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Fujitsu
Executive Institute

— Helping you connect with Asia —

Discussion Summaries and White Papers - Year One

Asia is one of the hottest issues in today's boardrooms. Many corporations and institutions are making critical investment decisions in the region. But how well do Chief Executives and Chairpersons understand the consequences and risks associated with current plans and commitments? Where do they go for advice?

Whether your organisation is working in, buying from, or selling to Asia - or facing competition from Asia - or recognises that much can be learned by a better understanding of the many different aspects of Asia, the Fujitsu Executive Institute has been created to provide invaluable insight for your most senior decision makers.



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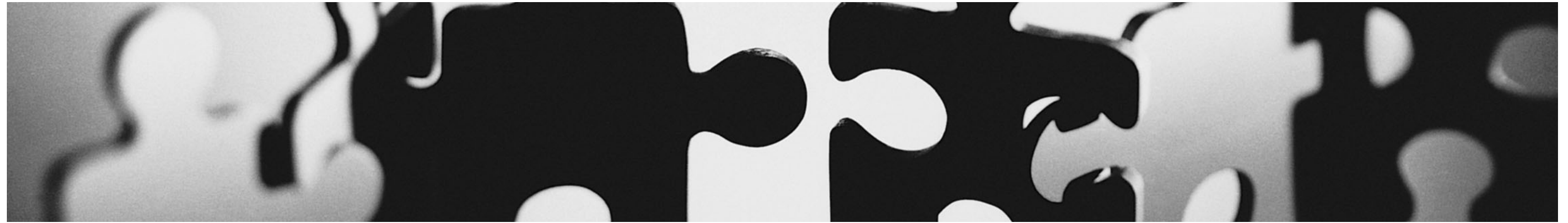
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FUJITSU EXECUTIVE INSTITUTE

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THE FUJITSU EXECUTIVE INSTITUTE (FEI)

Fujitsu is a leading Asian company, as well as a global corporation, and as such offers a unique insight into the complexities of the Asian world. It understands the variety of the culture as well as the business opportunities. Alone amongst the top IT services companies, Fujitsu is embedded under the skin of Asia, rather than looking in from the outside. The benefits of such a positioning are significant.

Whether your organisation is working in, buying from, or selling to Asia - or facing competition from Asia - or recognises that much can be learned by a better understanding of the many different aspects of Asia, the FEI has been created to provide invaluable insight for your most senior decision makers.

FEI - THE STORY SO FAR

The FEI is an invitation-only discussion group for Chief Executives and Chairpersons. It meets four times a year to discuss matters of strategic importance relating to the emerging Asia-Pacific economies. In its first year, the FEI heard presentations from Asian experts, an Ambassador and a High Commissioner, each one followed by an open discussion on the matters raised. The presentations and discussions are summarised here. We have also reprinted the four detailed white papers supplied by the speakers.

The FEI dinners have grown in popularity since the launch of the programme in 2004. Opinions, knowledge, fears and concerns have been readily shared and it has been known for members to have made changes to policy or strategy the very next day as a result of an insight from the speaker or the debate. One member said a comment made at one meeting was worth "too many £millions to admit".

OVERVIEW - UNDERSTANDING THE IMPACT OF ASIA

Asia is taking central position on the global map. By 2020, China, India and Japan are likely to be 3 of the world's top 4 economies, and this growth will not be achieved merely by selling cheap goods and services to the West. In the next 20 years, Asia will become the hub of consumerism, as over a billion people rise to a position of relative affluence.

A "one size fits all" approach to Asia will fail. Each culture needs to be understood individually.

Japan is a mature market struggling to extract itself from 15 years of recession. It could become the financial and technological engine of the region.

It has taken China just 26 years to become the world's fourth largest economy. It is now poised to become a sophisticated market economy with 300 million affluent consumers.

India is predicted to become the third largest global economy by 2020. It is following a significantly different route to China, with the focus on high quality software and services rather than low cost production.

A billion new consumers across China, Japan and India alone offer profound opportunities. Mature service sectors in the West, such as retail, finance, telecoms and healthcare, are barely established in countries such as China. The potential is immense. Asia will continue to change faster than any region before and the implications of this need to be on your management agenda now.

Management needs to evaluate the different Asian markets as they mature. Here are some immediate steps for consideration:

- Selective outsourcing of back office activities into India, Philippines and China.
- Joint ventures in China to develop service based enterprises, especially in finance and retail.
- Collaboration in the new digital society between European, Japanese and Korean government agencies.
- Private equity investment into the high growth economies, focusing on mainstream consumer interests (such as food processing, telecoms and retail).

But beware... Opportunity in this region sits side by side with risk. Management should consider the following risk factors before committing resource into the region:

- Understand the stability of governments and partnerships
- Look carefully at commercial and partnership structures. Being active in Asia is one thing, but how can your organisation extract attractive returns?
- How can you protect your intellectual property and inward investment?
- Do you have the local management presence to protect your interests?

The FEI programme continues to raise the level of debate on Asia. We hope that you will find this summary of the programme to date both interesting and informative.

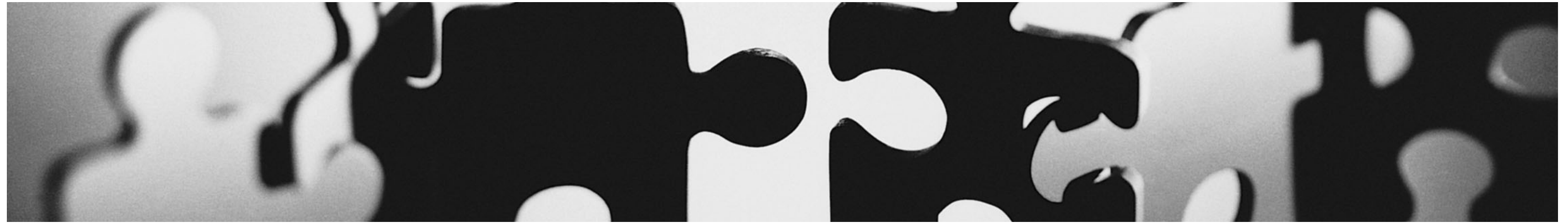


DISCUSSION 1
CHINA AT THE CROSSROADS

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CHINA - YOUR GREATEST OPPORTUNITY
IF YOU APPROACH US CORRECTLY



DISCUSSION 1 - CHINA AT THE CROSSROADS

SPEAKER: Professor Peter Nolan, Sinyi Professor of Chinese Management Studies, Cambridge

INTRODUCTION

Our first FEI discussion introduced four possible scenarios for China's evolution over the next 20 years.

Future 1: The status quo continues - "authoritarian rule without ideology". This will only promote first generation industrialisation and is not considered to be a viable option for any length of time.

Future 2: Communism ends and a multi-party democratic state emerges. This is considered the least likely option given Asian experience and culture.

Future 3: A gradual change (the most favoured within our discussion) driven by the emerging middle classes. The peasant majority will have little influence, but will benefit from higher wages and better public services. Wealth inequalities will gradually diminish.

Future 4: China breaks up into five separate Regional States with different rates of development (Hong Kong is an example of this). This could become part of the third option, overtly or de facto.

UNDERSTANDING CHINA TODAY

The total population of China is about 1,400 million, including about 800 million people living below the poverty line. The middle class makes up 5% (c70 million people) and enjoys a significantly higher standard of living than most. The wealthy have family fortunes created in the main by industry, property, banking and land ownership.

Without firm Government intervention, employers have little incentive to increase wages. The almost unimaginable size of the "available workforce" - over 800 million people - means worker-protection safeguards are many years away. China is associated with very low cost, but increasingly high quality production. Most production is done by many thousands of small units that are part of global value chains.

The value of the services sector has, as yet, been neither appreciated nor understood (it represents up to 80% of total global value).

One result of this is that whilst Chinese companies perform well in OEM situations, they have not competed successfully in the more advanced sectors such as aerospace, information technology or financial services.

WILL CHINESE BUSINESSES BECOME GLOBAL?

One major limiting factor on Chinese businesses achieving global status is the family-based ownership of major companies. Family businesses are nervous of public scrutiny and formal disciplines, which makes access to capital markets impossible.

The Chinese Government could fill the breach but it is directive in its lending, favouring certain sectors and ignoring others, so this does not compensate for the lack of a free capital market.

Large capital banks need to be assured that they can repatriate profits and companies need to escape from family ownership, if Chinese businesses are to achieve global status.

Will Chinese companies become your competitors? China's increasingly vibrant, aware and demanding domestic market will drive huge investments in research and development, creating businesses well able to compete on the global stage.

In the West, the old corporate "monoliths" are being replaced by agile, smaller entities created as a result of global connectivity. Chinese businesses are unlikely to move through all the steps that Western companies have taken. They may overtake us by learning from our mistakes. As corporate monoliths decay, an ever-increasing number of global value chain units will be in Asia. This will enable more Chinese companies to reach tier 1, changing their position in relation to Western businesses from supplier to competitor. Even in service sectors such as finance, IT, engineering and research, China's high level of education and low wages make a dangerous competitive mix

WHAT IS THE FUTURE FOR CHINA?

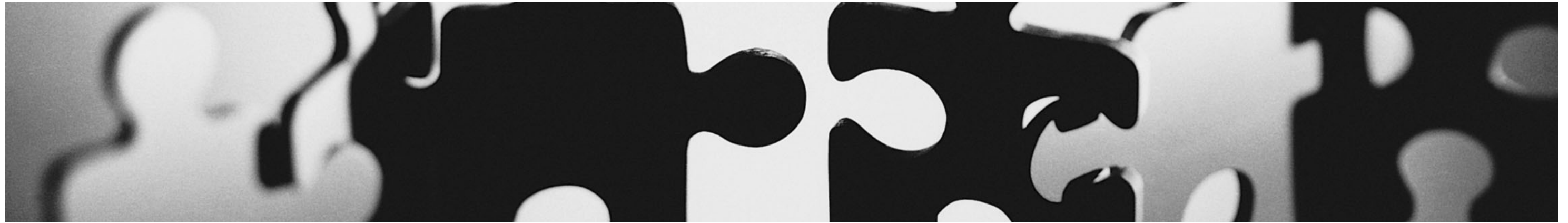
Neither collapse nor stability can be ruled out as future outcomes. There has to be some kind of equilibrium between State and market forces, but achieving this balance will inevitably involve turbulence.

One way or another, the forecast is for regime change, and western-style democracy is unlikely to be the result. The Asian "benign autocracy" model - as demonstrated so successfully by Singapore - is considered more likely.

The Chinese military and police structures do not support democratic rule and could potentially delay liberalisation. But the military influence remains strong by repeatedly raising the spectre of Taiwan and US involvement.

China is currently re-arming. Only the middle classes can move China away from totalitarian rule. They must play a progressively broader role, and be prepared to stand up for the right to enjoy their new status. The regime will only bow to such pressures if there is a collective approach.

A growing middle class will create a power base that is hard to stifle. It is assumed that the current leadership knows this and accepts it as inevitable.



DISCUSSION 2 - A JAPANESE VIEW OF ASIA

SPEAKER: Dr Ahn Kyung-Soo, Korean national and main board director of Fujitsu Limited Japan

INTRODUCTION

To succeed in Asia, you must understand the profound differences between 13 separate nations. You must never ignore the history and cultural heritage of each country. Asian countries with apparently similar cultures and languages cannot be dealt with in the same way. You would not necessarily expect customers in Scotland to react the same way as customers in Spain. The differences are much greater between Asian peoples.

The 'Big Three' economies in Asia are China, Japan and Korea. The Asian view of India is that it is partly Western and therefore not regarded as an Asian country. This perhaps surprising attitude has important implications (see Discussion 3, "The Indian Phenomenon").

UNDERSTANDING THE HISTORICAL DIFFERENCES

Asian history goes back much further than the West's and this should be understood and acknowledged when dealing with the region. China and Korea both have a recorded history over 4,000 years old, while Japan's history goes back for well over 2,500 years.

Japan has been relatively open to Western economic influences for the last 130 years and became even more open to western culture and approaches as a result of the Second World War. It was largely rebuilt by US aid, and embraced western culture before most others in the region. Korea began to industrialise after the Korean war of 1950-53 and now has a largely mature economic structure.

Therefore both Korea and Japan are at very different stages from China. Yet China has the power, human resources and the determination to overtake both, especially as it has concentrated on low cost (rather than high added value) production.

Japan's average growth rate is around 1%, whereas China averages a staggering 9%, forecast to continue long after the Olympic Games in 2008. This can partially be explained by the massive agricultural element within China, where 70% of the population works at very low rates of pay (under \$1 per day), and is regarded as a pool of labour for production purposes whenever more are required.

UNDERSTANDING THE ORGANISATIONAL DIFFERENCES

In business, Japanese organisations value long term relationships and strategies. Japan's industrial revolution created a rigid, vertically integrated model across primary industries such as automotive and electronics. Business is operationally focused using the Kaizen continuous improvement idea. Their development philosophy tends to be incremental but progressive and this has given Japanese companies a significant lead in several sectors. As in most developed economies, manufacturing is increasingly moving offshore, mainly to China.

China chose a more modular and open form of commercial integration where relationships are relatively short and there is significant competition across every supply chain. Labour, with its low cost and near infinite availability, is the economic focus. The huge population is increasingly demanding and the home market is starting to take precedence over export. Chinese production cannot satisfy national demand.

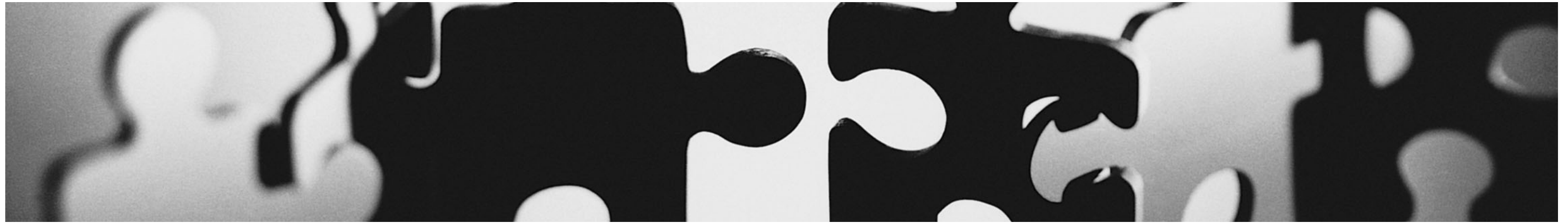
Korea's industrial approach is similar to China's. Many Chinese and Korean executives have been educated or trained in the USA and share similar views. Their business philosophy is typically more Western than Japan's. Korea's big difference is the small size of their home market. Korean companies have had to be more aggressive on the global stage compared to their Chinese counterparts. They have needed high capitalisation to do this, which has led to larger companies. Remarkably, just four mega-businesses dominate Korea, representing over 50% of the country's entire production.

CHALLENGES AHEAD

China and Korea enjoy vast trade surpluses and, with Japan, they underwrite almost the entire US trade deficit. This imbalance cannot continue for long, and an upward revaluation of the Chinese currency is expected within two years. Stable democracy exists in Japan and Korea, although there is growing social unrest against the excesses of affluence created by capitalism. China's system is totally different, of course. The Communist Party controls more than 60% of the economy and virtually 100% of the banking sector.

All three countries face the same demographic time-bomb and their rapidly increasing pension and healthcare costs will have to be met either by taxation or by businesses, either way increasing the cost of production.

There is no cultural history of state assistance in Asia because historically the extended family has always taken responsibility. However, as labour moves from the country to the cities and between countries, families separate and the state has to intervene. This problem is as urgent as that in the West and could potentially be a source of significant unrest in the region.



DISCUSSION 3 - THE INDIAN PHENOMENON

SPEAKER: His Excellency Kamalesh Sharma, High Commissioner for India

INTRODUCTION

India is an ancient culture with long held attitudes and proud beliefs. Its philosophy has influenced the entire world and its worldwide trading links are long established. It is far from being a country of poverty and want.

India's democracy is a fundamental characteristic and results in extreme stability. Indians value education and learning - the size of their graduate force is vast. In addition, they are very open to foreign ideas and overseas learning. Over 300 million Indians are now 'middle class' and heavy consumers.

Indeed the Indian home market is growing faster now than at any time in the past. Indians know they have moved more slowly than the Chinese in terms of recent industrial development. However they believe that their stability, education and democracy enable a more sustainable growth rate. This self-confidence is widely felt.

The UK has advantages when dealing with India as language, legal system and recent history are all shared to some extent. But the US and China have been more active than UK plc to date. It is time for UK plc to try harder.

KNOW YOUR HISTORY

Indian civilisation is 3,500 years old and has led the world in thinking and international trade for most of that time. Indeed, Indians operated globally before anyone else. In 1800, India and China produced 50% of the world's total output. Poverty is a relatively recent phenomenon and is regarded as a temporary problem. By understanding and respecting India's remarkable history and power, you will succeed better in relationships with Indian organisations.

THE ULTIMATE 'KNOWLEDGE SOCIETY'

India has invested in knowledge like no other nation, and currently boasts 12,000 undergraduate colleges, 1,000 technology institutes and 291 universities. This has rapidly moved the economy away from low cost manufacturing towards knowledge industries like IT, telecommunications and bio-technology.

The internet age has played into this strength and now over 100 multinationals have their R&D facilities in India. GE, for example, has 1600 employees of whom 500 are PhDs and 700 hold Masters degrees. Meanwhile, more than 160,000 Indians work in call centres, over 60% of which are foreign owned.

THE WORLD'S BIGGEST DEMOCRACY

Being the world's largest democracy may have provided stability but it has also inhibited change and slowed growth. India's political system has 50 parties, 20 of which are governing in coalition at any one time. This does not make for agility, but helps continuity.

Investments should be relatively safe. The legal system is based on the British model, so that the courts are independent, and Indian bureaucracy is generally characterised as slow but honest. Although China moved first and faster, India has woken up to the challenge and, it believes, will be able to sustain growth and success for longer due to India's democratic system.

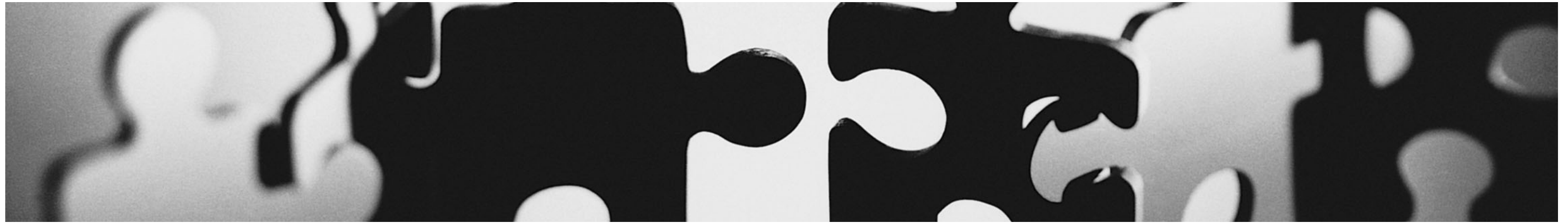
Indians believe the Chinese organise production better than they do, and make decisions faster. In contrast however, they also think Indians are generally better educated, manage people better and make better corporate citizens.

EAST OR WEST?

India sees itself as a trading nation with links to everyone. Trade with China is increasing rapidly and despite their British links and huge US trade, they generally feel more eastern than western. However Japan typically finds China easier to deal with than India (as evidenced by comments in discussion 2).

Since the demise of the USSR, the USA has formed strong relationships with India and is currently its major trading partner, though China could overtake the USA in this regard.

The Indians' love of fair play should be considered when developing relationships and commercial arrangements. Whilst the UK can never regain its position as India's primary trading partner, it could yet succeed as a bridge or honest broker between east and west.



DISCUSSION 4 - CHINA - YOUR GREATEST OPPORTUNITY IF YOU APPROACH US CORRECTLY

SPEAKER: His Excellency Zha Peixin, the Chinese Ambassador to the UK

INTRODUCTION

China needs to be seen as a market as well as a source of low cost goods and services. China's GDP quadrupled between 1980 and 2000. It will quadruple again by 2020. The middle class is demanding housing, schools, luxury goods, leisure and foreign holidays. There are 25 million more 'middle income' families every year and average incomes continue to grow. Growth rates are approaching 10% pa.

"A well off and socially harmonious society by 2020." This is the declared aim of the Chinese Government. However they know it won't happen without significant international trade, open markets and real opportunities for inward investment. Overseas companies must be able to acquire or invest in Chinese businesses and repatriate profits. If this can be achieved, the West can be China's partner in achieving its ambitions.

THE GOVERNMENT MODEL

The future of the current Government structure is a challenge in itself. China has created a unique blend of communism in central government and social democracy elsewhere. What is the future role of the three levels of Government (central, provincial and local) and will the initial effectiveness of this model in forcing through change be continued?

The model of 'Democratic Centralism', where government has set economic development levels, was intended to create an ever increasing consumer-led market economy. However the variations in the regional governments have acted as a brake in some cases. China is a multi-speed economy with some regions reluctant to reform and change the model. When investigating opportunities, UK businesses need to look carefully at regional statistics not just national ones. Some local bureaucrats have resisted progress that they found threatening.

A NEW FUTURE

1979 was a kind of 'year zero' in China, when President Deng announced a new policy of reform and opening to the outside world. This was a complete reversal of previous thinking. It is politically unwise to make too much reference to pre-1979.

Even as hard-line communism relaxed, some officials found it hard to accept the changes, as they feared reprisals should things change again. This led to some regions dragging their heels in terms of progress. Nevertheless, in 26 years, China has transformed itself from an agricultural economy with shortages, poverty and poor administration to the world's fourth largest industrial nation. It is on course to be the largest by 2020.

OPPORTUNITIES FOR OVERSEAS BUSINESSES

Capital investment in China will increase from US\$600 billion to US\$1.2 trillion over the next five years. Targets have shifted from low cost manufacturing into infrastructure projects (for example in telecoms, travel and education) and domestic consumer goods.

The 1980s and early 1990s saw poor results for foreign businesses, but recent ventures have been more successful. Over 60% of foreign companies are now in profit. Variations in approach by regional governments can be a factor in the success or failure of these ventures.

China works on five year plans. The eleventh is about to be published but known requirements include:

- 1 Major infrastructure projects (at least 30 new power stations). International partnerships are required, with the (Central) Government involved in the relationships and arrangements.
- 2 Technology transfer into China. They will require foreign companies to establish research centres in the country.
- 3 Finance, telecommunications and education will continue to feature heavily and will all require international partnerships. Already over a million Chinese workers have been educated abroad.

MAJOR CHALLENGES AHEAD

Resources will continue to be a major challenge. China is in competition with the rest of the developed world for resources. It is China's demand that is likely to take the oil price past \$100 a barrel and force other commodity prices to continue to rise. China's international alignments are with developing nations who can provide raw materials. However, as China's needs alter, so will its alliances.

China is developing local energy sources, including coal, nuclear power, bio fuels and hydroelectric power. It needs 'clean coal technology' if severe environmental impact is to be avoided. Nuclear power is planned to go from 2% to 5% of total energy input, whilst hydrogen-based public transport will mitigate dependence on oil.

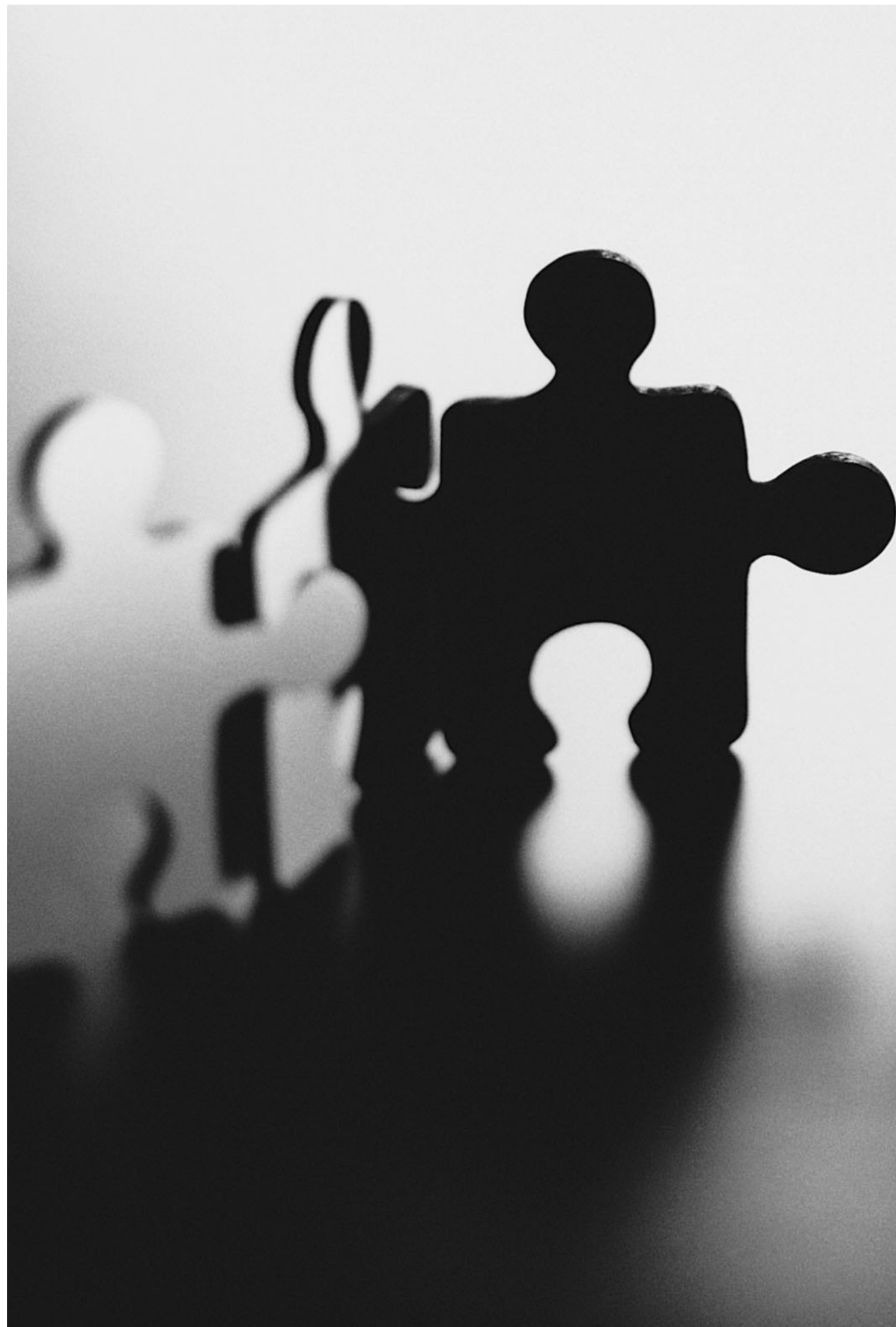
The Chinese will admit that corruption is a major challenge. Recent show trials were intended to change public perception and the Government is determined to make individual and organisational 'backhanders' morally unacceptable. A significant challenge to the foreign investor is where to draw the line between normal custom and illegality.

Intellectual Property protection is also a major challenge, as many of the protections that are normal in the west are currently missing or ignored in China.

China recognises that its financial system (particularly the banking system) needs reform - and that this is overdue. The current risks for inward investment are too high, because the regulations are inadequate to provide the expected levels of security to investors.

This has led directly to pension funds remaining cautious about investment in China despite the wealth-creating opportunities. However, venture capital groups are now entering the capital markets and at last offering alternatives to the Government as the primary source of capital.

The paradox is that Western fund managers see China as the motor to fund pensions over the next 50 years, but it will need adequate regulation within its financial markets for this to become a reality.

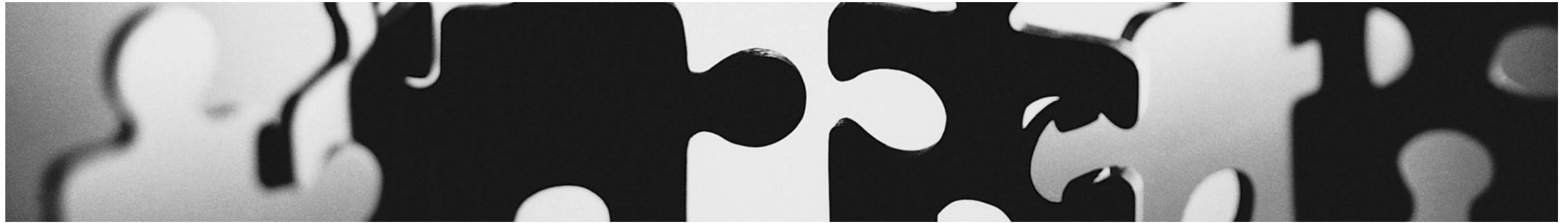


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WHITE PAPER 1 - PETER NOLAN - CHINA AT THE CROSSROADS

CHINA AT THE CROSSROADS: THE CHOICES

This paper examines the following question: is it possible for China to build a civilised, socially cohesive society over the next few decades, during what is still the early phase of China's industrialisation, and during which time there will still be a huge rural reserve army of labour?

Will China be condemned to pass through a long phase of harsh political rule in order to meet the imperative of the accumulation process? If China fails to achieve a socially cohesive path of development, will the society and political structure remain stable? Does the fact that China is trying to industrialise at the beginning of the twenty-first century make this task more or less difficult? Is this task made more difficult by the fact that China faces numerous other deep development challenges, including a wide-ranging threat to the natural environment?

Is it made more difficult by the fact that China faces a massive international relations challenge, notably in its relationship with the USA? What is the impact of the fact that China's large firms face a deep threat to their survival from the global giant firms headquartered in the high income countries? Is this task more or less difficult in a huge country such as China, with a long history of economic development, possessing a highly sophisticated culture?

Since the late 1970s, China has enjoyed one of the most remarkable periods of economic growth ever seen. However, the country faces deep economic, political and social challenges as it moves into the next period in its development. These challenges include the vast extent of poverty and rapidly growing inequality; the challenge for Chinese businesses from the global business revolution; a deeply degraded natural environment; declining capabilities of the state; a comprehensive challenge in international relations; widespread corruption within the Chinese Communist Party; and extreme dangers in engaging closely with the global financial system, which were vividly exposed during the Asian Financial Crisis. The Chinese leadership is trying to deal simultaneously with the challenges of globalisation, transition and development. No other country has ever faced such a set of challenges. There are no textbooks to guide China along this path. The responsibilities for the leadership are massive, because the price of failure is so huge. The possibility of social and

political disintegration is real. Every effort of policy has to be directed towards avoiding this potentially catastrophic outcome.

There is intense debate among Chinese policy-makers, scholars and society at large about each of these issues. There is a wide sense that the country has arrived at a crossroads in its long journey away from the administratively planned economy. At a crossroads in the middle of nowhere the traveller cannot stay put. He can turn to the left, to the right, or even turn around and go home. The other option is to keep on in the same direction as the road he has come down.

Some people argue that China has no alternative but to accept that this phase of development will be characterised by a harsh political-economic order. They compare this with the phase of 'primitive capitalist accumulation' in Marx's Capital Vol. 1. **The arguments in this paper are taken from China at the Crossroads, Polity Press, 2004**

Few people dispute that the main task for China's policy-makers is to ensure social stability. Many people argue that the only way to achieve this in such a turbulent, challenging environment, is through the exercise of harsh social control: the process of accumulation must come first or there will be no 'development'. Such arguments are typically supported with historical examples from early industrialisation elsewhere.

REGIME CHANGE?

Many people both inside and outside the country argue for a 'regime' change. They believe that the hard tasks that lie ahead can only be resolved with Western democratic institutions. Many people in this camp believe that the model for China to aim at is the USA, not the 'bankrupt' models of the European welfare states or 'quasi-socialist' Japan. Almost invariably, those advancing such arguments claim the authority of Adam Smith who, they argue, demonstrated that the only rational way to organise the economy is through the free market. Frequently, it is asserted that China's long economic history provides a powerful object lesson for today's policy-makers: China's achievement in technical progress in medieval times was blocked from making further progress by a despotic state that prevented China taking the capitalist path that was followed in Europe. They believe that the smaller the role for the state, the faster will China progress in the period ahead.

A third group, the 'new left wing', argues that the country has taken a fundamentally wrong turning by moving towards a market economy, increasingly integrated with and 'dependent' on the global economy. They believe that the country can only solve the growing tensions by reducing the country's reliance on international trade and capital inflow, and returning to the policies of the Maoist years, from the mid-1950s to the mid-1970s.

Another perspective is that China must continue along the path it has trodden for the past two decades, but adapting this approach to the fresh challenges that the country faces. For the past two decades, the Chinese leadership has been groping its way forward, away from the 'planned' economy of the Maoist period. In the sharpest contrast to the reform path of the former USSR, China has been 'groping for stones to cross the river'.

PREVIOUS MISTAKES ENSURE CAUTION

China's approach was deeply influenced by the disasters that the country has experienced since the middle of the nineteenth century, not least the massive famine after the 'Great Leap Forward', and the great suffering during the Cultural Revolution. China's policy-makers were determined to avoid such policy-induced disasters. The process of reform has throughout been treated as a complex process of comprehensive 'system transformation', in which economic, social, political and psychological factors are considered as a seamless whole. Unlike the former USSR China decided to address economic reform before considering political reform, though this was not inconsistent with making great efforts to improve the capability of the bureaucratic apparatus.

In economic reform, the watchword has been consistent experimentation before widespread adoption of a particular policy. Reform began in the countryside in the late 1970s and early 1980s with the system of contracting land to the individual household. It spread to the urban areas in the 1980s with the widespread introduction of the 'contract system' for individual enterprises. By the 1990s this had been replaced by a system of even wider enterprise autonomy, with taxation substituted for profit hand-overs to the state, corporatisation and flotation of part of companies' equity on domestic and international stock markets. Controls over foreign investment were lifted slowly, and were followed by a surging tide of FDI in the

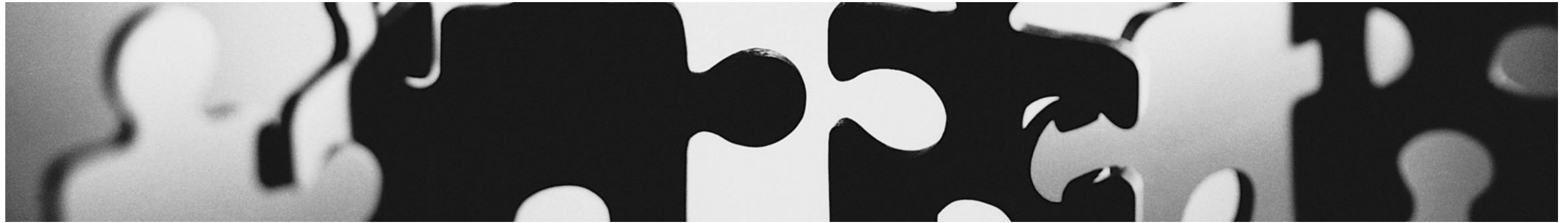
1990s. By 2002, China was the world's largest recipient of FDI, and had around US\$ 400 billion in accumulated FDI. Rural 'township and village enterprises' were allowed increased freedom in resource allocation, becoming a highly dynamic part of the economy in the late 1980s and early 1990s.

ENTREPRENEURS CONTRIBUTION TO SOCIETY

Market forces, including market-determined prices, and entrepreneurship gradually permeated the economy. Private business activity gradually was accepted and spread into all corners of the economy, though still not given formal protection. However, in July 2002, it was announced that private businessmen were eligible formally to join the communist party. At the Sixteenth Party Congress in 2002, Party General Secretary Jiang Zemin announced that citizens should be judged on their contribution to society and not penalised for their property holdings:

'Mr. Jiang's statement provides support for the speedier development of legal institutions for protecting private property and the wealth generated by the emerging middle class of entrepreneurs' (FT 10 November 2002). Controls over foreign trade were relaxed slowly over the course of two decades, and given a final impetus by China finally joining the WTO at the end of 2001. Foreign exchange controls also were only slowly relaxed, and by 2003, the renminbi was still not convertible on the capital account. China's incremental system reform produced outstanding results. By the time of the Sixteenth Party Congress in November 2002, China had decisively left one 'bank' of the river, that of the old Maoist system, but the 'other bank' was only dimly visible. At the end of 2002, at the Congress, a new generation of leaders was appointed, including a new Party General Secretary, Hu Jintao. In his first speech after being elected, he likened China's current situation to that facing the leadership under Chairman Mao at the end of the Civil War. In March 1949 at the Second Plenum of the Seventh Central Committee of the Chinese Communist Party Mao Zedong made a highly significant speech outlining the tasks ahead.

The victory over the Guomindang (KMT) was basically complete. The Party was entering a new phase in its development. Chairman Mao warned that it should guard against complacency, and realise that a long, arduous struggle lay ahead: 'To win countrywide victory is only the first step in a long march of



ten thousand li. Even if this step is worthy of pride, it is comparatively tiny; what will be more worthy of pride is yet to come' (Mao Zedong, 1949: 374). The central theme of the speech was the need for the Party to find a path through the enormous tasks that confronted them in the face of great challenges both at home and abroad.

In the same way, China now stands at a crossroads. It must grope its way forward in the face of these immense challenges, fully aware that there is a serious danger of system disintegration. This would be disaster for the Chinese people. It would render previous achievements meaningless. In their search for a way forward, China's leaders are looking to the lessons from the country's own past, as well as to those from other countries, in order to find a way to build a stable, cohesive and prosperous society. This effort is of vital importance, not only for China, but also for the whole world.

'USE THE PAST TO SERVE THE PRESENT': A CHINESE THIRD WAY

If by the 'Third Way', we mean a creative symbiotic inter-relationship between state and market, then we can say that China practised its own 'Third Way' for two thousand years. This was the foundation of its hugely impressive long-run economic and social development. The Chinese 'Third Way' was not simply an abstract set of rules about intervening with the market, but was a complete philosophy that combined comprehensive thought about concrete ways of both stimulating and controlling the market, with a deeply thought out system of morality for rulers, bureaucrats and ordinary people. When the system worked well, the philosophical foundation was supplemented by non-ideological state actions to try to solve practical problems that the market could not solve.

It is a complete misunderstanding (not least, by Karl Marx) to view the traditional Chinese state as a stagnant 'Oriental Despotism'. Confucianism produced a deeply developed concept of 'duty' which was the foundation of social prosperity and collective action. The fact that the system went through regular cycles when these principles were poorly observed, rulers and bureaucrats were corrupt and the economy and society foundered should not blind us to the underlying coherence and lasting benefit from this integrated system.

COMPARISONS WITH EUROPE

China today is groping for its own Third Way in totally different circumstances from those in Europe in recent decades. Europe was already industrialised, militarily strong, contained a mass of powerful, globally competitive firms and was able to assert strong controls over international capital movements until the 1970s without incurring international pressure to do otherwise. China today is painfully weak militarily compared with the USA. The vast mass of the population are still poor farmers and will remain so for a long period ahead. It is still firmly locked into the 'Lewis phase' of development.

The 'global middle class' constitutes a tiny fraction of the population. The economy is increasingly 'dependent' in the classic sense used by Latin American economists in the past. The high value-added modern sector of the economy is increasingly dominated by international capital, with close to US\$ 400 billion in accumulated investments, forming complete production systems within China, and accounting for over one-half of the country's export earnings. China faces intense pressure to liberalise comprehensively its financial system as the price for participation in the international economy.

Europe tried to pursue a 'Third Way' in order to build a civilised society after it had already industrialised and developed. China is trying to construct a 'Third Way', while it is still in the midst of economic development and industrialisation, with a huge rural surplus labour force, amidst a turbulent international environment, and with a surging flow of foreign capital into the country. China's leaders are trying to construct a civilised society in this uniquely challenging setting. In the early 21st century, China cannot step outside the mainstream of world history. It cannot close itself off from the main trends in international economics and politics.

It cannot turn round and go back to the Maoist period. However, system survival necessitates that it uses the market as the servant of the development process, not the master, as if the market possesses an intrinsic moral value, which the current US leadership and Western propagandists for the unfettered free market believe to be the case. In this effort China's leaders can make common cause with powerful streams in international thought that have gone against the current mainstream. They have at certain periods been highly influential both in the West, including even in the USA, and in the Far East outside the Chinese mainland.

'CONTROLLED' MARKET FORCES

At the heart of the thinking of the most powerful advocate of the dynamic force of the market economy, Adam Smith, was a deep awareness of the damaging impact of unfettered market forces. Smith understood the contradictions at the heart of the capitalist system. We have seen that his efforts to build a moral philosophy based on controlling the market rather than letting it dominate society, closely parallel the most fundamental issues in China's own philosophical tradition. Central to this long tradition was a belief that commerce and finance should be nourished, but not allowed to dominate society and control the political system, either centrally or locally. However, Smith gave no answers to the deep contradictions that he identified.

Writers such as Fukuyama and Ohmae argue that the collapse of communism and the rise of the global corporation have produced an end of ideological conflict. Yergin and Stanislav (The Commanding Heights, 1998) have chronicled the 'withdrawal of the state from the commanding heights, leaving it more and more to the realm of the free market', across a wide swathe of countries. However, they conclude their book with a prescient warning about the market: '[I]f its benefits are regarded as exclusive rather than as inclusive, if it is seen to nurture the abuse of private power and the spectre of raw greed, then surely there will be a backlash - a return to greater state intervention, management and control' (Yergin and Stanislav, 1998: 398).

WIDER CHALLENGES

Can free market fundamentalism prevent a 'China Financial Crisis'? Can it solve the problem of the rapid rise in social inequality within China? Can it solve the problems of the Chinese farm economy? Can it enable China's large firms to compete on the 'global level playing field'? Can it help China to deal with the massive international relations' challenge? Can it solve the Chinese environmental crisis? Can it provide China with an ethical foundation for building a socially cohesive society? Anglo-Saxon free market fundamentalism, which reached its modern apogee in the 1990s, offers no hope for sustainable global development, at the level either of ecology, society, or international relations.

China's numerous deep socio-economic challenges each requires creative, non-ideological state intervention with the market, to solve the innumerable practical problems that the

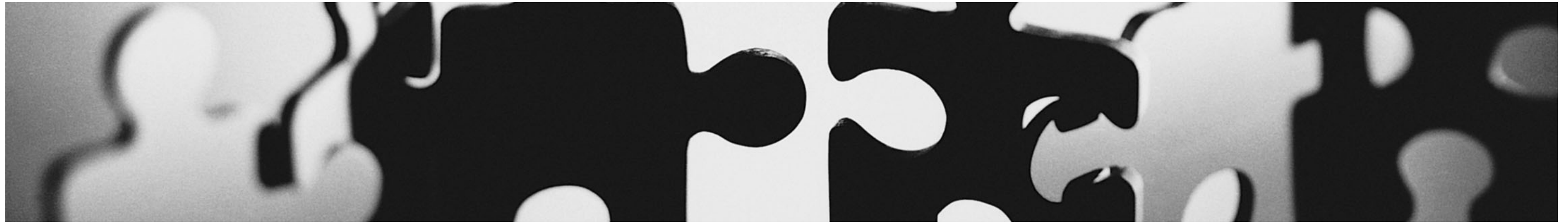
market alone cannot solve. The biggest challenge of all is in the relationship between China's financial system and that of the global economy, since this has the greatest potential in the near future to trigger system disintegration.

In groping for its own system survival, China can make a powerful contribution to global system survival. In tackling these problems China can look to its own long history of nurturing market forces while simultaneously placing them under control, in the service of the whole society, in order to achieve a socially cohesive overall political economy. It must creatively adapt these traditions to the particular challenges facing the country today, namely dealing with the challenges of globalisation in the context of a huge and still poor developing country, firmly rooted in the 'Lewis phase' of 'economic development with unlimited supplies of labour'. If China is able to marry the 'snake' of the global market economy with the 'hedgehog' of China's ancient history, as well as its recent history, especially that of the Chinese Communist Party, it will be able to offer a way forward for a stable, socially cohesive society within the country. If it fails to do so, the Chinese entire system of political economy may collapse.

"CHOICE OF NO CHOICE"

This would be devastating, not only for China, but for the whole global political economy. At the very least, China may be condemned to a long period of harsh social control to contain the surging tensions of the country's high-speed growth. During the Asian Financial Crisis, China had to take a 'choice of no choice' (mei you xuanze de xuanze) to survive by 'cutting the trees to save the forest' (i.e. making GITIC bankrupt). If it wishes the system to survive today it must also take the 'choice of no choice' to re-establish social cohesiveness, confidently using its own past traditions and the best traditions from outside the country. If China were to 'choose' the path of 'state desertion' and free market fundamentalism, it would lead to uncontrollable tensions and social disintegration.

Full liberalisation of international financial firm competition inside China and full liberalisation of international financial flows is the most dangerous area through which this disintegration might occur. A crisis in the financial system would fan the flames amidst the 'combustible material' in all other sectors of society, into which the long tentacles of the financial system extend. The 'choice' to increase and make



more effective the role of the state to solve the intensifying socio-economic challenges facing the country can only succeed if the Chinese state today, with the Communist Party at its core, as in periods of greatest prosperity in the past, can radically improve its level of effectiveness, and eliminate rampant corruption. State improvement, not state desertion, is the only rational goal for Chinese system reform. This is the 'choice of no choice' for China's system survival.

By taking the 'choice of no choice', China's own survival can contribute to global survival and sustainable development, by offering a beacon as an alternative to the US-dominated drive towards global free market fundamentalism. This is a cross-roads not only for China, but for the whole world.

CHINA AND THE USA

In the 1980s, the prime goal of US foreign policy was the overthrow of the 'evil empire' of communism in the Soviet Union. This goal was pursued through acceleration of the arms race and numerous channels of influence upon Soviet policy-makers. US policies played a significant role in the collapse of Soviet communism and the disintegration of the USSR. 'Regime change' resulted in the collapse of the state, which had disastrous consequences for the Russia economy and for the welfare of most Russians.

The Soviet economy had only negligible linkages to the US economy. The USSR accounted for a tiny fraction of American exports and there was no investment in Russia by US multinationals. Soviet exports to the USA were trivial in scale. The collapse of the Soviet economy had a negligible impact on the US economy other than the short-term fall in military expenditure. After the Tiananmen 'event' of 1989, US public opinion, led by hard-line anti-communist politicians and reinforced by 'human rights' campaigners, believed overwhelmingly that it was morally desirable for the US government to work towards the downfall of Chinese communism. In his early months in power in 2001 it appeared as if George W. Bush might pursue a confrontationist policy, seeking the overthrow of the Chinese Communist Party and 'regime change' in China. However, September 11 strongly affected US-China relations. Moreover, the consequences of 'regime change' in Afghanistan and Iraq were disastrous and forced a profound re-assessment of US foreign policy.

The Chinese and US economies have become deeply intertwined. US consumers benefit from the explosive growth of low-priced Chinese exports. US companies and shareholders benefit from China's absorption of booming American investments and from access to the low-cost manufacturing supply-chain in China.

US primary product producers (including food, oil and mining companies) benefit from exports to China, both directly from the USA and, increasingly, from production bases in other countries, such as Brazil and Australia.

The US government benefits from Chinese government purchase of its debt, which, ultimately, helps to underpin the growth of US personal consumption. 'System disintegration' in China, such as the US helped bring about in the USSR, Afghanistan and Iraq, would be a disaster for China, but would also have severe economic consequences for the USA. One can only guess at the military consequences.

THE EFFECTS OF GROWTH

China's high-speed growth since the 1980s has produced remarkable results. China is truly becoming the 'world's workshop'. However, huge challenges exist for the new leadership team of Hu Jintao (President, General Secretary of the Chinese Communist Party and Chairman of the Central Military Commission) and Wen Jiabao (Premier). These include:

- rampant corruption;
- growing domination of large swathes of the modern economy by global giant companies (China is more of a 'workshop for the world' than 'workshop of the world');
- stagnation over many years in the real income of the majority of the 800 million rural dwellers;
- deep unresolved problems in the country's leading financial institutions;
- a shocking increase in inequalities of wealth, income, consumption and lifestyle;
- a surging mass of 150 million or so rootless migrant workers in the cities;

- large-scale unemployment among the former elite 'industrial proletariat' in the state-owned enterprises;
- severe deterioration in the natural environment, including a crisis in water supply;
- fast-growing dependence on imported food and raw materials;
- a yawning gap in military capabilities with the USA; and
- an ideological and spiritual vacuum for the country's young people, the one-child 'internet generation'.

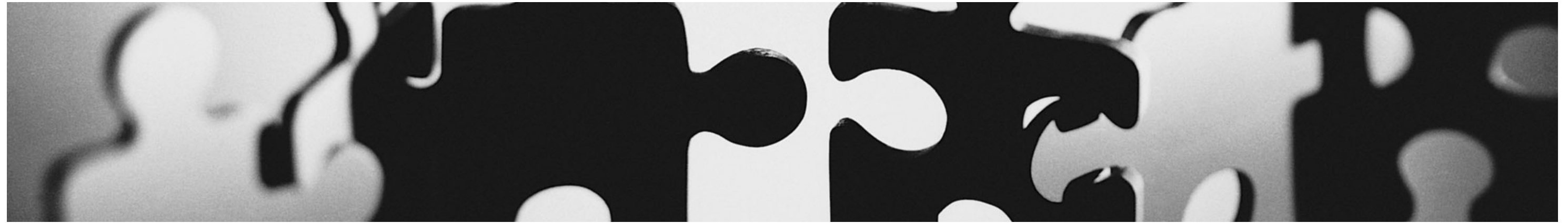
This potent combination of challenges threatens the stability of the whole Chinese political economy. To meet these challenges, the Chinese leadership has established two closely inter-related focal points for the country's development in the period ahead. Internationally, China is committed to a 'peaceful rise'. Domestically, China is seeking to build a 'socially just society'.

The new leadership bases its overall approach to development around a philosophy of 'using the past to serve the present', absorbing lessons from its own long history as well as from the development experience of other countries.

In this endeavour, the Communist Party leadership is attempting to find a 'Chinese Third Way' between the extremes of 'free market individualism', which seeks to maximise individual rights-based 'negative freedoms', and the Maoist approach of 'serving the people', which overwhelmingly stressed the individual's duties to society, and sought to maximise 'positive freedoms' for all citizens.

If China's leaders are successful in this monumental task, which is a 'choice of no choice' for system survival, it will not only secure the country's long-run sustainable development, but will also contribute, both practically and philosophically, to sustainable global development.

Under these circumstances, the main task of US foreign policy in the years ahead is clear. It is in the interests of US business and the mass of US citizens, not to speak of the rest of the world, to support the efforts of China's Communist Party leadership to achieve a socially just society, and, thereby, help to nurture the country's 'peaceful rise'.



WHITE PAPER 2 - DR. AHN KYUNG-SOO, FUJITSU LIMITED

For the West, the differences between the various Asian countries was often ignored or not appreciated - until it was too late. Even today there are organisations that make unwarranted assumptions about “the East” in general, and fail to achieve their potential as a result. However, those organisations that properly study the very different historical and cultural backgrounds and make totally different approaches as a result, are accepted and welcomed. But this also applies to Japanese organisations. At different times they have been outsiders, conquerors and damage-limitation specialists - and the history has been chequered to say the least. There are many mistakes that have been made - but equally many lessons that have been learned and not forgotten.

This background Paper therefore starts off by pointing out the variances in tradition, history and culture - moves into looking at the Power Balances (East and West) - provides some of the details of the area that we are considering and then goes into specific detail with the Chinese market place because that has by far the largest potential for Japan, although currently not growing as fast as India in strategic areas. I have shown the different types of approach required to attain specific goals. The fallacy of assuming that one method fits all in China is an expensive mistake, and could be one subject for our discussions. We also identify advantages for Western Companies due to Chinese aspirations and attitudes - is that a shared belief? Japan has some similarities with the UK in that it is an island race that sees itself as different from the mainland, and is also seen that way. Again similar to the UK, whilst accepting religious and cultural imports from the mainland, what has emerged over the years is sufficiently different as to cause challenges (and worse).

HISTORY - JAPAN

- Over 2,600 years of history
- Island, mono-racial nation
- Based on the Chinese culture and religion such as Buddhism and Confucianism transported via Korea. BUT Japan developed its own original one.
- Spirit of harmony “Wa”, unconsciousness of any specific religion, 8-million holy spirits all over the world (no absolute God).

- Very open to Western culture, but traditional spirits are still governing behaviour.
- Today, Japan is struggling with long-lasting recession after corruption of bubble economy, fire-fighting to regain its competitive advantage in the worldwide market.

HISTORY - CHINA

- Over 4,000 years of history
- Continental, multi-racial nation
- Sinocentrism: since ancient era, China has always been a centre of an advanced civilization and an influential leader in East Asian history.
- Foundation of Buddhism and Confucianism
- During the Great Proletarian Cultural Revolution, China lost its competitiveness in both cultural and industrial society in the world.
- Today, after recent change from communism to capitalism, China is dramatically regaining its power to become a world-class manufacturing centre, and the most emerging market in the world with 1.3 billion population.

HISTORY - KOREA

- Over 4,000 years of history
- Peninsula, mono-racial nation
- Follower of China in many historical and cultural perspectives; cultural gateway to Japan.
- Buddhism, Confucianism, Christianity
- Today, Korea is one of the most competitive countries with US leading edge industries.

Partly as a result of the differences in background, culture and religious beliefs the various different parts of “Asia” have created different approaches to embracing the Industrial Revolutions. It is important to appreciate the nuances between these approaches before approaching any form of business activity.

THE FOLLOWING BRIEF TABLE PROVIDES A SIMPLIFIED VIEW OF THE MAJOR DIFFERENCES:

Japan:

Bottom-up, “Kaizen” power of operation fields, backed-up by long-term employment. Operation-centric, Closed + Integral Architecture i.e. automobile, game software industries (Toyota, Honda, Nissan, Nintendo)

China:

Mobilization power of migrant workers Labour-centric, now changing to technology-centric, Open + Modular Architecture i.e. digital electronics industry (TCL, Lenovo, Haier)

Korea:

Concentration power backed-up by “Chaobel” financial combines Capital-centric, Open + Modular Architecture i.e. semiconductor, automobile industries (Samsung, Hyundai)

ASEAN: Association of South East Asian Nations:

(Brunei Darussalam; Cambodia; Indonesia; Laos; Malaysia; Myanmar; Philippines; Singapore; Thailand; Vietnam) Inexpensive manufacturing base for the Western enterprises Centric-centric, Closed + Integral Architecture i.e. home electronics, automobile, computer components industries

USA:

Conceptual power of business systems, rule-based management Knowledge-centric, Open + Modular Architecture i.e. computer and software industries (IBM, HP, Dell, Cisco, Microsoft)

From this view of the similarities and differences we can extrapolate a Japanese perception of the Industry “Power Balance” between the major players in the West and the three main countries plus the ASEAN group in Asia.

THE POWER BALANCE

To appreciate the reasons why this power structure is obtained, the historical background to Japanese business approaches needs to be factored in:

1. Official Development Assistance (ODA):

Started as post WW-2 compensation, as a symbol of leadership to develop the Asian economy.

2. Inexpensive Labour Supply Bases:

Japanese companies positioned ASEAN countries as inexpensive manufacturing bases used in their global supply chain to gain cost-competitive advantage in the worldwide market.

3. Emerging Business Market:

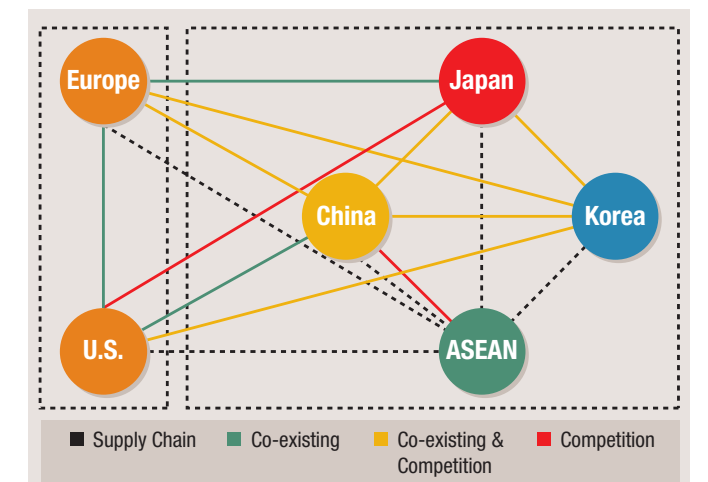
ASEAN as an emerging market to sell Japanese products

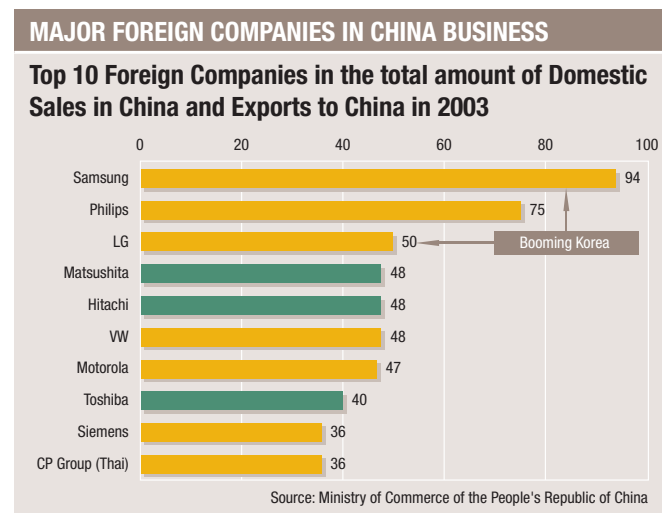
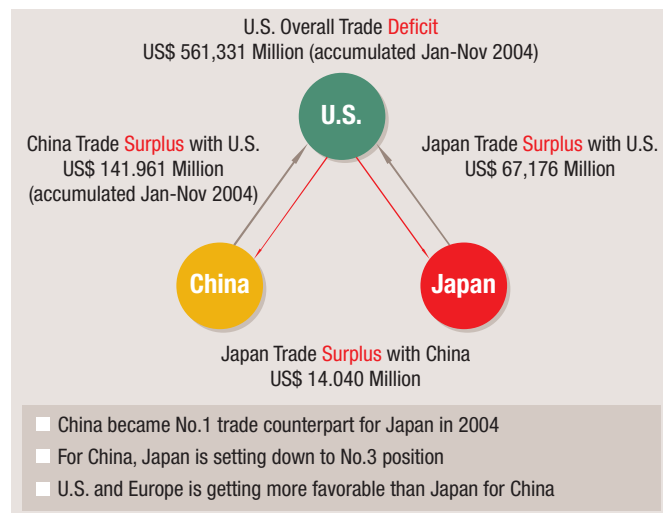
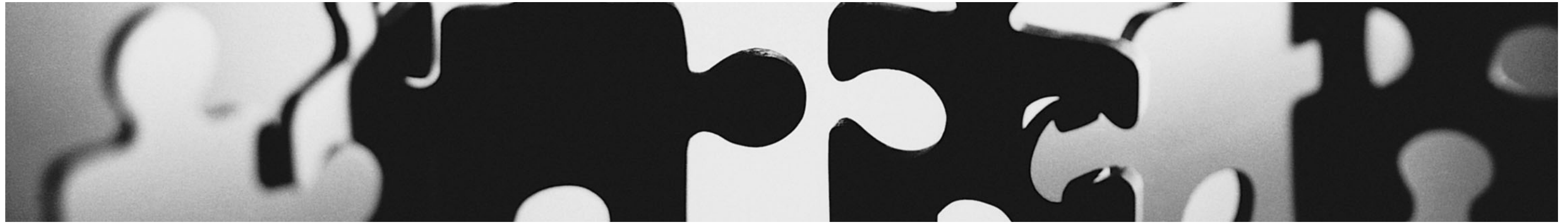
4. Economic Challenges from China and Korea:

The economic power of China and Korea now challenges Japanese businesses with their dramatic progress in technologies.

5. Co-existence and Competition with China and Korea:

Japanese and Korean companies are entering into China to develop both manufacturing bases and the consumer market. Japanese, Chinese and Korean companies are co-existing and competing with each other. Putting some figures against the current position gets us into astronomical sizes of surpluses and deficits - the meeting might wish to comment on their future viability.

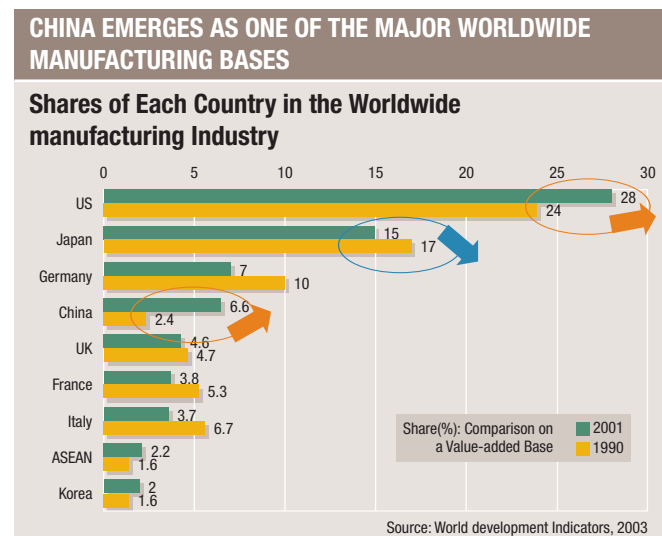




2004 TRADE BALANCE

The above figure is a snapshot, but in our consideration of the future viability of a market we have to look at the trends - and the following comparison between 1990 and 2001 shows the trends that we had already forecast. The question is how would a trend curve look for each country, and for China what are the internal and external factors that might significantly alter that curve. But you will see from the caption that Japan's view is clear - China has the potential to be one of the World's major manufacturing bases, and Japan is declining from that status. European countries are continuing their decline whereas the USA is currently continuing to expand.

Before we consider the entry and other strategies towards China - and the opportunities to sell to other parts of Asia as a potential stepping-stone into China - it is important to understand who are already seen as major suppliers and from which countries they operate. The facts show a surprising spread of countries of origin, with Korea very well placed.



THE JAPANESE OUTLOOK ON THE CHINESE MARKET

(1) The Positive (Bright) Side:

- a) Sustainable economic growth: For the mid-term, 8-9% growth can be expected until the Olympics in 2008 and China Expo. In 2010, however, even after these, 6-7% growth could be sustained.
- b) Wealthy people, potentially 20% of the population, will keep developing consumers' buying power.
- c) Enhancing QCD performance of manufacturers

(2) Current and Future Concerns:

- a) Increasing income disparities between rich and poor
- b) Serious environmental pollution problem
- c) Increasing overall labour cost - will lose cost-competitive advantage.
- d) Immature government system to manage industries
- e) Too fast economic growth, drastic change into capitalistic economy within traditional autocratic political system under the Communist Party.
- f) Still needs modernization in financial infrastructure, relaxations in foreign exchange control and labour regulation and in improvements in social welfare system.
- g) Raise the overall level of labour skills for sustainable growth by, for example, encouraging more innovation.
- h) Education problem: slanted education policy to position Japan as an imaginary enemy to create/sustain solidarity among the masses, and to protect their own political regime, after ending of Cold War between the East and the West.

As an example of how Japan views - and approaches - target markets it might be valuable for this top-level group to see the evaluations made for penetrating the Chinese marketplace.

No one will be surprised by the types of research undertaken nor (probably) of the results obtained and the actions that have been taken as a result. The point that you might find of particular interest is that this is not "Western" research, and the extrapolations are from Japanese senior executives, not US or European.

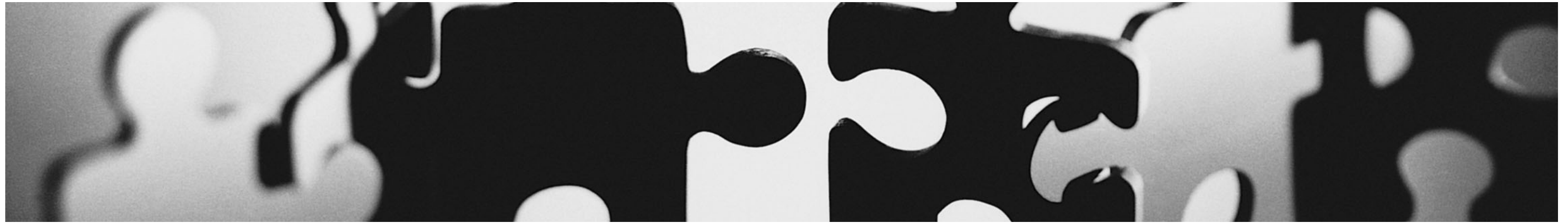
An area for discussion might be that some of the areas that a Japanese company might give a relatively high weighting could have a very low - or even non-existent - weighting for a Western company, especially a financial one. The question in the long term is "which of us is correct, and what is the balance of risk involved?"

Japanese companies tend to have very long term plans (up to 25 years or more) whereas the demands of the (particularly US) stock market can make for shorter-term decision making.

The following is a real example of how the Chinese market has been approached.

DEFINING MACRO CHARACTERISTICS

- (i) Multiracial nation with different languages, complex nature and geographical features, similar to the US or EU.
- (ii) Only few percent of 1.3-billion people rule the whole nation
- (iii) Mindsets underlying leading people in China:
 - a) Strong preference toward the Western
 - b) Strong will to catch-up the Western
 - c) Similar way of thinking to the Western
 - d) Short-term decision making: "never trust tomorrow, do the best today" "never trust even family, only trust oneself".
 - e) Flexible attitude: "take measures best suited to the occasion"
 - f) Sensitive to being racially discriminated against
 - g) Strong ambition to step-up to the top executive
 - h) Proud and ostentatious
 - i) Passion for well-known and big-name brands
 - j) Behaviour with traditional Sinocentrism: "China is only one nation that exists in the world." "China should rule everything, everything exists for China".



CREATING KEY FOUNDATIONS FOR FUTURE SUCCESS

Note: Japanese companies have learned much from their “Success and Failure” experiences in entering the Chinese market.

Foundation Work

- a) Lobbying: build close, in-depth, relationship with the government.
- b) Align your attitude to help the economic development policy of government.
- c) Make a favourable impression by emphasising your Corporate Social Responsibility (CSR) activities.
- d) Contribute to their educational business development to secure the minds of future generation in the market.
- e) Proactive appeal to the mass-media
- f) Locate your entire value chain in China
- g) Do not rule from your home country; establish complete local management.
- h) Implement IT-based management system for efficient operations and better corporate governance.
- i) Consider risk-hedge strategies in making decisions on investments in China; for example, make diversified investments between China and ASEAN.

DIFFERENT APPROACHES FOR EACH GOAL

(1) To achieve Success in Research and Development

- a) Establish R&D bases to enable analysis of over 1.3 billion consumers in China.
- b) Recruit excellent undergraduates for R&D human resources; “recruit scramble” is getting more serious. **Note:** China produces about one million undergraduates with engineering degrees annually.
- c) Position the R&D bases in China in your global strategy. Digital technologies are more suited with Chinese rather than analogue technologies because of their individualistic characteristics rather than teamwork-oriented mindsets.
- d) Understand the geographical differences within mainland China; consumers’ buying power, type of consuming, and the fact that 20% of entire population (260-million) have buying power and that this potential buying power is already beyond the entire Japan consumer market.

(2) To achieve Success in Manufacturing

- a) Recognize that the technology level of Chinese industry has been highly improved so the quality of Chinese products is competitive with Western products. Japan is the primary target for China to catch up with.
- b) Reduction of production lead time and purchasing cost is the foundation of profit to gain price competitiveness in China; tight collaboration with suppliers is the key.
- c) Reflect geographical differences within China to your value chain. For example, coastal areas are gaining more attention as consumer markets while western interiors begin to attract more manufacturers. We will see more labour shortage and rise of wages in the coast areas because of the competition for workers in the interior.
- d) To avoid the threats of “dead-copy” imitators, M&A is one of the effective countermeasures; buy-out the imitator and integrate it into your value chain. (i.e. Honda).
- e) Watch carefully the Chinese Government’s financial policy to sell-out Chinese national companies; you can obtain a manufacturing base and the market at once.

(3) To achieve Success in Sales and Distribution

- a) Develop local channel partners that complement your own lack of sales’ know-how in China; (they know the Chinese way of business).
- b) Through bonus-penalty system, educate your channel partners to enhance their ability to manage global-brand products; (you know the global way of business).
- c) Establish mutual partnerships by providing financial and technical support.
- d) Develop the most suitable business model; the global standard is not necessarily easily accepted by the Chinese market (i.e. Dell).
- e) Flexible distribution structure; flat structure will suit for urban areas, multi-layer structure for suburban areas.
- f) Create a “sellers” market to secure cash collection, that is one of the biggest headaches in China business; competitive, high quality, or quality branded products allow advance payment or short-term A/R.
- g) Develop your marketing strategies considering the characteristics of Chinese “new-rich” layers who are young, highly-educated and brand-conscious.
- h) Leverage on IT in your marketing - China is rapidly shifting into more IT-powered society and this aspect will provide increasing value-add.

(4) To achieve Success as an Employer (Human Resource Management)

- a) Remember that Western management style might not fully match Chinese employees’ characteristics.
- b) Maximize empowerment to your local operating company
- c) Implement Western style of the competency/performance - based HRM system to enable Chinese employees’ ability to achieve their full potential.
- d) Provide sustainable education programme with financial fund to fulfil Chinese employees’ needs for self-development of their career.

- e) Private Corporate College will contribute to educate both your local employees and customers. (i.e. Ericsson, Motorola).
- f) Top 20 Recruit Ranking Preferences:

01 Haier	11 Samsung
02 IBM*	12 TCL
03 P&G*	13 Motorola
04 China Mobile	14 China Unicom
05 Microsoft*	15 Intel*
06 Lenovo	16 Unilever*
07 Huawei	17 Nokia*
08 GE*	18 PricewaterhouseCoopers*
09 Siemens*	19 HP*
10 China Telecom	20 Bank of China*

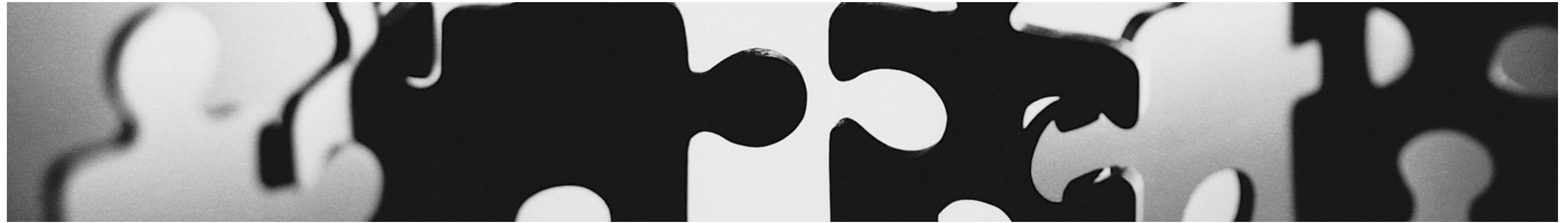
Western Enterprises- source “ChinaHR.com”, 2004

(5) To achieve Success by Avoidance of other Barriers to Entry

- a) Governmental Regulation:

Although China is in the process of transformation from the Guanxi-based society to a more rule-based society, especially after the accession to the WTO, foreign businesses will still often see many outmoded or excessive regulations. However, keep in mind that you can go around such unreasonable regulations by making the best use of in-depth lobbying activities with influential persons in government or industry leaders.
- b) Violation of Intellectual Property Rights (IPR):

While legal protection of IPR is positively progressing inside the Chinese government, you should be prepared for self-protection through both legal arrangements and physical protection such as black-boxing your core technologies.



WHITE PAPER 3 - INDIA: AN ECONOMIC BRIEF

DEMOGRAPHY

- At the end of 2004, over 50% of India's population of 1.05 billion was below 25 years of age. The working age population (15-60 years of age) is 610 million. As per studies, the ratio of working age adults to total population in India is likely to go up from 61% in 2003 to 66% in 2035. The trend in most other countries, particularly the developed countries, is shown to be the reverse.
- India has the third largest scientific and technical manpower. The educated and skill work force is increasing exponentially. Two million graduates, 300,000 post-graduates, 80,000 engineers, 60,000 doctors and 75,000 IT professionals are added every year to the workforce. The Indian labour market offers skills ranging from call centre operators all the way to Maths PhDs and from entry level white collar workers all the way to intellectual inputs.

SIZE OF THE ECONOMY

- India's GDP in 2003 was \$576 billion. It was the 13th largest economy in the world. On a Purchasing Power Parity basis, India's GDP of about \$3 trillion in that year made India the fourth largest economy in the world after the US, China and Japan.
- According to a Goldman Sachs report, India's GDP will reach the figure of \$1trillion by the year 2011; and by the year 2040, India's will be the third largest economy after China and the US in dollar terms.

MACRO-ECONOMIC INDICATORS

- During the period 1980-2003, the Indian economy grew at the average annual rate of 5.7%. Last fiscal year, the growth rate was 8.2% and the current year's is forecast at 7%. The target for the plan period 2002-07 is 7 to 8%.
- Agriculture, Manufacturing and Services sectors contribute 22%, 27% and 51% respectively to GDP. The shares of employment in these three sectors are 54%, 19% and 27% respectively.

- The annual inflation rate, based on wholesale price index, in the recent years has been varying between 4% and 6%. The Reserve Bank of India has fixed a target of 5.5% for fiscal 2004-05.
- The gross average savings rate and the gross average investment rate are 24% and 25% of GDP, respectively. The gross domestic capital formation is 25% of GDP. Both are steadily increasing.
- India's exports during the last five years have grown at the average annual rate of 13%. External trade now accounts for 33.1% of India's GDP representing a growth of over 50% in a decade.
- During the last five years, foreign investments, direct plus portfolio, have registered an annual increase of 14%.
- India is the fifth largest holder of foreign exchange reserves. On Feb. 28, 2005, forex reserves were of the order of \$131 billion. These stood against the total external debt of \$113 billion. The country has had positive current account balance since 2001.

INSTITUTIONAL FRAMEWORK

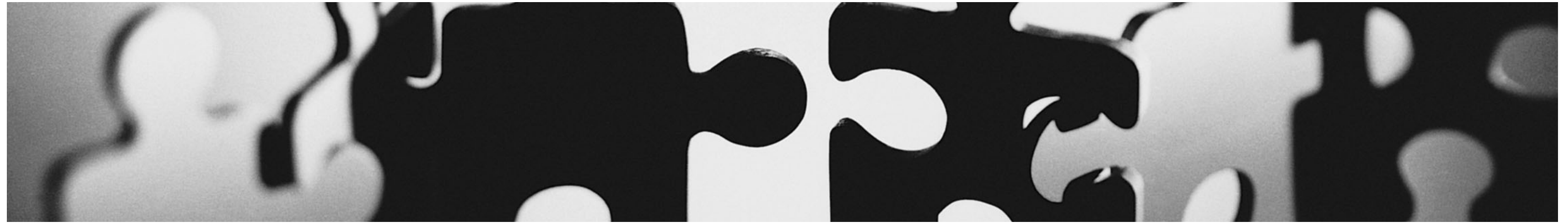
- India has a well developed financial services system including a massive network of banking institutions and a vibrant capital market. There are 295 commercial banks with over 66,000 branches. The non-performing assets are less than 3%. There are 23 stock exchanges with over 9000 listed companies.
- The country has 291 Universities, 1000 engineering and 200 medical colleges, 1000 institutes offering Masters Degree in Computer Applications and 12,000 undergraduate colleges. These include the world renowned Indian Institutes of Technology and Indian Institutes of Management.
- India has also a large network of research and development institutions including those in the Universities. In addition, over 100 multi-national companies have established their own R&D facilities in India. For example, GE has 1600 people in its R&D facilities in India of whom 31% are PhDs and 44% have Masters.

SECTORAL ACHIEVEMENTS

- India is not only self-sufficient in food, but also a major exporter of food grains. Last year, India was the second largest exporter of rice and the seventh largest exporter of wheat. The country produces every year 210 million tonnes of food grains and 100 million tonnes of fruits and vegetables. India is the second largest producer of rice and wheat and the largest producer of milk, sugar and tea in the world.
- India has a highly broad-based home-grown industry. There is practically nothing that the country does not produce today. Not only is the Indian industry broad-based, it is also rapidly becoming globally competitive. Soon India will emerge as a hub for the manufacture of engineering goods as well as a major exporter of such goods. Manufactures already constitute over 70% of India's exports.
- In the field of services, a rapidly developing high-tech and knowledge industry and a vast pool of technical and skilled work force are gradually leading India to become a global hub for services, particularly in the Information Technology and IT-enabled services sector.
- The IT sector is growing at the rate of 29% annually. By the year 2008, the revenue and exports in this sector are expected to touch \$77 billion and \$50 billion, respectively. The sector employs at present about 750,000 persons and is the most rapidly expanding employment sector. It is expected to reach the level of 2 million in the next four years.
- Within the IT sector, the BPO sub-sector has been growing at the staggering rate of 50-60% annually. Employment in this segment is expected to go up from the present level of 200,000 to about a million in 2006. India has emerged as an outsourcing hub for services. Offshore outsourcing to India includes a wide range of services such as designs, architecture, management, legal, accounting, drug development and customer contact/call centres. At present, there are about 250 call centres in India with a work force of 160,000. Two-thirds of these are captive centres run by foreign firms like GE Capital, American Express etc. The IT sector is rapidly moving up the value chain.

ECONOMIC REFORMS

- After following a policy of a planned economy for four decades after independence, India embarked on a comprehensive economic reform process in the early 90s leading to a rapid rise in the economic growth rate. The accelerated growth and the unprecedented high levels of foreign exchange reserves and FDI inflows have given more confidence and encouragement to the policy makers to accelerate the economic reform process in the recent years. There is now a broad consensus across the political spectrum on the need for strengthening and expanding reform and the market oriented policies of the government have become irreversible. India is well poised to exploit the gains from globalisation. Protectionism is being dismantled rapidly by cutting tariffs and quantitative restrictions. The average tariff rate has been brought down from 53% in 1988 to 16% in 2005. The entire country continues to move forward to get tariffs down to single digit levels of the East Asian countries in the coming 2-3 years.
- In view of the strong growth outlook, opportunity for diversification, low correlation with global risk factors, sophisticated security infrastructure, sound legal accounting systems etc. India is rapidly emerging as the preferred destination for foreign investment, both direct and portfolio. India is now being recognised as a major driver of the global economy. The World Bank and the UN have acknowledged that India is one of the two engines driving global economic growth and preventing global economic recession.
- In the UK, the FCO Strategy Paper published in December 2003 has termed for the first time India as a global player that will have important strategic influence. The UK, the EU and the US have signed strategic partnership agreements with India.
- Economic reforms in the country are firmly on course opening exciting opportunities for domestic as well as foreign investors. It is time for foreign investors to partake of these opportunities. As for the economics of foreign investment in India, a recent survey of the Federation of Indian Chambers of Commerce and Industry has revealed that as many as 77% of foreign investors in India are making profits and another 9% breaking even.



WHITE PAPER 4 - CHINA'S ECONOMIC DEVELOPMENT: BASIC FACTS

In 1979, China adopted the policy of “reform and opening to the outside world”. Over the years, tremendous efforts were made to carry out reforms in various fields. Since then, China has undergone a profound transformation never seen in the country before.

OVERALL ECONOMIC PERFORMANCE

In the 26 years from 1978 to 2004, China's GDP increased from 147.3 billion US dollars to 1.65 trillion US dollars with an average annual growth rate of 9.4%. Per capita GDP reached US\$1,000 in 2003. Its share of the world economy rose from 1% to nearly 4%. China's foreign exchange reserve increased from 167 million US dollars to 711 billion US dollars (updated by the end of June). The number of people living under the poverty line has dwindled from some 250 million to 26 million.

The era of commodity shortages has gone once and for all. For most commodities, supply can meet or even surpass demand. The total volume of its major industrial and agricultural products stands in the forefront of the world economies. The ownership structure has been readjusted, with the public sector becoming stronger through reforms and non-public sectors playing an important role in stimulating economic growth. Great changes have taken place in the structure of its economy with industry and tertiary industry playing increasingly important role. The infrastructure construction has made huge strides. China's economic system has been transformed from a highly centralized planned economy to a socialist market economy, with the market playing the basic role in the allocation of resources.

FOREIGN TRADE AND INVESTMENT

From 1978 to 2004, foreign trade increased from US\$20.6 billion to US\$1.15 trillion. China is now the 6th largest economy, the 3rd largest trading nation and the biggest recipient of foreign direct investment among developing countries in the world. By the end of 2004, China had attracted a total of 562.1 billion US dollars in FDI, approved the establishment in China of more than 500,000 foreign-funded enterprises and created a huge import market of some 560 billion US dollars annually. Over 400 firms out of the FORTUNE 500 have invested in China. Foreign investors in China have set up over 700 R&D centres. Over the past three years since China's entry into the WTO, its import and export scale has doubled, the import and export of high- and new-tech products have quadrupled. The proportion of export to GDP exceeded 30%. China's economy has become one of the most open economies in the world.

From 1990 to 2004, foreign investors had remitted US\$250 billion of their profits out of China. According to the 2004 survey of the American Chamber of Commerce in China, three-fourth of the surveyed US invested companies in China were making profits, and 42% of American-invested enterprises saw the profit ratio in China above their global average. Profit that Volkswagen generated from its joint venture in China equalled one quarter of the company's global profit.

RISING LIVING STANDARDS

In East China, where the population is nearly 500 million, the per capita GDP reached US\$2,000. Households with high and medium income (with annual income of over US\$6,100) cover a population of 140 million. Population with moderate income will increase annually by 20-30 million. Chinese household savings have exceeded US\$1.5 trillion. China has the world's largest mobile phone subscribers group, the third largest automobile market. The number of privately owned cars soared from close to nil in 1978 to 13.6 million by the end of 2004.

With 28.85 million outbound visits and more than 100 million inbound visits in 2004, China has become the fourth largest tourist market in the world.

INFRASTRUCTURE CONSTRUCTION

The total length of highways in China has reached 34 thousand kilometres, second only to the US. 72,000-kilometer railways have been put in operation, ranking third in the world. Handling capacity of Chinese ports stands at 4.1 billion tons, ranking first in the world. China has the world's largest fixed line telephone network and mobile phone network, and the second largest public internet with the number of users rising over 150 times within eight short years to over 100 million.

CONTRIBUTION TO WORLD ECONOMIC GROWTH

In 2004, China took up 10% of the growth of the world economy with its GDP accounting for about 4% of the world's total. It contributed 12% to the increase of the global trade with its external trade value taking up a 6% share in the world's total. By successfully feeding, clothing and sheltering one fifth of the world's population, China has made an important contribution to the stability and development in the world.

CHINA'S GOAL BY 2020

Seize the important window of strategic opportunities to build a well-off society in an all-round way for the benefits of our over 1.3 billion people. By 2020, China will quadruple its GDP of 2000 to approximately 4 trillion US dollars with a per capita level of some 3,000 US dollars, and further develop the economy, improve democracy, advance science and education, enrich culture, foster greater social harmony and upgrade the texture of life for the people.



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