Singapore, and Korea. All of this is perhaps reflected best by the fact that in 2006, more than 44 million foreigners entered and exited from China, a nearly 100 percent increase from just five years earlier when China entered the WTO in 2001 and, with exception to the year of the SARS disease, inbound travel is on average increasing at 10 percent a year.

China's entry and exit statistics for foreigners are again projected to double by 2012 to more than 80 million.⁴

Why are all these foreigners going to China? Some come to study Mandarin or attend one of China's universities. The Ministry of Education said that 195,000 foreign students attended Chinese universities in 2007, an increase of 20 percent.⁵ A large number of visitors are on short-term business or travel, but an increasing number of people are choosing to work and even live permanently in mainland China, much as expatriates have been doing in Hong Kong for quite some time. Now, the place that young and older businesspeople alike want to go is probably Beijing or Shanghai, not only because of

the more colorful lives those cities offer, but also the exciting opportunities and growth those cities promise.

According to the latest figures, in 2006 in Beijing, more than 70,000 foreigners were employed on long-term residence permits as well as another 7,000 working in diplomatic functions, while in Shanghai 35,000 work permits had been issued. Another statistic reported for Shanghai, stated that the number of foreigners doubled from 2002 to 2006, growing to about 77,000 expats working at foreign-invested enterprises out of a total 120,000 living in Shanghai.⁶ All these numbers belie the total number of foreigners living in both cities, which would include students, family members, business visa holders, and tourists who continually extend their stay. For example, according to the Japanese consulate in Shanghai, officially registered Japanese residents total more than 60,000, with unofficial figures at least 20 percent higher. Americans are listed by their embassy at 50,000, Germans at 30,000, French at 25,000, and so on. When populations of Koreans, Taiwanese, and Hong Kongese are added in, the total population of residents of foreign origin tops 500,000.⁷

China is currently home to more than two million foreigners from outside the mainland.⁸

What keeps them here?

For one thing, job opportunities that are superior to those available in their home country. Postings to cities like Shanghai and Beijing were not long ago considered hardships but today are plum assignments, an important line item on any executive's CV.

For younger businesspeople, China often offers positions in management and social status that would not be available to people of their experience level or income in their home countries. With or without Mandarin language skills, talented people are able to find jobs in China's cities and most enjoy a respectable salary that,

although generally lower and paid in Chinese currency, the RMB, the money goes a lot further thanks to a low cost of living.

Live Like a King

My experience building and leading businesses for multinational companies in China has been rich and rewarding. The business dynamics in China are different from those in the US or EU: You need to make fast decisions; you need to be flexible and active; and you need to be independent while at the same time accountable to the corporate HQ.

While life back home was often filled with daily routines of going to the HQ offices and attending endless boring meetings, coming home, doing the housework and honey-dos, along with a very predictable income, mortgage, car payments, and tuition payments for children, China is another story altogether.

China is a high-pressure work environment for foreign executives but with the perks of chauffeured cars, gardeners, private cooks and full-time housekeepers. School tuition here is expensive (about US\$25,000 per child at many international schools), but the company often takes care of that. Other benefits may include an overseas differential allowance covering all or part of groceries, utilities, housing, car and even domestic help. All in, the total cash package more than twice your US pay means life in China is far more than being comfortable.

With the leisure time that accumulates with so much domestic help, one can enjoy events like the F1 race in Shanghai, golf at a dozen newly designed world-class courses with full caddy service, enjoy various cuisines at top restaurants for half the price of those in New York or LA, or travel to a variety of scenic or historical destinations in China as well as the nearby resorts of South-East Asia. And, the sweetest thing of all, you can get away from the HQ and its corporate B.S. without sacrificing your career, as China has become a key posting to have on the CV for future moves up the corporate ladder.

— *Richard O. Smith, a typical director
at the China sourcing office of a multinational company*

Life in the Fast Lane

Although I've been in Shanghai for several years already, every day still seems new, because something interesting or exciting is going on. The city is constantly changing and business is fast. As a foreign consultant to MNCs in China, I get to work with high-level executives from both domestic and international companies that I'd not be likely even to meet in the elevator back home. Here I contribute to the strategic decisions of billion dollar companies.

While our salaries are usually not as high as the fabled expat salary-and-benefits packages that GMs get, and we often make less than our counterparts in the US or EU, for many of my classmates from graduate school, the city is full of chances to be a manager of a growing company, or be entrepreneurs.

Work-life balance is a mixed concept in China as business happens around the clock, but for every business dinner you need to attend, there's a leisurely business lunch at a sidewalk café to enjoy. For every business trip to a remote city, there's architecture, art, culture and natural scenery to view.

For the young businessperson in Shanghai, taxis are the preferred method of transportation, brand-new health clubs with the latest equipment keep the ravages of pollution and city stress somewhat at bay (weekly massages for US\$10 help as well), and meals out are like being on the *Food Channel*: Jean Georges tonight, Michelle Garnaut tomorrow, every cuisine from Brazilian BBQ to Thai. For fun, you can check out the world's largest indoor ski hill, see the Rolling Stones, Linkin Park or Avril Lavigne in concert, or go to the latest Phillippe Starck-designed nightclub where you can party all night to the music of the world's top DJs while dancing on a hundred-year-old building's outdoor patio with Shanghai's futuristic skyline as your backdrop.

— *David Kim, a typical early-30s entrepreneur with his own consulting company in Shanghai*

All this demand for Western-style living and dining is driving the prices of such products and services higher and higher. Rents for high-quality service-apartments (short-term stays of six months to two years) have been steadily increasing as the pace of new arrivals to the city is outpacing the speed of development of these premium executive residences. In fact, another indicator of China's increasing convergence towards international level standards, the annual Mercer Consulting cost of living survey, puts Shanghai and Beijing at a reasonable 20th and 26th most expensive cities to live in respectively.⁹ Another survey lists them as the 100th and 95th most expensive in the world.¹⁰ The trend across all surveys and almost all cities in China is increasing cost of living as more foreigners (the targets for these kind of surveys) move to China and require the international basket of goods those surveys use.

Regrettably for China, neither Beijing nor Shanghai placed within the top 50 for either quality of life or health and sanitation-style surveys,¹¹ but nevertheless executives hoping to rise in their companies often make the China experience a defining factor, and the quality of life in major Chinese cities is no longer a strong deterrent requiring hardship pay.

High cost of living rankings do not mean the cities are prohibitively expensive, only that to maintain a Western standard of living is expensive. If you can do without trips to the opera and subscriptions to the *Wall Street Journal*, French cheeses and a bottle of Cabernet Sauvignon with dinner, China's cities are very affordable even for new graduates.

The prices for many products and services, from 500 ml Nestlé water (US\$0.30), an hour-long foot massage (US\$5), an hour of housekeeper or private chef's time (US\$1.5–\$4) or a two-kilometer

ride in a taxi (US\$1.6), may work out to be just 10–20 percent of those in higher cost-of-living countries.*

As soon as people get to China, many find they don't want to leave. A typical foreign resident of Shanghai remarked, "Every time my flight from Shanghai approaches San Francisco, I always hope that something awry would force the flight back to China right away." Whether it is the job opportunities, the low cost of living or the increasingly international variety of entertainment and leisure activities, many foreigners are here to stay, despite some of the problems which the Chinese economy is suffering from.

Bamboo is Always Greener on the Other Side of the River

China is dealing with a number of problems that, by many standards, would actually be considered as advantageous or good for a developing country's economy:

- High growth rates, which mean opportunities for more business, more money, more expansion, or simply a good time to start your own company, but are not always a good thing when it comes to the environment and conservation of resources.
- Increasing wealth of urban residents, a trend that is generally positive except for the increasing wealth divide between city and countryside, and quickly-rising labor and operational costs.
- Large numbers of students going abroad to study at top foreign universities. This may also seem overwhelmingly positive, except that China often has trouble getting its best and brightest scientists and engineers to come back as *hai'gui* — sea turtles. According to one Chinese study, of approximately one million students that

*A note on the exchange rate: During the writing of this book, the RMB has been appreciating at an unprecedented rate against the US dollar. Before 2005, the rate was fixed at 8.27 RMB per dollar. As this book goes to press, the rate is approximately 7 RMB per dollar, so we use this rate for conversions throughout the rest of the book unless otherwise noted.

went abroad, only 275,000 returned.¹² Or if they do return, providing adequate jobs at international compensation levels for new undergraduates educated abroad to be satisfied with, lest they become *hai'dai* — seaweed — drifting in the tides of international labor differentials.

How China deals with these economic and social issues is of concern to those with a macroeconomic perspective on China's development, but in some cases, as with the high growth rate, solving the problem would create new problems such as how to employ China's rural migrant workers as they enter the cities. Balancing the urban and rural incomes is a task that tests China's commitment to market reforms as in fact some people are getting rich first, as originally envisioned by Deng Xiaoping.¹³

China is the New Gray

Stepping out of an aircraft at Shanghai's Pudong International Airport any time between April and October, the heat will hit you like a wave yet, incongruously, you may notice the skies are gray and overcast. It looks like rain, but it's more likely the haze of pollution that settles over one of China's busiest cities during much of the year. China's economy is a mix of good and bad and consequently, has often been criticized on a number of fronts:

- Laws and regulations are like one big gray area, which leaves interpretation in the hands of many, which is how power comes into play among different organizations, among different regions, and in different situations.
- Transparency of most institutions and businesses is at best gray, if not opaque, due to a long-standing practice of working in a kind of black-box environment where the procedures and decision criteria are hidden behind networks of relationships. The Chinese bureaucracy is still this way: Despite a large amount of effort to put up ministry websites, solicit public opinion and so on, the reality

is that the workings of the legal system including the courts, the decision making processes in the government, are all still difficult to understand, much less influence.

- The high-speed growth and lack of enforcement of environmental regulations quite literally make the dust-filled air and everything it touches a slightly duller shade, resulting in pollution both inside and outside China, affecting quality of life.
- Some workers, such as the floating migrant population, often exist in a legal gray area, neither allowed to fully integrate with the local communities nor be adequately compensated for the sacrifices they make in health and income. Human rights is still a new concept in China, but much has been done to improve the situation of migrant and rural workers in recent years, part of the government's plan to bridge the wealth divide.
- The graying of the working population is also a major concern. Like many other countries, China has experienced a baby boom. But unlike other countries, it also reduced the size of the subsequent generation with the now-infamous One Child Policy, which has resulted in nearly 100 million one-child families and prevented the birth of about 400 million additional people,[†] causing a number of unexpected or negative demographic effects, not the least of which is too many seniors who are living much longer thanks to improved diet and better healthcare, not enough working population to support the pension system, or not enough children to sweep the tomb (a Chinese traditional practice carried out every year to show respect to ancestors).

[†]In the 1970s, Chinese couples averaged six children before the One Child Policy, which has been reduced to an average of 1.8 children per couple now. There are a number of circumstances in China where multiple children are allowed: Rural families whose first child is not a boy, is disabled, or who pay a fine can have a second child. Urban dwellers as well can have multiple children if a fine is paid or, more recently, if both parents came from single-child families themselves. These multiple effects have probably created a mini-baby boom starting in 2007 as the eligible children reach marriageable age right about now and people aim for Olympic Babies (having a child born in 2008) all at the same time.

- Growing materialism and sense of wealth entitlement is starting to exhibit itself in negative ways. China's infrastructure may be world-class, but sometimes the behavior of the people isn't up to the same standard. For example, Chinese in cars treat the roads as their personal space, treating other drivers, cyclists, and pedestrians with indifference. Campaigns to eradicate spitting on the street after the SARS crisis have largely failed, and Chinese tourists traveling abroad are cautioned by their own government to tone down their behavior which may include shouting, jostling, and smoking in public places.
- Its economic data is often underreported due to the sheer size and effort involved in data collection in everything from unemployment figures to the migrant population. At times, data is exaggerated, for example when provincial governors report their progress on key performance indicators. At other times it is underreported, as in the case of undocumented children born after the One Child Policy was implemented. Data about China is better thought of as gray rather than black and white.

The Chinese government has realized all these problems and has undertaken several measures to deal with the largest of them. Fortunately for China, and for you, these problems are not only solvable, they are where the greatest opportunities exist: Multi-billion dollar industries that are just waiting for the right companies and entrepreneurs to step in to provide solutions.

China's Dark Side

Finally, there are the problems that are truly devastating to a developing economy's output, social conditions, and reputation:

- China's black market is really more of a gray market since the stores and even malls can be full of counterfeit merchandise and operate in the open, complete with advertising and business cards. The city governments of Shanghai and Beijing, for example, have

closed the most notorious fake goods markets, and foreign firms are increasingly winning cases against retailers that sell fakes.

- Occupational deaths from industries such as coal-mining that are the highest in the world. China's media is covering these accidents and acts of negligence more openly.
- Tainted drugs, food products, personal care products, pet food that contain dangerous chemicals sometimes added as a substitute for active ingredients, causing injury and death when ingested. In 2008, the government completed an overhaul of all toy exporters' quality-control processes and acted quickly to recall food products suspended of problems.
- Exploitation of workers in remote kilns, or at piecework factories with abysmal conditions and low wages — two situations that are fortunately starting to change as company executives are thrown in jail and the government has begun to enforce a new set of labor laws from January 2008.
- Business and government corruption, including land grabs by government officials, price collusion by instant noodle manufacturers, nepotism, bribes, and kickbacks, are all still present, but are the target of central government campaigns to reduce the distorting effects they have on the economy.
- Social unrest arising from the extreme wealth divide between the cities and countryside and the inevitable problems as tens of millions of people relocate into cities, leaving rural lives behind. To provide them with affordable housing, the borders of large cities such as Shanghai are expanding quickly with low-income housing projects.
- Territorial disputes between China and neighboring regions create an environment of geopolitical instability. In our view, many of these potential hotspots will be resolved with business interests in mind: China and the US may fight over prices, Taiwan and mainland China may argue over direct flights from Taipei to Shanghai, but the chances of military conflict seem more and more remote.

- The high potential for inflation resulting from China's trade surplus, its currency exchange rate controls, lack of adequate convertibility of the Chinese RMB into other foreign currencies, and booming stock market and land price bubbles.

These issues have been headline news in the Western media whenever a story on the downsides of China's growth appears, whenever a new trade dispute arises or, in the sadder cases, whenever the circumstances are so truly shocking or sad that we can't help but pay attention. While examining these deep, mostly structural problems is beyond the scope of this book, it is important to acknowledge that China is still a developing country and, as such, is bound to face growing pains. One must also be aware of China's full situation because several of these problems have the potential to derail the Chinese economic miracle, for example, worker exploitation, social unrest and inflation.

Working in the coal mines

China's coal-mining industry is essential to energy production in China. About 80 percent of China's power comes from coal, and the government maintains control of the official price, which creates an environment rife for corruption and cutting corners to make more money. Inside China, it seems a week doesn't go by when another illegal coal mine, perhaps reopened after it had been closed for safety reasons, collapses and traps dozens, even hundreds, of miners below ground. The fate of these workers is not good as, being illegal in the first place, the mines have little safety equipment and the owners often do not inform authorities in a timely matter in the case of disaster, preferring to flee the area with cash in hand. So, the combination of poor facilities and poor management leads to an unreasonably high number of deaths. In 2006 and 2007, the government stepped up efforts to crack down on the unauthorized mines and increase penalties for operators. The State Administration of Work Safety announced a 20 percent decrease

in coal-mining fatalities for 2007, but that meant that 3,786 still perished.¹⁴ With China's use of coal only increasing and nearing shortage levels, this situation is not expected to end anytime soon.

On the other hand, cases of worker exploitation that were supposed to have been eradicated long ago seem to be back. 2007's case of worker exploitation in the north-western Shanxi Province brick kilns is one such example. It was found that certain factory owners, with connections to local government officials, had been essentially treating workers as slaves, without pay or freedom to leave. A death caused by management-hired thugs brought the issue to light in the media, all the more shocking for the fact that many workers had suffered physically and mentally, even to the point of being kidnapped from elsewhere to work in the kilns. In the ensuing investigation, more than 500 workers in similar conditions were rescued from a number of locations. China is no stranger to labor exploitation charges, perhaps the first widely reported story being the Nike shoe controversy of the early 1990s.

In fact these may be isolated cases, bad apples, to paraphrase the terminology used in the US case of Enron and other companies to describe poor corporate practices. There is evidence that labor conditions are improving steadily. Factory conditions have improved remarkably, especially in those connected with foreign investment. China has both a monthly minimum wage for full-time workers and hourly minimum wage for part-time work, set at the provincial level based on local conditions. The central government can influence the local governments to increase their wages in response to trade imbalance pressure and the growing urban/rural wealth divide.[‡] For example, in 2004, the monthly wage in Shenzhen was RMB600 (US\$85) per month while in Shanghai it was RMB570 a month

[‡]The minimum wage, as it does in the West, generally only applies to new workers, the untrained, or unskilled labor, many of whom may be newly graduated students or migrant workers, thus it is not indicative of typical wages Chinese workers are receiving. In fact, in the cities, there is a new class of white-collar workers who are earning thousands of RMB a month, buying cars and even their own apartments.

(about US\$81). By 2007, this had increased to RMB850 (US\$121) per month in the Shenzhen special economic zone area, and RMB840 (US\$120) per month in Shanghai. In July 2008, Shenzhen again increased the minimum wage to RMB1,000 in the city. In order to combat inflation, Guangdong Province announced it would raise the minimum wage from RMB780 to RMB860 (US\$122) per month.¹⁵ This is still somewhat less than a “dollar per hour” soundbite that is often applied to China and other developing countries’ labor rates, but with living costs in those cities being quite low it is still a livable, if not comfortable, wage.

In regard to part-time workers, the minimum is RMB6.5 (just under a dollar) per hour in Shanghai at present, but local market labor supply and demand are constantly testing these low numbers. For example, in 2007 a newspaper investigation showed that McDonald’s, KFC and Pizza Hut were allegedly underpaying their workers in Guangdong, prompting a full investigation by the provincial labor authority. In 2007, McDonald’s took the proactive step of raising its wages for 95 percent of staff, with those in Guangzhou and Beijing getting at least a full 15 percent above the minimum wage.¹⁶

Skilled-worker exploitation?

It is increasingly harder to argue about skilled-worker exploitation in the Chinese cities, where wages have risen quickly (10–15 percent a year in many places) and dramatically upset multinationals’ hiring plans. Suddenly, now that skilled Chinese workers are not so cheap anymore, prime office rents are through the roof, and people with international skills hard to find, companies are finding China’s labor environment to be very competitive indeed. While it is certainly still valid to talk about China as a low-cost labor country, the government wants to avoid that impression by focusing on more value-added industries, while low-cost labor-intensive products are being produced further west outside of the cities or even in other competing countries such as Vietnam. A recent survey by Mercer Management

Consulting, the world's leading human resource consulting firm, said that China was one of the most competitive labor markets in the developing world for finding and retaining talent.¹⁷

China Bubbles

Whenever you hear about over-building, skyrocketing land and stock market prices, and giant infrastructure projects, there is always the danger of an economic bubble. Indeed, China's construction projects alone would appear to qualify, but unlike other recent global bubbles such as the dot-com bubble in the US, the Thai land and stock bubble preceding the Asian financial crisis, or Japan's bubble economy of the 1980s, China's situation is fundamentally different: It has a managed exchange rate and capital inflow and outflow controls, allowing it to resist speculation and avoid (for the most part) hot money flowing into the economy. There are only a few things that could upset China's ascendancy to become the biggest economy on earth by 2050 or sooner. Various economists inside and outside China diverge on the details, but there is general agreement that the most likely scenario to derail China's upward trajectory is inflation.¹⁸

With its consistently high GDP growth and China's foreign currency controls, it may be said that China is pursuing a kind of neo-Mercantilist trade policy (though the fact it has joined the WTO and opened most markets speaks otherwise). It has already accumulated money to the tune of US\$1.76 trillion in currency reserves as of April 2008. An in-depth discussion of inflation and currency management systems is beyond the scope of this book, but simply speaking, with so much money accumulating inside a closed system such as China, the prosperity of the people is bound to put upward pressure on prices as they seek to spend their increasing wealth.

Two things have prevented this from happening in China in recent years. First, the RMB rate was kept undervalued from 1998 to 2005, and foreign currency transactions were controlled by the government and held as reserves rather than being circulated into the

system. Rather, China would prefer to buy Treasury Bonds from the US, financing the US debt, to allow the US to buy more products from China. Second, the Chinese population in general didn't have a lot of investment opportunities and thus tended to keep or reinvest a lot of their money without consumption, resulting in a national savings rate that has been around 50 percent for most of the last decade, compared with an essentially zero percent savings rate in the US.¹⁹

This fragile balance started to tilt beginning in 2006. With few places to invest their money (Chinese *outward* investment and the amount of foreign currency citizens can buy is also limited), the Chinese real estate and stock markets have been booming. Shanghai's stock market nearly doubled in 2007; the nationwide property price index has been on a steady increase for the last two years, with the national average in 70 cities increasing 11 percent in the first quarter of 2008, essentially growing more RMB wealth. Now, with China's state coffers overflowing with foreign currency and the RMB money supply starting to bubble up, this potential for inflation is compounded.

When Pork Flies

It all started rather quietly — pork prices in the local wet markets increasing, people buying more chicken instead. It had happened before: Farmers not slaughtering enough pigs causing a minor shortage, prices go up, farmers raised more pigs on this signal, the price fell back to normal or sold at a discount. The pig cycle was as constant a feature of life in pork-crazy China as the yearly rice harvest. Except, in 2007, it wasn't entirely about misjudging the market.

Farmers now had to pay more for grain, food prices were going up even for slop, a wave of blue-ear disease hit some stocks, medicines were expensive. For a while people did without, buying other meats instead, but it is hard to describe how important pork is to the Chinese diet. It is said that Mao Zedong's favorite dish was fatty fried pork in red sauce. With the exception of northern or western areas that tend to prefer lamb,

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most of China eats pork in the way Americans eat beef or Japanese eat fish. So, gradually, people started paying the higher prices.

Then the hoarding began. Regular consumers were seen fighting over rare discounts on pork, then some universities announced they would buy enough pork to serve their entire student body for the semester to keep prices stable for students. When all was said and done, pork prices increased more than 48 percent in 2007. Switching over to chicken or beef didn't help much either — they were up 39 percent on the year.²⁰

In 2007, warning signs of food price inflation were seen in China's consumer price index (CPI), the representative basket of goods that measures price levels (made up of about one-third food items, among other daily necessities). The CPI started off the year well enough at 2.2 percent in January (under the 3 percent target the central government had set, yet above the 1.5 percent average set in 2006), and throughout the year it continued to rise steadily and topped 6 percent regularly in the last half of the year, ending at 6.4 percent in December or 4.8 percent overall for the year. While hardly hyper-inflation, this was still alarming because the inflation resisted all attempts to tame it: Interest rate increases to discourage lending, deposit rate increases to encourage savings, forcing banks to hold more money in reserves, increasing the amount of foreign currency Chinese residents could buy and hold, stiffer penalties for price collusion, new taxes on stock market transactions, and real estate policies to discourage speculation. Finally, price controls and monitoring of key daily use commodities such as grain, cooking oil, tobacco, salt, meat, milk and the liquefied petroleum gas (LPG) that people run their motor-scooters on, automotive gas, diesel and even that most Chinese of foodstuffs, instant noodles. The government has even hinted at wider-ranging price controls on everything from medical care to tuition, even basic water and electricity. All actions and threats have failed. It's not just individuals who were suffering from inflation; the Producer Price Index reached a three-year high

in the first quarter of 2008, going up 6.9 percent. Power, materials, labor, everything is going up in price.

The final market force which would usually correct the upward inflationary pressure is the currency volume: If there is too much of a certain currency in the global system, its relative value begins to depreciate, thus reducing the ability of that country to buy more things in the global market. The only trouble with China is, it prevents its currency from decreasing (or increasing) based on global market supply and demand — it controls the value through what is called a managed float exchange rate policy. This control is similar to a cork on a bottle of champagne and, right now, the Chinese economy is a big *Nebuchadnezzar* which could pop at any moment.

Keeping this from happening is the guiding hand of China's central bank, the People's Bank of China, and ultimately it is China's leadership at the top that is trying to manage the ever more complex system to a soft landing rather than a bursting of the bubble. To the government's credit, the inflation hasn't yet reached unmanageable proportions, with a total yearly increase for 2007 of just 4.8 percent, triple the 1.5 percent CPI increase in China in 2006 (India, another fast-growing developing economy, was at 5.2 percent and Russia at 9.4 percent in 2007 in comparison) and interest rates are at a nine-year high but not unreasonable 7.47 percent, allowing further increases if needed.[§] Furthermore, the RMB has appreciated, albeit slowly, so while overheating of an economy is a worry, if you knew that the economy was going to continue to grow at least 5 percent per year for the next 10 years, isn't that a place you would like to be doing business in?

A growing number of economists feel China is likely to continue its strong growth path²¹ and China's own government in fact requires a growth rate of at least 7.5 percent during the 11th Five-Year Plan to achieve the goal of doubling per capita GDP by

[§]The government raised the benchmark one year lending rate six times in 2007, usually about a quarter percent at a time.

2010,²² and to keep generating enough jobs for the newly employable entering the market. Then there are the effects of international events on stimulating development:

China's economic growth will not slow down in the next five years with the hosting of the Summer Olympics in 2008 and Shanghai's hosting of the World Expo in 2010 and the subsequent halo effect, and most of all because the Chinese government would never allow a loss of face when the international spotlight is on China. China may even bid for the 2018 World Cup.

A high domestic growth rate also indicates healthy gains in corporate earnings, real estate and retail consumption — all key sectors to be looked at in the later chapters focused on various industries.

Crisis is Opportunity

All of these problems exist, are well-known and often-reported in more articles and books each year than most of us have time to read, yet the public and policymakers outside China never seem to tire of hearing about them with a sense of curiosity, *schadenfreude*, or dread.

It is not the purpose of this book to either ignore the problems or to go over ground that has already been covered in a number of excellent publications about China.

The purpose of the book is to reframe these issues for what they are to enterprising companies and entrepreneurs: Opportunities.

The Chinese word for crisis is 危机, spelled *wei'ji*, with the first character meaning *danger* and the second being part of another word commonly translated as *opportunity* or *chance*. It is almost a cliché now, but in the same way that Al Gore tells us global warming is one of the greatest threats to our environment and way of life, while at the same time saying it's an opportunity to enterprising energy-saving companies and individuals to shine, each of the above-mentioned issues in Chinese development becomes a chance for somebody to solve a problem and, incidentally, make a lot of money in the process.

Indeed, a graphic from *The Inconvenient Truth* movie shows Shanghai and Tianjin, two of China's most populace cities, being mostly underwater by 2050 if the worst-case climate change predictions are correct. The weight of some of the massive buildings in Shanghai is already causing parts of the city to sink into the ground.²³ This is a problem waiting for a solution.

Similarly, relocating hundreds of millions of people into cities is a very tough job, but you will also find opportunities relating to urban living, from construction to the service industries such as management consulting, accounting and human resources, and other services that are urgently needed in the industrializing and growing urban economies.

When it comes to cleaning up the environment, saving electricity, or generating new energy, China needs all three as soon as possible. The resulting opportunities in green businesses of alternative energy, pollution control, waste reduction and ecotourism are some of the biggest in the world. Red China is becoming green.

Finally, China's social issues such as aging, population imbalance, affluence and the wealth divide affect every industry from education and healthcare, to travel and investment. These are the basis for the supertrends and the biggest business opportunities in China's Olympic Decade.

The 21st Century's Biggest Economy

In the coming years, as part of what is increasingly being called the China Century, the largest creation and accumulation of private wealth ever to occur in the history of the planet will happen, in China. This is much bigger than Microsoft. In fact, by some projections, it's bigger than the biggest economy in the world today, the United States, which by 2050 or even sooner China is predicted to surpass in terms of GDP.²⁴

China's own National Bureau of Statistics announced China's 2007 GDP growth was 11.9 percent, revised from the initial figure of 11.4 percent. Either way, it was above forecasts and possibly straying into overheated growth. The World Bank in 2006 projected the Chinese economy would grow at 11.3 percent in 2007, and slow to 10.8 percent in 2008. Where most developed countries strive for 3 percent as a respectable figure (the growth for the United Kingdom was 2.8 percent in 2006 and the United States grew at 3.3 percent in the same year), 10 percent and higher growth stands out.

The Chinese government has made it a priority to manage the growth. Among developing countries, those rates are not unheard of, but China has maintained the growth for more than *20 years*.²⁵ The first priority then is to keep the economy, awash in money from export trade and domestic demand, from overheating as inflation threatens to wipe out the savings of the already poor rural populace and reduce quality of life in the cities. China's Premier Wen Jiabao said at the 2007 National People's Congress that GDP growth needs to be kept under 8 percent in 2007,²⁶ yet Shanghai's GDP grew by 11.9 percent in 2007, the fastest pace since 1994, according to the National Bureau of Statistics. The Chinese National Academy of Sciences predicts that growth will slow to 10.8 percent as higher interest rates and monetary tightening policies implemented in 2007 begin to take effect, but the potential for overheating of the

economy is still there as exports and the trade surplus continue to increase.

As with the national economy's tradition of five-year plans (China is currently in the midst of its 11th Plan), Chinese cities also have five-year plans, and with the biggest cities growing at above the national target, both Shanghai and Beijing have set more conservative growth targets in order to act as the brakes on the economy. Beijing, for example, is aiming to grow at a reasonable-sounding 9 percent a year for the next five years and wants to increase its per capita GDP from US\$7,000 to US\$10,000 by 2012. Shanghai, on the other hand, always the faster-growing of the two, will nearly double its GDP from about US\$165 billion in 2007 to US\$276 billion by 2012, a yearly growth of about 10 percent. Shanghai, which has recorded double-digit growth for the past 15 years, usually greater than 11 percent, perhaps did not want to suffer the loss of face from breaking its streak by merely matching Beijing's target. Next to Shanghai, nearby Jiangsu Province continues to grow at 14 percent plus growth rates as well, showing that the regional economy which Shanghai is a part of is hard to slow down. Shanghai's per capita GDP is projected by the government to reach US\$13,800 by 2012.

Superlatives, Chinese Style

While biggest, tallest, fastest doesn't always mean best, some of China's megaprojects and feats of business daring make for interesting experiences.

Fastest passenger train in operation: The Shanghai Maglev train connecting the airport to halfway to downtown — 432 kilometers per hour.

Tallest bungee jump: Macau.

Biggest ferris wheel: First there was the Tianjin Eye, at 110 meters, then the planned Shanghai Ferris Wheel (which has been derailed, for now, pending additional studies) at 170 meters, but they all pale in comparison to the US\$100 million Great Wheel of Beijing, a 208 meter

(Continued)

monster that dwarfs the 135 meter London Eye. The Beijing Great Wheel will have 48 cars that will carry 40 people each and it will be finished in 2009.

Highest cellular tower: Mt. Everest, 6,500 meters, giving mobile phone service to the handful of mountain climbers, sherpas and yaks.

Biggest shopping mall in the world: South China Mall in Dongguan, Guangzhou, 7.1 million feet of leasable retail area (and may also be one of the emptiest, as leasing has yet to reach capacity). The second biggest mall in the world is in Beijing, at 6 million square feet. The Dubai Mall is projected at 9 million square feet but, not to be outdone, the American developer of the Mall of America is trying to build a 10 million square foot facility (that's three times the size of America's biggest mall, the King of Prussia Mall in Philadelphia) in Wenzhou, the boomtown south of Shanghai that made it big in shoes and cigarette lighters.

World's tallest hotel: Depending on when you set the bar, at the time of writing the world's tallest hotel is the Grand Hyatt Shanghai on the 88th floor of the Jin Mao Tower, but it will be surpassed by the 93rd floor of the Park Hyatt in Shanghai's new World Financial Center building in July 2008, and then possibly by the Hong Kong Ritz-Carlton Hotel in 2009.

Longest ocean-crossing bridge: The Hangzhou Bay Bridge, joining Shanghai and Ningbo, 36 kilometers long at a cost of US\$1.7 billion, and opening in 2008.

Biggest airport/building in the world: Terminal 3 and the Beijing Capital International Airport, 2.95 kilometers long, 1.3 million square meters of floor space, at a cost of US\$3.8 billion.

When is the best time to invest in China?

Now. As this book is being written, China is finishing preparations for the 2008 Olympics to be held in Beijing. As a preview for the Olympics, China held the Special Olympics in October 2007 in Shanghai and it was said to be the best ever. The city was mobilized with more than 40,000 volunteers to host 7,500 athletes and

families, and the event's opening and closing ceremonies were so elaborate and expensive that they rivaled the ceremonies of the actual Olympics in prior years. Opening ceremony tickets were not sold to the general public, only to groups, but there was no difficulty filling Shanghai's 80,000-person stadium. It is a sign of things to come from China and a strong indicator of the power the Olympic effect will have on China, not only in 2008, but in the entire Olympic Decade.

As of May 2008, the Olympic Torch Relay had suffered major protests in the UK, France, and the US, but continued onwards in a more subdued manner throughout South America, Africa, and South-East Asia. At the same time, protests against Western media such as CNN and companies such as France's Carrefour supermarket chain continued. Yet the Olympics will undoubtedly go on and be successful as China's window to the world, but the country will have to find some real solutions to the problems the extra attention on China is likely to bring.

The Olympic effect is a well-known, if not scientifically proven, correlation between development and the cities and countries that host the Olympics. The difference is in the size of the effect, China's GDP and population being much larger than many of the countries that have hosted the Olympics in recent years. China has been aspiring to host the Olympics for decades and, now that time has finally arrived, all levels of the government are fully behind it: Beijing, city governments in regions around the country where other sports venues have been constructed, and the national government wanting to ensure the entire event puts China in a good light, as well as helping to stoke the economy in a more sustainable direction.

The Olympic effect is not just about land prices, it is about the economic activity that results from the construction of the venues (approximately US\$1.8 billion in direct spending on venues, billions more on city beautification, neighboring developments both residential and commercial), the media promotions, the everyday

citizens participating in sports and leisure in greater numbers, and the business opportunities resulting from increased tourism.²⁷

With the upcoming Shanghai World Expo²⁸ in 2010, hosting the Asian Games in Guangzhou (also in 2010), and other events, China's economy will continue to be stimulated to grow through both internal and external challenges, meaning that now is as good a time as ever, in fact probably the *best time ever*, to begin or increase your business here.

What You Will See in China

Each chapter ends with a summary of the drivers, trends or opportunities mentioned within. When it comes to China from an introductory perspective, we may now better understand China's positive and negative sides, and some bear repeating before moving on:

1. You need strength to catch a trend, and trends are caught by those who know in advance what is going to happen. This book is your guide to become rich and glorious by riding China's *Supertrends*.
2. Increasing air travel over the last five years and predictions of global companies like Boeing for the next 20 years indicate a clear trend: More and more business is being done in China. Are you one of those people on the next plane?
3. China comes with good, bad, and downright ugly problems. Each problem, however, is a potential opportunity for businesspeople to solve. The best trends and how you can make money from them are covered in the following chapters.
4. China's growth will not slow down in the immediate future, thanks to the positive growth effects related to the 2008 Olympics and 2010 World Expo in Shanghai, so what better time to get into the economy?
5. China's markets are now open to foreign competition across most industries. Markets may still be highly regulated or suffer from structural issues (such as IPR enforcement) in some cases, but it is better to jump in than miss the boat.

Overall the message seems clear: China now!