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Developing Business in China

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QUOTE

“The Chinese use two brush strokes to write the word 'crisis.' One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger-- but recognize the opportunity.”

John F. Kennedy’s Speech in Indianapolis, 1959

INTRODUCTION

This work is the result of many personal events and experiences that I had in recent years. The current financial crisis was the first of those events. Having started my undergraduate studies while the world economy was facing the worst crisis it has ever faced had an impact on my learning. Basically, I wanted to understand why certain events occurred, and eventually be economically competent. Although I could not reach some of these goals, as great experts still do not have a complete picture of all of the financial turmoil, I definitely improved my understanding of the key operation in finance, economics and management and expanded my knowledge beyond my initial limits.

Influential was also my experience during my internship in China that I managed to get while I was studying. This made me begin to consider the possibility to focus my thesis interest on China, its social structure, the outstanding issues it has and, especially and the difference with the other emerging countries.

In fact, the company I was working for, SAAT Logistics, a tailor made offering 3PL freight forwarding solutions, has fully contributed to my understanding of the Chinese work environment. During my time there, I had the opportunity to host, to talk, to exchange useful information and an overview of the procedures for international trade, as well as to find and manage customer's needs.

Simultaneously, working alongside and socializing with Chinese colleagues, who would then become good friends of mine, allowed me to dive into their culture and the more I learned about how business was conducted in China, the more I realized the importance of Chinese culture in the successes of many firms.

This work deals with China, and attempts to marry the business knowledge I acquired at work with the cultural enrichment I had. But before doing so, it equips the readers with enough tools and reasons to answer compelling questions as to the

choice of firms to expand in emerging markets, and the reasons why China is a better option among major growing nations, such as Brazil, Russia and India.

An additional section is inserted and another question is raised, which encompasses much of the fear of the exceptional growth in China: Will it be sustainable? By reaching an answer to this urgent issue, a historical review of the geopolitical issues of China will be realized. This is crucial to really understand the real state of the Chinese market as a whole, and to look beyond the economic situation of China and its reasons for increasing demand for natural resources.

In fact, we will recognize the link between the growth of China and its attitude increasingly aggressive towards regional conflicts on resource requests. In short, China's performance cannot be summarized by simple macroeconomic parameters only: there is no more the case than meets the eye. Note, however, that a comprehensive study of geopolitics in China is beyond the scope of this article and the results of this section should be seen as complementary to the entire document.

CHAPTER 1: Why develop activities in a Large Emerging Market (LEM)?

Introduction

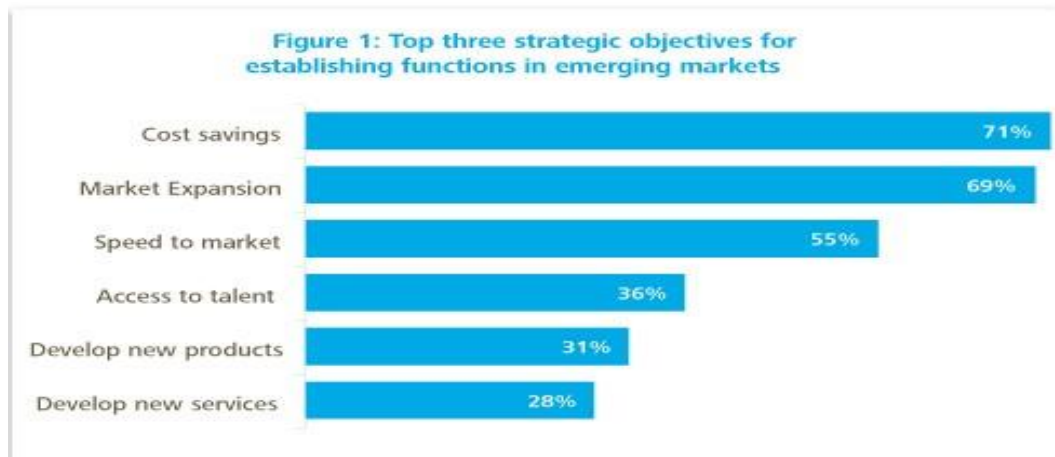
In this chapter, we'll be seeking an answer to the question of why companies should do business in key emerging markets in the first place. This is done by providing the reasons that lead companies to focus on these regions of the world. A study by Deloitte Consulting will be used as the main reference throughout the chapter

1.1 - Reasons encouraging firms to seek China's opportunities

Over the last fifty years, the number of companies with International links all over the world have jumped. Some of these players are often on Forbes list of 500 most successful companies, while others are small but still have significant operations. It seems that it has become quite a popular trend among companies to address an important emerging market and settle agreements there. Based on a 2009 study Deloitte conducted interviews with several executives and a survey of 247 consumer frames and industrial products companies with a presence in emerging markets, companies are increasingly geographic emerging markets a centerpiece of their model overall business. Over the next three years, upwards of 88 percent of companies plan to increase their presence in emerging markets. In fact, almost half of these organizations expect 20 percent or more of their worldwide income to have their origins in emerging markets. In addition, a third of these companies plan to invest more than 20 percent of their investments in these regions. In addition, forward-thinking companies are not content to simply increase their presence in low-cost centers. They have become more strategic in their operations by establishing basic functions of their value chains in these regions.

What are the strategic objectives for the establishment of a presence and functions in emerging markets? Following the above study, it appears that 71 percent of the companies are driven by cost savings opportunities; 69 percent reported market expansion as a crucial determinant; others instead identified speed to market (55

percent), access to talent (36 percent), new product and services development (31 percent and 28 percent respectively) as key factors for their choices. The top three objectives will be examined promptly below.



Source: Deloitte Study (Last updated on July 17th 2011)¹

1.1.1 - Lower expenses

Expansion to new destinations can be driven by a simple arbitrage price / work, which is an economic phenomenon where jobs move to countries in the places where it is inexpensive and / or poor. International obstacles or disintegration removal are the main causes attributed to this change Taking place in the last decade; This factoring --other keep stimulating this practice include increased production costs in the country of origin, opportunities to benefit from a large pool of workers at a fraction of the usual cost, increasing competition in the domestic market. As Stephen Roach, chief economist at Morgan Stanley, points:

"In an era of excess supply, companies lack pricing leverage as never before. As such, businesses must be unrelenting in their search for new efficiencies... offshore outsourcing that extracts product from relatively low-wage workers in the developing world has become an increasingly urgent survival tactic for companies in the developed economies"(Roach, 2003).

¹ Deloitte Study available at:
http://www.deloitte.com/view/en_US/us/article/43cc586731101210VgnVCM100000ba42f00aRCRD.htm

1.1.2 – Expanding the market

Major emerging markets are driving the world's economy; China is prime choice for many products, such as mobile phones, and in 2005 has become the world's second market for new automobiles, with sales of almost six million (*Peter Enderwick, 2007*). Rapid growth and development lay out great opportunities infrastructure specialists, service companies and establishment of public-private partnerships. However, such spur in economic activities usually goes one way in emerging markets due to severe income disparities and widening gap between social classes. At the same time, such differences in purchasing power create further opportunities for a business willing to adopt low pricing policies. In fact, lower-income groups in markets like China are numerically important segments allowing economies of scale to be achieved and are consumers who offer the most interesting challenges (*Prahalad 2005*)².

1.1.3 – Market speed

As illustrated in the bar chart, 55 percent of the company in the study reported that establishing their position and affairs in large emerging markets is propelled by the speed improvement they gained to the market into question. Working home to sell in a target area is not ideal; the amount of time wasted increases, ranging from weeks to months, and the tailoring to actual needs of local customers decreases, causing product failure to happen more frequently. Nokia make a powerful example of what "speed to market" means. Nokia has been in India since 1995, and it conquered 50 percent of the mobile phone market. D. Shivakumar, managing director of Nokia India, attributes this success to the company's completely localized value chain. Indian operations for everything from R&D to manufacturing, marketing and sales give Nokia the power to launch new phones in

² Prahalad, C. K. (2005). *The Fortune at the Bottom of the Pyramid*. Upper Saddle River, NJ: Wharton School/Pearson Education.

a matter of weeks, rather than months, with designs that cater directly to the needs of its local customers³.

1.1.4 - Hedging

A parallel benefit of serving such markets and, in particular, the vast number of low-income consumers materializes in hedging. In finance, this refers to an investment position meant to offset potential losses deriving from price movements in an asset. The logic behind internationalization hedging coincides with that of financial one except, the aim is to offset potential decreases in consumers' demand in other regions of the world. This is becoming more and more a tipping factor in the current financial uncertainties main markets are facing. With Europe's demand for key products following a rollercoaster trend and U.S.' heading for a W-shaped recession, companies have long realized that lacking a back-up source of revenue from other markets may linger on their ability to be competitive in the long term.

Having the possibility to draw out of other "boxes" makes the difference between staying alive with the few and succumbing with the many. This is, indeed, the case of China, which is acting as the locomotive for consumers' demand for goods and services. In general terms, the countries making up the BRIC group tend to be target due to their size and relative influence on the global stage, as well as for the amount of natural resources they host within their lands. Other countries, though, are being analysed more and more often by companies producing/offering an array of different goods and services globally. These range from Eastern Europe's countries, North/South Africa's nations to Latin American ones. Some of them "offer" strictly defined markets that function as double-edged swords, while others retain a bag of possibilities to benefit from lower production and labor costs.

These countries have substantial natural resources deposits, human capital, greater catch-up work to do, potential demand growth and, in particular, BRIC countries

³ Radjou, Navi (2008). "How Smart Multinationals Use India to Reinvent Themselves Globally." Harvard Business Review

are a good match ” for hedging purposes because their potential internal demand, that is the demand and purchasing power enjoyed by their citizens, is increasing year by year by a far greater percentage than in other countries. BRIC members, therefore, can be viewed as sparkling stars and can be compared, to certain extents, with post-war European countries. Out of the BRIC countries, however, China is the locomotive training the others as it is gaining a dominant position and enjoying more foreign capital injections, thanks to the many reforms it set out to put in place in order to open its doors to the world. Furthermore, companies have noticed that Chinese demand is gradually outweighing European counterpart and is thus helping to offset gloomy prospects in Europe/U.S., which pushes them to invest more in such market.

1.2 - Summary n°1

There are multiple and diverse reasons why firms decide to expand in LEMs; usually, inexpensive labor cost is a key one. Others include the willingness to expand their influence, desire to offset demand imbalances and speed to market. The next chapter will be complementary in that it will offer insights and tools needed to make the choice of target country among LEMs.

CHAPTER 2: Which is the most profitable country among LEMs?

Introduction

Emerging markets have so far behaved as the key drivers of a global development and growth, attracting financial investors and firms that were, in turn, lured in by plentiful opportunities offered. In this chapter a closer look at these markets will be given in order to find the optimal one. In doing so, a broader approach is taken that emphasizes the drivers currently in place to identify a target country. The scope will then be narrowed and enhanced via the inclusion of macroeconomic parameters. In the end China will be selected, which will bring this work to its core

2.1 - Going Global

Going global always sounds so intriguing and exciting when associated with firms and growth opportunities. However, it is never a smooth road and Thoughtful steps ought to be taken if one wants to grasp the matter into question. That is, a comprehensive process has to be carried out in order to lay out the amount of effort that will be required before further delving deeper into the real practicalities.

First of all, we should clearly identify what that means and actually entails. Specifically, we should ask ourselves the following: What is internationalization? Does simply selling a few amounts of certain goods abroad make a firm international? Too often is the case that SMEs (small and medium size enterprises) misunderstand the meaning of such process and try to define themselves international, when, in fact, they are not. Internationalization is the process by which a firm expands its line of operations and influence in other countries, other than its own, via the set-up of new locations/offices and presenting the respective markets with their offerings after having truly acknowledged the amount of resources it will require to deal with risks, uncertainties and challenges that may arise (Eugenio Cibruscola, 2011).

Such definition is based on key assumptions, which may guide SMEs growth choices:

- I) The firm holds offices in the countries where it wishes to operate;
- II) The products it sells are aimed at the greater market, as opposed to a handful of potential clients, and are exposed to likely different preferences from the usual ones.

However, it ought to be noted that SMEs do not enjoy a vast amount of resources, especially financial ones and each decision has to be pondered on carefully and accurately. Since their resources are limited, the choice of targeting one country, China for instance, over another, such as Romania or Ukraine, represents a true commitment on the management's side. In fact, management is centralized in small enterprises and the manager is often the owner as well, who brings in capital and has to cover losses with his own resources if they occur.

2.2 - Country identification

Given the above scenario and circumstances, what leads SMEs to choose one country over another? Certainly whether or not a country is emerging constitutes a relevant factor. But, what may be the drivers, therefore, of a company's strategy in deciding to invest in China, as opposed to other highly "qualified" emerging nations? Empirical evidence suggests the following:

- 1) Links with someone present in the country of interest

As a manager of a SME, you may wonder whether going international is worth your firm's commitment, especially if you are experiencing it for the first time. The risk and uncertainties are as high as your expectations, whilst certainties are as volatile as the degree of cultural differences between the two countries.

However, knowing someone who has long been working in the country you wish to enter, such as an intermediary, may provide that guarantee you need to start off. Moreover, you will be reassured that the intermediary has tested the process over time and can make a significant impact on your plans.

2) Exhibitions

Exhibitions may also present good opportunities for a firm to understand whether a certain country is worth the effort and commitment required. In fact, there are many insights a firm could gain while attending an event, such as:

- The quality of clients and investors interested in holding a position in the target country/market
- The quality of competitors that devote their own resources to that market
- Whether new products or projects are sold in that country first. That is, a firm might gain a significant competitive advantage by selling there first rather than covering all markets
- Whether, of course, local and foreign clients show interest in your offerings
- The possibility to sign deals, which may evolve into future long-lasting business links, provided that adequate follow-up is carried out

3) Inbox Requests/Orders

There are also cases where a firm may consider an expansion on the basis of requests it receives from consumers, factories or other firms abroad. In an era of digital change and online shopping, it has become common to visit companies' websites, view their offerings, estimate their reliability and, finally, decide to contact them in order to request orders and, perhaps, establish a business relationship. Clearly, this is a driver with a minor influence, but is still worth being mentioned, as one needs not to underestimate the power of the Web.

4) National “missions

A firm also may be tempted to face an international challenge after being invited to partake in “business trips-missions” organized periodically by the respective Chambers of Commerce they are registered to. Certainly, such trips represent a first contact with new markets but they are generally overrated and often lead to disillusionment due to over expectations firms form before leaving. Although promoted by high institutions, the time at disposal, 3-4 days on average, is in many instances not enough to establish and maintain relevant business contacts;

“...These missions eventually boil down to mere fieldtrips missing the real purpose: getting contacts with foreign clients and investors”⁴.

5) Long-standing focus on target country/geographic area

Finally, a firm’s management may have had their eye set on a particular country or geographic area for quite a long time and carried out such an extensive research that they now feel ready to proceed with their plans. The drawback of this driver is the amount of time, which doubles normally, but the degree of reliability it conveys is unparalleled. First of all, there is no real commitment until management has a deeper understanding of the market in question, such as a more informed view of the regulatory and competitive landscape, factors driving local demand, the country’s economic and social stability, currency risk, labour costs, as well as the cultural challenges. Second, the greater amount of time spent studying and researching the country may provide useful information to forecast future trends, iron out potential kinks and build an effective database. Last, but not least, it will allow the company to test whether or not social barriers have been correctly estimated.

2.3 - The golden driver

It would now be appropriate to question which of the aforementioned driver is the best and can yield better results. Would it be more effective to rely in “national

⁴ Gino Salica, CEO and Founder of TwinSide Consulting.

missions” only? Would it be wiser to wait and see how things turn out in the long run? Would holding a presence in exhibitions secure future success? Would a handful of inbox requests represent the spark to light the terrific fire of business?

The equilibrium rests in the middle; that is, the golden driver is a combination of all drivers previously detailed, rather one or the other. However, this still does not fully answer out the original question of why a firm should choose China over many others. Those drivers supply evidence of actual forces leading management to enter such market, but they need to be complemented with an in-depth understanding of the workings behind them. Why China, then? Why not Brazil or Russia or India? One should analyse the subject from more diversified perspectives to be able to make an informed and well-educated choice with regards to where resources will have to be spent on.

2.4 - Relevant parameters

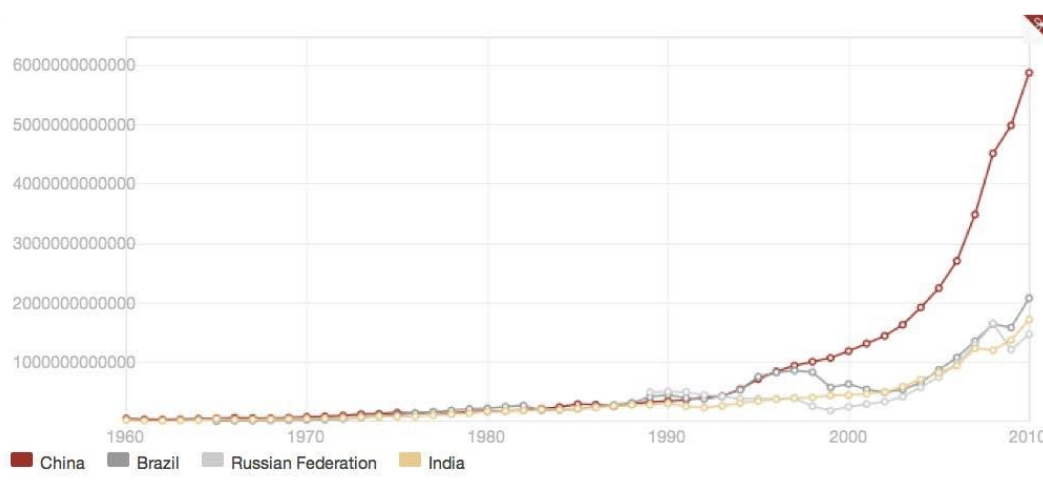
This section will present various parameters, both macroeconomic and non as to complement the previous analyses and allow to answer the second of our questions: why China is a "better" mattress to land on now.

2.4.1 - Gross Domestic Product (GDP)

The GDP is the most followed measure of the state of an economy; it is an aggregate measure of total production for a country, representing the market value of all the goods and services produced by the entire economy during a quarter, including personal consumption, government purchases, private inventories, paid in construction costs and the foreign trade balance⁵. What it conveys to investor is the size of an economy, when looking at it as a whole, and its relative health, when viewed from real GDP figures, which account for changes in the price level and provide a more accurate estimate.

⁵ Investopedia Library and Tutorials at :
<http://www.investopedia.com/university/releases/gdp.asp#axzz1bXJ0qoEl>

Not only can GDP be used to evaluate an economy, but it can also be employed to compare different economies. To this extent, China is one of the world's most relevant markets, with a population of 1.3 billion people, and the most promising one, given its GDP of \$9.24 billion (2013) which is greater than any of its counterparts (i.e. Brazil, Russia or India). This implies that a presence in such market, be it major or minor, may yield huge profit opportunities than in other areas of the world.



Source: World Bank's Website – World Development Indicators⁶

Note: GDPs above are calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources. Data are in current U.S. dollars. Dollar figures for GDP are converted from domestic currencies using single year official exchange rates.

GDP figures do provide interesting and useful insights regarding a country's market scenario without even stepping there. In fact, by mere comparison of crude numbers, China is to be chosen over the other BRIC members. However, GDP alone can only provide so much of useful information a firm needs as it fails to measure or express changes in a nation's quality of life, unpaid labour, real savings, standard of living, transactions on the black market and/or uneven inflationary price changes (e.g. housing bubble).

⁶ World Bank's Comparison Chart available at:

<http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries/CN-BR-RU-IN?display=graph>

GDP data ought to be paired up with further relevant data, such as time required to set up a business activity, opportunities for business expansions, difficulties in the environment, performance forecasts by thirds parties on the target country, legal and regulatory environments and, most importantly, analysis on the political and legal systems.

2.4.2 - GDP annual growth

While a crude shot of GDP at a certain point in time provides one side of the coin, glancing at how the figures “fluctuated” on average also enriches the analysis and allows for in-depth reasoning. Since the introduction of economic reforms, China’s economy trotted faster than during the pre-reform period. From 1960 to 1978, in fact, real annual GDP growth was evaluated at 5.3 percent, while from 1979 to current days, time span of reforms, it surged by nearly 10 percent. This essentially has meant that China doubled in real terms the size of its economy in real terms every eight years. The only stain in such an extraordinary growth lies in the interval of time between 2007 and 2009, when the growth slowed down from 13 percent to 9,2 percent. That coincides with the turmoil shaking financial markets; however, the Chinese government was able to roll up its sleeves and implemented a significant stimulus package and a monetary expansion policy, which allowed for the achievement of 10,3 percent threshold in 2010.

Table 1. China's Average Annual Real GDP Growth: 1960-2010 and 2011 Estimate

Time Period	Average Annual Growth (%)
1960-1978 (pre-reform)	5.3
1979-2010 (post-reform)	9.8
1980	7.9
1985	12.8
1990	3.8
1991	9.3
1992	14.2
1993	14.0
1994	13.1
1995	10.9
1996	10.0
1997	9.3
1998	7.8
1999	7.6
2000	8.4
2001	8.3
2002	9.1
2003	10.0
2004	10.1
2005	9.9
2006	11.1
2007	14.2
2008	9.6
2009	9.2
2010	10.3
2011 IMF Projection	9.6

Source: Official Chinese government data, the Economist Intelligence Unit, and the IMF. (Wayne M.Morrison 2011)⁷

2.4.3 - Size of the country's economy

Although GDP and GDP average annual growth figures are systematic indicators of economic activity and describe the amount of such activity, need to be married with extra data to offer a comprehensive, though still limited to certain extents, view of the actual size of an economy. The Chinese one has been under considerable debate as it changes depending on the type of economic viewpoints it is looked at from.

By choosing to adopt nominal exchanges rates as our point of observation, which simply reflect the prices of foreign currencies vis-à-vis a benchmark currency (usually the dollar) and exclude differences in the prices for goods and services across countries, China's GDP in 2010 was estimated by the Economist Intelligence

⁷ U.S Congressional Research Service Paper available at: <http://www.fas.org/sgp/crs/row/RL33534.pdf>

Unit (EIU) at \$5.8 trillion, slightly higher than that of Japan's and about 40% the size of the U.S. economy (Wayne M.Morrison, 2011).

If PPP (Purchasing Power Parity) basis is selected, which basically estimates the amount of adjustment needed on the exchange rate between countries so that exchange is equivalent to each currency's purchasing power, we obtain a slightly different scenario. The PPP exchange rate increases the measurement of China's economy and in 2010 it was 69.6 percent the size of the U.S. economy and its per capita GDP was 16.4 percent that of the United States.

These two standpoints do convey some important results as to why China should be preferred over other "contenders". As we have scratched the top part of the iceberg, we are now ready to consider further indicators to take into account when analysing the option to choose among countries, such as the number of tax payments and people traffic and stability, which will come in handy in our study.

Table 2. Comparisons of Chinese, Japanese, and U.S. GDP and Per Capita GDP in Nominal U.S. Dollars and PPP: 2010

	China	Japan	United States
Nominal GDP (\$ billions)	5,824	5,461	14,660
GDP in PPP (\$ billions)	10,203	4,299	14,660
Nominal Per Capita GDP (\$)	4,440	43,060	47,260
Per Capita GDP in PPP (\$)	7,770	33,900	47,260

Source: Economist Intelligence Unit estimates. (Wayne M.Morrison 2011)⁸

2.4.4 - Taxes

Knowing how many tax payments a business has to make over time is also very crucial in choosing among large emerging countries. GDP figures may lead wrongly to enter an area where, eventually, losses exceed profits, which are given up to the government. This has been, so far, a plague for certain European economies that chased off an array of investors due to the heavy burden of taxes, although they are

⁸ Paper available at: <http://www.fas.org/sfp/crs/row/RL33534.pdf>

economically attractive countries. The logic behind aiming for a large emerging country within the BRIC group lies in the expectation that long-term profits will justify the costs incurred and challenges faced and, most importantly, that taxes there will be of less amount than those paid in the homeland.

China requires fewer tax payments than its BRIC counterparts and is thus a better option to go at. Russian Federation and Brazil position themselves close to the level achieved by China; however, if we couple this information with that of GDP the reader can still conclude that China is the optimal path to embark on.

2.4.5 - Economic and social stability

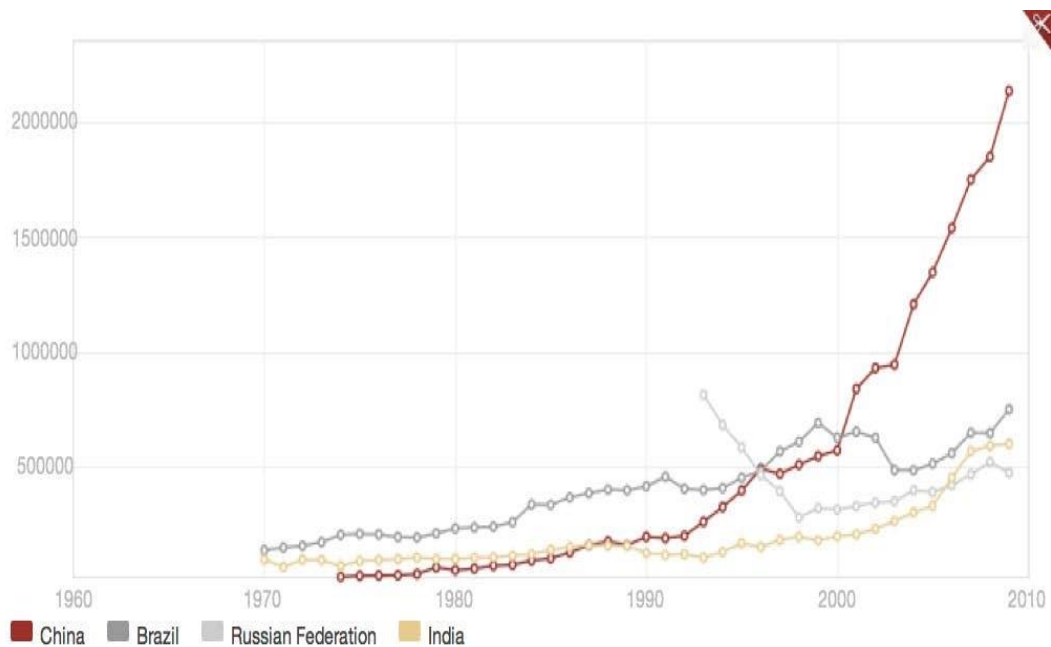
It would be advisable for a firm to investigate systematically into a country's activities with the rest of the world, thus researching whether or not a particular country is financially stable. Firstly, this means frequently checking credit rating agencies' reports on countries' performance; this is critical as firms' operations will be dependent on the economic prospects the country can have in store for them. An example of it is Greece today. Due to the economic and social instability of the country, which was aggravated by slow political and economic response to its weak financial standing, the actual condition of the market is problematic for those firms having physical business affairs there.

Secondly, it calls for a skim through figures and see how much debt the country holds, both its and that of other countries. In October 2010, the China was again recorded as being the world's biggest investor in US debt with sound sum of \$906.8 billion, a 32.6% increase compared to the same period in 2008⁹. What this position entail is far more relevant than the increasing economic trend it experienced over the last decade. Financing the world's biggest economy means financing the world's economy and its operations, now and in the future. An interested investor, as well as a firm, should then feel reassured about China's stability from such standpoints.

⁹ Guardian UK Newspaper Article – “US federal deficit: how much does China own of America's debt?” available at: <http://www.guardian.co.uk/news/datablog/2011/jan/18/us-federal-deficitchina-america-debt>

2.4.6 - Air transport

Large volumes of air traffic into and within a country are one major indicator of several trends: increasing globalization in politics and the economy, non-stop business opportunities, leisure travel, and urbanization. Moreover, the growth in air travel, both inwards and outwards, lures foreign air carriers to court local firms for partnerships or M&A/Joint Ventures transactions. Therefore, financial activity may be spurred by “simply” increasing air traffic, hence increasing the number of passengers hovering over the country (James K. Yuann, Jason Inch, 2008)¹⁰.



Source: World Bank's Website – World Development Indicators ¹¹ **Note:** Registered carrier departures worldwide are domestic takeoffs and takeoffs abroad of air carriers registered in the country.

The sequence in the rectangle above provides an insightful shot of the current air traffic among emerging nations and undoubtedly shows the domination of China in expanding its air traffic in less than 30 years. The real jump is identified from year

¹⁰ James K. Yuann, Jason Inch (2008). Supertrends of Future China: *Billion Dollar Business Opportunities for China's Olympic Decade*. New Jersey; London; Singapore; Hong Kong; Taipei; Chennai; Beijing; Shanghai: World Scientific Publishing Co. Pte. Ltd. p3-150.

¹¹ World Bank's Comparison Chart available at:
<http://data.worldbank.org/indicator/IS.AIR.DPRT/countries/CN-BR-RU-IN?display=graph>

1990, which coincides with the set of economics and development reforms the government set out to lay out for the future. Another spike can be found between 2001 and 2008; it might be pure coincidence but that interval actually matches with the bid process for the Olympics, which saw China winning over Canada, France, Turkey and Japan, and the necessary construction works started from Beijing and then expanded to other areas of the country.

Moreover, in October 2007, six new direct flights from the US to China were announced, and under a May 2007 agreement, the total number of direct flights via US carriers alone will increased to 23 a week by 2012. Even more importantly, Boeing estimates that China will require to augment its fleet to 4,460 by 2026 (*James K. Yuann, Jason Inch, 2008*)¹². China's Civil Aviation Authority also reported that the country would build 97 new airports throughout the whole national soil, yielding a total of 244 airports by 2020¹³. China will, therefore, continue to welcome more passengers in the next years and this, in turn, will indulge other carriers and businesses from abroad to turn their eyes to this market and sought any opportunity to make the year's deal. Where do all the passengers come from? Why do they go to China in the first place? Why is it important to have this piece of information anyway?

To begin with the first question, it is obvious that nowadays' flights to China are loaded with people coming from virtually all over the world, even though back in the 1980s the majority of travelers to China were from Hong Kongers, Taiwanese or simply Asian. This change is justified, as discussed earlier, by the various works undertaken from 2001 onwards and also by the entrance of China into the WTO in 2011. WTO membership opened up China's market for more international trade and investments, and allowed the world economy to enjoy China's exports (*Gregory C. Chow, 2001*)²⁰.

¹² James K. Yuann, Jason Inch (2008). *Supertrends of Future China: Billion Dollar Business Opportunities for China's Olympic Decade*. New Jersey; London; Singapore; Hong Kong; Taipei; Chennai; Beijing; Shanghai: World Scientific Publishing Co. Pte. Ltd. p3-150.

¹³ General Administration of Civil Aviation of China at: <http://www.caac.gov.cn/English/> ²⁰ Gregory, G. C. (2011). *The Impact Of Joining WTO On China's Economic, Legal and Political Institutions* p2-10.

Over the years, several individuals have invested money into spending time at Chinese universities in order to familiarize themselves with the culture and learn mandarin. According to the Chinese Ministry of Education, 195,000 foreigners attended Chinese universities in 2007, which signals an increase of 20 percent. Some others come for short-term travel, but increasingly is the case that they choose to live and work permanently there. The same holds for senior or executives that are transferred to China and eventually decide to make it their own home. What these groups have in common or the common reason why they go to China, learn the language, travel or work is that job opportunities are superior to those back home. For younger talents, China offers positions in management and social status that they could only dream of in their home countries and, at the same time, lower cost of living compared to places like U.K., U.S. or other developed countries. Relocating in China is also valuable for executives looking to advance their career up the corporate ladder and enjoy extraordinary perks, such as chauffeured cars, gardeners, private cooks and full-time housekeepers (*James K. Yuann, Jason Inch, 2008*).

It is important to at least have a basic awareness of these trends as it may help debunk myths about the kind of quality a firm can find in the labour force in a large emerging market. As will be overviewed later on this work, the steps China took and progresses it made combining education reforms and economic growth explain much of its outstanding performance in recent years. Success does not only depend on the amount of products you produce and sell; it is also a function of the efforts to bring quality to the system.

2.4.7 - Human Capital and R&D

What distinguishes a promising market from a simply interesting one to the eye of an expanding firm is the quality of labour force, hence human capital, it could hire once it has settled in. Having the possibility to recruit talented and, most importantly, educated individuals is definitely a key factor for long-term success, as Macroeconomics literature has always suggested. In an extremely competitive scenario, such as the international market nowadays, it is of the utmost important for a firm to retain quality employees and be able to innovate in order to bring in something unique and differentiate itself from its competitors. It is that firm willing to run the extra email that will secure a dominant position and future success. To do so, it is vital that the target country can provide highly performing graduates and qualified individuals as resources for firms. It is commonly accepted that India has been educating top graduates, however this does not directly imply educated minds can only be outsourced there. In fact, there are two trends that have been shaping China's education and basin of human capital resources the country can provide to the job market: education expansion through reforms and increase in R&D by the government and local authorities with the main aim to boost economic activity and development. What these means is that the government does care for what the possible fruits R&D and education can help reap; if we compare this with what is going in countries, such as Italy, where funds are cut away from research, we can get a better view of why this is a vital factor to be considered.

The implications of all the aforementioned actions were and will be tangible for the firms operating in China; they will be able to conduct research activities at a fraction of the cost incurred in their home countries and with greater availability of talented human capital. Moreover, they will enjoy knowledge infusion from returning brain drain, Haigui (Sear Turtle) students, who will also be of help in connecting Western and Asian cultures within working environment conditions.

2.4.7.1 - Education

China has been working up significantly skilled labour force in the last decade and this has manifested itself in growing numbers of educated Chinese students and the size of investments in R&D relative to GDP figures. When China opened its doors towards the end of the “70s”, it realized that it was lagging behind the most developed countries in the world and that a series of reforms was necessary to speed up its blooming and opening processes, as well as its economy. The very first step in doing so was to reform the education system and adapt it to the American model, which was deemed to be the prime one. In the winter of 1977, a year after the end of the Cultural Revolution, with the strong support of Deng Xiaoping (the late master planner of China’s reform), university entrance examinations were held for the very first time after a 10-year suspension. 11.6 million Chinese took the entrance examination, which set a historical record. A major change, however, occurred from the “90s”; since the 1990s, in fact, when China made higher education a priority, the number of universities accessible to students increased and the share of graduates from secondary schools who continued on in higher education has risen significantly.

Province	Number of universities
Beijing	30
Jiangsu	9
Shanghai	8
Hubei	7
Shaanxi	6
Sichuan	4
Liaoning	3
Heilongjiang	3
Guangdong	3
Hebei	2
Tianjin	2
Jilin	2
Anhui	2
Fujian	2
Shandong	2
Hunan	2
Chongqing	2
Guansu	1
Zhejiang	1

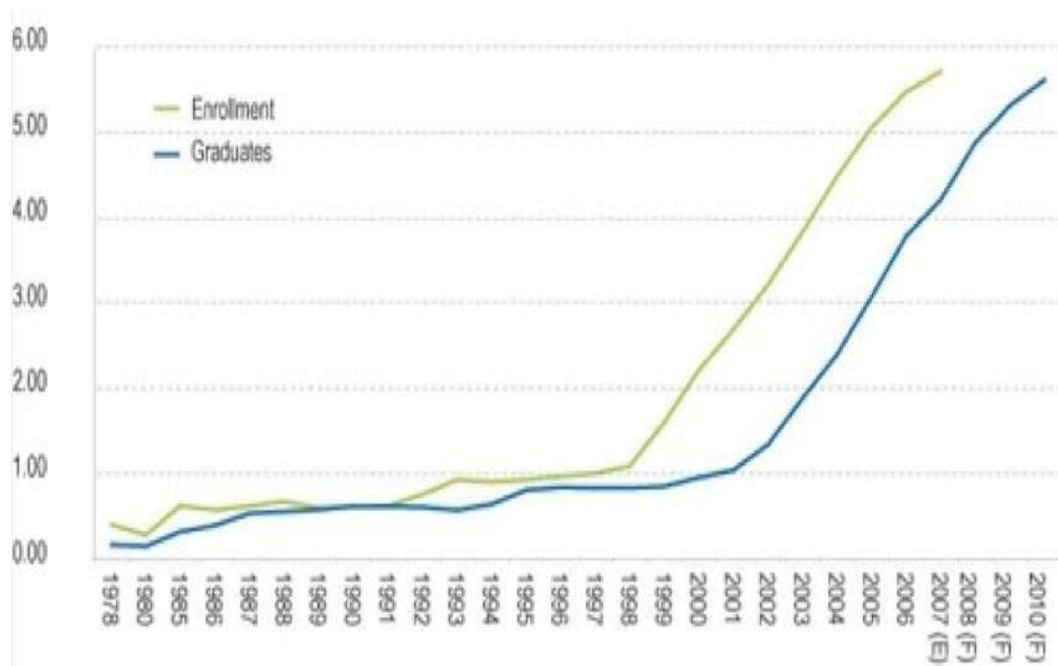
Source: China Knowledge Group¹⁴

What can be observed by looking at this table is a list of China's key universities (the ones displaying strong faculty and greater researches in the respective fields) and their location. A great number of universities nests within the provinces of Beijing, Jiangsu, Shanghai, Shaanxi and Hubei. While Beijing and Shanghai tend to top the list due to their influence, the former being the capital of the People's Republic of China as well as the head of the national government and the former being the commercial and financial centre of mainland China, the others do hold a significant role in China's economy and education prospectus.

Jiangsu, for example, has coal, petroleum and natural gas deposits; moreover, heavy industries, such as chemical industry and construction materials, have been developed. They include machinery, electronic, chemicals, and automobile. Recently, the government has worked hard to promote the solar industry and hoping it will be worth 100 Billion RMB by 2012¹⁵. All of this creates unparalleled learning opportunities for students interested in heavy industry and chemistry. It also worth taking into account that Jiangsu is a very wealthy province with the second highest GDP, thus being able to attract top students and researches to its institutions.

¹⁴ China Knowledge Group – “China Overview” available at:
<http://www.chinaknowledge.com/Business/CBGdetails.aspx?subchap=1&content=8>

¹⁵ The China Perspective Online Journal Article available at:
<http://www.thechinaperspective.com/topics/province/jiangsu-province/>



Source: China Knowledge Group¹⁶

In this other figure, instead, we can gain a better understanding of the education growth in China from as early as in 1978 to 2010. The graph shows a continuing spike from 1997 onwards, which precisely coincide with the type of reform mentioned above. Such trend is likely to go on for years to come, as China carries on its economic development and its GDP increases more and more, thus yielding more funds for education and R&D. In fact, this latter factor is what boosted China's economy in the last years. What has always distinguished the American system from many others in the rest of the world is the large availability of funds channelled for researches/researchers and the universities themselves. The idea behind this line of thinking lies in the meaning Americans attach to education and the benefits R&D can bring to society, economics development and business in plain terms. Education, R&D and success are, thus, key concept and almost synonyms; China is a living testimonial of what happens when more funds are channelled to R&D as a share of GDP¹⁷.

¹⁶ Figure Available at:

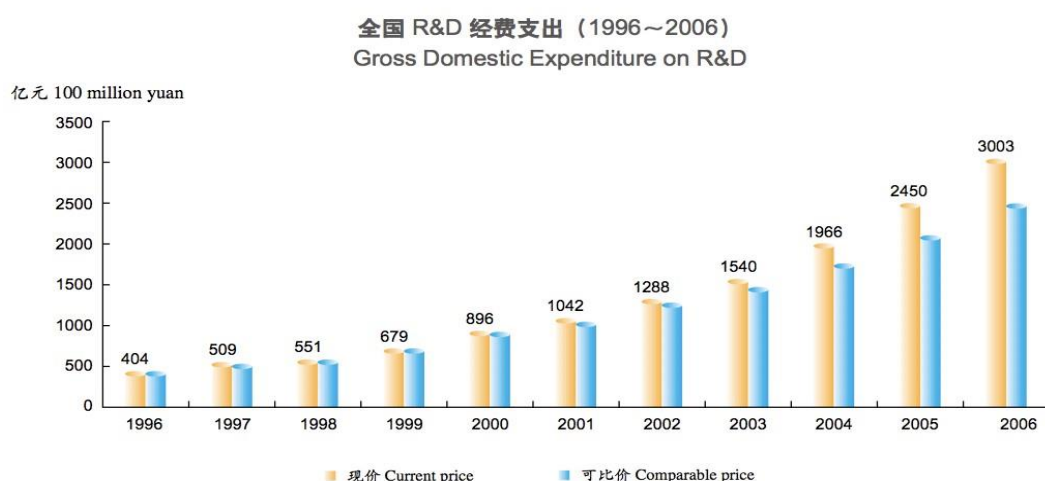
<http://www.chinaknowledge.com/Business/CBGdetails.aspx?subchap=1&content=8>

¹⁷ China Science and Technology Statistics (2007) Data Book – Ministry of Science and Technology of The People's Republic of China available at:

<http://www.most.gov.cn/eng/statistics/2007/index.htm>

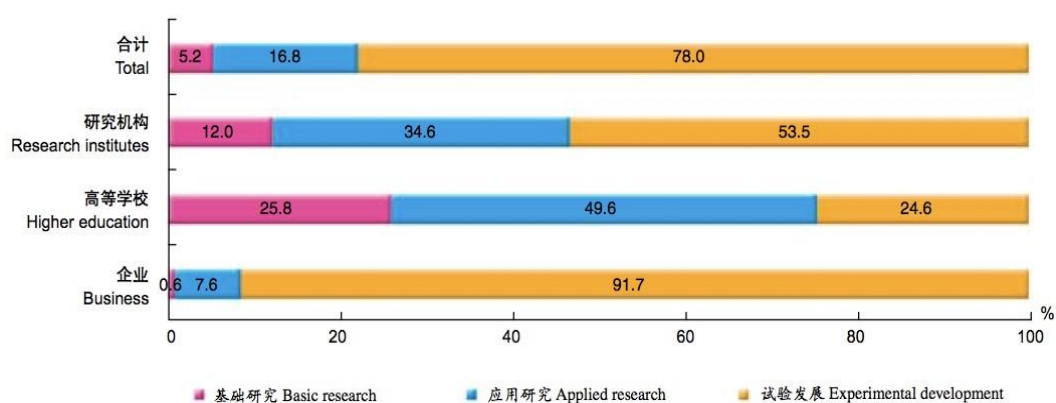
	2001	2002	2003	2004	2005	2006
R&D经费支出 (亿元) GERD (100 million yuan)	1042.5	1287.6	1539.6	1966.3	2450.0	3003.1
R&D经费支出/国内生产总值 (%) GERD/GDP (%)	0.95	1.07	1.13	1.23	1.33	1.42

Source: Ministry of Science and Technology of the People's Republic of China

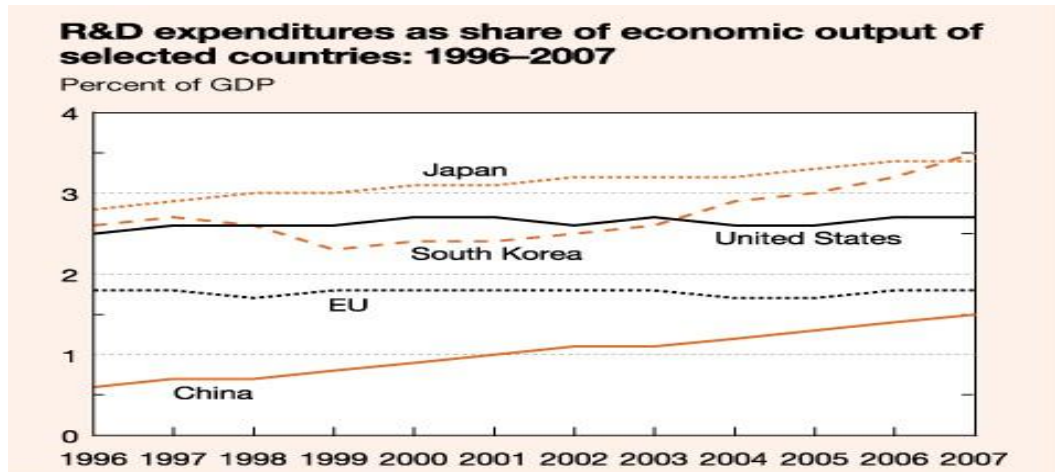


Source: Ministry of Science and Technology of the People's Republic of China

1-3 全国 R&D 经费支出按活动类型分 (2006) GERD by type of activity



Source: Ministry of Science and Technology of the People's Republic of China 2006



Source: The National Science Board (NSB) – 2010 Science and Engineering Indicators

Table 4-13
Gross expenditures on R&D by performing sector, for selected countries: Most recent year
(Percent)

Country	Business	Government	Higher education	Private nonprofit
United States (2007).....	71.9	10.7	13.3	4.2
Japan (2007).....	77.9	7.8	12.6	1.7
China (2007).....	72.3	19.2	8.5	0.0
Germany (2007).....	69.9	13.9	16.2	0.0
France (2007).....	63.2	16.5	19.2	1.1
South Korea (2007).....	76.2	11.7	10.7	1.4
United Kingdom (2007).....	64.1	9.2	24.5	2.1
Russian Federation (2007).....	64.2	29.1	6.3	0.3
Canada (2008).....	56.1	9.6	33.8	0.5
Italy (2006).....	48.8	17.2	30.3	3.7

NOTE: Top 10 R&D performing countries.

Source: The National Science Board (NSB) – 2010 Science and Engineering Indicators

2.4.7.2- Haigui

Chinese refer to students returning from overseas as Hai Gui, or Sea Turtles. The pronunciation of turtle in Chinese is similar to the words that mean ‘coming back from overseas’; these are students that obtained their education abroad in countries like the U.K., the U.S, France, Germany and so on. The phenomenon began after the dot-com burst, when two trends combined to make China more attractive to its people abroad: the lack of jobs, especially in technology areas in the United States; and the growing number of opportunities in China as the economy ramped up its pace of development in high-tech (*James K. Yuan, Jason Inch, 2008*). Clearly, not all students that leave for universities abroad will eventually return home; for every one person that comes back, there is a handful of others who never return. China,

however, is doing its best to continually increase the share of educated-abroad Chinese students returning home by luring them with preferential policies such as niche spots at top universities, extraordinary job opportunities or supporting their businesses.

The success and development of China, as previously suggested, have also been and will be determined by the continuous infusion of knowledge among locals, expatriates and returning Chinese, by the opportunity for foreign businesses to draw resources out of this basin of high-calibre human capital and by the reassurance that government will fund R&D activities that will bring tangible benefits for its economy and development.

2.4.8 - Competition Analysis

As a further matter, an analysis of legal and competitive factors needs to be carried out as well in order to place down the right base upon which to see the overall challenge. In particular, one should assess how hard it is to enter the Chinese market; if so, what makes it so hard? Is it the legal framework too complicated to work within? Are competitors too harsh on new entrants? What are such competitors? How did they gain such leading role in that country?

In fact, a firm might be tempted to approach China because of its outstanding performances and endless opportunities for foreigners, but it might not have updated its legal system to ease business requests and operations. This tends to be frustrating for foreign investors, who may use up a great deal of resources for their plans and reap significantly less than expected. Furthermore, not having modern institutions suited to the task at hand can represent another major obstacle, often connected to the legal one. Such was the case of Eastern European countries in the aftermaths of WWII and of Brazil and Russia today, the latter growing at an impressive rate but having a dated institutional framework that has concerned investors about their capability to meet innovation, which has more and more been propelled by financial evolution in IT. Under this standpoint, the Chinese

government has been making progresses to ease bureaucracy for foreign enterprises, and seems to be opening more and more as it develops economically and socially.

Although cultural differences do influence the final short-listing, it is wise to recognize that such barrier is also an invaluable opportunity. A market characterized by great cultural differences is certainly a tough one to enter, but it will also discourage other potential firms interested in gaining a stake in it. That said, resisting through initial difficulties with local languages may yield outstanding benefits in the long term. Competition, as anticipated, will also need to be accounted for properly by the management of a firm

Paragraph Summary: In 2.4. an array of parameters were illustrated that allowed to restrict the target market of interest to China. GDP and tax figures were compared, past and future trends detailed and explanation of such trends given. All of this sets the ground for a closer look at "who" China actually is.

2.5 - Location in China

Through an analysis of certain indicators to look at and research actions to undertake, the previous sections helped us answered the original question: why China? Now it is the time to examine how China's market is fragmented; just as occurs in developed nations too, China has its own strategic economic poles and key cities.

China's economy is divided into different categories, or tiers, of cities, which define the status of a particular geographical location with respect to its population size, economic activity (past, current and prospective) and relevance within the country. Tier 1 cities are major metropolitan areas and are considered to be the prime choice for investment and expansion opportunities as they were the first to be opened to competitive economic forces. In China they are: Shanghai with GDP of USD 228

billion¹⁸ (1US\$=6.6RMB) and population of 14 million; Beijing with GDP of USD 184 billion and population of 12.46 million; Guangzhou with GDP USD 138 billion and population of 10.26 million in 2009 respectively. Tier 2 cities are, instead, smaller in economic size and population and in China they round up to 15. Normally, they host most of the manufacturing facilities and industrial complexes in the whole country and, thus, are ideal for relocating production and diverting costs. Differences exist between the two categories and they affect investors' choice based upon the kind business they wish to operate.

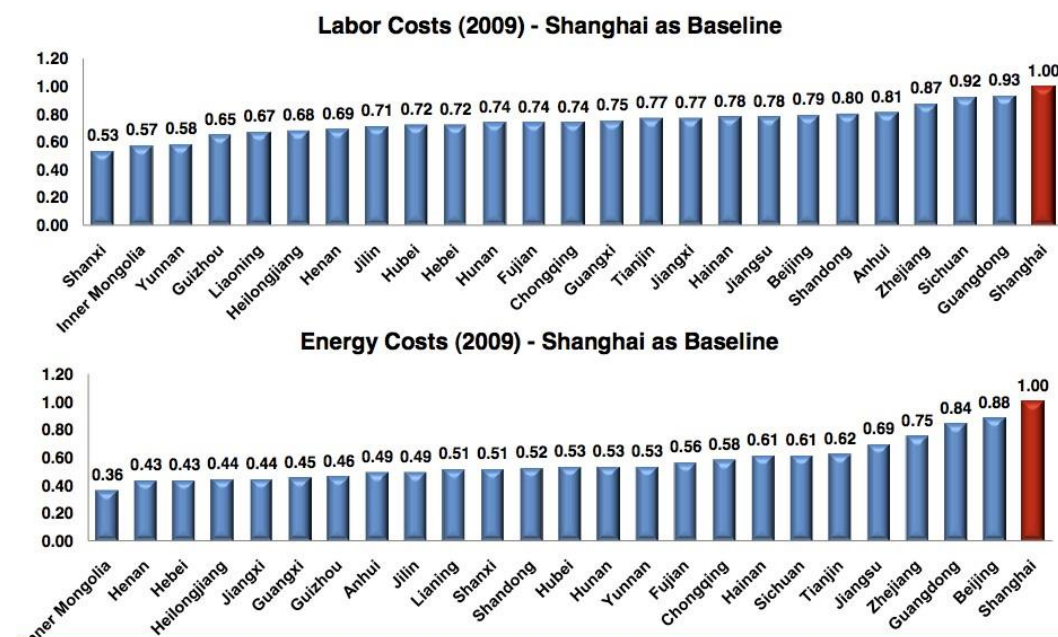
Tier 1 cities tend to express higher operating costs, sophisticated consumers and may be saturated in long term, but they also offer a larger pool of talents to draw human resources from. On the other hand, Tier 2 cities have lower operating costs, which attracts large manufacturing companies to relocate there, lower rent expenses and a more standardized pool of talents. The following is a list of the categories discussed with detailed information on their size and potential:

Category	City	Population (Millions)	GDP (US\$ B)	GDP/capita (US\$)	FDI (US\$ B)
China Total		1,335	4,985	3,734	90.0
Tier 1	Shanghai	19.2	220	11,466	10.5
	Beijing	17.6	178	10,110	6.1
	Guangzhou	10.3	134	12,990	3.8
Tier 2	Tianjin	12.2	110	9,027	9.0
	Dalian	5.9	64	10,794	6.0
	Qingdao	8.5	71	8,361	2.2
	Nanjing	7.7	62	8,030	2.4
	Suzhou	9.4	113	12,095	8.1
	Hangzhou	8.1	75	9,216	4.0
	Ningbo	7.2	62	8,570	2.2
	Xiamen	2.5	24	9,389	1.7
	Shenzhen	8.9	120	13,473	4.2
	Zhuhai	1.5	15	10,198	1.2
	Wuhan	9.1	68	7,434	2.9
	Chongqing	32.8	96	2,919	4.0
	Xi'an	8.4	40	4,729	1.2
	Chengdu	12.9	66	5,124	2.8
	Kunming	6.2	26	4,245	0.6

Source: JLJ Analysis¹⁹

¹⁸ Starmass International Consulting – “Overview of China Major Cities” available at: http://www.starmass.com/china_review/city_overview/china_cities.htm

¹⁹ JLJ Group – “Chin’s Tier 2 Cities: Understanding Opportunities & Challenges” available at: <http://www.mitc.com/PDFs/JLJTier2Cities2011.pdf>



Source: JLJ Analysis



Source: JLJ Analysis

2.5.1 - Entry strategies

Entry via Tier 1 cities has been the dominant strategy for the majority of foreign companies since these cities have the largest and most open markets. It is most common for franchisors to establish a Joint Venture or a WOFE in Tier 1 cities to set up supply chain networks, and establish brand image through a few direct owned stores. Further store expansion is done either through direct-owned stores,

partnerships, or franchising. With Tier 1 cities becoming increasingly expensive and competitive (e.g. many foreign brands present, difficult to find good locations, etc.), many companies are considering entering via Tier 2 cities.

Entry via Tier 2 cities has not yet been done by many companies, but Dunhill, for example, entered via Tier 2 markets and later expanded into Tier 1 cities. There are several barriers for entry via Tier 2 cities. Purchasing power is rapidly growing, but still limited; Tier 2 markets are also fragmented, characterized by a large number of potential cities that can each accommodate only a few numbers of stores. For example, KFC, a relatively mature brand in China, has less than 20 outlets in Chongqing compared to more than 150 in Shanghai. The implications include release of products in smaller volumes and at reduced prices²⁰.

2.6 - Summary n°2

The following question opened up our investigation: which is the "cash cow" among large emerging markets? In answering this question, a section was first spared to better understand what going global means and entails. A list of modern drivers were then supplied and discussed, which sparked a doubt as to whether those drivers could alone be enough to decide on a specific large emerging market. To address this issues, macroeconomic data and charts were used to offer the right benchmark needed to choose one particular country. This analysis, complemented with previous drivers, highlighted China as preferable candidate and an initial review was started to see "who" China really is by looking closer at development policies, inner potential and its market segmentation, namely tier 1 and tier 2 cities and the strategies of entry into their markets. What will follow in the next Chapter will delve into it; precisely, some major modes to step in China will be presented, examined and compared in the end.

²⁰ US Commercial Service - "China- Franchising Industry: Access Dynamics and Emerging Markets" available at:
http://export.gov/china/build/groups/public/@eg_cn/documents/webcontent/eg_cn_027119.pdf

CHAPTER 3: Will China's growth continue?

Introduction

The previous analyses and discussions generated the conclusion that China is an optimal market to invest resources and energies in, given its outstanding growth and lingering potential to be exploited, that entry opportunities as well as cultural challenges and dynamics do exist for businesses. However, doubts about China's ability to maintain its current growth rate legitimately arise and the question of whether China's growth will last in the next few years erupts. This chapter will attempt to find an answer to this question by presenting a series of economic, social and geopolitical issues China is facing that have recently been reported on renowned newspapers and academic papers, and will explain why these are important to the case at hand.

3.1 – Adjustments or slowdown?

Albeit all major tassels of information about China have been supplied and the relevant “feasibility-market” questions answered, now comes the big question mark that is keeping most analysts in the field awake at night and hyper during the day: how longer can China sustain its booming economy before it blows up itself?

We have already concluded that China possesses the potential to continue growing the future, but worries are present about what its boom sustainability. Talks and words are being spared on the topic by all major journalists and newspapers, which bring up a wealth of different standpoints that do allow to enrich one's view with quality information.

On The Economist article issued on October 22nd 2011, the dreary performance of Chinese stocks listed in Hong Kong, the rising price of insurance against a Chinese sovereign default, and rare, downward pressure on its currency feed the mouth of

fear of China²¹. The article, moreover, adds that such fear is nothing but a mere reflection of problems that run far beyond China's own border or its government's rigid influence⁸⁴. For instance, sales to the EU, displayed a downward trend by registering a 7,5 percent in September, thus alarming relevant authorities as it was an event that had not occurred since 1995.

Nearly at the same time, China became a net exporter of a fear-related product, namely anxiety. Inflation may be falling, but it flew at high altitude for longer than expected. To make things a slightly more worrying than they could already seem, Chinese property market is facing an adjustment period and seem to be showcasing a slowdown, as developers/builders await a demand pick-up in order to avoid selling at a discount.

The wait becomes all the more painful when one realizes what it needs to be done to cool inflationary forces: tightening the taps of credit. The logic is simple, less money available, less money is spent, thus all the other mechanisms that enter the equation once one is on a spending spree are quenched. The result of this measure is high kerbside rates and indebted businessmen performing a runner from their homes. This unfortunately makes sense if we recall our analysis of Guanxi; admitting public failure may be seen a loss of face to the public's eyes, so it may be a better option to leave and never come back to a specific place.

The Chinese government, however, seems reluctant to ease its grip on measures of this at a time of high inflation. This will prove to be a great challenge for the government in the next years. On one hand, growth is stimulated by continues increases in demand, which is in turn propelled by greater availability of money at hand; on the other hand, too high increases in demand push prices, expectations and wages up and skyrocketing inflation is certainly not what an economy needs to attract foreign firms interested in, for example, relocating their production in China.

²¹ The Full article is available at:

<http://www.economist.com/node/21533405?fsrc=scn/fb/wl/ar/afraidofabump> ⁸⁴
According to government officials, control is needed to maintain unity and peace

For the time being, it appears as if the government is a match for the challenge and can keep a lid on the financial system. In other countries, alleviating the symptoms without tackling the fundamental causes could not go on for ever without a painful wake-up, but in a closed system, as it is that of China, it actually can.

3.2 - Geopolitical

Besides the economics worries that people have about China, it is worth noting that an economy's stability is dependent on its geopolitical stability. To this extent, a great deal of research has been devoted to analysing the development of Chinese territorial issues over time and how these could interfere with China's economic growth and stability. Territorial disputes in the South China Sea and East China Sea are of remarkable geopolitical significance because they represent an intersection of history, territory sovereignty, geostrategy, and energy security.

A recent article published by China Briefing²² helps in shedding spotlight on three major disputes. It does so by dividing issues into territorial and maritime sovereignty, it then goes on describing each of the three disputes that have been afflicting China and its people. Due to academic scope matters, this paper will only discuss two of the three disputes and will start precisely with territorial disputes. These stem from claims of ownership of land itself and usually refer to historical presence in determining rightful control. Maritime boundary ones, instead, relate to the territorial delimitations defined by the 1982 United Nations Convention on the Law of the Sea (UNCLOS III)²³.

²² China Briefing is published by Asia Briefing Ltd, and was founded by Chris Devonshire-Ellis, the Principal of Dezan Shira & Associates in 1999.

²³ The full text can be found at:

http://www.un.org/depts/los/convention_agreements/texts/unclos/unclos_e.pdf

3.2.1 - Spratly Islands

The South China Sea, an area of 800,000 square kilometres, is for the most part rimmed by land. Many of Asia's most influential states are its littoral countries: Malaysia, Brunei, Indonesia, the Philippines, Thailand, and Singapore; the Indochinese countries of Cambodia and Vietnam; and the People's Republic of China and Taiwan²⁴.

The South China Sea's significance has been recently highlighted much for its abundance of natural resources such as oil and natural gas. The international Energy Agency reported in September 2010 that "total Chinese oil demand is expected to average 9.5 mb/d in 2011"²⁵. As a consequence, over the past two decades competing claims to island territories, cast governments, especially Chinese one, into a tangled nexus of regional jurisdictional conflicts and rivalries²⁶. Securing enough energy to sustain its economic growth is "just too" important for China.

South Chinese Sea is composed of various islands scattered throughout the region, among which are the Spratly Islands and Paracel Islands. The islands are vital to China for various reasons. To begin with, they are the world's most productive areas for commercial fishing and the region itself is also one of the busiest shipping lanes. Secondly, and most importantly, they are rich in natural resources that vital for China's economic growth, as mentioned above. Last, but not least, their location is strategically crucial; they lie between Vietnam and Philippines, which means they offer a critical staging location for blocking ships traversing the South China Sea²⁷. A first fire of tensions flared up in 1992, when China passed a special territorial sea and contiguous zone act to legalize its claims to the Spratlys. Article 2 of this legislation specifically identifies Spratly archipelago as Chinese territory⁹¹.

²⁴ Heinemann World Atlas (1995), 78–81; J. R. Morgan and M. J. Valencia eds., *Atlas for Marine Policy in South-East Asian Seas* (Berkeley: University of California Press, 1983), p3–4.

²⁵ International Energy Agency: <http://www.iea.org/>

²⁶ Christopher C. Joyner. "The Spratly Islands Dispute in the South China Sea: Problems, Policies, and Prospects for Diplomatic Accommodation"

²⁷ Joyner, Christopher (1999). "The Spratly Islands Dispute in the South China Sea: Problems, Policies, and Prospects for Diplomatic Accommodation." *Investigating Confidence Building*

Claims by Taiwan today resemble those of China; the bases for Taiwan's claims are its historic ties to the area into question⁹². However, claiming legal title to sovereignty simply upon alleged links between their discovery and Taiwan is not enough to rule out other contenders in the dispute.

Vietnam, instead, forwarded its claims basing its argument on historic activities during the Nguyen dynasty (17th–19th centuries) and the right of cession that was apparently bestowed by the French in 1933. However, doubts emerged with regard to the authenticity of the historical record Vietnam supplied⁹³ and to legal title that France possessed before giving it all to Vietnam. Nonetheless, Vietnam moved in 1975 and occupied thirteen islands of the group. Moreover, in 1989 it acquired presence in three more islets; by 1999, the number of troops it had sent there surged and reached a remarkable number of 600⁹⁴.

The Philippines also entered the arena of claims and justified its on the “discovery” of specific islands by Thomas Cloma⁹⁵ back in 1947. To defend this position, they sent hundreds of on eight islands.

⁹¹ The Law of the People's Republic of China on the Territorial Sea and Contiguous Zone became effective on 25 February 1992. See People's Daily Beijing, 26 February 1992, 4, reprinted in United Nations, Law of the Sea Bulletin No. 21 (August 1992), 24–27.

⁹² Kien-hong Yu, “Reasons for Not Negotiating on the Spratlys: A Chinese View from Taiwan,” in Hill et al., *Fishing in Troubled Waters*, p139–149.

⁹³ Valero, Gerardo M. C. (1994). "Spratly archipelago dispute: Is the question of sovereignty still relevant?". *Marine Policy*. 18 (4), p320–22.

⁹⁴ Joyner, Christopher (1999). "The Spratly Islands Dispute in the South China Sea: Problems, Policies, and Prospects for Diplomatic Accommodation." *Investigating Confidence Building Measures in the Asia Pacific Region*. Ed. Ranjeet Singh. Washington DC: Henry L. Stimson Centre.

⁹⁵ Thomas Cloma, an enterprising Filipino businessman and owner of a fishing fleet and private maritime training institute, aspired to open a cannery and develop guano deposits in the Spratlys

Finally, even Malaysia and Brunei have recently brought up claims to certain islands and reefs in the Spratlys, mainly relying on certain continental shelf provisions in the 1982 LOS Convention.

In short, the geopolitical situation remains complicated and the possibility of military clashes increases, albeit the time being there is good reason to believe that large-scale military will be avoided from all parties involved. Nonetheless, it is evident that South Chinese Sea is a patchwork of different wants and needs over key natural resources, which will be in short supply in the future as China requires more and more of them to keep its growth at constantly high levels.

3.2.2 – Other Islands

The Diaoyu islands, also known as the Senkaku Islands in Japanese, are located to East of China, in the NorthEast of Taiwan and SouthWest of Japan and are disputed among Taiwan, Japan and China. While the Diaoyu Islands are not so strategically important as the Spratly Islands are, they are also rich in natural resources. Unlike the Spratly Islands, the Diaoyu Islands have been controlled by Japan since 1895.

Chinese and Japanese claims were put forward in the later "90s", with China exposing a quite aggressive behaviour in more recent times. That should not be a surprise if we consider the increasing need of China to tap into more natural resources and the availability of them in that region. Besides the notable conflicts and developments from the "70s", a more recent incident worth being mentioned happened in 2010, when a Chinese fishing trawler collided with two Japanese Coast Guard patrol boats.

Tension broke out between the two parties the days following the incidents, as Japan detained the captain of the trawler and China, in turn, enforced an embargo on rare

earth elements. This was eventually lifted once Japan released the Chinese captain, but unyielding attitude persisted on both sides after the event and Chinese even demanded an official apology of Japan, which rejected, thus flaming up the relationship between them.

The following table gives an overview of the Diaoyu islands disputes and yields a deeper understanding of the relationship between China and Japan by highlighting dated events:

Senkaku/Diaoyu Islands	
Claimants	PRC, Taiwan, Japan
Chinese Name	Diaoyu Islands (钓鱼岛)
Geopolitical Significance	Oil, natural gas, fisheries, shipping links
Ownership and Claims (from 20th century)	1942-1972: U.S. Administration 1971: China, Taiwan claimed sovereignty 1972: U.S. returned islands to Japan under Okinawa Reversion Treaty
Current Administration	Japan
Notable Conflicts and Developments	1978: Japanese right-wing group built lighthouse on an island; China and Japan shelve issue 1990: Anti-Japanese demonstrations in Taiwan and Hong Kong over lighthouse recognition; incident shelved 1996: Japanese right-wing group built new lighthouse on an island 2010: Collision incident between Chinese fishing boat and Japanese Coast Guard, Chinese fishing captain detained

Source: China Briefing News at: <http://www.china-briefing.com/news/2011/05/31/chinas-territorial-disputes-in-the-southchina-sea-and-east-china-sea.html>

3.2.3 - Future of these conflicts

It would be understandable at this point to enquiry about the future of these disputes, to wonder whether there is going to be any massive military actions in those regions, to question if these actions could have an effect on China's economy and, most importantly, on the world's economy as a whole.

For the foreseeable future, China will retain predominance in the Spratlys and keep its eye peeled to seize any opportunities available within the Diaoyu Islands matter, as well as throughout the South China Sea. The investments on R&D showed in our path create benefits for firms, but have dark side in them; through investments, China has developed its technology and military capabilities that it is now using as motives and means to execute conquering policies. These will most likely be driven by the pressure of its internal demands and growing population consisting of locals, foreigners and Haiguis.

New resources are needed, which will require extensive exploitation of offshore petroleum reserves. The Spratlys emerge as a key consideration precisely for their key basin of natural resources, and China has demonstrated its willingness to implement operations aimed at bolstering its interests in that area. In this regard, China acts no differently from its opponent, the United States, which went a long way in acquiring resources via military troops, something that was described as "acting in the best interest of national security" from 2001's Bush Administration's Energy Task Force.

3.2.4 - Other known tensions

Clearly, South and East Chinese Seas disputes are not the only tensions that have been afflicting China. A quick look at China's geographic map identifies more areas where it is involved in diplomatic and/or military actions. Tibet protests for independence, for instance, that still run nowadays, made the news of all major and non-newspapers across the entire globe (*BBC, 18th October 2011*)²⁸.

Likewise, tensions exist and persist with North Korea, especially after it attacked China in 2010 (*BBC, 24th November 2010*)²⁹ causing their relationship to strain even more. Luckily, Beijing did not counterattack and kept muted even when Western leaders and editorials had condemned North Korea's artillery barrage and expected a response from its southern neighbour.

²⁸ <http://www.bbc.co.uk/news/world-asia-pacific-15347106>

²⁹ <http://www.bbc.co.uk/news/world-asia-pacific-11828846>

China's northern border witnessed a flood of protests and tensions. Large-scale mining has brought growth and wealth, but not everyone is benefiting, and tensions are rising between indigenous Mongols and Han Chinese who have poured into the region (*Los Angeles Times*, June 02nd 2011)³⁰.

Finally, China experienced difficult times in its relation with Hong Kong back in 2004, when Hong Kong democracy's lobbying efforts to allow great political freedom irritated Beijing officials, who returned the pressure by asserting even greater control over Hong Kong's political system, thus straining its ties to the great financial even further (*Council on Foreign Relations*, July 1st 2004)³¹.

3.3 - Why to be aware

The importance of studying these disputes, as well as other disputes, lies in the potential side effects they could bring to China and the world's economy. Should a military conflict take place and evolve into a war, then China would have to convert its civil economy into war mode. This would, in part, increase the GDP to certain extents but it would also depress the activities of many current firms and suggest refraining from any expansionary plans to others. The amount of money available to people and businesses might decrease as more financial resources would be directed to the military cause, banks could decrease its money outflows as businesses would not enjoy the same demand and be unable to repay big loans, to mention but a few results. An analysis of likely incidents, should this scenario ever materialize, is out of the scope of this work. But it is worth having worked this up on a basic level, as it reinforces the impact of existing conflicts among nations on overall expansionary plans and choices of firms.

³⁰ <http://articles.latimes.com/2011/jun/02/business/la-fi-china-coal-20110602>

³¹ Council on Foreign Relations article at: <http://www.cfr.org/china/china-beijing-hong-kongtensions/p7726>

3.4 – Summary n°3

Dismal performance of Chinese stocks, high inflation for longer than expected, credit tightening, and geographical disputes, to mention some but a few kinks in the future path of China, have stimulated talks and concerns about its ability to secure future economic growth. On the one hand, increases in internal demand are needed to prop up the economy in the long run, on the other hand these also push up prices, which in turn bolster high wages expectations. A scenario that is unlikely to be welcome by China's policy makers, as high wages are in contrast to the major reasons why foreign firms choose China in the first place. Finally, pending geopolitical issues represent a drain on the nation's purse in terms of monetary and military resources, and a threat to the world's economic stability, as military conflicts usually shape the look of an economy. Nonetheless, China seems capable of juggling its issues management with national economic imperatives.

CONCLUSION

In this essay, I tried to provide an answer to the question of why a company should do business in a large emerging market (LEM) in the first place and why it should choose China anyway.

I consider all this as an essential topic to discuss, especially in the current turbulent times, for multiple reasons.

First, East cannot be considered as an option, it should be an imperative. With the demand for goods and services roller coasting in Europe and the US, offsetting the losing positions in these markets with a prosperous outlook in emerging markets may be a viable alternative.

In addition, size and demand development matters. In a country of 1.3 billion people, where consumer's needs are changing, adapting and catching up with Western ones, there is a great opportunity for products/services expansion. Even more if we consider a relevant trend stemming indirectly from the one-child policy; in fact, allowing families to bear one child created a generation of Chinese used to getting everything they want as they are the only representatives of their families.

I am convinced that China is playing and will continue to play a dominate role in the world's economy recovery. Gaining a foot and stake in it now, even a small one, is as important as flocking to the United States was at the time of its extraordinary economic boom.

Furthermore, a position within the Chinese market does not imply confining business interest to China. Not only is it a big enough platform in itself, but it is also a gateway to other Asian countries.

I firmly believe that tuning to culture in China is, perhaps, more effective than any strategic measure one could possibly take to do business there. My experience in Shanghai demonstrated the unique role of understanding local culture in business affairs and success.

Hence, I do support the results obtained that firms cannot thrive in Chinese markets unless they make a genuine effort to understand its culture, build and manage a proper network.

Finally, I wished to briefly examine China's geopolitical standing as I am of the opinion that a question into its outstanding growth is legitimate and an evaluation of its issues does provide a clearer view of what China is. It enriches the overall study and opens up one's own mind to forces that could impact business affairs in future times.

In conclusion, choosing a target country is not an easy task and can actually become a cumbersome process. Many parameters must be taken into account, the overall macroeconomic analysis must be performed which includes a clear assessment of the current competitive strengths and energies must be devoted to understanding the culture and all its dynamics.

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3. <http://www.bbc.co.uk/news/world-asia-pacific-11828846>
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