American Developers Abroad: Prospects in China

by

Zhu Xiao Di

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Signature of Author ______________________
Department of Urban Studies and Planning
May 10, 1991

Certified by ______________________
Dr. David Birch
Senior Researcher and Scientist
Thesis Supervisor

Accepted by ______________________
Professor Philip Clay
Chairman of the MCP Committee
Department of Urban Studies and Planning

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ABSTRACT

In the past decade or two, the U.S. has witnessed a tremendous amount of development. However, many of the forces driving this development boom are on the wane or reversing direction. For many years to come, domestic demand will fail to match supply. A gloomy domestic market reinforces the efforts in searching for a global prospect.

Although currently not a "hot" spot, China prospect has its own significance. This thesis first discusses, in brief, the passing of the construction boom in America, highlighting the need to explore a global market, particularly looking at prospects in China. It then introduces the traditional ways of getting things done in China over past forty years in terms of project development. It carefully reviews the most recent period of history when a lot of development projects have been completed in China with foreign developers and investors playing an important role there. It also includes four case studies, one big development project in Shanghai, an early hotel project in Nanjing, another hotel complex under construction, and a hotel renovation project in Warsaw, Poland, illustrating the difference in development process between America and a different society such as China and Poland.

It gives updated descriptions of the current business climate in China for foreign investors, particularly for American developers, and raises the question of whether China's market potential should be readdressed, and then helps to redefine the market in China for foreign developers, including Americans. It highlights the different development skills needed in different societies. Simply <u>transferring</u> the development skills of an American developer to a potential Chinese market will never be a solution. A developer has to <u>adapt</u> and <u>adjust</u> himself in the new environment and, most of all, must be willing to do so.

In short, it summarizes the past experience and assesses future prospects in China for American developers, and may serve as an adaptive guide to those willing to adjust to the unaccustomed setting.

Thesis Supervisor: Dr. David Birch

Title: Senior Researcher and Scientist

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Introduction

In the past decade or two, the U.S. has witnessed a tremendous amount of development, particularly in primary office space and downtown shopping malls. Along with this rapid expansion has come the establishment of sophisticated development and construction capability on an unprecedentedly large scale. However, by the end of the 1980's, signs of overdevelopment appeared. What is more, many of the forces driving this development boom are on the wane or reversing direction. The present surplus of development capability will not be easily absorbed. For many years to come, domestic demand will fail to match supply.

What will happen to this oversupply of development capability? Will it die out or move elsewhere? Where will it move? Attention at the moment may be attracted to some current "hot" spot such as Eastern Europe, but settings now less in the limelight may offer better, especially long-term opportunities. I propose to examine the potential in one such setting: the People's Republic of China. Actually, because of the similar social structure in socialist countries, the China case may even provide useful guide for the prospective Eastern European market.

Whenever long-term planning for a potential international market is under concern, it is easily justified to put China on the top of the list. The mere fact of holding a quarter of the human population makes it an important prospect for anyone seeking a large market. For more than a century Western businessmen, including Americans, had their eyes on China and never lost a chance to try their luck there. In the last decade, after thirty years of locking its door against the West, China threw the door open, attracting visits from tens of thousands of Western businessmen, American developers among them.

Since the early 80's, American developers joined others in exploring and sharing in a new China market. Yet, in just a few years, the developers experienced much too dramatic a market change. Within a five-year span, most of those who had done any projects in China were already in a most unfavorable situation. There was too much oversupply. One domestically-built Beijing hotel even reported an occupancy rate of 15% in December 1987.[1] The political setback of the Spring of 1989 merely capped the trend; it did not begin it. On the other hand, many foreign developers had spent a fair amount of time and money, yet had erected not a brick.

Yet, it does not necessarily mean that all the opportunities are gone or that foreign developers never made any money in China. For instance, in the mid-80's, the rent for a three-bedroom apartment in Beijing was in the range of $3,000 to $6,000 a month, [2] even more profitable than a property in Manhattan. Today, because the Chinese government is more desperate than ever in soliciting foreign investment, the cost of land in many areas is merely 10% of what it was a couple of years ago. In some cases land could rent for as little as $0.10 per square foot per

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[1] Far Eastern Economic Review, March, 1988, p.54.

[2] a) The China Business Review, July-August, 1985, p.36; b) The Real Estate Finance Journal, Winter, 1990, p.46.

year.[1] New realities are generating new mystiques. It is worthwhile to explore this realm or nation of mystiques.

To proceed, this thesis will first discuss, in brief, the passing of the construction boom in America, highlighting the need to explore a global market, particularly looking at prospects in China. It will introduce the traditional ways of getting things done in China over past forty years in terms of project development. Then it will carefully review the most recent period of history when a lot of development projects have been completed in China with foreign developers and investors playing an important role there. It will include four case studies, one big development project in Shanghai, an early hotel project in Nanjing, another hotel complex under construction, and a hotel renovation project in Warsaw, Poland, illustrating the difference in development process between America and a different society such as China and Poland.

The proposition to be explored then is this: despite the recent political setbacks in China, China's market potential should be readdressed. The basic premise, however, is that different societies require different approaches to assessing market potential. China's 1.1 billion population, if taken alone, could be a misleading indicator of market potential, particularly in real estate and especially for foreign developers. Moreover, developers as team leaders in production need quite different skills in different societies. Simply transferring some of the surplus American development capability to a potential Chinese market will never be a

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[1] Far Eastern Economic Review, June 28, 1990, p.69.

solution. A developer has to adapt and adjust himself in the new environment and, most of all, must be willing to do so.

It is hoped that this thesis will serve as an adaptive guide to those willing to adjust to the unaccustomed setting. At the same time, the thesis is also aimed at helping to redefine the China market potential for foreign real estate investors.

Part One

Boom Is Over In America, And Global Market Shall Be Explored More Earnestly [1]

Section A: Boom Is Over

The bulk of the construction boom in America in the last decade or so was office space. There were many forces driving this development boom. However, several of those forces are on the wane or reversing direction now. Therefore, such a boom not only is no longer sustainable, but also is not expected to appear again in the near future. Because of this domestic market, incentives to explore market abroad are expected to be even stronger now than ever before.

To illustrate this change in the driving forces of the past real estate boom in America, let's look at one of those factors, i.e. the demographics. A surge in the workforce will understandably demand additional office space. But what happens when that surge has passed? Unfortunately, many people seem to have ignored this issue. So we built more office space than we needed.

When office space started to boom in the 1970s, the demographics were "right" to support such a boom. At that time, the number of young people entering

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[1] For detailed sources of the statistics used in this part of the thesis, see America's Future Office Space Needs: Preparing for the Year 2000, by David Birch, Susan MacCracken Jain, William Parsons, and Zhu Xiao Di, National Association of Industrial and Office Parks, 1990.

the labor force was increasing rapidly. These new entrants were associated with new jobs and demanding new space. Particularly between 1960 and 1975, the percentage of new entrants in the total labor force was increasing. In other words, the number of new entrants increased more rapidly than the labor force as a whole. The driving force behind this increase was the Baby Boom or War Babies phenomenon.

After the Second World War, many more babies were born per year in this nation than before. In 1940, there were only 10.5 million U.S. children younger than five years old. By 1950, that number had increased to 16 million. In 1960, it was over 20 million. That is to say, the number of babies born between 1955 and 1960 was twice the number born between 1935 and 1940. This dramatic increase has often been referred to as the Baby Boom or War Babies phenomenon, for all of those babies were born after the Second World War.

As time passed, this "bulge" passed through different age groups much as a watermelon might pass through a snake. By 1970, the boom was in the age groups 15-19, and 20-24. The numbers of these two age groups jumped from 13 million and 11 million in 1960 to 19 million and 17 million in 1970. Because these age groups were the source of most new entrants into the labor force, there was a new entrants boom by 1970.

However, this baby boom phenomenon continued for only about one generation. The number of children younger than five years old dropped from 20 million in 1960 to 17 million in 1970. This remarkable drop, often referred to as the baby bust, created a very similar trough following the bulge for each different age group. As a result, in the past decade, the size of the age groups between 15 and 24 has noticeably dropped.

The reason behind this drop is a drastic drop in the fertility rate. Between 1960 and 1970 it dropped by more than fifty percent. Fewer mothers had babies, or each mother had fewer babies; overall fewer were born. It is that simple. Many people thought that members of the baby boom generation, when they reached childbearing age, would in turn create another baby boom--an ″echo effect″--making the boom continue cyclically forever. But, that did not happen. The potential cyclical effect of the baby boom was almost completely offset by the decline in the fertility rate.

In 1990, there is supposed to be an ″echo″ boom in the youngest age group. But this echo is only one-fifth the size of the original Baby Boom. The next ″echo″ will be only one-fifth the size of this ″echo″; at this rate the ″echo effect″ will soon die out. The long-term consequence is a decline in population growth. The baby boom phenomenon is only an accidental exception, occurring during the after-war economic boom.

In conclusion, since the war, the baby boom effect increased the number of new entrants into the labor force until it peaked in 1980. In the decade since then, the baby bust effect has decreased the pool of new entrants into the labor force. In the future, this ″echo effect″ may again increase the number of new workers a little, from time to time, but never in as much magnitude. And this echo effect will soon die out.

What is more, people began to retire earlier over the past three decades, especially males. Thirty years ago, more than thirty percent of the men over 65 years old were still working. Today, only 15% of the men of this age are working. In the next decade, less than 10% will still work. Even people in younger age groups retire earlier. Thirty years ago, 85.2% of men between 55 and 64 were working; today, the figure is only 65.5%. Meanwhile, more women retire before the age of 65. In 1960, more than 10% of the women this age were still working. By the year 2000, only 5.4% of women this age will be working. This dramatic decline in the retirement age, together with the decrease in the number of new entrants into the labor force, will constrain our workforce during the next decade. As a result, not only have we built too much for the present, but we will not have a large demand in the future.

Section B: Search for a Global Market

A gloomy domestic market reinforces the efforts in searching for a global prospect. For many developers, it is not a nicety, but a necessity, to move globally. Some developers may even move in such an astonishing manner. For example, the following day of the lift of Kuwait from Iraqi occupation, deals about redeveloping the international airport at Kuwait City were already made. It is not our task in this thesis to persuade American developers to move into a global market. Nor are we advocating a China market for them. All we want to do and have to do is to contribute to the existing, accelerating search for a global market, and therefore contribute our knowledge to the growing global economy.

Although currently not a "hot" spot, China prospect has its own significance. First, China with its huge population always seems appealing in terms of offering long-term opportunities. Later in this thesis we will deal with the issue of readdressing the China market in more details.

Second, China experience in the past decade may offer useful guide to future development in other socialist countries or formerly socialist countries, including Eastern Europe and the Soviet Union. Actually, comparing the Chinese experience with an Eastern European case may be even more interesting and informative for any Americans who think seriously about doing business in China or Eastern Europe, or the Soviet Union. Later in this thesis we will use one such case in Poland and compare it with Chinese cases.

Third, although it may sound odd both ideologically and morally, the current situation in China after the bloody event in Tiananmen in 1989, compared with the chaos in a declining Soviet empire and the transition from a centrally-planned economy to a market economy in Eastern Europe, may seem even more appealing to the Western business world, especially to the developers. One of their rules of thumb is that "among a developer's best friends are clarity, predictability, and stability in government policy, rules, and regulations." As Fleissig and Kayden, who taught a real estate seminar in China last summer, pointed out: "If they [the Chinese] understand that certainty, stability, and predictability are a developer's best friends, then maybe they will increasingly appreciate the need for political stability as a prerequisite for robust foreign investment."[1] In that sense, the risks of investment in China, compared with the risks of investment in other communist or formerly communist countries, such as Eastern Europe or Soviet Union, are not necessarily higher, if not lower. In terms of operating in China, Hilton comptroller Alan Bredile once said: "We don't find it any more difficult than, say, getting along with New York labor unions."[2]

Fourth, in a most recent move, China announced a new tax law effective from July 1, 1991. The law consolidates varying rules for different types of ventures and sets a uniform basic tax rate of 30%, plus a 3% local tax, for all foreign enterprises. (Existing lower-tax incentives in special economic zones (SEZs)

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[1] Urban Land, September, 1990, p. 14.

[2] Real Estate, March, 1986, p.128.

and development zones are intact.) What is more, the law abolishes a 10% withholding tax on dividends sent abroad. To Americans, this 30% tax rate is below the U.S. federal corporate rate of 34%. This reassures U.S. companies that they won't generate excess foreign tax credits that can't be applied to U.S. taxes.[1] According to Richard Hammer, a specialist in Chinese tax policy at Price Waterhouse, "That's very progressive and sets China apart from other countries."[2] Overall, on top of relative low labor costs and an improving infrastructure, as Hammer says, the new tax law makes China very attractive to foreign investors.[3]

As China may become more attractive to foreign investors in general, it will also generate more opportunities for foreign developers, including American ones. Since most of them are still fairly ignorant about this vast, mysterious land, first let's look at how things got done in China in the past forty years or so, i.e. since the foundation of The People's Republic of China.

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[1] The Wall Street Journal, April 24, 1991, A1.

[2] Ibid.

[3] Ibid.

Part Two

How Did Things Get Done in China?

Section A: A Centrally-Planned Economy and Society

China does not have "developers," as far as the word has been understood by Americans. Yet projects did get built in China in the past forty years. How did things get built? It will be helpful for the American developers who want to build anything in China to understand the "traditional" development process in China. American developers may have quite a different role to play if they try to build anything in China, as shown by the past ten years. But the traditional process in the Chinese domestic development will likely to have some effect on the new projects done by any foreign developers.

First of all, we have to understand how a centrally planned economy functions. The following description helps illustrate the difference between a centrally planned economy and the Western market economy:

> Consumer goods flow from producers to consumers. Labor services flow from consumers to producers. Material inputs and capital goods flow from producers to producers. In a market economy all flows go through markets. In a centrally planned economy all flows are controlled by the planning authority. It orders the producers to produce certain consumer goods and distribute them to the consumers. It assigns labors to work in various production units. It orders producers to produce material inputs and distribute them to

> other producers. It also directs the production of capital goods and the construction of investment projects.[1]

In China's centrally planned economy, such serious concerns for a Western capitalist economy as profits and efficiency were not major considerations. Currently they may want to consider those issues earnestly, but the system constrains the capability of doing that. That is why the reform taking place in China since late 1970s has happened in the first place. The fundamental issue is that, in a centrally-planned economy, products themselves are seen as goals, not means to achieve profits.

What is more, in a shortage economy in which there is centralized control and allocation, the key concern is the availability of necessary inputs, not their price. The state's central administrative organs fix prices for most important consumer and producer goods. Local economic bureaucrats set the price and control the supply of locally distributed products. Prices of food, clothing, housing and other products have little to do with their actual cost or demand, and more to do with what the government believes are "necessities" and what type of consumption pattern it wants to encourage. The products from an inefficient factory in which unit production cost are high will be priced the same as products from a highly efficient factory.

> For this reason, in a centrally planned economy, although prices affect consumption patterns, they neither encourage nor discourage production; for the objective of enterprises is not to make profits but

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[1] China's Unsolved Issues: Politics, Development, and Culture, by Suzanne Ogden, Prentice Hall, Englewood Cliffs, New Jersey, 1988, p.262.

> to fulfil quotas. Managers do not make decisions based on price. If an enterprise does make profits, the bulk of them are turned over to the central planning authority. If the enterprise loses money, the state authorities may blame the manager but will subsidize the loses. [1]

This system did not change much until October 1984 when the Party Central Committee further decentralized control over state enterprises. Instead of remitting profits to the state, they started to pay taxes on profits. However, that did not change the essential vertical relationships in the social network or fabrics.

A centrally planned society is a hierarchical society, where everyone (i.e. either an individual, or an organization, or an agency, or an institution) has its status in the network of vertical relationships. Each one belongs to someone else, except the highest authority. One's status depends on to whom it belongs. For example, all factories manufacturing chemical products would belong to a government agency called Bureau of Chemistry. From central, provincial down to city or county level, each level of government has its Bureau of Chemistry. The status of any chemical factory depends on to what level's Bureau of Chemistry it belongs. To a large degree, this status decides how much priority it may have in its accessibility to inputs distribution.

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[1] "China's Unsolved Issues: Politics, Development, and Culture", p. 261, Suzanne Ogden, Prentice Hall, Englewood Cliffs, New Jersey, 1988.

Section B: Process and Procedure of Development [1]

In terms of property or project development, in a planning economy, any higher level government or authority can order its subordinates to build any project. On the other hand, those who want to initiate a project must apply for and get approval from higher level authorities. The following is the regular procedure of such a process.

All projects have to be approved by Economic Planning Committee of local and/or the central government, depending on the size of the project. The applying and approving process is called "establishing the project," a standard technical term used nationwide. The application should include: 1) reason--why it should be built, 2) land size, building area, and type of frameworks (e.g. steel, bricks, etc.), 3) investment budget and resources, 4) social and economical effects and/or returns, 5) configuration, geologic and hydrologic data if necessary, and 6) date of completion. The application should get approved first by the responsible local governmental department (e.g. the Department of Education, if it is a school project; or the Department of Culture, if the project is a cinema), and then by the Economic Planning Committee of the same level of government. If the project is large enough, it may require approval from the same types of agencies at a higher

[1] This part is based on correspondence with several Chinese who have been working on project development for more than ten years in China.

level authority. Once approved, the project is "established" and may go for the process of design.

However, if the land on which the project is to be built is not under the control of the "building unit" (i.e. the institute or organization or anyone who initiated the process to build such a project as its eventual owner), an application for controlling the land by eminent domain has to be filed and approved by the Land Planning and Management Bureau of the local government. For more than three decades in China, those who currently occupy the land had actual controls over the land. In other words, they can fill in the undeveloped or underdeveloped areas until no room is left. From then on they have to apply for control over new land or site if they want to build anything more. If approved, the design process may begin.

Design work is done by contracting with a designing institute. Most Chinese cities have a designing institute. Each province also has one. A designing institute is a state-owned institute with professional architects organized in doing team work on project design. It will survey the topography and do the design according to the requirements of the "building unit." The range of design usually includes framework, structure, water, electricity, ground foundation, lighting, etc.. Usually, it takes two to three months to design a building of twenty to thirty thousand square feet, and the design fee is about three to five percent of the total investment or development cost.

For a large scale project, a design program may be required. Principal concerns in a design program are: 1) topography, 2) function--specifying different functions for different areas, 3) facilities such as water, electricity, etc., 4) diversifying design pattern, 5) focusing the center building, 6)traffic mitigation, and 7) landscape. A design program needs to be approved by the responsible governmental department again. But before its approval, written opinions from several other governmental agencies--Planning Bureau, Fire Department, Health Care Bureau, Environment Bureau, etc.--are required. A design program may take one to two years to complete and three to five years to implement.

After design drawings having been done by the contracted designing institute, the "building unit" should apply for a construction permit from the Planning Bureau of the local government. Once approved, the Planning Bureau will draw redlines on the design drawings and set construction lines on the site. No construction work can be done beyond the set lines. This process is generally referred to as "setting redlines."

With construction permit and approval from the local government, the "building unit" can bid for a "construction unit," a professional construction company with a construction certificate. There used to be only state-owned construction companies in China. But in recent years, construction sector grew fast mostly due to the establishment of numerous collectively or privately owned construction companies. The bidding process may or may not be open to the public. The winner signs a contract with the "building unit." The contract may or may not cover the building materials. If not, all the building materials are provided by the ″building unit;″ otherwise the ″construction unit″ provides all the materials while the ″building unit″ pays at the government-fixed price. Because of the various prices of the building materials in recent years due to the reform, many ″building units″ now choose to try to buy the materials cheep and then provide the materials to the ″construction unit.″

The final process of construction is inspection and certification. After the construction done, the ″building unit,″ the Planning Bureau, Construction Bureau, and the responsible governmental department will inspect and provide a certificate for the completion of the construction of the project.

In summary, the main issues of any project development are the following:

a) How do you get money for the project? If you do not have the money, can you borrow it? If not, the only thing you can do is to ask for grant from the responsible governmental agency along with your application for the approval of the development. That, obviously is going to complex if it does not jeopardize your development plan altogether.

b) Similarly, you have to have access to building materials. Usually, each institution or ″working unit,″ as it is called in China, has a certain quota of building materials, provided the institution or the ″working unit″ is large enough. Beyond the quota, if you want to build anything more, you have to find access to extra materials. Again, you may ask the responsible governmental agency for help, but that just puts you further away from the implementation of the development plan.

c) Do you have control over the land on which you want to build your project? If not, you have to apply for that kind of control over the land if you have a site in mind. Otherwise you simply request to be given a site from the higher level authorities. Needless to say, if that is the case it will take a long while before you can move an inch further on your development plan.

d) How do you get approval from those governmental agencies? That depends on the type of development project you want to do. At different times, different types of projects get different degrees of priorities from different levels of government or authorities. Timing is the most important issue, although how you frame and phrase your plan is also critical. Bureaucratic headaches are notorious in China's daily life. Actually, ancient China has been given the credit for creating or inventing the bureaucratic system.

e) Finally, you have the problems of the design and construction teams because of the supply constraint. During a construction boom you may find it very hard to get a design institute and/or a construction team.

There may be even more issues at hand, such as public relationship problems. For foreign developers who understandably know less about the subtleness of this local relationship, the issue might be even more problematic. For example, Clement Chen, the foreign developer for the first joint venture hotel project in Beijing, Jianguo Hotel, in order to secure the cooperation of all possible city organizations, threw a cocktail party for representatives of about 40 different agencies, from the police and fire departments to the telephone office and the parks administration. Still, one neighborhood committee was overlooked, and the project was plagued by residents who interrupted work when they hurled watermelon rinds and empty bottles, among other things, at the rising structure.[1] This might be a best example why a foreign developer should try to learn about how things get done traditionally in China.

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[1] Real Estate, March 1986, p.122.

Part Three

What Happened in the Last Decade or so in China, In Terms of Real Estate Development With the Involvement of Foreigners?

Section A: Booming from Nowhere

After nearly thirty years of isolation and/or internal turmoil, in late 1970s China finally opened its door to the world. In view of its over one billion population, both as potential customers and as cheap labor supply, the opening of the country immediately generated excitement among the investors of the Western world. Beginning in the late 1970's, waves of foreign businesses arrived and established their presence in China. Among those newcomers was a handful of real estate developers and investors, who saw a lucrative playing field devoid of much competition.

Ever since Marco Polo's exploration, China has intrigued the rest of the world as a land of mystery and wonder. During the Cultural Revolution, the country was almost completely closed to outside world. This isolation has resulted in a tremendous tourist demand, which became the first opportunity seized by those foreign developers and investors.

Tourism receipts increased dramatically and provided the country with desperately needed foreign exchange. In 1979, approximately 1 million foreign visitors made trips across the country, spending Rmb 175 million (about US $ 113 million [1]) on travel, accommodation, food, and memorabilia. It may seem low that, on average, each person only spent $113, but that was already about six times of the monthly salary of an average Chinese city resident at the time. In the following year, these tourism figures jumped by an incredible 488 percent! [2] The response from foreign investors and local authorities was expectable. A real estate gold rush was under way to meet the increased demand.

The first hotels built with foreign capital were mostly joint ventures between foreign firms and the Chinese governmental agencies. The most noted of these hotels include the Jianguo Hotel and the Great Wall Hotel of Beijing, the Jinlin Hotel of Nanjing, and the White Swan and the China Hotel of Guangzhou.

The China Hotel in Guangzhou is typical of the new hotels. It is nineteen stories tall with 1,200 hotel rooms, offices, apartments, and a shopping arcade. Initially it employed 180 managerial personnel and 3,000 staff, including both foreign and local personnel.[3] It was reported to have generated a return of US $20 million in the first year of operation. On a US $100 million investment, that accounts for a substantial rate of return.[4]

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[1] Real Estate Finance Journal, Winter, 1990, p.42. The author of the article used a wrong exchange rate in calculating the equivalent value in American dollar. The mistake has been corrected here.

[2] Ibid.

[3] Real Estate Review, Fall, 1988, p.88.

[4] a) Real Estate Review, Fall, 1988, p.90; b) Real Estate Finance Journal, Winter, 1990, p.43.

The first three joint venture hotels opened in Beijing, the Jianguo (1982), Great Wall (1983) and Holiday Inn Lido (1984), were almost instant successes.

Jianguo Hotel in Beijing is the product of a joint venture of Clement Chen & Associates, a San Francisco real estate development and management company, and China International Travel Service, a quasi-governmental agency of China. It occupies 183,000 square feet of land; building area is 323,000 square feet; and there are 529 hotels rooms. The term of the joint venture was specified as ten years.[1] After then, the foreign partner is supposed to transfer its share of stocks to its Chinese partner at the book value, according to China's JV law.

When Clement Chen first went to China in November 1978, as many other American, Asian and European early arrivals, he was dreaming of a vast hotel chain across the entire country. However, a ten-day tour put a bridle on such ambitions. In some cities land available for a hotel site was not even accessible by roads, not to speak of other amenities. The relatively primitive state of the country convinced Chen that what China needed most was not a big fancy hotel but a no-nonsense one. He then came to the idea and suggested to Chinese officials that he replicate a Hilton hotel that he had just finished building in Buffalo, New York. By using exactly the same design and specifications, he could save on costs as well as time. The Chinese authorities bought the idea. So, now the Jianguo Hotel in

[1] Beijing Guide, Beijing Daily Press, 1983, p.99.

Beijing and the Hilton Hotel in Buffalo are virtual twins--with identical floor plans, carpeting, draperies, and furniture. [1]

The success was immediate. Since its opening in February 1982 through 1986, the 529-room Jianguo Hotel in Beijing had nearly a 100% occupancy rate.[2] Payback on the investment was remarkable during this period: Clement Chen's net profit on the Jianguo Hotel in 1983 was $1.5 million and doubled every year in the following two years.[3]

Part of its secret to success was to bring in skilled outside management, according to David Hayden, a partner of Graham & James, who negotiated the joint venture for the Jianguo Hotel. He compared Jianguo Hotel with another project in Beijing, the Great Wall Hotel, developed by Becket Investment Corp., an arm of the Los Angeles architectural firm Walton Becket Associates. At first, the Great Wall Hotel complied with the Chinese authorities' wish by using local staff. A year later, however, its US owners decided that they had to ask Sheraton to manage it for them.[4] Since then a 95% occupancy rate had been enjoyed, and by 1986, McDonald Becket, chairman of Becket Associates, admitted that the

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[1] Real Estate, March 1986, p.122.

[2] Forbes, July 29, 1985, p.104.

[3] Real Estate, March, 1986, p.122.

[4] Forbes, July 29, 1985, p.104.

returns on invested capital "so far have been substantially more than 25 percent a year." [1]

But a far more important factor leading to the successes of these early projects is the best timing for these projects. As long as a project was among the first in the city, its immediate success was guaranteed. Another Sino-foreign joint venture project, the Astor Hotel in Tianjin, reportedly earned a profit of US $1.6 million in its first year of operation in 1986, on a renovation investment of US $10 million.[2] Since the potential returns were real and compelling, the general mood of the investors were very high. An investor in one non-hotel project said he expected to get his money back in five or six years, at least twice as fast as he was accustomed to in the U.S..[3]

By mid 80s, virtually all the major U.S. hotel chains were looking into this alluring market, either through management contracts or as partners with other developers. Holiday Inns, which was then managing the Holiday Inn Lido in Beijing, was negotiating additional management contracts as well as considering going into development. The Hilton chain's Shanghai hotel, developed in partnership with a Hongkong-based developer, CINDIC Corp., was scheduled to

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[1] Real Estate, March, 1986, p.122.

[2] a) Real Estate Review, Fall 1988, p.90; b) Real Estate Finance Journal, Winter 1990, p.43.

[3] Real Estate, March, 1986, p.122.

be completed in 1987.[1] As word of the returns enjoyed by early entrants spread, the crowd of aspirants continued to grow.

The underlying reason for these early successes is the rapid increase of foreign expatriates and tourists in major Chinese cities. Until 1980, the Beijing foreign community was a small enclave of diplomats and business people whose activities centered on the Beijing Hotel and foreign embassies. But according to a study by the Capital Construction Department of the Beijing Planning Commission, the city's foreign population swelled to well over 10,000 by 1985. This included some 1,500 business people, 6,000 diplomatic personnel and their families (including UN personnel), 1,000 experts and teachers, 2,000 students, and 300 journalists. If the family members of all groups were included, the number of expatriates would reach at least 12,000. When China's General Administration for Industry and Commerce began to register foreign offices in Beijing in 1980, only one hundred firms signed up. That number became close to 650 by 1985, an increase of more than five-fold. In addition, there were scores of unregistered representatives on temporary duty and a long list of companies waiting to be registered. And the pace of growth was even expected to speed up: the Beijing Planning Commission estimates that the city would have between 1,200 and 2,000 registered foreign representative offices by 1990.[2]

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[1] Real Estate, March 1986, p.128.

[2] The China Business Review, July-August, 1985, p.36.

Foreign residents arriving in early 1980s quickly occupied most of the available rooms along Chang'an Avenue--the city's major east-west artery and site of many government ministries. By late 1983, the municipal government had to come up with some creative alternatives: opening new space for foreign firms in formerly Chinese office buildings, such as those above the Peace-Gate Beijing Duck Restaurant and Cultural Palace of the Nationalities. They also let foreigners use hotels such as the Xuanwuman, Guanghua, Retan, and Dadu that had previously been reserved for use by Chinese cadres or Hong Kong travelers.[1]

Because accommodations have not kept pace with the influx of foreigners to the city in those years, the lack of space caused skyrocketing rents. The Beijing Hotel raised its rents three times every year between 1981 and 1984, making all rooms at least 130% more expensive than in 1981.[2] By 1985, the new Lido Apartments, in the uppermost scale of the deluxe range, rented for $6,000 a month for a three-bed-room apartment, while a deluxe three-room suite at the Sheraton Great Wall Hotel cost a hefty $125,000 a year.[3]

Driven by this lucrative demanding market, a new wave of construction was underway. Both foreign investors and developers were playing a major role in

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[1] Ibid.

[2] The China Business Review, July-August, 1985, p.37.

[3] The China Business Review, July-August, 1985, p36.

Beijing's building boom. Ninety percent of the new projects involved joint ventures with foreign firms or at least be partially financed with foreign capital.[1]

At first, those projects under construction would be coordinated by the Beijing Hotel Service Company (BHSC), the city's traditional leader in the hotel industry. Along with the Beijing Municipal Travel Bureau, BHSC has traditionally been responsible for hotel projects. But the task of expanding Beijing's hotel and office facilities became far too massive to be handled by BHSC and the travel bureau alone, even with their foreign partners. As a result, many other Chinese organizations sensed a golden opportunity to earn foreign exchange and were rushing into the real estate business. These organizations were as diverse as the Mineral and Metals Import and Export Co., the Capital Iron and Steel Hotel Development Company, the China Council for the Promotion of International Trade, and the Bank of China.[2]

Typically, a Chinese organization in Beijing initiated a hotel, apartment, or office building joint venture by applying to the Capital Construction Department (CCD), under the Beijing Planning Commission. Approval could be expected if the location seemed appropriate and the costs reasonable. Once approved, the Chinese party--sometimes in conjunction with a foreign partner, if one had already been chosen--carried out a feasibility study. But CCD had to approve the feasibility study before the Chinese party could sign a formal contract with its foreign

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[1] The China Business Review, July-August, 1985, p.37

[2] Ibid.

partner.[1] (For more information about the process of setting up a joint venture in China, please see the Appendix A.)

Most of those new entrants to the field in Beijing at the time were undertaking just one large project. But collectively, it created an unprecedented boom.

[1] The China Business Review, July-August, 1985, pp.37-38.

Section B: From Boom to Bust

When China first opened its doors to foreign investment many believed it would offer unlimited opportunities for all kinds of business, including property development. Property investors, lured by the thought of potentially lucrative profits, rushed into the Chinese market. Between 1983 and 1985, a large number of projects were given the go-ahead. As one analyst said, in 1984 everyone seemed to have the same bright idea--to start a joint venture with the Chinese to develop property.[1]

When extremely high rates prevailed for expatriates accommodations in 1984 and 1985, however, troubles also began. Chinese units that controlled the rights to choice sites saw an opportunity to make easy, hard currency profits in joint venture real estate arrangements with foreign partners. But few Chinese or foreign developers carefully considered what the supply and demand for accommodations would be like at the time the new projects opened.

Take Beijing, for example. At the height of the boom the city had as many as 50 central-level and 90 local-level real estate development projects involving foreign investment on the drawing board or under way and roughly equal number of wholly Chinese-financed projects either approved or under construction.[2]

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[1] Far Eastern Economic Review, March 3, 1988, p.54.

[2] Far Eastern Economic Review, March 3, 1988, p.54.

The problem is compounded by China's inefficient transportation system. The apparent lack of coordination between China's transport authorities and those of tourism, foreign investment and trade, is a huge problem to foreign investors for hotel and other real estate projects in China.

At peak tourist season, it is almost impossible to get a seat on a flight into Beijing or Shanghai. CAAC, China's national airline, had a virtual monopoly on domestic flights and controlled the country's international flight schedules. Its lack of capacity and its bad quality of services were notorious to many foreign visitors. The Railroad system was even worse, which ranks 100th in the world in terms of rail-track per capita.[1] Trains in China regularly pulled away from stations with twice as many passengers as seats.

Tourists visiting Beijing and Shanghai usually would like to make side trips to places such as Xian and Guilin but were discouraged by the difficulty of getting air or rail tickets. Meanwhile, hotels in those places were hungry for customers. According to David Tong of Deloitte Haskins & Sells, an international firm of financial consultants and accountants, the Chinese hotel market, therefore would be saturated for at least ten years.[2]

Although airports at several key cities are being developed, it was not happening fast enough to counter the ultimate glut in hotel rooms and office space envisioned around 1990. Even though some foreign investors might have foreseen

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[1] Far Eastern Economic Review, October 4, 1990, p.59.

[2] Far Eastern Economic Review, June 9, 1988, p.41.

this, the fact that it was easier to raise funds for commercial projects, such as hotels, than it was for national infrastructural projects may have contributed to the imbalance. This is because the income from hotels were already in foreign currency, while a foreign developer of an infrastructural project in China had to depend on the Chinese government's capability to pay in foreign currency.

Compounding the problem was a lack of regulations stipulating minimum debt/equity ratios prior to 1986.[1] Only since early 1986 had the Chinese government began to require a certain minimum debt/equity structure of foreign companies investing in China to curtail the activities of marginal firms.[2] As a result, many foreign developers, particularly small firms with limited financial resources, tried to structure deals that were virtually risk-free. The Chinese side hoped to only invest its land-use rights, while the foreign side intended to take out commercial loans backed by 100 percent guarantees from Chinese financial institutions to cover its entire equity contribution.

Chinese authorities did not realize they had a problem on their hands until 1986. The disorder reigning in real estate development to some extent reflects China's confused transition from a planned to a market-oriented economy. The initial scheme was to draw foreign investment into real estate development while central and local planning authorities monitored the rate of growth. However,

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[1] The China Business Review, November-December, 1987, p.9.

[2] Real Estate, March, 1986, p.122.

market forces allied with bureaucratic self-interest to overwhelm the less formidable barriers to excess growth erected by the planning authorities.

During a meeting of the heads of China's regional tourism bureaus in 1987, State Councilor Gu Mu warned of a flood of accommodations over the following three years that "threatens to outstrip any conceivable growth in the numbers of foreign visitors we receive annually." [1]

Actually, by the second half of 1986, when it had become clear that the situation in Beijing, Shanghai, and Guangzhou was getting out of hand, the State Council had already responded with Directive 101, which ordered a complete freeze on approvals to build luxury accommodations in these three cities. [2] Approval for any project that did not have a signed contract was to be rescinded. As a result, in Beijing alone, the number of proposed real estate projects involving foreign investment fell from 120 to 56. [3] Large-scale real estate projects lacking central-level Chinese backers were bound to be among the hardest hit.

Then in July 1987, the council imposed a tax amounting to 30% of the total construction costs on all domestic, non-productive projects which fell outside the State plan.[4] This directive was aimed at local projects that siphon off badly needed construction materials from key State-plan projects.

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[1] The China Business Review, November-December, 1987, p.8.

[2] Ibid.

[3] Far Eastern Economic Review, March 3, 1988, p.54.

[4] Far Eastern Economic Review, March 3, 1988, p.54.

But these measures came too late to limit the number of projects already under way.

The looming property glut in Beijing is just one aspect of a national disease--uncontrolled construction spending by local governments. Billions of Renminbi (--Chinese dollars) have been diverted from priority areas, such as transport, energy development and manufacturing, into property.

Besides, Beijing authorities had trouble maintaining any control over real estate investment because many of the projects were backed by powerful, central-level organizations whose subsidiaries held equity shares in the venture. A few prominent examples include: the China World Trade Center, backed by Ministry of Foreign Economic Relations and Trade (MOFERT); the Shangril-La Hotel, backed by the China Non-ferrous Metals Corporation; Noble Tower, backed by the State Science and Technology Commission; the Kunlun Hotel, backed by the Ministry of Public Security; the Capita Guesthouse, backed by the State Council; the Palace Hotel and Jinglang Hotel, backed by the People's Liberation Army; and the International Cultural Center, backed by the Ministry of Culture.[1] Boasting their own deluxe hotel projects, these organizations gained prestige as well a "manor" in the capital--or at the very least a future source of inexpensive, deluxe office space. In many cases, these central organizations had the clout to slide their pet projects through the approval process, despite growing disquiet among local planning and construction authorities.

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[1] The China Business Review, November-December, 1987, p.9.

Section C: A Glut Foreseen

The Glut in Beijing

The Beijing Boom was transient. According to Andrew Ness, marketing manager of international property consultants Richard Ellis and the author of a press report released in 1987 on real estate in Beijing for the National Council for US-China Trade (a non-profit-making agency backed by US businessmen), the number of hotel rooms in Beijing would double by the end of 1990. Office space and apartments for foreigners would increase five-fold over the same period. Such expansion could, for example, result in about 70% of office space being surplus to requirements, Ness reported.[1] In the words of H.R. Jenni, the director of Swiss-Belhotel which was managing Beijing's first joint-venture hotel, Jianguo Hotel, "It will be a buyer's and not a seller's market." [2]

Based on Ness's report, here is what it would like to be the consequence of this boom: [3]

* Hotels

With 84 hotels (20,000 rooms) currently existing in Beijing in 1987, it was more than sufficient to provide accommodations for the estimated 1.05 million

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[1] Far Eastern Economic Review, March 3, 1988, p.54.

[2] Ibid.

[3] a) The China Business Review, November-December, 1987, pp.10-14; b) Far Eastern Economic Review, March 3, 1988, pp.54-55.

foreign visitors who would come to Beijing in 1987. The Beijing Tourism Bureau predicted that 1.5 million foreign travelers would visit the capital in 1990, a growth of 43%. At the same time, the city would have about 123 hotels with roughly 40,000 rooms by 1990, nearly doubling the city's supply of hotel space. This estimate did not even take into account the large number of wholly Chinese-owned projects. About 30% oversupply was predictable, even if the projected increase of tourists to 1.5 million could be materialized.

* <u>Offices</u>

In September, 1987, Beijing had 11 buildings offering pure office space in various configurations, including two actual office buildings. The remaining space was in hotel wings, apartment complexes, or Chinese commercial buildings where a portion of space can be rented to foreign companies. These buildings collectively offer more than 540,000 square feet of space.

In 1987, Beijing had an estimated 1050 foreign offices. The average foreign firm requires 1,650 square feet of office space. However, adding the existing office space to the 2.8 million square feet that would be brought onstream over the following three years by the 15 high-rise office facilities then under construction, the city would have 3.4 million square feet of office space by 1990. Based on 8% annual growth, the estimated number of foreign firms in Beijing in 1990 would be 1,320. An oversupply of about 40 percent would be inevitable.

However, the distinction between hotels and office buildings remained blurred in Beijing since up to 66% of the 952 officially registered representative offices in Beijing still conduct operations from hotel rooms. For example, in Sept 1987 only about 60 of the 180 US firms in Beijing had offices in commercial buildings rather than hotels. With that in mind, the percentage of oversupply estimated for office space may not be as large as the percentage of oversupply for hotels rooms.

* Apartments

In September, 1987, Beijing had 10 apartment buildings or apartment complexes (apartment being defined as any residential unit of one room or more containing a kitchen), offering a total of 1626 residential units. This means that only one third of the city's 5770 expatriate businessmen and diplomats in need of commercial housing lived in apartments, while the rest still lived in hotel rooms. Unfulfilled demand was therefore estimated at 4154 units. Lido was reported to have at least 100 families still waiting for its fully booked apartments, which cost about US$5-7,000 a month for a 650-1700 square-foot flat.

The apartment market appeared to be in better shape simply because this sector of the market was the last to attract property developers. The shortage of accommodation was exacerbated by the Chinese Government's slowness in providing housing for the much-expanded community of foreign diplomats and journalists. One resident foreign correspondent, for example, has been waiting for a year for a flat.[1]

[1] Far Eastern Economic Review, March 3, 1988, p.55.

However, some 20 new projects adding 4926 apartments or detached/semi-detached single family homes were supposed to be finished by 1990.[1] Although the projected relationship between total supply and demand for apartment space was not too badly out of whack, there was a problem. The majority of these apartments were built to deluxe standards while most of the clients were looking for cheaper accommodation.

Situation in Shanghai and Other Cities

The glut came to Shanghai a little bit later than in Beijing. By the mid 1988, Shanghai had about 20 hotels with some 5442 rooms which would take foreign visitors and they were still generally well booked through the year. [2] Shanghai Municipal Tourism Bureau's Xu Zhicheng told the Far Eastern Economic Review that between January and October 1987, the average hotel occupancy rate was around 75-80%. The rate was even higher for second and third class hotels.[3]

But more rooms have been pouring into the market in the following two years. By 1990, the number of completed hotel rooms in Shanghai, according to

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[1] The China Business Review, November-December, 1987, p.12.

[2] Far Eastern Economic Review, June 9, 1988, p.41.

[3] Ibid. pp.41-43.

1988 estimation, would be about 20,000, 267% more than what was available in 1988. But visitor traffic was then projected to increase only 71%. [1]

Other cities such as Guangzhou (Canton), Guilin, Xian and Hangzhou faced a similar threat of oversupply. Guangzhou above all had occupancy problem since 1986. It had managed to survive so far because of the spring and autumn trade fairs every year and the large number of people going to and coming from Hong Kong at other times of the year. But profit margins were reported to be thin.[2]

Although the State Tourism Administration time and again called for a temporary halt to approvals for the building of new joint venture hotels in six major tourist cities--Beijing, Shanghai, Guangzhou, Guilin, Xian and Hangzhou, it could not do much to stop smaller new hotel projects from being approved. Only projects of US $30 million and above would have to be approved by central authorities in Beijing. Provincial and municipal authorities had the power to approve projects worth less than US$30 million. [3] Self-interests of these local governments made them only too happy to give a go-ahead to those projects. As a result, almost every city in China opening to foreign visitors had a problem of oversupply of foreigners-oriented hotels by the end of the last decade. Within a span of five years, the boom became the bust.

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[1] Far Eastern Economic Review, June 9, 1988, p.43.

[2] Ibid.

[3] a) Ibid.; b) According to some Chinese authorities, this remains even true today for non-hotel and productive projects.

Section D: The Last Straw on the Camel

Although many foreign investors and observers as well as the Chinese government had more or less by 1987 envisioned a possible or even inevitable imbalance between demand and supply of property development oriented to foreign expatriates in China, none of them could have predicted either political instability or economic retrenchment brought by the Tiananmen Incident in the spring of 1989.

A wave of political unrest swept through China. Tens of thousands of high-spirited students, workers, and city residents took to the streets, longing for a political liberalization that would parallel the ongoing economic reform within the existing political system. On June 4, that hope for a modernized China ended abruptly in a trail of gun smoke. Foreign expatriates pulled out of China. Potential tourists stayed away from China. The blow on the property projects was immediate and severe. Existing projects were deserted by customers. It was terribly hard for projects newly opened to business to find any customers at all. Unfinished projects had even problems in the completion of the construction.

Prior to June 4, 1989, average occupancy rates for these projects were between 70% to 80%.[1] In June, 1989, occupancy rate in Shanghai dropped to a low of 20%. By October, it only recovered to between 40% to 50%. [2] In Guilin,

[1] Asian Wall Street Journal Weekly, October 2, 1989, p.1.

[2] Ibid., p.4.

occupancy even slipped from pre-June, 1989's 90% to between 5% to 10%.[1] The average occupancy rates in major Chinese hotels were estimated at between 30% to 40%,[2] and this is reported to be the case even today.[3]

It is probably painful now to know that between 15% and 20% of the estimated $42 billion in total lending to China went to property development. Loans outstanding to the sector were estimated at between $6 billion and $8 billion.[4] In that sense, the problems facing lenders to China are largely of their own making. In the words of a U.S. banker in Hong Kong, "those bankers who went too far are getting what they deserve." [5]

Japan is the most exposed of China's creditors. Between them, the Tokyo government and Japanese commercial banks have made loans of about US $20 billion to China.[6] Sensitive about their relationships with Beijing, some banks, notably Japanese ones, have refrained from calling on the guarantors to collect their debts.[7]

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[1] a) Asian Wall Street Journal Weekly, March 26, 1990, p.3.; b) Asian Wall Street Journal Weekly, October 2, 1989, p.1. c) Asian Wall Street Journal Weekly, July 31, 1989, p.20.

[2] Asian Wall Street Journal Weekly, October 2, 1989, p.1.

[3] a) UPI, February 6, 1991; b) According to some Chinese authorities.

[4] Asian Wall Street Journal Weekly, October 2, 1989, p.5.

[5] Ibid.

[6] Asian Wall Street Journal Weekly, October 2, 1989, p.5.

[7] Ibid.

Foreign bankers are not the only ones who are nervous about those loans. Because China has no national mortgage laws, foreign lenders to joint ventures have demanded guarantees from the state-owned Bank of China and other quasi-governmental agencies, such as China International Trust and Investment Corp. (CITIC), as well as provincial or local trust and investment corporations. Despite tight limitations on the total loans Chinese agencies can guarantee--the official ceiling is 20 times the entity's foreign-exchange fund--due to the lack of alternative sources, many guarantees in excess of the ceiling have been issued for joint venture loans.[1]

Those organizations are presumably the most nervous about the loans to large hotel projects. For example, the guarantors of many of the outstanding loans for Beijing's joint venture real estate projects are Chinese financial institutions--primarily the Bank of China, CITIC, and Beijing International Trust and Investment Corporation. Many of these organizations feel overextended. Actually, starting two or three years ago, they were no longer willing to guarantee 100% of the loan. Indeed, in the largest project in Beijing, the $380 million China World Trade Center, MOFERT had its two most financially secure foreign trade corporations, SINOCHEM and SINOTEX, provide guarantees only for the $280 million in loans.[2]

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[1] The China Business Review, September-October, 1989, p.18

[2] The China Business Review, November-December, 1987, p.17

In the past instances of defaulting borrowers, Chinese guarantors have generally honored their guarantee obligations. For example, in February 1989, the Guangxi International Trust and Investment Corp. repaid as guarantor a $14.5 million loan for the Guilin Garden Hotel. [1] However, if significant number of guarantees were called upon, it is doubtful whether the many undercapitalized guarantors would be able to repay the often enormous debts that they have guaranteed.

To the surprise of many foreigners, perhaps, when those Chinese financial agencies gave their guarantees, none of them seriously thought of the possibility of being called upon. One Japanese banker's experience may shed some insight as to the behavior of those guarantors. In a negotiation session over a hotel project in 1989, although he could not go back to his bank without a guarantee, he was expected not even to bring up the subject in China. In his words, "It is very strange in China (that) they give a guarantee on the premise that the guarantee will not be called." [2]

Most bankers hope they can reschedule hotel debts if they believe the project will be profitable in the long term. But banks that agree to reschedule debt may simply add their problems, since they are virtually gambling that they can eventually recoup their investment. From foreign developers' perspective, besides rescheduling loan payments, they have to renegotiate the terms for the joint

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[1] The China Business Review, September-October, 1989, p.19.

[2] Asian Wall Street Journal Weekly, October 2, 1989, p.5.

ventures themselves. Otherwise they will not have enough time to make any profit after loan payment before they have to turn their shares of the projects to their Chinese partners. On another front, the foreign developers may have to try to reduce tax liabilities through renegotiations with the Chinese government. With all these problems on their hands, they may have to be "grinning and bering it," as the developers of the huge Shanghai Center are. Actually, their case may probably best illustrate all the problems typical to those foreign developers.

Part Four

Case Studies

Case One

Shanghai Center: A Story Decade Long [1]

Section A: 'A City Within City'

Shanghai Center, the largest foreign real estate project in Shanghai, and the third-largest American investment in China to date, is a cooperative venture between the Shanghai exhibition Center and Seacliff Ltd., a consortium composed of The Portman Companies, the Atlanta-based firm of the architect and international developer John Portman, and American International Group (AIG),

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[1] Synthesized from articles from the following sources:

"The Real Estate Finance Journal", Winter 1990, p.47;

"Real Estate", March 1986, p.128;

"The China Business Review", July-August, 1985, pp.44-45;

Ibid. March-April, 1990, pp.40-43;

"Progressive Architecture", May, 1989, pp.45-46;

Ibid. March, 1986, p.31;

"Interiors", October, 1988, p.147;

"National Real Estate Investor", January, 1987, pp.72-73.

an international insurance group, and Kajima Corporation, a Japanese construction, design and engineering firm.

After over 40 visits to China between 1979 and 1985, by Portman alone, not to speak of others, Shanghai Center was conceived. It was its developers' lofty goal that Shanghai Center would become the focal point of international business and culture in the city.

Originally budgeted for US $175 million, Shanghai Center is a 2 million-square-foot project, designed to complement the Shanghai Exhibition Center, and to respond to market demands for exhibition, office, apartment, and hotel facilities. It was also envisioned to stimulate new international activities in Shanghai as it was originally scheduled to open in the spring of 1988. Following a pattern common to all commercial development during the past years in China, Shanghai Center was to be transferred to the Chinese government after about 20 years of operation.

The complex consists of three towers, one of which hit 50 stories--dominating the Shanghai skyline. The complex contains a 700-room hotel complete with ballroom, meeting rooms, restaurants, a business center, and recreational facilities; over 250,000 square feet of office space for small and medium-sized businesses, 50,000 square feet of retail space; 70,000 square feet of exhibition facilities; parking for 350 cars; a modern 1,000-seat theater, much like the one in Portman's Marriott Marquis Hotel in New York. The complex also features two towers containing furnished apartments, each with kitchen facilities.

Shanghai Center occupies a prime four-acre site on Nanjing Road--heart of the city's downtown business district, directly across from the Shanghai Exhibition Center. This site allows convenient access to the city's major traffic arteries, airport, main business and government offices, and shopping and residential areas on Nanjing Road. In addition, the site is close to a station on the proposed rapid transit system, and to the city's railroad station.

The choice of Shanghai itself was part of Portman's overall strategy. He saw Shanghai as China's most vital city--a bustling metropolis that could eventually become China's gateway to the West, much as it was prior to 1949. To Atlanta-based architect and international developer John Portman, Shanghai was a city with a reputation for both business acumen and glamour, seeking to regain its international prestige. At the time, the city was desperately unable to accommodate the foreign businesses and visitors it longed to attract. And in a larger picture, the country was expanding its economy and contacts with the outside world at a tremendous pace. The future for a massive all-purpose real estate project in Shanghai really looked bright.

The Portman Companies also thought that they had considerable experience in dealing with overseas cultures. Active in Europe and the Middle East since the 1960's, the company opened an office in Hong Kong in 1980 and later an office in Singapore. In fact, Portman formed a separate trade consulting company, Atlasia, in early 1982, to help the Chinese identify trading opportunities. In early 1986, the firm formed a separate company, Portman Overseas Properties, specifically to pursue opportunities in Asia.

The Portman Companies tried to avoid as much of squabbling as it could by laying elaborate groundwork. Portman even sponsored two trade fairs, in 1982 and 1983, in the Atlanta Merchandise Mart (another Portman property). "The mayor and vice mayor of Shanghai, as well as several other officials, have all been to Atlanta," said Portman, "and had a chance to see what we've been able to create here."

Portman and A.J. Robinson, who heads Portman Overseas Properties, kept bringing up their project, which, the Chinese were told, would include a hotel that could serve as a showcase for Chinese furnishings, rugs, and decorative items. The strategy succeeded.

At that point Portman turned to Kamsky Associates to bring in equity partners. AIG (which actually opened its first office in Shanghai some 50 years ago) took the largest position, putting up $30 million.

Financing was supplied by CCIC Finance, a joint venture of Bank of China, First National Bank of Chicago, Industrial Bank of Japan, China Resources Co., a trading company, and others totaling to nineteen financial institutes. Negotiations for Shanghai Center were concluded in 1985, when forecasts for market growth were bright. The project was then expected to open in the summer of 1989 at a total cost of $175 million, to be paid off within nine years.

The Portman company was responsible for the design as well as construction management of the project. It began by doing architectural work on this project, but later became involved as owner, developer, and operator for the Shanghai Center.

Although Portman is the prime developer, they have taken on a Japanese partner, Kajima Corporation, one of the largest construction companies in the world. When the project was completed, Portman and Kajima would share the ownership of the center.

Kajima is responsible for the overall construction of the project, although much of the work was done by Chinese contractors. The architectural work actually involved three parties. Portman Associates was the prime contractor, but architects from Kajima Corp. and the Shanghai Industrial Building and Design Institute also played a critical role in most phases of the architectural and engineering work.

By the spring of 1989 it was clear that the 1985 projection of $175 million was not going to be sufficient to complete the Center, while a four-year building spree has overloaded Shanghai with some 18,000 hotel rooms. Inflation in China had sent the cost of materials soaring and infrastructural problems had slowed construction.

In April, 1989, the Shanghai Center partners and their creditors--19 banks that had provided the bulk of the Center's financing with a $145 million syndicated loan--entered into negotiations to discuss refinancing the project. The arduous negotiating process was complicated by the fact that the Bank of China (BOC) is both a lead lender and lead guarantor of the project. China, in the midst of a severe credit crunch, was unable to provide a cash infusion to the project. Yet a more threatening factor or gloomy fate was awaiting for the project.

Section B: June 4, 1989: the Immediate Impact

When demonstrations and violence swept through China in May 1989, construction of Shanghai Center was about 75% complete, and Seacliff was planning a December 1989 opening. Following the Tiananmen incident on June 4, however, foreign construction crews were pulled from the site and construction stopped for about one month. That one month ended up costing about three months of construction time due to difficulties in re-calibrating the construction schedule, thereby delayed Shanghai Center's opening date again.

Hiring plans were also thrown off by the turmoil; mass recruitment was originally scheduled to begin with a June 5 ad campaign, which was postponed until late September.

The effects of Tiananmen reach much farther, however. By mid-1989, it became painfully clear then that feasibility studies conducted in 1985 could predict neither political instability nor economic retrenchment, and both would have painful impact upon Shanghai Center. Tourist travel, which was booming in 1985, would then take at least one more year to regain 1988 levels, even by an optimistical estimation. By which time there would be at least five more hotels competing for the business.

In order to demonstrate their long-term commitment to Shanghai Center, in August, 1989, the foreign partners had to come up with $20.5 million to complete construction. Following Tiananmen, the foreign lender banks grew increasingly concerned about China's country risk, and therefore about Bank of China's ability to guarantee the loan. Unwilling to increase its own exposure on the project, one bank even proposed that the borrowers use their own credit to guarantee it. It took nine months for them to reach a conclusion in January 1990.

Under the new agreement, none of the creditors has increased their financial commitment in the project and no additional creditors have been introduced to spread the risk. However, Seacliff now does not have to repay the majority of the principal until the end of the nine-year payback period, which has not changed, and will pay only interests for the first few years. This arrangement will give Shanghai Center some breathing time for the next few years, but it will probably have to refinance the project in about five years when the bulk of the principal starts to fall due.

In the meantime, in order to further improve the project's financial position, Seacliff has also been negotiating with Chinese authorities to restructure the terms of their contract. Seacliff's restructuring strategy involves trying to protect the Center from large operating deficits by seeking concessions in two basic areas: terms of its lease and taxation.

*Lease terms Seacliff has requested an extension on its existing 18-year operating period. The Chinese initially offered a four-year increase. But Seacliff rejected this offer as insufficient, and asked for a 40-50-year lease. An extended lease would obviously help ensure that the Seacliff partners receive a return on their investment.

*Taxation Seacliff is seeking tax exemptions or reductions to increase cash flow, specifically requesting property tax exemption for at least the first year of operations.

Negotiations on these issues have been underway in earnest since July 1989, but were not even expected to conclude before the Center's opening. Because of the size and visibility of Shanghai Center, any decision concerning restructuring will ultimately be made in Beijing. However, strong support from Shanghai municipal authorities was understandably necessary to have any bargaining power in the capital. But local authorities were unable to agree on some issues and some did not even wish to take any responsibility for the project at all, given the low esteem with which Beijing was currently regarding real estate projects.

Whether the Shanghai Center's high profile is an asset or a liability in its negotiations is also debatable. Chinese leaders recognized that not helping such a large, visible sign of multinational foreign investment would certainly send a chill down the spines of much of the foreign business community, and municipal officials liked the technology and employment opportunities the Center would brings to the city. However, awarding concessions to Shanghai Center would send every other foreign project in China knocking on Beijing's door for the same treatment. Thus, parties to the negotiations are keeping a tight lid on the terms. Despite the secrecy, however, Shanghai Center is being closely watched as a sort of litmus test--for even though real estate projects occupy a distinct niche in the investment arena, the business community will likely view the outcome of the negotiations as indicative of the regime's attitude toward foreign investment in general.

China's altered political and economic climate have not only forced Shanghai Center to restructure its finances, but also to reevaluate its marketing strategy. According to Public Relations Director Pasty Whitcombe, though the Center's marketing strategies haven't changed significantly, the targets of its promotional efforts have. Original plans involved the partners working with municipal officials to promote the city's image abroad, but these plan have been put on hold.

Advertising, which was launched worldwide in April 1989, stopped in June and did not resume until January 1990. Though the message was the same--"Now, everything is possible," reflecting the high standards throughout the Center--the audience was not. Trying to attract new business from overseas was not considered promising given the current political and economic climate in China. Therefore, for at least the first year of operations Shanghai Center advertising would be aimed at companies already doing business in China.

The Center's public relations campaign, likewise, would aim to enhance the Center's image among companies already active in China, stressing the strength and vision of the Center. And in many cases Shanghai Center does have something unique to offer. Perhaps most important, BellSouth International has created a telecommunications network that enables tenants and guests throughout the Center to undertake any business activity they would at home--such as sending faxes and telexes--while also providing such sophisticated services as voice mail and room-to-room electronic mail.

The hotel is supposedly the first foreign one to have a large volume (over $1 million worth) of five-star quality furnishings and fixtures in China, and will also feature unusual artpieces--such as seventeenth century-style "zhi jing" (brocade weaving) in its grand atrium and interior alcoves. The retail plaza will boast the city's largest discotheque, and the theater hopes to stage international productions not commonly seen in China.

The theater and the exhibition hall is certainly a distinguishing feature. For an early scheduled opening in September, 1989, A.J. Robinson, Executive Vice President of Portman Overseas, was even trying to book the original Atlanta production of "Driving Miss Daisy."

Sales representatives for the office, apartment, and retail spaces would also focus primarily on companies already in Shanghai, followed by those located in Beijing and elsewhere in China.

When the Center finally opened in March, 1990, Seacliff claimed that about half the retail, office, and apartment space had been leased--among the companies that have booked office space were Hong Kong and Shanghai Banking Corp. and Hewlett-Pachard--and hoped to fill the rest by the end of the year. Since few new companies were moving to Shanghai, however, and those already there were sending fewer expatriates, the salespeople would find a smaller--and more competitive--pond to fish from.

The Portman at Shanghai Center, managed by the Peninsula Group and promoted separately from the rest of the Center, is currently the soft spot in project. With the leisure travel market uncertain, the Portman, like virtually every other hotel in China, is trying to attract business travelers. The hotel is offering 50% off its rack rates for the corporate market, so that regular room prices may range from $95-325. Off-season group rates of $50 per night have also been offered.

According to Executive Vice President of Portman Overseas A.J.Robinson, there is also some concern about the apartment towers. "The number of hotels offering discounted long-term contracts makes it more difficult to market our apartment space."

Aside from the credit crunch and general downturn in business, China's economic austerity program has created other difficulties for Shanghai Center, the most significant of which affect the project's imports. In perhaps the most outstanding example, Shanghai Center requested to import 30 Mercedes Benzes--as it claimed a competitor did in 1987--for the Center's taxi fleet. The luxury Benzes were denied up front, but with help from the Shanghai Municipal Foreign Economic Relations and Trade Commission (FERTC), Shanghai Center was granted import licenses for 12 sedans and nine vans by the Ministry of Foreign Economic Relations and Trade (MOFERT) in Beijing.

Customs authorities, however, told Seacliff that the Center could import only four of the 12 sedans on a duty-free basis (--Duties on auto imports are extremely high). And the problems did not stop there. The Japanese suppliers of the four vehicles have refused to sell them due to onerous constraints under new State commodities inspection regulations, which require suppliers to provide two vehicles for inspection and crash testing for each model they intend to export to China. Seacliff has approached Shanghai FERTC and MOFERT on the issue, but it has not yet been resolved. In the meantime, the Center is leasing autos from an existing fleet in the city.

Today, we do not know too much about the business details of Shanghai Center, such as whether they imported their desired cars or not. But an interesting phenomena is the business climate change in the city (in terms of reduction of bureaucracy, etc.) since June 1989. Ironically, more positive things have happened and prospects for foreign investors have improved significantly.

Shanghai was left behind by China's southern provinces during the economic reforms of the 1980s. Its bureaucracy was described by A.J. Robinson, Portman Overseas chief executive, as "the worst in the whole of China." Yet, according to him, this has been "changed dramatically," and the city is now going ahead with major development projects. These include the building of a much-needed subway system, development of Shanghai's port, and highway construction.[1]

The new mayor, Zhu Rongji, should be given credit for part of this change, according to A.J.Robinson. For his efforts to cut back red tape hindering potential

[1] KYODO News, Hong Kong, Oct. 22, 1990

foreign investors to the city, he earned a nickname as "one-chop Zhu" among the foreign business circle.[1] In 1988, he set up the Foreign Investment Commission, reducing the number of departmental approvals from 133 to 20, to simplify the approval process for foreign operations. [2]

The present General Secretary of the Chinese Communist Party, Jiang Zemin, handpicked by Deng Xiaoping after June 4, 1989, also came from Shanghai. He used to be the Party head of the city before he moved to Beijing.

Not coincidentally, in spring of 1990, the Chinese central government gave its approval for the development of Shanghai's Pudong industrial zone, a 135 square mile region east of the city destined to become one of China's most important special economic zones.

All these may be only a mixed blessing for Shanghai Center. The city's business climate may help bring in more foreigners for the city, yet its ambitious development plan may well intensify the business competition for Shanghai Center. If the municipality tries so hard to attract new comers, the existing Shanghai Center will certainly not get the desired priority, and will fall into a position as an unfavored child. The highest irony here is that the Portman's have fought for over ten years against the worst bureaucratic machine in order to get their project done, and now only to find a pro-business local government trying its best to do anything to help the center's potential business competitors.

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[1] Ibid.

[2] Far Eastern Economic Review, May 31, 1990, p.58.

Case Two

Jinlin Hotel: Early Game, Without Rules [1]

As mentioned before, Jinlin Hotel in Nanjing is one of the earliest hotel projects with foreign investments built in the early 80s in China. It has 791 rooms. The building area is about 650,000 square feet. Located right in the center of the city, (--occupying one quarter of the central square), the 37-story building dominates the city's skyline. When it opened in September, 1983, it became the highest building in the whole of China at the time. Its rotating top-plaza not only amazed the city residents but also generated a lot of tourists throughout the country. For a long while, everyday hundreds of people waited in long queues to buy the Rmb 3 dollar admissions to the top-plaza alone.

Its foreign developer is actually a Chinese, Tao Xinbo. He is an oversea Chinese living in Singapore. He holds 51% of the stock of a Singapore firm and is reportedly having an investment of US $2.2 billion in Singapore, with personal property amounting to about US $300 million.

In the end of the 70s, he approached the mayor of Nanjing at the time, expressing his intent to build a modern hotel in the city. He told the mayor that he was born in Nanjing and therefore wanted to build something for his home city. He said he had been living overseas so long that he would like to come back home

[1] This case study was done by interviews through correspondences, using statistics from Chinese sources, and through my personal observations while living in the same city.

in his retired life. By making a contribution to the city, he hoped that, in return, he would get permits and assistance to build a single family house in a favored site of his in the city and rehabilitate his ancestor's cemetery in the suburb some time in the future. The story was touching, and the mayor bought it immediately.

Because at the time there was no such a thing as a joint venture yet in China, here is what they actually did instead. With Tao's personal guarantee, Nanjing government got a conventional permanent loan of US $45 million from a Hong Kong bank with a term of 14 years and 6-7% interest rate. The money was used to buy most of the construction materials and equipment in Hong Kong and other places out of China. The shopping list included HVAC, elevators, steel, wood, marble, granite, and alloy, as well as construction equipments such as a crane from Italy, a concrete mixer from West Germany, and construction elevators from France. Because it was the "established project," not the construction company, which applied for the imports, it got a special duty-free customs treatment.

On the home front, the city spent Rmb 30 million (about US $ 15 million) on the other construction materials such as concrete, and another Rmb 7 million (about US $ 3.5 million) on the labor. As a show of good will, Tao donated US $3.5 million to build the rotating top-plaza.

The design was done by a Hong Kong firm, introduced by Mr. Tao. The design team included Japanese and Canadian architects. At first, Tao wanted to bring in a Hong Kong construction firm. But later on, the Construction Ministry of China decided to let Nanjing No.1 Construction Company do the job.

The construction began in April, 1980. It took about two years to finish the frame and structure, and another year for the interior. The original configuration was changed due to topology. Many decisions were made by non-professionals. For example, it was the former governor who decided that the building should be 37-stories high.

Before the hotel was open, the mayor became the governor. As a result, the hotel's ownership changed hands from the city to the province. Now it belongs to the Tourism and Travelling Agency of Jiangsu Province.

As the guarantor for the loan and the original conceptual developer, Tao has probably got some benefits and may even still stays in the deal. But we do not know any details in this respect.

The project was apparently a success. In 1988, the gross revenue of the hotel was Rmb 96,910,400 (about US $25.7 million), among which, 35% was from bedrooms, 19% from restaurants, 35% from retailing, and 11% from other services. About 60% of the revenue was in foreign currency. After paying a tax of Rmb 27,762,400 (about US $7.4 million), the hotel still had a profit of Rmb 26,450,000 (about US $7 million).

Around 1985, there were some challenges raised about whether the hotel was actually earning a profit. It soon got quelled down by the provincial government. But from the provincial government's perspective, even if the project does not earn a profit, it is still desirable in terms of earning foreign currency, because the amount of foreign currency used in the operation is far less than the amount of foreign currency flowing in through the revenues. Therefore, self-interest of local governments must lead them towards favoring such a kind of project, even if it does not "make money." That also helps to explain the boom-bust phenomenon happening in the mid and late 80s.

Case Three

The Grand Hotel: Late Game, Breaking Rules[1]

In December, 1978, Jiangsu, China, and Aichi, Japan, became sister provinces, and, at the same time, a sister city alliance was established between Nanjing, China, and Nagoya, Japan. Since then a lot of cultural and technological exchanges and business contacts and co-operations have been developed between this double-level sister alliance. In the mid-80s, the municipal government of Nanjing decided to set up a joint venture between the Tourism and Travelling Services Agency of Nanjing and the Chamber of Commerce and Industry of Nagoya to build and manage a modern hotel complex. On June 17, 1987, the feasibility study report was completed and signed by the both sides. The project was listed as one of the sister provinces (cities) alliances' "friendly activities" officially recognized by the Chinese government.

A few years earlier, the municipal government of Nanjing had planned and actually done some site work for a domestic-market oriented hotel project. Because of some internal policy change, this hotel project was stopped by the central government. By setting up a joint venture, the municipal government got a new chance to apply for the "establishment of the project." The city offered the site of the stopped hotel project to the joint venture to be counted as part of its equity

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[1] This case study is based on interviews through correspondence and the feasibility study report of the project.

share. The central government responded to the new application by sending a seven-member team of high-ranking officials to the city to inspect and study the feasibility of such a project. They concluded that the city currently had more tourist demand than its accommodation capacity. Based on their report, the new project was eventually "established" with the approval of Premier Li Peng.

The term of the joint venture was set to be 20 years of operation. Six months before the term expires, with approvals from both sides, the joint venture may apply for an extension of its term, according to China's JV law. Each side would get a share of earnings and losses in proportion to its share of capital.

The whole project was phased into two parts. Phase One would include a 24-story three- to four-star hotel. The project would occupy 107,640 square feet of land, and the building area would be 333,684 square feet. The hotel building would have about 300 bedrooms and 40 units of offices, totalling 193,752 square feet, as well as parking and restaurants and other facilities. Phase Two would include a six to seven story apartment building of about 65,000 square feet, and more parking and recreational facilities such as swimming pool and bowling halls.

The total budget was estimated to be US $29,999,500 with each side providing half of it. (Notice that it was specified this way so that it did not exceed the US 30 million limit for a local government to be authorized to give the building permit.) Besides the registered capital (which was specified as 60% of the total capital, 30% from each side), each side would bring in 50% of the rest of the capital through separate financing by each side and then passing it to the joint venture. Alternatively, the joint venture may try to get financing with each side providing 50% guarantee.

Over budgeting was set to be limited to 5%. The joint venture would try to get finance for the over budgeting part, if there was any, with each side providing 50% guarantee. The estimated total investment of US $29,999,500 and interests payments were expected to be paid back within 13 years.

The site work previously done by the Chinese side was estimated to be worthy of US $3,231,200, counted as part of the registered capital of the Chinese side. Other facilities such as gas, water, and electricity provided by the Chinese side would also count as its capital contribution, estimated to be worthy of US $3.16 million.

For future reference, the exchange rate between Chinese and Japanese currency would be the official rate on the date of transaction set by the Chinese government on a daily base.

Most of the construction materials would be bought within China. Some left-over materials for the original hotel project would be used, e.g. 850 tons of steel. Some materials, such as glass and electronic equipments, would have to be imported.

The construction work would be done by a selected local construction firm. There were about nine construction firms capable of doing such a project, including No.1, No.2, No.3 Construction Companies of Jiangsu province and No.1, No.2 Construction Companies of Nanjing. Most of these companies had built similar projects before elsewhere in China, such as Shenzhen SEZ. The selection would be through a public bidding.

The followings are some details of the deal, specified in the feasibility study report signed by the both sides:

Responsibilities for Each Side

The Chinese Side:

1. To provide building permits and "redline" drawings.

2. To deal with applications, to get registration and business and commerce certificate.

3. To deal with the Chinese design institute.

4. To facilitate infrastructures.

5. To apply for and obtain all the possible tax benefits.

6. To facilitate recruiting and training of the employees.

7. To recommend capable managerial workers.

8. To provide its share of capital.

9. To do any other things as the JV requires.

The Japanese Side:

1. To recommend the rest of the design team from abroad to co-design with the Chinese design institute.

2. To facilitate purchasing imports.

3. To arrange for the Chinese to be trained abroad (--without providing expenditures).

4. To recommend capable managerial workers.

5. To provide its share of capital.

6. To transfer its share of stocks to the Chinese side, according to China's JV law, when the term of the JV expires.

7. To do any other things as the JV requires.

Board of Trustees and Managerial System

The Board of Trustees consists of ten people, five from each side, including one chairman (reserved for Chinese) and one vice-chairman (reserved for Japanese). The term for each trustee was specified as three years.

There would be one general manager (reserved for Chinese), and three vice-general managers (one reserved for Chinese, and two reserved for Japanese). Their terms were set to be two years, and they would be hired or fired by the Board of Trustees.

Forecasting of Economics (In US Dollars) [1]

Gross Revenues:	336,161,000
including: bedrooms)	168,080,100

[1] Obviously these are aggregated figures for twenty years of operation. However, we do not know whether they are simply the sums or some dicount rate has been used.)

restaurants)	84,040,600		
retailing)	50,412,200		
others)		33,628,100	
Expenditures:		237,251,300	
Operating Profits:	98,909,700		
Income Taxes:		26,938,500	
Local Taxes:	2,694,100		
Impact Fees:		8,860,500	
Net Profits:	60,416,600		
including: (Chinese)	30,208,300		
(Japanese)	30,208,300		
Actual Earnings:	87,747,200		
including: (Chinese)	43,873,600		
(Japanese)	43,873,600		

<u>Breakdown of Benefits</u>

Governments:		50,958,300	36.74%
including: Commerce Taxes)	15,949,700		
Land Using Fees)	5,376,000		
Income Taxes)		26,938,500	
Local Taxes)		2,694,100	
The Chinese Side:	43,873,600	31.63%	

including: Net Profits)	30,208,300	
Depreciations)	13,665,300	
The Japanese Side:	43,873,600	31.63%
including: Net Profits)	30,208,300	
Depreciations)	13,665,300	

The project had several advantages, at least as viewed by the involved two sides in their feasibility study report. First, most of the ground and underground site work had been done, therefore shortening the construction period. Second, the Nanjing airport was under construction to be extended, and it was expected to be finished before the hotel would open, and a new line was going to be opened between Nanjing and Nagoya. Third, the Japanese side with its network in Japan, particularly in Nagoya, had the capability to bring in more tourists from Japan. Fourth, 60% of the total investment was to be registered capital, therefore it did not need any Chinese financial agency to be a guarantor for the finance the project needed.

Today, the project is under construction. The ground work has almost been completed. It is estimated that the structure above the ground will be finished next year and the interiors will be completed in 1993. The current budget of $30 million is not enough to cover the whole costs, according to some Chinese official. However, they are not going to apply for an over-budgeting yet, because it will involve approvals from central government, which is not easy at this moment. They would rather wait until the building is almost done and then push the central government to approve for the final touch.

From this case, we want to highlight a few points.

a) the important role of Chinese local government and the Chinese partner, and how enthusiastic and co-operative these agencies can be.

b) the current business management level and development process in China. For example, feasibility study is required. From the feasibility study discussed in the case, we can get some sense about what the general concerns are. For example, it is spelled out in the study how large a share and how much the central and local government will get from the deal. We also notice how they manipulated data (i.e. aggregating the revenue for 20 years instead of annual revenue estimation) so as to make the deal more appealing.

c) how they tried to address some of the main concerns of the central government in order to get approval, e.g. indicating that the project did not need a central Chinese financial institute to be the guarantor of the loan, and postponing over-budgeting applications, etc..

d) how well the Japanese understand the Chinese mentality and are patient and co-operative, virtually trying the impossible and having made it. For example, it broke the rules of the central government that no more hotel project is allowed to be approved, by lining up with the local and provincial governments and complying with the regulation of the $30 million budget limit while waiting for the time to get over-budget approved.

Case Four

The Europejski Hotel Renovation Plan in Warsaw, Poland: Small Fish in Deep Water[1]

The Europejski Hotel is a renovation project in Warsaw, Poland. Its developer, Andrew Gutowski, graduated from the Center for Real Estate Development at MIT in 1987. His father did many projects in the import-export business. Observing a hotel shortage in Warsaw, the father suggested that the son go over and see if they could build a hotel there. At his father's invitation, Andrew went to Poland in early 1989. By using some of the marketing skills he got at CRED he did an informal analysis of the hotel market and found that the occupancy rate was about 90% in Warsaw. Given the change that they expected in the economy, the Gutowskis decided that to do a new hotel in the city would be a very wise idea.

In most socialist countries there is no land market per se. Land is owned by the state, and no one has bought or sold land, and so no one knows what the land is worth. To avoid this land issue, they decided not to build a new hotel but to look for an existing historic property that they could renovate.

As two individuals, they felt they needed some clout behind them. So they found an operator for the hotel before they even found the building. It was a group

[1] Based on two speeches by Andrew Gutowski at CRED, MIT on December 5, 1989 (see Newsletter, Spring 1990, Vol.6, CRED, MIT) and April 11, 1991, and a telephone interview with him.

called Kempinski, which was 40% owned by Lufthansa, which has a five star hotel chain. They selected the group for its skills in downtown urban hotels and its associations with West Germans, who composed most travelers to Poland at the time.

The property they found turned out to be Poland's largest, most historic hotel, the Hotel Europejski, built in 1885 by a very famous Polish architect. At one time it was one of the absolute best hotels in all of Europe. By the time they found this hotel, it had deteriorated into the East Bloc's worst hotel. Sometimes for days there was not even hot water in the hotel.

The building had to be totally gutted, and everything had to be imported, all the heating and ventilating systems, the air conditioning, all the kitchens, the carpets, most of the furniture. However, they tried to utilize Polish workmen and techniques as much as possible. Because of the rebuilding after the Second World War, the Poles are among the world's best historic restoration experts. The stress to use Polish workmen also helped the authorities accept the developers as outsiders to do this project.

Because it was a hotel project, the national tourist agency, Orbis, naturally became their Polish partner. The Polish government is working hard to get foreign investment, so the government has been very supportive. Actually both the Prime Minister's office and Solidarity have become heavily involved in this project because of its visibility. Once Andrew went to meet the president of an organization, and before he got there the Prime Minister had called about the project.

Financing turned out not to be that easy. One time they got to a point where they actually got a banking commitment from the private arm of the World Bank, IFC. But the Polish partner did not have the money for their part of the equity. So they had to throw away the bank commitment and start all over again. There were many businessmen going to Poland. They were mostly Italian, Swedish, German, and British, but not American. They were coming from countries having the financing. According to Andrew, you have to go in with the financing, you can not find a deal and then go get financing. That is really the secret to any work in the Eastern Bloc. You have to go look for the sources of money before you go in. Since the only sources were the countries that were providing these export guarantees, they tried some Italian construction firms that bring Italian financing, and finally got their financing through an Austrian construction firm with a German affiliate.

Another real problem in doing this work turned out to be that there were absolutely no management skills in middle management in any of the companies they were dealing with. There has been no need for them. Any decision made by a state-owned company does not result in anyone getting promoted or fired, so non-decision making is the norm. It has been a very tough process negotiating this deal because no one wants to make a decision, and once a decision is made, they feel little compunction about changing their mind somewhere along the way. They have had to renegotiate the deal many times as they have gone along, through several changes of management.

Once Andrew met with the joint venture company's chief economist to look at their own internal analysis of the deal, and this Polish man had never heard of discounted cash flow. He did not know what an IRR or an NPV was. "We're coming from such divergent backgrounds that it is very difficult to convince them that it's a good deal, or to try to present our viewpoint. We had to re-work our deal to meet his parameters. There was no way of convincing the management that the way we looked at deals was the right way, or a correct way, or an international way. We had to restructure the deal in ways their internal management could understand and present to their board," said Andrew.

Andrew realized, fortunately not too late, that "you sometimes have to scrap your own preconceptions and try to understand what is happening in the particular country you are working in." What are the traditions? What are the ways things are done there? These are really critical questions.

One thing is for sure, though, that is, it takes time for a foreign developer to figure out the real issues behind the things he is hearing or apparently seeing. In Andrew's own words, "it often took a lot of vodka late at night to find out what the real issues were."

Another interesting aspect about this deal is that as the negotiations were going on, the laws had been changed underneath. In fact, the laws have been changing almost every day. The developers have also gone through four governments in the process. Changes there were really dramatic.

One logical result of these drastic changes is uncertainty. Every time the government changed hands, the negotiations of the deal had to be interrupted. Actually, for more than a year, not a single one building permit has been given in Warsaw, Poland. Along with the power structure change, the deal often had to be negotiated with different parties. For example, by March, 1991, it was clear that the real owner of the Europejski Hotel building is not Orbis, but the State Treasury. Therefore, instead of having a JV with Orbis, Andrew was asked by the State Treasury to purchase the hotel either wholly or partly from the State Treasury. It is up to Andrew to make the decision, and the rehabilitation plan is right now on the desk of the Minister of Privatization for the final approval.

During these two years working patiently on the Europeski Hotel project, Andrew got a rare chance to lay ground work for other projects in Poland. After trying a dozen of deals, at least two other projects are under progress now. One is a shopping mall, the other is a mixed-use project of retail, office and hotel. It was scheduled for Andrew to bring in the whole development team, the architect, the financier, etc., to Poland this May, and they are going to be shown with Polish leaders, including Walesa, on a TV program. The Polish government wants to use this program as an evidence of bringing in more foreign investment, while Andrew wants to use this chance to help push the local governments. Although everything is still changing dramatically in Poland, at least we can say one thing with certainty before we finish this case. That is, the small fish can really swim well in the deep water there.

Part Five

What Is Going On Now

Section A: Game Is Not Over

Despite the immediate impact of the June 4 Incident in 1989, China's market is not a deserted land. Some foreign investors and observers are actually viewing the situation as a window of opportunity. The rationale is that when all your competitors are leaving, that is precisely the time to enter and dominate the market. As one top executive for a major Japanese trading company remarked, "Now may be the window of opportunity for doing business in China." [1] Were it not for moral and ethical concerns, this might be sound business advice. Actually, in the Chinese language, as one analyst rightly pointed out, [2] the phrase for "crisis" is literally composed of two words: "danger" and "opportunity".

Japanese were not the only ones who tried to seize this opportunity. Some Americans obviously shared the same view. One of them is Prescott Bush, the President's brother. As early as September, 1989, Prescott Bush went to China on a business trip, representing Asset Management, International Financing & Settlement Ltd., a financial-services company. [3]

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[1] The China Business Review, September-October, 1989, p.19.

[2] Ibid.

[3] Asian Wall Street Journal Weekly, September 25, 1989, p.18.

The company was trying to line up several investment projects in China, including a wood-processing venture and a satellite-linked database network. In Shanghai, Mr Bush had a 30% stake in a project to build an $18 million joint-venture deluxe country club for expatriate residents. The club's facilities would include an 18-hole golf course and 12 tennis courts. Another project he was involved in in Shanghai was a $20 million town house complex for foreign residents. As he himself explicitly put it, "there are big opportunities in China, and America can't afford to be shut out. We don't want to lose the market to the Japanese, the Germans or anyone else." [1]

One thing for sure is that not every foreigner has left China. Indeed, visitors did come in, sometimes from very unexpected places. Perhaps the most unexpected guests recently staying in those joint-venture hotels in Beijing are some Yugoslavians. As the desired clientele of genteel capitalists disappeared from Beijing, the city's top hotels are attracting an unusual breed of socialist fat cats: Yugoslavian black marketeers.

> They are vacationers with a purpose and they are flooding into Beijing at the rate of nearly 1,000 a week. Staying usually six or seven days, they mine money from the cracks between their country and China's half-reformed socialist systems. They buy whatever isn't available in Yugoslavia, from silk shirts to cigarette lighters to fishing rods, and resell it for prices five to 10 times higher on the black market back home. A typical profit from such a trip is $3,000. [2]

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[1] Ibid.

[2] The Wall Street Journal, December 27, 1990, A6.

As a matter of fact, few foreign multinationals pulled out of China. Some have stayed because they expect the Chinese government to relax its austerity program. Others are preparing for a business upturn. The words of the managing director of Japanese construction firm Maeda, which is working on the Daya Bay nuclear power station in Guangdong province, may typically illustrate this kind of attitude. "Now is the time to get in on the ground floor. We're looking forward to large-scale projects that may develop in 10 or 20 years." [1]

Foreign investors are not only staying in China for future prospects. Profits are real and at present. A recent study of 3,000 joint ventures by the Guangdong provincial government showed that 70% JVs were making an operating profit. Most new enterprises manage to turn a profit within 3 to 5 years. [2] Current tax rates for foreign investments are like the following: for foreign-owned business and contractual joint venture, tax rates are progressive with five classification in the range of 20% to 40%, plus 10% local tax. For joint ventures, tax rate is 30%, plus 10% local tax. In certain areas, such as SEZs and development zones, tax rate can be 15% or even lower.[3] As mentioned before, a new tax law effective from July 1, 1991, will be more favorable to foreign investors.

Besides, after June 4, 1989, China actually liberalized the legal code for JVs. The JV law was first passed in 1979. In early 1990, the National People's Congress

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[1] Asian Business, November, 1990, p.54.

[2] Ibid.

[3] According to some Chinese official sources.

amended the JV law. Now, for example, a JV can be chaired by a foreigner. The post used to be reserved for the Chinese side.[1] According to an annual poll, the top 10 JVs in China, six of them located in Shanghai, had an average profit rate of more than 82.4%.[2]

To call it sad or bad, it is true that memories can be short. After shaking with convulsions for a couple of months after Tiananmen Square, Hong Kong today seems unchanged at all. For Hong Kong manufacturers who employ several million workers across the border in Guangdong province, business has hummed along with few disturbances.[3]

Even the Chinese in Taiwan seem to have surprising faith in the mainland's economic prospects. Since June 4, Taiwan's investment in China has continued to grow. Investors from Taiwan may actually be adding to their China stakes. Of course, this faith may be born partly of necessity. Wages in Taiwan are eight times higher than in China's Fujian province.[4] No wonder manufacturers of labor-intensive products swarmed across the straits. In many cases, when the Taiwan government relaxed travel restrictions, whole factories were dismantled and shipped to China through Hong Kong.[5]

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[1] Asian Business, November, 1990, p.55.

[2] Far Eastern Economic Review, October 4, 1990, p.69.

[3] Fortune, Pacific Rim 1989, p.28.

[4] Fortune, Pacific Rim 1989, p.24. and p. 32.

[5] Ibid. p.32.

Also, the Chinese government explicitly expressed as its policy to give Taiwan businessmen a more favorable status than other foreign investors.[1] By now, Taiwan businessmen have backed about one thousand projects in China worth approximately $1 billion. Despite the Tiananmen Incident, trade between Taiwan and the mainland reached $3.8 billion in 1989, up 28% from the previous year. In the first six months of 1990, Taiwan's investments in Fujian province were doubling the amount of money invested in the same period in 1989.[2] Indeed, as some analysts believe, China may become a vast labor pool for Hong Kong, Taiwan, and Singapore businessmen who share the same language and culture.[3] Even Japan wants to tap this labor pool, including in high-tech areas such as software. In a recent move, Japanese software companies want to use the surplus of Chinese software engineers to complement its own shortage.[4] With all these activities going on, to say the very least, the game is not over.

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[1] According to Chinese official sources.

[2] International Studies of Management & Organization, Vol. 20, Novemver 1-2, 1990, p.93.

[3] Ibid.

[4] KYODO, March 8, 1991.

Section B: China's Changing Tide[1]

In the wake of the astounding June 4, 1989 Incident, many Chinese provincial and city officials found land leasing their most viable option and the easiest and cheapest way of attracting foreign capital. China's coastal areas are scrambling to lease large tracts of land to foreign property developers in an effort to raise cash to finance further development. Leading the race are the special economic zones (SEZs) of Shenzhen, Xiaman, Zhuhai, Shatou and Hainan Island, followed by the cities of Canton, Fuzhou, Shanghai, Tianjin, Dalian, Hangzhou, Ningbo and Qingdao.

Foreign investment in China had actually already fallen sharply by the late 1980s. Right after the June 4, 1989 Incident, interest from most Western countries almost dried up, particularly from US companies. Taiwanese businessmen and Hong Kong entrepreneurs are still attracted to China, but their investments are mainly in low-tech production, an area not high on Beijing's wish list.

Even Guangdong province, which accounts for 43% of foreign investment in China, has been hit with a general decline in foreign investment. In the first quarter of 1990, such investment dropped 20% from a year earlier to US $420 million.

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[1] The source of this section is Far Eastern Economic Review, June 28, 1990, pp.68-69, if not specified otherwise.

Land leasing is expected to help change all this. As mentioned before, all land in China is in public ownership, especially after 1982, when a new constitution formally abolished private land ownership. Ironically, in reality, between the early 1950s and the early 1980s, land was actually a free commodity for most Chinese enterprises. Starting from last decade, China began to recognize land as an economic resource with its own value. Since the first establishment of the Sino-Foreign Joint Venture Law in 1979, foreign investors have been required to pay land use fees for the right to use the land they require. Land use fees varied from about US $0.5 per square foot per year in Xiamen and Zhuhai SEZs to about US $4 per square foot per year in Beijing. [1] After extensive research on foreign land controls and tax systems had been done, especially on places like Hong Kong, open bidding and auctions for land use rights were introduced to Shenzhen SEZ in 1987. In December, a foreign construction company became the first wholly owned foreign enterprise winning a land use rights auction in China. It paid more than US $6.5 million for the land use rights to 11.5 acres of land in Shenzhen. [2] The winning bidder retains the rights to any types of development that conforms to the local planning and zoning code. This method of land rights leasing soon spread out to other places, because, for local governments, it generated much more revenues than collecting land use fees. For example, Shenzhen municipality

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[1] The Real Estate Finance Journal, Winter 1990, pp.40-41.

[2] Ibid. p.41.

reportedly earned more than US $9 million through leasing five plots of land in 1987, 2.5 times the amount the city collected as land use fees in 1987.[1]

According to the State Land Administration, 80 tracts of land have been leased to foreign developers since 1987. Hong Kong companies were awarded 50 of the tracts, followed by companies in Taiwan with 14; Japan, five; Singapore, five; the Philippines, three; the U.S., two; and Thailand, one. During this period, 1,643 acres were leased, raising more than Rmb 560 million (US $119 million), according to Chinese officials.

So lucrative is land leasing expected to become that Beijing has even indicated that it wants a share of the proceeds. It is demanding that the Shenzhen SEZ, the first open area to experiment with land leasing, hand over up to 60% of its earnings from land leases. Shenzhen officials, however, are reluctant to part with this capital, a Hong Kong trader in the zone says, and the two sides are trying to negotiate a compromise.

Beijing is also taking a more liberal attitude towards property trading. In July 1989, a Chinese company granted an American camera maker the right to lease 60 million square feet in Guangdong province to third parties for 25 years.[2]

In September, 1989, in Guangzhou alone, negotiations and bidding process started to lease seven plots of land. These downtown plots, totalling 10.4 acres, range in size from 0.7 acre to 2.5 acres. They are designated for office and

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[1] Ibid. p.42.

[2] The Asian Wall Street Journal Weekly, July 24, 1989, p.22.

residential use. Rights on the land run for 70 years. During the same period of time, an American company, MGM Inc., acquired a 70-year lease on 2.1 square miles of land in Tianjin, where it planned to build an industrial park.[1]

Ideological and political opposition within the communist party to leasing large tracts of land to foreigners appears to have been quelled. In March, 1990, Premier Li Peng announced that the central government supported the development of Hainan Island's Yangpu port area by a Japanese consortium led by Kumagai Gumi.

In May, Li announced provincial regulations governing the leasing of virgin land to foreigners in the SEZs and open coastal cities. The regulations allow foreigners to lease land for infrastructural development. Developers are allowed to sell or rent the buildings once they are completed. The government, however, retains control of all resources under land surface.

The leasing periods for these ventures were set at 70 years for residential land, 50 years for commercial land and 40 years for industrial land. These regulations, mostly targeted at Hong Kong, Macau and Taiwan investors, pave the way for coastal regions to involve themselves more actively in leasing deals and to formulate more-detailed rules. Actually, rules are far from clear yet. In the competition for funds by offering pieces of land for leasing, some local government, such as Fuzhou, offered, as early as 1988, for auction land with a lease as long as

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[1] The Asian Wall Street Journal Weekly, August 21, 1989, p.10.

90 years, though not authorized by Beijing to experiment with land use transfers at all. [1]

Lease rates, too, vary widely. They were as low as US $0.10 per square foot on Hainan Island and in the Xiamen SEZ. In 1989, the average price per square foot in the SEZs and open coastal cities was US $8.95, according to the State Land Administration.

The Xiamen SEZ became a hotbed for real-estate speculation by Taiwanese entrepreneurs hoping to cash in on the waves of Taiwan visitors to China. "The Xiamen real estate market is very unstable now," said Or Nam-yuen, a HongKong-based property broker. Zone officials had been slow to enforce rules covering land sales, leading to a breakdown in support facilities, he complained.

Observers said 60% of the Taiwanese investors in Xiamen were only looking to make a quick buck rather than investing in the long term. They said some of these investors had already had their fingers burned. After the June 4, 1989 Incident, property speculators from Taiwan were finding it difficult to sell some newly built housing targeted at their fellow Taiwanese.

Some of the SEZs, notably Zhuhai, have announced a reduction in land prices by as much as 30-40% to woo foreign developers. In June, 1990, a 50-year lease for a plot of industrial land complete with basis amenities in the zone could be had for US $4.65-5.57 per square foot, as the total rent for land.

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[1] Far Eastern Economic Review, June 9, 1988, p.43.

A year after the Tiananmen, residential and commercial prices in the Shenzhen SEZ, however, returned to their pre-June 1989 level, according to Y.F. Kwan of Tian An Development, a Hong Kong based property-development company. Industrial prices, however, have yet to recover fully, he said.

In an effort to deal with foreign developers more sophisticatedly, particularly in terms of land leasing, China, through the United Nations Development Programme, invited a group of Western real estate experts to give a five-day course in Fuzhou, the capital of Fujian province. The course was offered at the end of May and early June in 1990. The majority of over 50 participants were officials from provincial cities throughout the country charged with leasing land to foreign investors. [1]

Until recently, Shanghai had been cautious with its land transfers, having set what foreign investors considered an excessively high price for real estate. When the city auctioned its first parcel of land (138,856 square feet) to foreigners in 1988, the property's using right was sold to a Japanese firm for US $200 per square foot. In 1989, the municipal government managed to lease another plot of about 38,750 square feet to a Hong Kong company for US $214 per square foot.[2] It was still, though, only about one third or a quarter of the land price of a 99-year lease in Hong Kong.

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[1] Urban Land, September, 1990, pp.11-14.

[2] An non-publicized Chinese source. According to Far Eastern Economic Review, June 28, 1990, p.69, however, the price for the first parcel was only US $32 per square foot. We do not think that was accurate.

Now, however, Shanghai has made land leasing a major part of its campaign to lure foreign investment. On March 28, 1990, a leasing contract of a large tract of land of more than 400,000 square feet called Parcel B7-B10 in the southwest suburb of Shanghai was signed between the Land Using Management Bureau of Shanghai municipality and a Hong Kong firm, Comalong Co., Ltd.. A shelter company, Shanghai Comalong Industrial Development Co., Ltd., was set up afterwards, with US $50 million investment to build an industrial park for Taiwanese businessmen. The plan included eight 8-story industrial buildings. The total building area would be about 1 million square feet. The whole industrial park would have a capacity of holding sixty businesses, and would include a 33-story service building as well of about 500,000 square feet for office, products exhibition, and recreational facilities.

During a week-long visit to Hong Kong in June 1990, Mayor Zhu Rongji promised Taiwan investors that they would be allowed to lease land more cheaply in the city's Pudong District than in any SEZs.

Actually, the Pudong District development plan well represents the most recent policy shifts of the Chinese government in its overall strategy involving utilizing foreign investment. Now, China tries to attract foreign investment focusing in three areas:

1) high-tech industry;

2) export-oriented industry (70%, at least 50%, of the products should be exported);

3) large tracts of land development. [1]

The Pudong District development plan is a major part of the third category mentioned above.

[1] According to some Chinese authorities.

Section C: The Pudong District Development Plan in Shanghai

Pudong is a 135 square-mile area on the eastern shore of the Huangpu River across from central Shanghai. It is relatively isolated and underdeveloped. Currently it is accessible only by ferry or through two narrow and congested road tunnels. [1]

The Pudong District development plan was publicly announced in April, 1990. The idea of the Pudong development project was actually first proposed by an American Chinese architect, Lin Tongyan. In the mid-1980s the proposal was already pretty much in detail. But for years it has been put on hold because of disagreement about whether the area should supplement or compete with the SEZs in the southern provinces, and whether it should be given special economic zone (SEZ) status. [2]

Not coincidentally, after the replacement of former Party head, Zhao Ziyang, who pushed for priority to be given to the southern provinces of Guangdong and Fujian, by former Shanghai party secretary Jiang Zemin, the Pudong District development plan was given a go-ahead. Both elder statesman Deng Xiaoping and Premier Li Peng have now given their seal of approval, barring any policy change or leadership upheaval in Beijing.[3] The first of three

[1] Far Eastern Economic Review, October 4, 1990, p.68.

[2] Far Eastern Economic Review, May 31, 1990, p.57.

[3] Ibid.

phases is scheduled for completion around 1995. According to Shanghai Mayor and party secretary Zhu Rongji, the estimated cost for the first phase alone amounts to US $10 billion or more. The central government has promised to provide US $1.38 billion for the first phase while the Shanghai government will set aside at least US $0.21 billion a year for the project. [1] A lion's share will be loans from Chinese banks. The People's Construction Bank of China has promised US $2.1 billion of loans, and the Agricultural Bank of China may also lend a considerable amount. [2] By the end of May, 1990, municipal officials, including Mayor Zhu, were still hoping that foreign investors would be persuaded to stump up more than half of the required sum. Yet, after a subdued response, officials said that they would have to depend almost wholly on domestic sources of funding. [3] To give Shanghai some fiscal elbow-room to deal with the development, the central government has allowed Shanghai to submit actually a smaller percentage of revenue to the central government. [4] Other sources include bond expectedly to be purchased by Shanghai's 13 million residents, whose deposits in the banks amount to US 4.6 billion. [5]

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[1] Far Eastern Economic Review, May 31, 1990, p.57.

[2] Far Eastern Economic Review, October 4, 1990, p.69.

[3] Far Eastern Economic Review, May 31, 1990, p.57. and October 4, 1990, p.68.

[4] The China Business Review, September-October, 1990, p.50.

[5] a) Far Eastern Economic Review, May 31, 1990, p.57; b) Some Chinese authorities.

Unlike China's other five SEZs which are outward-processing and re-export oriented, the Pudong District emphasizes hi-tech industries and financial services. The whole district will be divided into five sub-districts with relatively concentrated industries:

* Waigaoqiao--export processing, petro-chemicals and energy.
* Jinqiao--pollution-free industries.
* Huamu--residential, commercial, financial and cultural facilities.
* Liuli--metallurgical and construction industries.
* Zhangjiang--scientific, research and educational facilities.[1]

The municipal authorities have outlined a multi-billion dollar plan to make Pudong more accessible. They will spend US $5.51-6.35 billion on infrastructural developments in the next five years. The bulk of it will go to transportation projects. Investors will be granted a five-year tax holiday, with a 50% tax reduction for the following five years providing a commitment to operate for at least 15 years. [2] The blueprint includes plans for a modern container port in Waigaoqiao sub-district, an international airport, two or three bridges and five to six tunnels across the Huangpu River, as well as road and subway linkages. [3]

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[1] Far Eastern Economic Review, May 31, 1990, p.57.

[2] Far Eastern Economic Review, October 4, 1990, p.68.

[3] Far Eastern Economic Review, May 31, 1990, p.57.

On September 10, 1990, regulations detailing incentives for investors were announced.[1] The ten preferential policies granted to Pudong include: a low profits tax rate of 15% for JVs and foreign enterprises; duty-free imports of raw materials and equipment; a five-year tax holiday for foreign businesses involved in building infrastructural facilities followed by a 50% tax reduction for another five years; foreign banks and other services will be allowed to open their branches on a trial basis; the right of Pudong to retain its revenues for further development; and the right to lease large tracts of land for 50-70 years for development.[2]

One particular feature not available elsewhere is the establishment of a free-trade zone in the Waigaoqiao sub-district. Imports into this area will be tax-free if they are intended for re-export. Only foreign currency transactions will be permitted, and the non-convertible Rmb will be banned from the zone. What is more, traders are exempt from having to obtain visas. [3]

According to a Chinese bank official in Shanghai, 30-40 foreign banks have already applied to set up a branch there, and only two or three may be given licenses initially.[4] Between April and October, 1990, that is, between the development plan was first announced and the regulations were publicized, more than 1,350 foreign business delegations have visited Pudong. Most of them are

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[1] Far Eastern Economic Review, October 4, 1990, p.68.

[2] Far Eastern Economic Review, May 31, 1990, p.57.

[3] Far Eastern Economic Review, October 4, 1990, p.68.

[4] Ibid.

Taiwanese, and come from small and medium-sized firms. Discussions ranged from setting up food processing operations to golf courses. One contract has been assigned so far as we know. It is a US $25 million project by US firm Dupont to build a factory producing agricultural chemicals. [1] A number of other major foreign companies have also come to Pudong. About six or seven projects worth US $20 million apiece have been discussed.[2]

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[1] Far Eastern Economic Review, October 4, 1990, p.69.

[2] Ibid.

Part Six

Prospects and Lessons for American Developers

Having studied the past experiences of project development in China, particularly with the involvement of foreign developers and investors in the recent past years, we obviously want to know the prospects for future American developers' role in China if they want to participate, and what lessons we can draw for them. Many things can be said about this subject. Here we only want to emphasize some most notable points.

Section A: Readdressing China's Market Potential

Two mistakes are the most easily made in assessing China market. People tend to either overlook China market as if it were not existing at all, or over-estimate it as if it had unlimited potentials. These two extreme views tend to dominate alternatively, leaving little room for a more moderate, justified and realistic third path. Particularly for a foreign developer, such as Americans, either of these extreme views can be very misleading. As we have noted before, in the mid-80s, there was a moment when it seemed that everyone got the same "bright" idea--to develop a real estate project in China. The lesson from this rush is really simple. China's huge population is one thing, a possible tenant or buyer for such a real estate project in China is quite another. Despite China's 1.2 billion population, none of China's citizen could possibly become a client of such a project in the foreseeable future. Not a single Chinese citizen can afford to, or be allowed to, become such a client capable of paying foreign currency. For the foreign currency issue alone, all possible clients of a foreign developer's project must also be foreigners or foreign and JV firms, except for infrastructural projects where the Chinese government becomes the client and pays in hard currency. So, for an American developer who wants to build in China, the first thing is to forget about the 1.2 billion Chinese for a moment, and think only of the Chinese government and about how many foreigners will go and/or stay in China. Therefore, it breaks into following separate yet associated issues.

a) How strong, both politically and economically, is the Chinese government? And therefore how much infrastructural development it can afford to develop? And last, if there is going to be a political upheaval in China, including a possible splitting or overthrown of the current regime, how is that going to affect an American developer?

b) How many tourists can be attracted to China? And what is its capability to supply accommodation?

c) How many foreign businessmen will be attracted to China? How many businesses will be set up and how many expatriates are going to be generated because of that? Even if negotiations do not successfully lead to the establishment of any new foreign or joint venture businesses in China, the negotiations alone may generate some space needs--hotel, office and even residential. If a new business does come out as a result, industrial space may be needed.

Although it is very hard or almost impossible to come up with some definite or quantitative answers to the above questions, it is certainly helpful to spell out the issues and try to do a better analysis. (For statistics about foreign tourists in China, the number of foreign firms in Beijing, and China's foreign trade, please see Appendix B.)

Section B: China's Political Future And Its Implications to American Developers

To gauge China's political future is perhaps the most difficult thing under the sun to do. A handful people may give a dozen of different opinions. An expert's well-thought prediction can be badly out of whack as any stupid fool's. Even to touch the issue is somewhat dangerous and often looks unwise. However, to speculate which path it will take is often much more difficult than to foresee the possible coming results. If our interest here is simply to analyze its implications for American developers, instead of China's political future per se, our task may not be as difficult and unrealistic as it may look at first sight.

Just like China's market potential, predictions about China's political future tend to be extremely different from each other. Optimistic views are not hard to be found at all both among those academics called "China Watchers" and those businessmen who are currently doing baseness with China. At least one reason for this kind of optimism is fairly easy to understand. It gives them legitimacy for what they are doing now. To hold a really grey view about China' future is professionally almost equivalent to be committing suicide.

Therefore, to be more conservative, which is not unwise, it is the pessimists' opinions that are worthy of more attention in our analysis here. A best candidate for representing such a view is Mineo Nakajima, professor of international relations at Tokyo University of Foreign Studies. Despite being called Japan's top

China-watcher, his academic history dating back to the mid-60s is actually a personal crusade to show up what he views as the flaws in Japan's policy toward China, namely, overestimating China's potential. He bewailed the fact that the Japanese continue to have unrealistic expectations of China in both diplomacy and economics. According to him, Japanese businessmen seem to want to pour a good part of their huge capital surplus into China. The fact that China's cumulative debts to Japan already total close to $40 billion only serves to give one more reason for some Japanese businessmen to hold even closer relationships with China and spend more money there. At the diplomatic level, Nakajima traced to the fundamentally anti-Soviet attitude of the officials in Japan' Foreign Ministry. He also says that experts in the West have long tended to overestimate China's potential, pinning on individuals as different as Henry Kissinger and Ezra Vogel. The reality is, as Nakajima sees it, "There is no experience in human history of so many people modernizing. The gap between China and the surrounding countries will continue to grow wider and wider. China may become a permanent basket case." [1]

In his recent book, "The Tragedy of China: Where Will Deng Xiaoping Navigate China?", Nakajima offers five possible scenarios for China during the next few years:

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[1] Across the Board, May 1990, pp.48-51.

* Rule of terror. The suppression of dissent will continue and intensify. On the international front, China will adopt an aggressive policy of xenophobic isolationism.

* Only for the home crowd. A dual policy of internal crackdown combined with "smile diplomacy" toward the West and improvement of ties with Moscow. Reforms may gradually be introduced as the ranks of the ruling gerontocracy thin out.

* Victorious counterrevolution. Demonstrations nationwide on an unknown scale finally lead to the toppling of the Communist Party from power.

* Regeneration from within. A possible a la Gorbachev changing society from top to bottom, leading a counterrevolution from within such as occurred in Poland and Hungary.

Coup d'etat. This could lead to a new era of warlordism that would only end when pent-up resentment among the people toward the anarchic state of affairs and the degenerating economy resulted in an upheaval. [1]

Among those five scenarios, notably only two (--the first and the last) could be viewed as really negative from a foreigner's perspective and could lead to a re-closing of China's door. In those two cases, a foreign developer of a real estate property may conceivably become a victim. But even that is not for sure.

[1] a) The Tragedy of China: Where Will Deng Xiaoping Navigate China?, by Mineo Nakajima, Kodansha, 1989; b) Across the Board, May, 1990, p.51.

First, the period of warlordism early in this century in China did not necessarily mean a closed door to the West. On the contrary, those warlords depended, in general, very much on their different foreign imperialist supporters. As a result, many foreigner-oriented projects got built. Actually, signs of "Dogs and Chinese are forbidden" on the sites of those projects in many major Chinese cities at the time were real humiliations for any good-natured Chinese.

Second, the closing of China's door after the 1949 Revolution in China was not a one-sided decision or choice. To a large extent, it was the Western xenophobic anti-communism which forced or at least helped China close its door. Today, with an entirely different Western attitude toward China, China's door may not be easily closed even if the Chinese government chooses to do so. What is more, after the 1949 Revolution, the Chinese government never chose to close the door to the whole of the outside world. It did close to Western "imperialists," but for those "Russian big brothers," the door was widely open as it had never been before, until the Russians pulled out from China in the early 60s by their own decision.

Third, anti-foreign movements were occasionally used only for power fighting purpose, not for ideological reasons. Once consolidating their power, the strongmen, whoever they are, tend to re-open the door again. To some degree, only the hardliners can afford to do things that others dare not to do. A recent example is that Premier Li Peng approved the development plan for Hainan Island's Yangpu port area, which the more reformist governor had had a hard time to justify his advocation for [1] and the depleted, more reformist, former Party head and Premier, Zhao Ziyang, had hesitated to approve. A classical example of this kind of political behavior would be President Nixon's first visit to China. Only because he was such an arch-anticommunist could he afford to do such a political maneuver.

Besides, even if Mr. Nakajima was right, i.e. both Japanese and American politicians and businessmen have been overestimating China's potential, as long as this "illusory" belief prevails, foreign developers' economic interest will not be hurt at all. For them, the real issue is not whether Nakajima is right or wrong, but whether the majority foreign business community will believe Nakajima or not, and how soon. If they continue to horde into China for another decade, most developers may have already earned a good fortune in China by then. As a matter of fact, a growing global competition will make both Japanese and American businessmen feel even more unable to afford to neglect a potential China market, even though Nakajima calls it the "mythology of the vast China market."

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[1] Far Eastern Economic Review, June 28, 1990, pp.68-69.

Section C: China's Big Government

Americans have often heard of debates about how big a government should be. But it may really take them some imagination to realize how big the Chinese government is. First, the Chinese government is not just an executive branch. Congressional, judicial, and executive power are all tied together. In other words, one man or a handful clique have all the power in their own hands. Second, the government is the biggest employer and controls the production of the whole society.

So far, we have not heard of any American company doing any major infrastructural work in China. On the other hand, we have noted some Japanese firms doing this sort of work. For example, Maeda is working on the Daya Bay nuclear power station in Guangdong province, and Kumagai Gumi is going to develop Hainan Island's Yangpu port. There may be many reasons for this difference. But one of them seems to be the failure of Americans to deal with the Chinese government properly and successfully.

In the Poland case we studied before, we have also seen how important and essential to have government support. It may sound incredible and ridiculous to have the Prime Minister call your business partner to ease the negotiation which you are going to start with. However, that is the reality.

It is very easy for an American to think about only two functions of a government: regulation and public spending. But in a country like China or

Poland, the government has a much more important role to play in the business world.

Not only the central government, but local governments, too, may also have a crucial role to play. Take the sister city alliances for example. When a city official responsible for construction in Guangzhou came to Vancouver, he was overwhelmed by Canadian technique. As a result, he bought several hundred thousand dollars worth of computer-aided design and mapping software from a local company. [1] Few American municipal officials would have such an fiscal freedom. In that sense, they are not VIP at all, as their Chinese counterparts are.

Another example is the Grand Hotel case. The Japanese developer obviously took the advantages of the sister city (province) relationship between Nanjing, Jiangsu, China, and Nagoya, Aichi, Japan. If it was not promoted as one of the "friendly activities between sister provinces (cities)," its approval would be out of the question. The central government would not even send an inspecting and studying group to the city in the first place, since it was at a time when the Chinese government had already put on hold of all hotel projects throughout the country because of the envisioned bust.

It is obvious that in the Grand Hotel case the local government played an important, active role. The municipal government took the chance of setting up a JV, particularly through a sister provinces (cities) alliance, which was encouraged by the central government's policy, to revive a dead project stopped earlier by the

[1] American Demographics, June, 1990, pp.44-45.

central government. This strategy not only helped to get the approval of the project, but also saved its budgeting expenditure by using left-over materials for the old project.

Section D: Local Governments' Attitudes And Priorities Given to the Regions by the Central Government

Since China is such a vast country, local governments' attitudes toward foreign investments and project development can be very crucial. Also important is the priority given to the region by the central government. Portman's experience in Shanghai can be used as a good example. As early as the end of the 1970s, Portman started his China visits, not even one year later than Clement Chen's first visit to China. Then why could Clement Chen open his Jianguo Hotel in Beijing in 1982 while Portman could not finish his Shanghai Center until 1990? The size or scale, of course, is different. But besides that, there seemed to be other crucial factors. One simple fact is that the initial negotiation for Shanghai Center dragged on until 1985. Why did it take so long? Was bureaucracy alone to blame?

We know that Clement Chen also confronted with enormous bureaucracy in Beijing. Actually, some of his encumbrances seemed to be far beyond an individual's capability to handle. For example, there was no central government department responsible for reviewing such projects at the time, so plans had to be submitted to China's highest central executive body, the State Council, where they needed the personal approval of fourteen individuals. It took months to submit answers to questions raised by each of them. Then, at the local level, the planning and development board decreed that the building in Beijing should be at least nine stories high. But a four-story apartment building stood right in back of the proposed hotel, and the city board ruled at the same time that Chen's building could not block the sunshine for residents in this apartment building. Numerous design proposals and modifications were rejected. Yet a compromise was eventually reached. [1] The deal was closed within a year or so.

Yet it took Portman four and a half years to wrap up the Shanghai Center.[2] Why? There were maybe many reasons. But the following is at least an important one. It turned out that the place of his choice, Shanghai, had some inherited internal disadvantages during the early and mid-80s. During the Great Cultural Revolution between the mid-60s and mid-70s, Shanghai was the power base of the radical group called the "Gang of Four." Headed by the wife of Mao, they advocated an extremely anti-Western-capitalism policy. After Mao's death and the end of the Cultural Revolution in 1976, political battles absorbed most of the energy of the city. At the same time, a large development project of a modern steel plant in Shanghai's out-ring suburb, backed by Mao's handpicked successor, Hua, was under construction in the late 70s. This stigmatized association with Hua further blocked the way of the area's development potential when Deng Xiaoping came to power in 1979.

Under Deng's administration and the open-door policy, many other areas, such as the southern provinces of Guangdong and Fujian were given a go-ahead and actually started large-scale development immediately. Beijing as the capital

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[1] Real Estate, March, 1986, p.122.

[2] Real Estate, March, 1986, p.122.

was also given some priority to be used as a show window. Again, Shanghai became a major political battle field. Primary concern of the time was to replace officials who had been in power before by others who would be more loyal to Deng's policy.

New officials' hands were tied with inner affairs. Large development plan or foreign investment campaign was virtually out of the question. No local officials would jeopardize their personal political future by heatedly advocating such a project against the central government's favored ones. Actually, in the early 80s, many of the city's regulations looked formidable to any foreign developers or investors. For example, for every one foot of land cleared for a project, the city required the developer to provide seven square feet of suburban housing for the uprooted residents. [1] As a result, despite its prominence in the world, by the end of 1989, due to its local officials' luke-warm attitudes and the lower priority given by the central government (especially during the early 80s), Shanghai had attracted only about US $ 2.5 billion, or about 3.5% of total foreign investment in China, [2] compared with the lion's share of Guangdong province of 43%. [3] Portman was right in recognizing Shanghai's long-term potential. Unfortunately, in short-

[1] Real Estate, March, 1986, p.122.

[2] The China Business Review, March-April, 1990, p.28. The estimation here of the total foreign investment in China is different from other sources we quoted before. For example, one source quoted before estimated a total US $42 billion lending to China (see Asian Wall Street Journal Weekly, October 2, 1989, p.5.). But Nakajima stated that Japan's loan to China alone amounts to US $40 billion (see Across the Board, May, 1990, p.48).

[3] Far Eastern Economic Review, June 28, 1990, p.68.

run, swimming against the wind only resulted in facing such encumbrance of "bureaucracy" as Portman's chief executive A.J. Robinson called "the worst in the whole of China." [1] As Portman himself admitted, he was on "a virtual emotional roller coaster. Any number of times, we felt the deal was all but signed, sealed and delivered--only to encounter another hurdle and another few weeks or months of negotiations." [2]

By 1985, after four and a half years negotiation, Portman eventually wrapped up the deal. By then, Shanghai municipal government also began to change their attitude toward foreign investment. Now they tried to catch up with the southern provinces. For example, in February, 1985, they set up Shanghai Hongqiao United Development Co., Ltd. with registered capital of Rmb 70,000,000 (about US $24 million). (For more information about this company, please see the Appendix C.)

Within five years this company has developed more than a dozen of buildings of hotels, offices, and apartments. Five of them have been completed and opened for business, with building area of 4.66 million square feet. By the end of 1989, the company's registered capital had increased to Rmb 131,700,000 (about US $32 million). Now they are negotiating with an American firm to build a commercial park (trade center with exhibition halls) of 3 million square feet. Of

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[1] KYODO News, HONG KONG, October 22, 1990.

[2] Real Estate, March, 1986, p.122.

course, all these efforts and enthusiasm of Shanghai municipal government, from a business point of view, were only competitive with Portman's Shanghai Center. [1]

For several reasons, we are hesitant to give direct advice here to American developers as to which places in China are good for them to build their projects. One simple reason is that the markets of different metropolitan areas in China for foreign developers are of a much smaller size than the markets in any metropolitan area in America. If we point out a potential market in America, it may take dozens of developers following our advice and moving there to fill the market. Yet, in China, only a handful of foreign developers may crowd the market and make the area not a good place to go and build at all. Therefore, at any given time when a reader of this thesis wants to go to China to build, the places we point out as "good" (if we do that) may turn out to be already too crowded and no longer to be a good place at all.

However, here we would like to give some general advice or guidelines in terms of good locations in China. Currently, the Chinese central government is clearly interested in large tracts of land leasing and large scale development, particularly in Shanghai and the province of Hainan Island. And the local governments of both areas are also obviously having enthusiastic attitudes. Shanghai has a better industrial, commercial, and financial base; while the Hainan Island is basically a primitive, undeveloped land with vast natural resources, and the location is attractive to the Southeast Asian businessmen. Fujian and

[1] An non-publicized Chinese official source.

Guangdong provinces have already had close ties with Hong Kong and Taiwan. The local governments will continue their efforts to link with Hong Kong and Taiwan, despite the central government's shift of priority to other places like Shanghai. And actually the withdraw or the threat to withdraw the favor previously given by the central government will hardly turn the clock backwards now in these two provinces.

Other coastal and inland cities may have desires to have foreign developers come and build something there, as far as local governments' attitudes are concerned. But currently the central government is putting a ban on new projects in these cities. However, small size and non-hotel or non-tourism-related projects may still get chances to be approved. And some of these cities, such as Nanjing, are not overbuilt yet and are only waiting for the central government to loose its control. Once that comes true, those foreign developers who have already had some contacts and standing now on the top of the waiting list will be given go-ahead and catch the next wave.

Section E: Government Intervention

As mentioned before, government's support could be very helpful and, in some cases, even essential. But the flip side of it, of course, is that such a "big" government can also be a colossal obstacle when it intervenes in business affairs.

In China's social and political system, the government's right is almost unlimited. Sometimes this can reach a point where it will look ridiculous to a foreign eye, but may seem only too natural for a Chinese. For example, many leasing or long-term rent contracts of Beijing's hotels and office towers note that management reserves the right to raise the rent "on orders" from the Beijing Municipal Pricing Bureau, which is responsible for regulating prices, including hotel rates.[1] This is because, in a centrally-planned economy, prices are set by the government, not the enterprises. So, even for the private sector of the economy, which is allowed by the government now, the government may feel it is only too natural for it to "reserve" such a right.

Of course, sometimes the government would actually use, not just reserve, its rights. For example, in the first quarter of 1987, authorized by the State Council in 1986, Beijing Municipality started levying the "Four Utilities Fees." This directive applied to all new projects, both with or without foreign investment; productive, or nonproductive. The levy attempted to shift the burden of paying for

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[1] The China Business Review, July-August, 1985, p.37.

the new infrastructure required by these projects from the city to the projects. The four utilities were water, gas, heating, and sewage.

What upset foreign developers most was not the levying of this fee, but the retroactive application of this tax to projects dating back as early as 1985. They argued that the large tax altered the underlying feasibility of their projects and was unfair since they could not have predicted these additional fees when they first decided to invest. We do not know whether they finally reached any compromises with the municipality. If not, e.g. the deluxe Palace Hotel might have to pay an astounding Rmb 25 million (about US $7 million). [1]

Another example is that by 1986 Portman still did not know what tax rates they would be assessed. He claimed that the Chinese government's tax rates could be anywhere from 15 to 50 percent. [2] This kind of uncertainty alone may drive a foreign developer or investor crazy.

In another recent example, a foreign investment enterprise (FIE) purchased and had shipped to Shanghai a piece of equipment specified in its feasibility study and contract. When the equipment arrived, the foreign investor was told it could not be cleared through Customs. A new internal directive mandated that the item could no longer be imported, since China had the capacity to manufacture it. The

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[1] The China Business Review, November-December, 1987, p.16.

[2] Real Estate, March, 1986, p.122.

issue has been refereed to authorities in Beijing and we do not know whether it has been solved yet. [1]

A direct reason for this absurdity is the recent cash or credit crunch, particularly for foreign exchange. In the face of the current shortage of foreign exchange in China, the central government is trying to maximize foreign-exchange revenues to meet large amounts of foreign debt payments due soon. In Shanghai, it is reported that officials are trying not only to maximize foreign exchange revenues, but also to minimize its outflows. In the past, foreign investment enterprises have been relatively free to purchase equipment and raw materials from abroad and to incur overseas travel and training expenses as they deemed appropriate. But in the last quarter of 1989 several FIEs in Shanghai complained that the State Administration of Exchange Control (SAEC) was actually trying to control their Bank of China foreign-exchange accounts, allowing or disallowing every foreign-exchange payment. [2]

This frenzy to earn foreign exchange often undermines the government's stated policy of creating an attractive environment for foreign investment, especially when different and local departments are left to their own devices to fulfill foreign-exchange quotas. Perhaps the most absurd case in squeezing foreign exchange from whatever source possible was an internal notice from the SAEC sent to the local department in charge of newspaper circulation in Shanghai. The notice

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[1] The China Business Review, March-April, 1990, p.30.

[2] The China Business Review, March-April, 1990, p.30.

instructed the department to demand payment in Foreign Exchange Certificate (--a special kind of Chinese currency readily to be exchanged into foreign currency) rather than in ordinary Rmb for local newspapers purchased by FIEs in the Union Building, a modern building on the Bund housing several FIE offices. [1]

The point we want to make here is that, in China, the government can really do anything it wants at any time. Of course, government officials would always deny any inconsistency between their new orders or directives and the previously publicized, more general, government policies.[2] And, unlike in America, there is virtually no court where you can suit the government.

[1] Ibid. p.29.

[2] In an interview, a Chinese official in the Foreign Investment Commission under the Municipality of Nanjing frankly expressed this view. To quote his own words: "Any related government agency or department may give orders or directives at any given time. And, of course (laugh), none of those agencies would think their orders are inconsistent with the central government's policies."

Section F: Learn to Play a New Game

If the past experience of foreign developers' involvement in China tells us anything, that is: it is a new game, and it has always been a new game. Not more than fifteen years ago, it was totally unimaginable that any foreign developer would be able to build any project in China. Yet, today, billions of dollars and hundreds of high-rising buildings have permanently changed the skylines of almost every major Chinese city.

The whole process is so dynamic that games were played without rules, setting the rules, breaking the rules, and setting the new rules again. It has always been a learning process to anyone involved. The only difference may be: whether you have learned anything at all, and, how expensively you have spent to learn that. In any case, patience is necessary. Without it, you will achieve nothing. Perseverance is another tip. Some developers went to China, got frustrated, pulled out, and built nothing. For a moment they forgot about the whole scene. Then, all of a sudden, they heard that others have built things there after they had left and earned a remarkable profit. All they could do then was to scratch their heads and say: "Gee! How come!"

Having noticing so many differences in development process and the structural difference in social settings between two different societies like America and China, it is not hard at all to realize that if an American developer wants to develop anything in China, he has to adapt and adjust himself in the new settings, because it is a new game to play.

So many things are different in the development process. For example, in America, site control is the first step in a development. But in China, site is a secondary matter. The first thing is to "establish the project," as explained earlier in this thesis. First, you have to convince the governmental authorities that what you plan to build is also what they want to see built. Whether in a joint venture or in a 100% foreign ownership, the project has to be approved by the government agency before its site may be discussed at all. Since all land is owned by the Chinese government, both the site and its price are under the government's control. Sticking to a coveted site may lead you no where. During the eighteen months of negotiations for The Great Wall Hotel in Beijing, the developer, Becket, said that the site of the hotel was changed three times. [1] Today, it is clear that these changes did not prevent the project from being an early success. Of course, this does not mean site is not important. But to understand its importance in a context of different social settings, and, in a comparative sense with other factors such as timing, proves to be also and even more important.

Portman's chief executive explicitly expressed the conventional wisdom of the industry. "Choosing a site in Shanghai is no different than in any other city--

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[1] a) Progressive Architecture, March, 1986, p.32; b) Real Estate, March, 1986, p.122.

there are three things to keep in mind: location, location, and location."[1] Shanghai Center does occupy the best location in Shanghai. But why did it not achieve an instant success like the Jianguo Hotel in Beijing? The developer seemed to have overlooked another important factor: the timing.

In China, timing is so important, not only in the sense of marketing the space once you have built it, but to the degree of whether you can build anything at all in the first place. Early comers like Clement Chen had successfully built their projects while many others went to China, even for several times, only to experience a lot of frustrations of negotiations with no results. If not for the sister provinces (cities) alliance, the Grand Hotel project would not happen at all, for example, since it was already a time when such a project was forbidden by the central government.

On the other hand, choosing a proper Chinese partner is no less important than choosing a site. Ownership vehicle is often taken into consideration in America for tax benefit reason. However, in China, there are many other considerations. For example, Shanghai Center's developers chose to have it as a 100% foreign-owned venture, instead of a joint venture, for a quite different reason. This structure was chosen by Portman for the relative freedom of operations it would allow. Despite its merits, it does lack some advantages of a joint venture, most obvious of which is the role the Chinese partner may have played. In a joint venture, the Chinese partner can take care of many problems in

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[1] The China Business Review, July-August, 1985, p.45.

dealing with bureaucratic issues. This is particularly true because of the hierarchical structure of the Chinese society. Different players are treated differently according to their status. Therefore, the status of its Chinese partner may eventually decide the fate of the project.

In the case of Europejski Hotel in Poland, the developers chose and accepted the governmental agency which was traditionally in charge of the hotel business in the country to be their partner, exactly as was the case in those early cases in China, such as Jianguo Hotel in Beijing. By following the easy route, Andrew got as much help as possible from the Polish government. In contrast, Shanghai Center's developers seemed always at odds with the political structural changes in China. Without a Chinese partner, the project never fit in closely with the hierarchical structure of the society. Portman tried to cultivate a good working relationship with the municipal officials, including inviting the mayor and other officials to visit America between 1982-1983. Yet, by the time the construction was underway and probably the time when assistance from mayor's office was most needed, the mayor left his office. After June, 1989, for a while it seemed that no particular Chinese group had much self-interest in helping the project. Finally, when the city's business climate changed, the municipality's enthusiasm for new development projects seemed only to help the center's business competitors more than it may help the center.

The above discussion about status also leads us to discuss another status issue. Because of the difference in the two societies, a big name in one society does not necessarily mean anything in another. The advantages enjoyed by big developers in America are often not found in China. Once you move the arena it is a totally different game. Actually, most projects done in China in the last decade were not associated with real super developers. Portman was probably the biggest American developer who did build something so large there in China. Other super American developers either went there and built nothing or only something much more moderate in size with much lower profile, or have not finished their projects yet. To say the very least, it is still arguable whether it is an advantage to be a super developer. A small firm may well achieve some success in China.

In the Poland case, Andrew seems to be a small fish that could not be smaller. Yet that did not prevent him from making a deal to renovate probably the most prominent hotel in Poland and once the most prestigious one in Eastern Europe in history. The moral is that the new frontier or arena, such as China or Eastern Europe, seems to be equally, if not more, suitable for smaller developers and smaller projects. This may be particularly true in Eastern Europe today, while China has already experienced such a period of free development, mostly by small firms, and has moved into a new stage of large tracts of land leasing and large-scale development.

But no matter whether in Eastern Europe or in China, whether it is a small developer or a big one, one thing is important, i.e., a developer's skills can not be readily transferable to a totally different society. As Andrew said, "a developer sometimes has to scrap his own preconceptions and try to understand what is happening in the particular country he is working in." [1] In the Poland case, we know now that Andrew's Polish partner did not know either NPV or IRR. In the Grand Hotel case we find that in the feasibility study report they were using a quite different method in calculating the project's economics.

Portman's executives seemed to think otherwise. A.J. Robinson twice stated publicly that the company's strengths were readily transferable to China. In an article on "The China Business Review" on July-August issue in 1985, he wrote:

> John Portman Associates, Inc. of Georgia, has been working on real estate development in China since 1979. With a background in building multi-use urban projects, the company's strengths are readily transferable to China. Currently, Portman is undertaking a large-scale multipurpose complex in Shanghai called Shanghai Center.[2]

In another article--appearing on the January, 1987 issue of "National Real Estate Investor", he used almost exactly the same words.

> The Portman Cos., Atlanta, began working in China since 1979. With a background in building multi-use urban projects, the company's strengths were readily transferable to China. Currently, we are undertaking a large-scale multi-purpose complex in Shanghai called Shanghai Center.[3]

We do not want to say anything too conclusive. But here is an interesting episode to end our story about this America-backed hotel, office, and apartment complex built in Shanghai. Immediately after the Tiananmen Incident, an advertisement appeared in Time magazine for Shanghai Center. The contrast

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[1] Newsletter, Spring 1990, Vol. 6, CRED, MIT.

[2] The China Business Review, July-August, 1985, p.44.

[3] National Real Estate Investor, January, 1987, p.72.

between the chirpy ad and the bloody photos a few pages away was bad enough. What caught the eye was the new venture's slogan: "Now, everything is possible."[1] It was nothing but irony to indicate that anything positive may happen in China while such a horrible thing was happening there. Today, for those who are aware of the bankruptcy of the company, the sentence may sound even more ironic.

After more than a decade of experience under China's open-door policy, actually not only foreign developers, but all foreign investors have learned a lot through their China operations. Recently, Asian Business interviewed many foreign executives in China and concluded that foreign companies are choosing their JV partners more carefully now. One such executive confirmed that a sympathetic partner can sort out many of the hassles of doing business. "If both sides are cooperative and considerate, then all the problems can be solved. If it's the reverse, very simple matters can become very complicated and you can't do anything," said he.[2]

Yet those foreigners have a lot more to learn, particularly the Americans. For them the pitfalls created by language and cultural differences appear even more problematic.

In advising Western companies thinking about investing in China and Vietnam, a former Harvard University law professor, now a New York lawyer, Jerome Cohen, said: "What matters is not when you enter a new market, but how."

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[1] Fortune, Pacific Rim, 1989, p.21.

[2] Asian Business, November, 1990, p.54.

He believes Americans should study how the Japanese venture into new territory. According to him, when China opened its door, Japanese firms invested heavily in manpower to build relationships with Chinese government functionaries, to scout out the best potential partners, and to understand the business environment. For example, Mitsubishi dispatched scores of Chinese-speaking Japanese employees to backwater provinces as well as to major cities, while even a decade later it is still exceptional today for an American or European firm in China to have more than a handful of Occidental employees who can speak the local language. [1]

Even his advice to those who consider investing in Vietnam should be well taken for investors in China. Since the payoff in Vietnam is apt to be years away, he asked, what should U.S. and other multinationals be doing now? His answer is:

> "Prepare those advance teams: Get to know the right people in Vietnam, and get to know the lay of the land. Hire and train some of the thousands of smart, resourceful Vietnamese who fled their country after the war....Why? Because dealing with a socialist country takes a long time. If you wait until the embargo comes down to begin your dialogue with the Vietnamese government, then you'll be entering not with the second wave, but with the third or forth wave." [2]

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[1] Fortune, Fall, 1990, Vol. 122. No.8, pp.61-67.

[2] Fortune, Fall, 1990, Vol. 122, No.8, pp.61-67.

Section G: American Developers' Advantages and Disadvantages In China, Compared with Developers of Other Nations

American developers have some advantages as well as disadvantages in China, compared with others, such as Japanese, Taiwanese, people from Hong Kong and other Asian and European countries. In government regulations, China gave the Taiwanese, their "blood brothers," explicitly favorable status. In some places, such as Jiangsu province, only Taiwanese are allowed to lease large tracts of land. [1] In Fujian area, for geographical reasons and family ties, more connections have already been existing between Taiwan and Fujian province.

People from Hong Kong look more like "step-brothers" to Chinese. The tie between Hong Kong and Guangdong province is already very tight. Proposals for them to be merged after 1997 have already been made. [2] Besides, both Hong Kong and Taiwan, and even Singapore, share the same language and culture with mainland China.

As for Japan, its advantages have been explicitly expressed by Shanghai's mayor, Zhu Rongji. His assessment of Americans' advantages and disadvantages in China compared with Japanese's is pretty straight forward and really helpful. In an interview by The China Business Review, Mayor Zhu said:

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[1] According to an interviewed Chinese official.

[2] South China Morning Post, March 6, 1991.

> "Chinese would rather buy goods from the United States than from Japan. US technology is better and US companies have been more willing to transfer it. The Japanese, however, have three advantages when it comes to doing business with China: Their prices are lower than those offered by US companies; they better understand the Chinese mentality and system (I could say they understand it too well; some of them have successfully used illegal means--bribing corrupt officials--to do business); and most important, they have financing. [1]

It is generally true that in the past years few American developers have successfully cultivated and used their relationships with the Chinese government officials. The only exception we know about is the following example. The chief enterprise of Lamar Financial is a savings bank, but Lamar's principal owner is the family of Stanley Adams II, who had long been interested in the Far East. He had been talking to a Japanese company about a joint real estate venture in North America, and it happened that the architect consulted about the project was a Chinese-American, Henry Hwang, who has offices in Houston and Taiwan and important connections in the People's Republic of China, among them a cousin who is deputy mayor of Guangzhou (Canton). Soon a group was put together, including some Taiwanese with mainland connections of their own, and Realty Development International was formed as a Lamar subsidiary. With all the relationships the group had, it was able to reach an agreement for an office, hotel and residential complex in what it believes was record time.[2]

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[1] The China Business Review, September-October, 1990, p.51.

[2] Real Estate, March, 1986, p.128.

In terms of understanding Chinese mentality and system, Americans should really try to learn from the Japanese. Actually, Americans have got a very good chance. Currently there are more than 50,000 Chinese students enrolling in most American universities. No other nations in the world has a comparable number of Chinese students. It could become a vast human resource. Also, because English is the official first foreign language in the Chinese education system, the number of Chinese who can speak English is far more than those who can speak Japanese or any other foreign language. Besides, due to historical reasons, in China, the image of Japan is never as popular as that of America. In general, pro-Americanism in China is in sharp contrast with the anti-Americanism found in many other areas of the world.

In short, it seems fair for us to come to the following conclusion: American developers should really, and could, take their advantages, and try to learn, if they want, to improve their competitiveness in China. There has been, is, and will be games for American developers to play in China. It all depends on whether they want to play, and, where and when and how.

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Statistical History of US from Colonial Times

Statistical Abstract of the United Steates

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Monthly Labor Review

Projections of the Population of the United States, by Age, Sex, and Race: 1988-2080

APPENDIX

A. PROCEDURES FOR SETTING UP JOINT VENTURES IN CHINA

SOURCES:
The China Investment Guide
Longman Group Limited
3rd and 4th Editions
1986 and 1989

B. (I) Number of Foreign Tourists in China

(II) Number of Registered Foreign Firms in Beijing

(III) China's Foreign Trade

SOURCES:
China Statistical Yearbook
The China Business Review
Beijing Daily

C. A BRIEF INTRODUCTION OF SHUDC

SOURCES:
THE COMPANY'S BROCHURE

The China Investment Guide, 4th Edition,

Longman Group Limited 1989

Chapter 13

Procedures for Setting Up Joint Ventures

13.1 Identification of Chinese Firms as Cooperation Partners 349

13.2 The Three-Step Procedure for Making Investment in China 349

13.3 Authentication of a Joint Venture as a Legal Person 350

13.1 Identification of Chinese Firms as Cooperation Partners

Generally, foreign investors may contact Chinese companies, enterprises, other economic entities or consultants in the same or similar business lines directly by letter or telex. If it is difficult to make direct contact or impossible to find a suitable liaison channel, then initial ideas (in respect of trade lines, products, technology, markets, proposed project location, etc) concerning investment projects may be presented to the Ministry of Foreign Economic Relations and Trade (MOFERT) or to the local Chinese government office. Alternatively, Chinese embassies, consulates, commercial offices, or banks and trading corporations stationed abroad are the proper bodies through which these proposals may be forwarded to the appropriate Chinese potential partners. For the sake of efficiency, foreign investors may also present their initial ideas or investment proposals to the China International Trust and Investment Corporation (CITIC) or local trust and investment corporations, consulting corporations or foreign enterprise service corporations. (Their names, business lines, addresses, telex, cable and telephone numbers, etc, are separately listed as appendices to this book.) In order to express their investment intentions to the Chinese side, foreign investors are advised to send their pamphlets or catalogues and annual reports to their Chinese counterparts so as to promote mutual understanding through such informative materials. Experience has shown that this is a simple and effective method of introduction. The Chinese side will respond to the foreign investors directly or through other convenient channels and will try their utmost to expedite communications or negotiations.

More opportunities are regularly available for foreign investors to find the right partner, for example at various exhibitions, including the half-yearly Guangzhou Fair, investment discussions, seminars on economic cooperation, etc, held by the Chinese government at various levels, enterprises and academic institutes, etc, and from press releases on investment projects issued periodically by the governments of provinces, autonomous regions and municipalities as well as in the open coastal areas. Information can also be obtained from Chinese newspapers, periodicals, economic news and investment bulletins.

13.2 The Three-Step Procedure for Making Investment in China

1 *Identification of a Chinese enterprise for cooperation*

Correspondence by letter or telex is the usual path for foreign firms to follow for direct contact with a Chinese enterprise at the preliminary stage of starting investment business in China. The Chinese enterprises will have been recommended preferably by Chinese official agencies in foreign countries, such as embassies, consulates, commercial offices, banks, trading corporations, and so forth. Information can also be obtained upon request by foreign firms from the Ministry of Foreign Economic Relations and Trade (MOFERT) or other government departments in the provinces and cities. Other appropriate channels for people overseas to obtain information on subjects of wider interest are the China International Trust and Investment Corporation (CITIC) or other similar companies, consulting firms, and foreign enterprise service agencies in China. Though the above-mentioned official bodies and business units are not held liable for their recommendations and information, it can be assumed that they are doing the work in good faith and to the best of their knowledge and ability.

To substantiate their proposals or inquiries, foreign firms are advised to send to the Chinese side their brochures, product catalogues, annual reports, particularly their business lines, details of technology, markets, business scale, location of the project site in China, etc, at the initial approach. Exhibitions of Chinese industrial and agricultural products, symposiums on investment in China, and seminars on economic and technical cooperation are frequently held overseas by Chinese organisations. Chinese and foreign businessmen can hold on-the-spot discussions, and exchange ideas, views, suggestions and other information to pave the way for more detailed discussion later. More often than not, potential partners are identified by both sides.

Discussions between the two sides at this stage centre mainly on the following:

- The name and address of the proposed project;
- The size of the proposed project — capital amounts. (*Renminbi* and foreign exchange), output, cash flow, source of funds on each side;
- The form of the joint venture;
- Details of the technology and product quality;
- Details of the market: both domestic and overseas markets, and proposals for the balancing of foreign exchange; and
- The method of profit distribution.

2 *Letter of intent and feasibility study report*

Based on what has been discussed and agreed upon by the two parties, a letter of intent shall be signed by them and submitted by the Chinese party to the higher authority in charge of foreign investment for examination and approval. If that is approved, the Chinese party will then be allowed to start negotiations with the foreign party.

Negotiations will proceed item by item so that each party is able to pursue what he wishes and may obtain what he pursues. On the other hand, each party must protect itself from irrational liabilities and responsibilities. The Chinese side upholds the principle of equality and mutual benefit when carrying out international business. This principle serves to lubricate negotiations.

During negotiations, a team of people designated by both parties will work on the feasibility of the proposed project. The joint report on the feasibility study will supply a firm foundation for the joint venture contract and articles of association to be entered into later. Disagreements between the two sides are unavoidable. If the problems are too serious to be resolved by the parties themselves, they can be reported to the higher authority for timely advice. Even if there is no disagreement, the higher authority should be informed of the progress of the negotiations from time to time so that no last-minute hitches will appear during the course of the examination by the higher authority.

3 *Submission of the joint venture contract and articles of association for examination and approval*

Both parties should appoint their legal counsels at the start of negotiations until the joint venture contract and articles of association are completed. After these documents are signed by both parties, they shall be submitted to the higher authority or its authorised organs in the provinces and cities, together with the following documents:

- The application for establishment of the joint venture;
- The joint feasibility study report prepared on behalf of the two parties;
- The agreement, contract and articles of association signed on behalf of the two parties;
- The name list of the board of directors, its chairman and vice-chairman(men); and
- A letter of opinion signed on the establishment of the joint venture by the competent department in charge of the Chinese party to the joint venture and the government of the province, autonomous region, directly administered municipality, special city under the state plan, open coastal city or special economic zone where the joint venture is located.

No organs or organisations apart from MOFERT or its authorised organs are authorised to examine and approve or disapprove the legal documents mentioned above in this section.

13.3 Authentication of a Joint Venture as a Legal Person

Within one month of the receipt of an approval certificate for the establishment of a joint venture, the Chinese party (in most cases) to the joint venture can apply, together with the certificate and other supporting documents, for registration with the administration for industry and commerce of the province, autonomous region, municipality, open coastal city, special city under state plan, or special economic zone where the joint venture is located in accordance with the *Regulations of the People's Republic of China on the Registration of the Enterprise Legal Person*, promulgated by the State Council on 13 June 1988. The date of issue of the business licence is the date of formal establishment of the joint venture which shall be simultaneously regarded as a legal person. The production and operation activities and the rights and interests of the joint venture shall be under the jurisdiction and protection of the laws of the People's Republic of China. Being a legal person, the joint venture is endowed with civil powers and civil conduct ability regarding the fulfilment of civil obligations and liabilities.

China Investment Guide, 3rd Edition, Longman Group Limited, 1986

14.1 Finding Chinese Firms for Cooperation

Generally, foreign investors can contact Chinese companies and information services by letter or telex. If it is difficult to make direct contact with the relevant companies, messages may be sent to the local Chinese government office or the Ministry of Foreign Economic Relations and Trade, presenting initial ideas for projects including fields of investment, products, technology and marketing. Foreign investors may also present their ideas to Chinese embassies, consulates, banks and trading bodies abroad. These proposals will be forwarded by these organisations to the appropriate potential partners for cooperation. For the sake of efficiency, foreign investors are also welcome to present their initial ideas or proposals to the China International Trust and Investment Corporation or local companies who hold the same status. For the business scope and addresses of such companies see appendices to the book (pages 833–6). While expressing their investment intentions to the Chinese side, foreign investors may send pamphlets introducing their products, technology and sales so as to promote mutual understanding. Experience has shown that this is a simple but effective method of introduction. The Chinese side will respond directly or through government departments, trust and investment corporations or companies of the same status. These organisations will help the two sides set up direct contacts either through meetings or correspondence.

To provide further channels for foreign investors to find the right partners for cooperation in China, the Chinese government, enterprises and academic institutes hold regular exhibitions, investment discussions and seminars on economic cooperation, including the Guangzhou Fair that is held twice a year, and press releases on investment projects given at various times of the year by the governments of provinces, autonomous regions and municipalities. Chinese newspapers and periodicals also provide a channel for finding business partners in China. This do-it-yourself search for Chinese partners thus provides a sound basis for investment decision-making.

14.2 Procedures

According to the provision stipulated in Article 9 of the Implementing Regulations for the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, the procedures for applying for the establishment of a joint venture are as follows:

- Presenting written proposals for cooperation.
- Submitting feasibility study reports for examination and approval; and
- Presenting the joint venture contract and articles of association for examination and approval.

Presenting Written Proposals for Cooperation

When a potential partner is found, the two parties concerned may present their views and specifications concerning the principal matters of joint investment through correspondence and telecommunications. Their communications should contain the name of the potential joint venture, its location, production capacity, total investment, percentage of investment for each party, form of investment, form of cooperation, division of profits, source of funds, product quality and methods of marketing. When the two parties reach agreement on the major aspects through consultation, the foreign party should request the Chinese party to present its proposals on the cooperation project to the local department in charge of joint ventures and the department regulating and ratifying joint venture projects.

When approved by the former, it should be sent to the latter for examination on whether the project is necessary for the economic development of the country or the locality and whether all necessary requirements have been met.

After the project is endorsed, it is usually open to the Chinese party to invite the foreign party to China to begin negotiations. An agreement on bilateral contributions may be signed as a basis for further negotiations.

Presentation of Feasibility Study Reports

According to the approved principles in the project proposal and the content of the letter of intent or memorandum, the two parties should analyse and study the content of bilateral contributions and draw up a feasibility study report. The report should then be filed by the Chinese party or both parties together. When necessary, either party may invite the other to carry out a field study on matters of technology, products, business scale, quality and potential markets for the projects and followed by another feasibility study report that should be approved by both parties. The Chinese party should request the local department in charge of the project to examine and sign the report and then submit it to the government department in charge for approval.

Presentation and Ratification of Joint Venture Contract and Articles of Association

After a feasibility study report has been approved the two parties should draw up the joint venture contract and articles of association through negotiation. Legal advisers or lawyers for both parties may attend the negotiations and assist in working out the contract, articles of association and other legal documents acceptable to both parties.

After the signing of the necessary documents by their representatives, the two parties may apply for the establishment of the joint venture according to the provisions of Chinese law, producing the following documents to the ratifying department:

- Application for setting up a joint venture;
- Feasibility study report drawn up by all parties concerned in the joint project;
- Agreement, contract and articles of association signed by representatives of all parties;
- List of the chairman and vice-chairmen of the board and members of the first board of directors appointed by all parties to the project; and
- Views of the department in charge of the Chinese party and the views of the provincial, regional or municipal government responsible for the establishment of the joint venture.

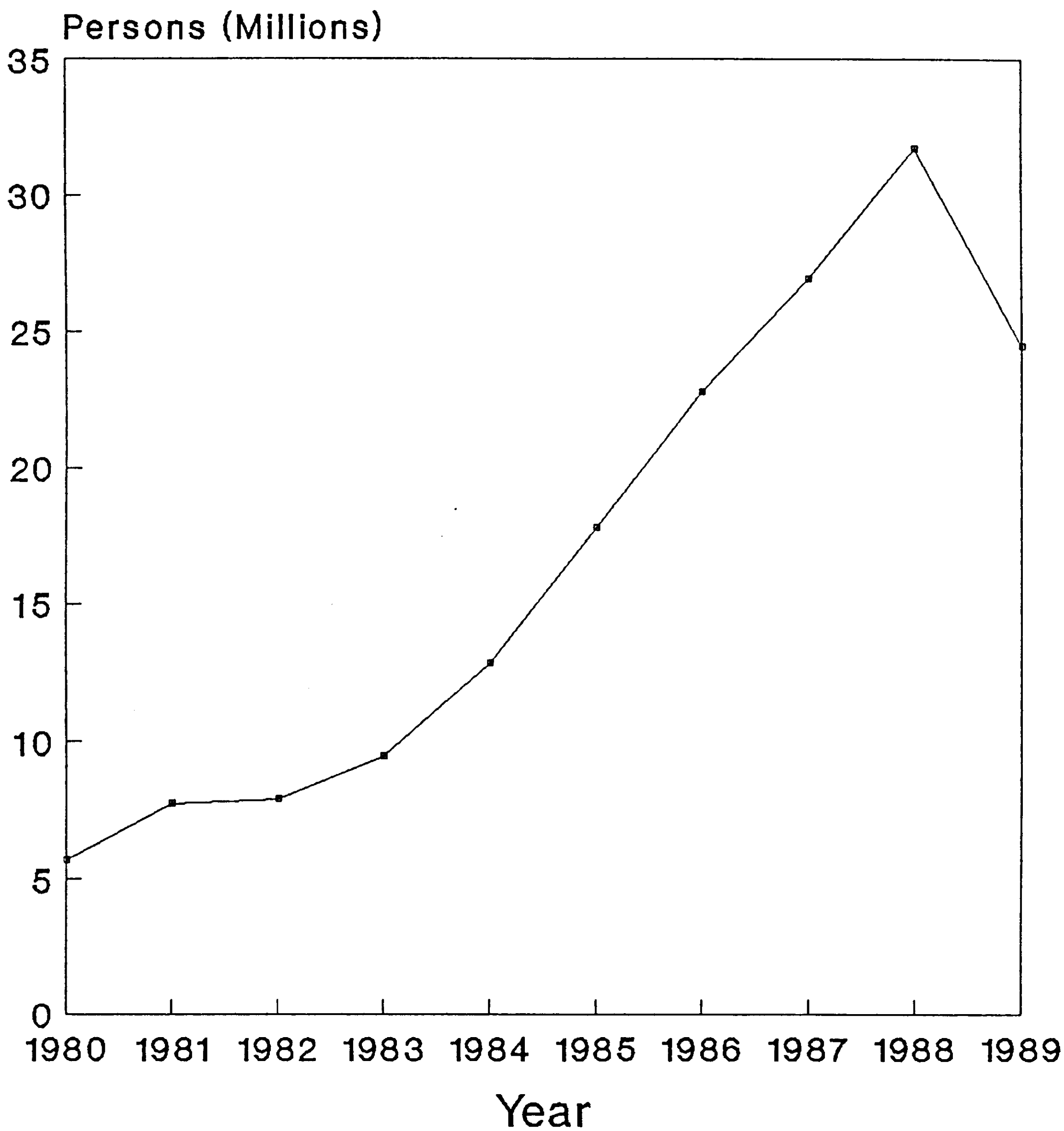
The endorsement procedures for the above-mentioned documents may be entrusted to the Chinese party.

Within three months of the receipt of the above legal documents by the ratifying department, approval or rejection shall be given and amendment may be required to be made by each party.

14.3 Establishment of Joint Ventures and Legal Status

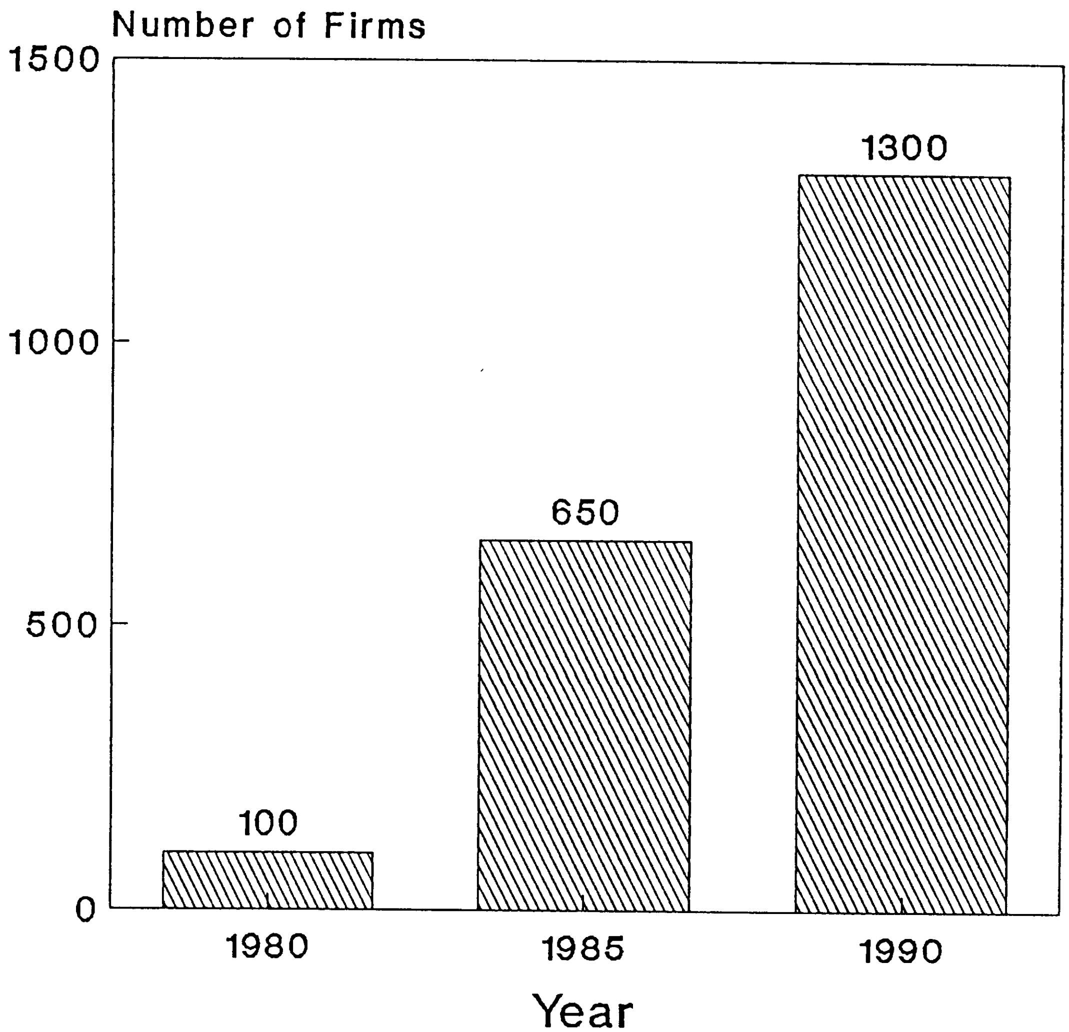
Within a month from receipt of approval, an applicant may apply for registration with the industry and commerce administration of the province, autonomous region or municipality where the joint venture is located, according to the Regulations of the People's Republic of China on the Registration of Joint Ventures Using Chinese and Foreign Investment. The date when the local industry and commerce administration bureau issues its licence is the date of the joint venture's formal establishment. The joint venture may then be regarded as a company allowed to operate legally and whose interests come under the jurisdiction and protection of the laws of the People's Republic of China.

Foreign Tourists in China (1980-89)



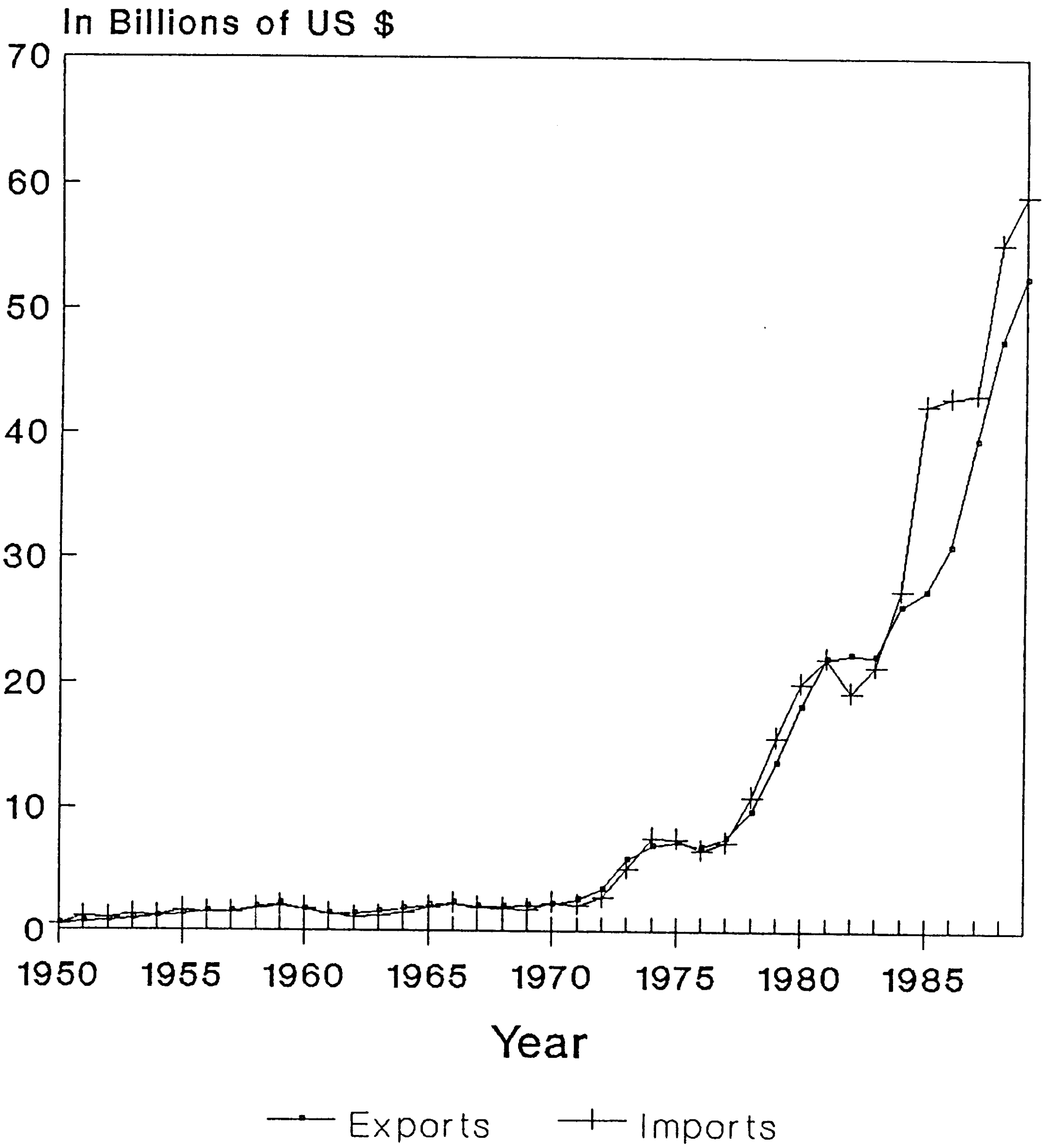
Sources: China Statistical Yearbooks

Registered Foreign Firms in Beijing (1980-1990)



Sources:
<u>The China Business Review</u>
<u>Beijing Daily</u>

China's Foreign Trade
(1950-1989)



Sources: <u>China Statistical Yearbooks</u>

上海虹橋聯合發展有限公司簡介 A BRIEF INTRODUCTION OF SHUDC

一九八四年十月十九日市長汪道涵、副市長阮崇武、倪天增、葉公琦參加了上海虹橋聯合發展有限公司合同簽字儀式.

Mayor Wang Daohan, Vice Mayors Ruan Chongwu, Ni Tianzeng and Ye Gongqi of the Shanghai Municipal People's Government, present at the ceremony of signing joint venture contract of SHUDC on Oct. 19, 1984.

上海虹橋聯合發展有限公司是經中華人民共和國對外經濟貿易部於一九八四年十二月三十一日批准的中外合資經營企業.公司系由下列企業共同投資組成:

- 上海市閔行虹橋開發公司
- 中國銀行上海分行
- 中國銀行香港分行
- 金城銀行香港分行
- 浙江興業銀行香港分行
- 新華銀行香港分行
- 廣東省銀行香港分行

公司於一九八五年二月十四日經國家工商行政管理總局登記注册并核發營業執照,具有中國法人資格.

營業執照:工商企合字09051號

注册資本:人民幣柒千萬元(1985年)

人民幣壹億叁千壹佰柒拾萬元(1989年)

Shanghai Hongqiao United Development Co. Ltd. is a Sino-foreign joint venture approved by the Ministry of Foreign Economic Relations and Trade of the People's Republic of China on Dec. 31, 1984. The Company is jointly invested by and composed of:

- Shanghai Minhang & Hongqiao Development Corp.
- Bank of China, Shanghai Branch
- Bank of China, Hong Kong Branch
- Kincheng Banking Corp., Hong Kong Branch
- The National Commercial Bank, Ltd., Hong Kong Branch
- Sin Hua Trust, Savings & Commercial Bank Ltd., Hong Kong Branch
- Kwangtung Provincial Bank, Hong Kong Branch

The Company has been duly registered in China, holding the business licence issued by the State Administration for Industry and Commerce on Feb. 14, 1985 and is hereby qualified as a legal entity.

Business Licence No.: GSQH09051

Registered Capital: ¥70,000,000 (1985)

¥131,700,000 (1989)

公司宗旨

積極引進外資和國外先進技術、管理經驗，加速虹橋開發區的開發和經營，使開發區建設成爲上海市對外經濟貿易、外事和旅游事業的中心場所之一，爲促進上海市與國際間的交往，加速現代化建設服務.

THE AIM OF THIS COMPANY

To speed up the development and to strengthen the management of the Hongqiao Development Zone by actively bringing in foreign funds, advanced technology and management experience so as to develop the Hongqiao Development Zone to be one of the foreign economic and trading, diplomatic, tourism and recreational centres of Shanghai, to help promote international exchange and to accelerate the modernization of Shanghai.

經營範圍

經上海市人民政府批准，統一負責虹橋開發區的開發和經營.

· 組織建設區内市政公用基礎設施，負責區内土地的使用管理和收費.

· 以獨資、合資、合作等多種形式從事房地產經營，興建并出租辦公樓、公寓、住宅等，興建并經營旅館、餐廳、商場、文體娛樂、交通運輸和其他服務性企業.

· 辦理本公司和區内企業的有關進出口業務.

· 爲投資者介紹在區内興辦企業的合資、合作對象和其他委托代辦業務.

SCOPE OF BUSINESS

To undertake the development and management of the Hongqiao Development Zone as authorized by the Shanghai Municipal People's Government, viz:

· To organize the construction of infrastructure, to take charge of the land utilization and land management and to collect expenses concerned in the Development Zone

· To handle business in real estate with our own investment or in the forms of joint venture and contractual joint venture, such as the setting up and renting of office buildings, apartments and residential buildings, the building and managing of hotels, restaurants, and shopping malls, and the establishing of recreation facilities and transportation and other service industries.

· To handle import and export business for the enterprises in the Development Zone

· To recommend participants for foreign investors in setting up joint ventures or contractual joint ventures in the Development Zone and to handle business entrusted by clients.

董事會成員及正、副總經理

董事長 謝武元
副董事長 張學堯 薛鏡澄
常務董事 黄文斌 黄克歐
陳昌華 李國柱
董事 崔書明

總經理 謝武元
副總經理 黄文斌
趙沛 方耀堂
總經理助理 軒中才

BOARD OF DIRECTORS AND EXECUTIVES

Chairman Xie Wuyuan
Vice-Chairmen Zhang Xueyao Xue Jingcheng
Managing Directors Huang Wenbing Huang Keou
Chen Cheongwah Li Kuozhu
Director Cui Shuming

General Manager Xie Wuyuan
Deputy General Managers Huang Wenbing
Zhao Pei Fang Yaotang
Assistant General Manager Xuan Zhongcai

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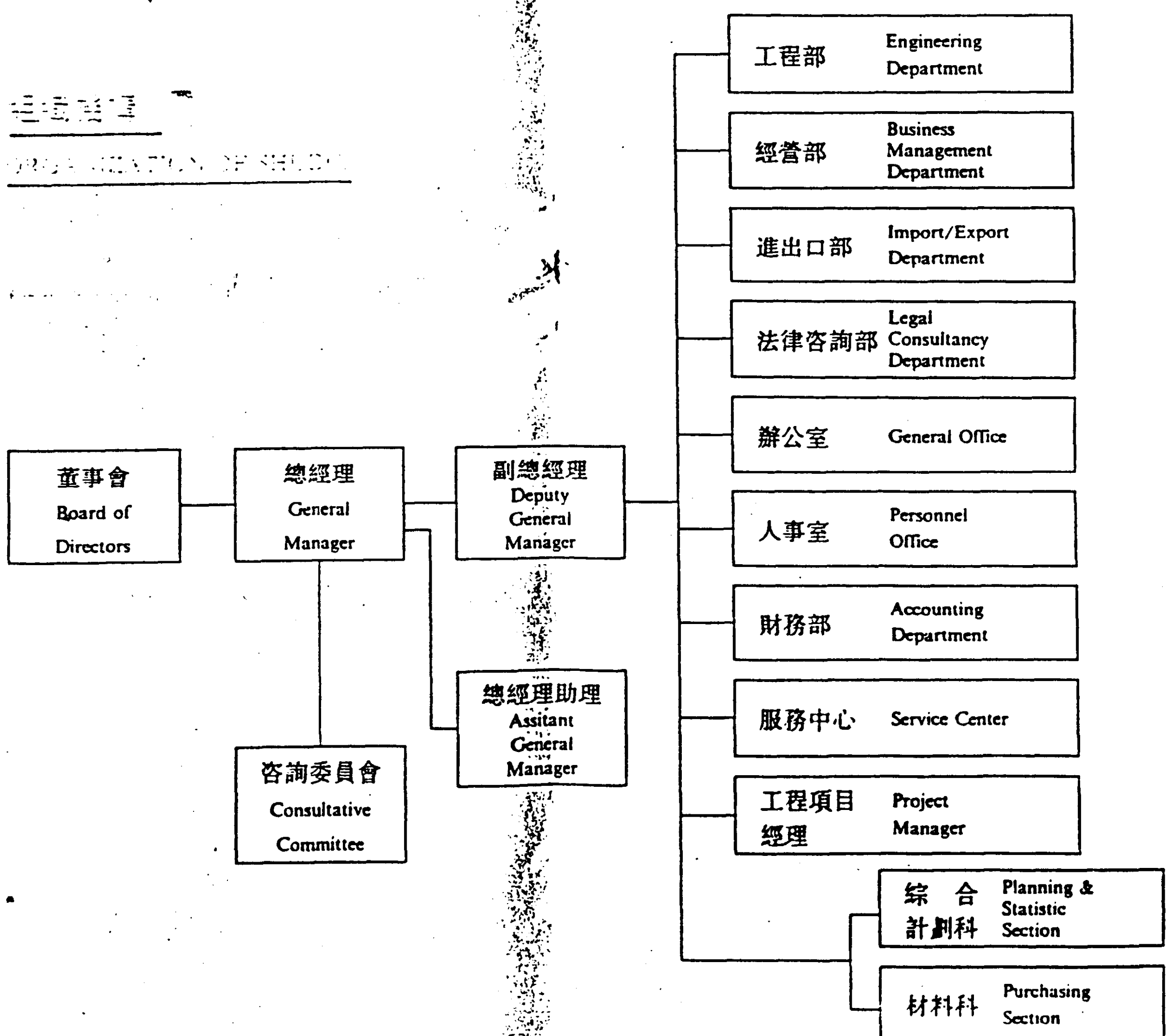
ORGANIZATION OF SHUDC



虹橋開發區概況

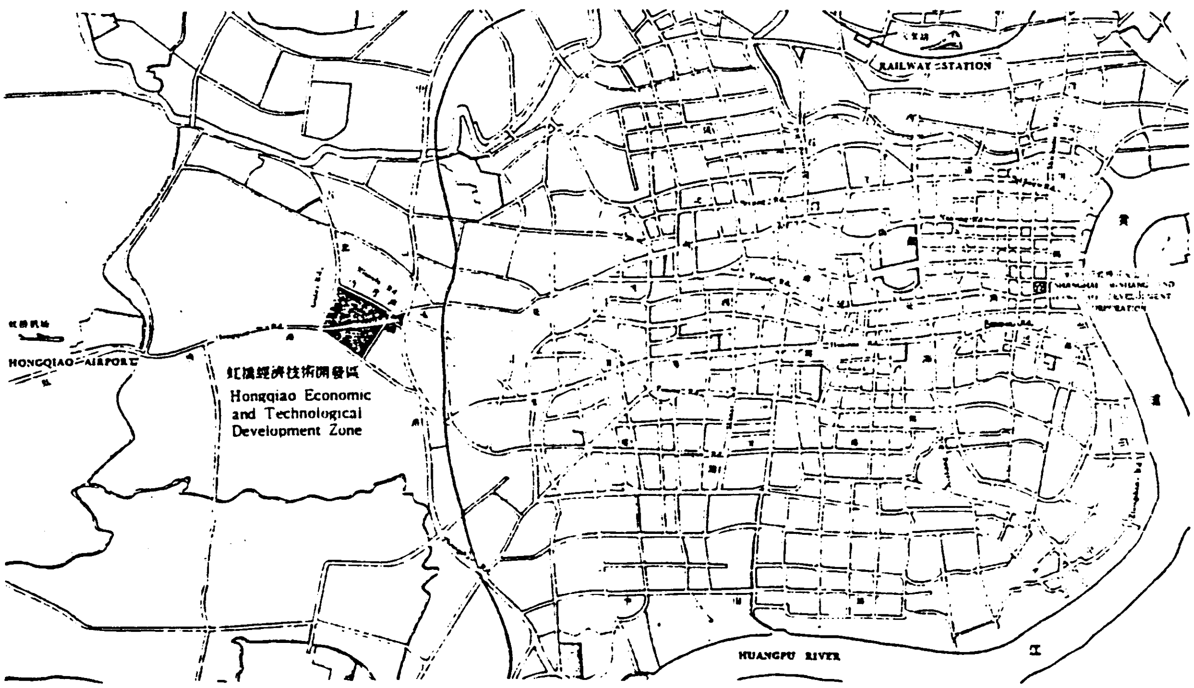
HONGQIAO DEVELOPMENT ZONE GENERAL INFORMATION

虹橋開發區是國務院批准的沿海城市十四個經濟技術開發區之一．它是上海市爲適應對外開放需要，爲外國駐滬領館、中、外客商、外僑和僑胞提供辦公、業務活動、居住、旅游條件而新闢的以外貿中心爲特征的現代化新區．

Hongqiao Development Zone is one of the fourteen Economic & Technological Development Zones along the coastal cities approved by the State Council of the P.R.C. The modernized new town featuring the centre of foreign trade is set up to meet the needs of opening to the outside world and to provide foreign consulates, domestic and foreign institutions, foreign nationals and oversea Chinese with space for offices, living quarters, venue for business activities and facilities for tourism.

地理位置：

LOCATION:



開發區位於上海市區的西部，距虹橋機場5.5公里，距市中心6.5公里．東起中山西路，西至古北路，北臨仙霞路，南界虹橋路，延安西路在區内横貫東西．

Hongqiao Development Zone is located in the west part of Shanghai urban, 5.5 kilometres east of the Shanghai Hongqiao Airport and 6.5 kilometres west of the city centre. The New Area is bounded by Zhongshan Road (West) to the east, Gubei Road to the west. Xianxia Road to the north and Hongqiao Road to the south, with Yanan Road (West) crossing the area from east to west.

總體規劃：

開發區規劃面積	65.2公頃	100 %
其中：		
・建築開發	30.4公頃	46.6%
・游憩公園、绿化、其它	19.3公頃	29.7%
・道路	15.5公頃	23.7%

MASTER PLAN:

Total land area	65.2ha.	100%
of which:		
· for building construction	30.4ha.	46.6%
· for recreation, open space, park, green belt, etc.	19.3ha.	29.7%
· for road	15.5ha.	23.7%

開發區規劃建設：

- 各國駐滬領事館、領事館及辦公綜合大樓
- 高層辦公大樓
- 高層旅館
- 高層公寓建築群
- 展覽展銷中心
- 商業服務設施
- 體育游憩設施
- 文化醫療設施
- 郵政電訊設施
- 综合服務設施

THE PLANNED PROJECTS OF THE DEVELOPMENT ZONE

- consulate buildings, consulate and office building complex.
- high-rise office buildings
- high-rise hotels
- high-rise apartment blocks
- International Trade Mart
- commercial service facilities
- sports and recreation facilities
- culture and clinic facilities
- post office and telecommunication facilities
- comprehensive service facilities

市政公用基礎設施

· 道路

橫貫開發區的延安西路路幅寬40米，六車道。仙霞路、古北路及區內主要道路路幅均爲24米，四車道。區內規劃有地鐵通過。

· 排水

納入西區城市雨水、污水分流管網系統。日處理7.5萬噸的天山污水處理廠和芙蓉江路雨水泵站已建成使用。

· 供水

接通城市上水直徑φ1500毫米總管，由上海市自來水公司提供服務。

· 供電

由上海供電局提供服務。35千伏變電站和110千伏變電站向區內提供用電。

· 煤氣

接通城市煤氣總管，由上海市煤氣公司提供服務。

· 電訊

由上海市市內電話局提供服務。天山路電話局和首期已有10000門程控電話的古北路電話局已投入使用。

· 供油

由區內加油站提供汽油、柴油、潤滑油等服務。

INFRASTRUCTURE

· ROADS

Yanan Road (W), crossing the Development Zone, 40 m in width, 6 lanes; Xianxia Road, Gubei Road and other main roads in the Development Zone all 24 m in width, 4 lanes. A subway is planned to pass through the Development Zone.

· SEWERAGE

Rain water and sanitary sewers to be connected to the city seperate sewerage systems. Tianshan Sewerage Plant with capacity of 75,000 T/day and Furongjianglu Rain Water Pumping Station have been put into operation.

· WATER SUPPLY

To be connected with the φ 1500 mm city water main. Services to be provided by Shanghai Water Plant.

· ELECTRICITY

To be provided by Shanghai Power Industry Bureau through 35 KV and 110 KV transformer stations.

· GAS

To be connected with the city gas main. Services to be provided by Shanghai Gas Company.

· TELECOMMUNICATION

Services to be provided by Shanghai Telephone Bureau. Tianshanlu Telephone Exchange and Gubeilu Telephone Exchange with its first stage installation of 10000-line programmed-control telephones are in operation.

· PETROL

Gasoline, diesel oil, lubricating oil, grease, etc. to be supplied by Petrol Station in the Zone.