China: Harnessing Long Term Investment in the Chinese Market

A Business Proposal for Long Term Investment In China

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Executive Summary

Overview:
The attractiveness of investing in China has led to a dramatic inflow of foreign investment over the past decade. With double digit GDP growth and a market size of over 1.3 billion people, global firms have looked to reap this fast growth, profit off low costs, and supply an increasingly attractive target market for new sales.

Investment Proposal:
With a $1 billion investment, my recommendation is for a $500 million dollar direct investment in Unilever Lipton tea brand in Hefei. This investment will supply capital for expansion projects, giving investors a share in the company to reap the expected immediate impact of expansion and the expected long term growth rate of the company. The other $500 million is recommended to be placed in Yum! Brands restaurant chains. Specifically, 50% of this investment will be directly funded into Yum! China, with the remaining 50% used to open new franchises in China over the next 10 years. This investment will allow for immediate returns and long term growth, as Yum! Brands develops into the dominant restaurant industry player.

Investment Risks:
While strong returns are expected, economic, policy, and political risks threaten Chinese investments. Specifically for this investment, currency fluctuations, competition, and labor costs provide some economic risk to each industry. Policies relating to trademark protection and health standards could also affect both investment avenues as both deal with foodstuffs and rely heavily on brand image. Main political risks include labor disputes and local governance differences. However, the largest risk factor in China seems to be the unclear future of Chinese financing due to possible poor lending and future defaulting bonds by banks. This major risk has led to the above investment decisions. Yet, all of these risks may be mitigated in some way through this investment, ensuring long term stability and growth of this fund.

Implementation:
In order to best reap the returns of this investment, the following steps should be taken in implementation.

1) Collection of funds totaling $1 billion within the next year
2) 50% of funds should immediately be invested in Unilever Lipton in Hefei
3) 25% of funds should be invested into Yum! Brands
4) Hire current/former Yum! Brand employees for advising committee in China
5) 25% of funds invested in opening new Pizza Hut and KFC franchises in China over a 10 year period

Summary:
This investment will lock in marginal short term returns immediately, but will provide a far less risky portfolio of solid long term returns due to the stability of Unilever and Yum! Brands in China, guaranteeing a return on your investments.

China: Harnessing Long Term Investment in the Chinese Market

For the past decade, double digit economic growth and the world's largest population have attracted uncountable investors to China. While such outstanding growth has allowed for exaggerated returns over the past decade, it is unrealistic to assume this astonishing growth rate will continue infinitely. So while large short term gains are still evident, long term investing will better provide steady returns and lower risk. When investing in China, it is imperative to understand the complexity and dynamic nature of the Chinese market. Even with a strong understanding, the Chinese market still provides potential risks along with its opportunities. To best understand these investment opportunities, the Chinese economy as a whole must first be analyzed to expose possible overall threats and opportunities. After this overview analysis, the restaurant, tea, steel, and banking industries will be analyzed in detail to clarify the economic, policy, and political risks involved in each sector. Finally, I will explain my recommendations for strong investments in the restaurant and tea industry in the long, while still recognizing immediate gains, as well as clarify why investing in Chinese steel and banks currently provides more risk than reward. This investment proposal, through careful analysis, will harness and control this current growth and provide short term returns and a steady long term 1 billion dollar investment portfolio, while clarifying threats to minimize long term risk.

China: Booming Growth, Future Risks

When looking at China as a whole, investment opportunities seem endless. The country continues to impress with unmatched GDP growth and an astounding emergence into power on a global scale. It seems that China has grown so quickly that it seems to have instantly developed from a third world country to a world leader, almost bypassing the middle ground. This astounding GDP growth, international expansion, population size, and advantageous business costs have provided and continue to produce strong short and long term investment opportunities. However, an inevitable stagnation in growth, financial stability issues, difficult employee relations, and competition poses a large investment threat as well in China.

The Chinese economy's growth as a whole has dwarfed that of every other world power over the past decade, with an average growth rate of over 10%, creating business revenues and producing an emerging middle class.[1] A majority of this growth has come due to coastal cities and heavy investments by the government, domestic venture capitalists, and a dramatic increase in foreign direct investment. The government has also done a strong job stabilizing inflation in the past decade as well, in large part due to the stabilization and monitoring of currency and RMB levels. Foreign investment has continued to surge in the country as more firms continue to look for opportunities to invest, manufacture, or supply the Chinese and foreign markets. This entry of foreign investment has only grown in the past five years as WTO entry has caused more loose restrictions on foreign investment in China and international trade has boomed with growth over 29% annually.[2] While this growth slowed dramatically in 2009 by nearly 26%, international trade still provides great opportunities. [3] While this international trade has heavily favored exports, the growing middle class and largest world population also has provided great opportunities for sales and growth.

The enormous Chinese population has offered an economic opportunity not only as the world's largest target market, but also has supplied a skilled workforce to manufacturing companies in China. Currently, it is estimated 20% of urban households in China hold discretionary purchasing power. While this figure currently is vastly overmatched by USA purchasing power, the number is expected to jump to 37% in the next four years.[4] While it may be argued that this small purchasing power discounts a growing middle class in China, this growth potential and the sheer number of Chinese citizens provides robust long term advances in purchasing power, and therefore strong long term investments. Furthermore, this population provides strong direct manufacturing opportunities in China. Manufacturing has been shown as the most heavily invested industry in China, and with wages at prestigious firms such as Broad Air Conditioning starting at only $120 per month, labor costs make China very attractive .[5] However, while investment is very attractive in China, there are still major threats that come with this fast growing economy.

The most dangerous threat to both short and long term investments in China is the financial stability of the economy and the key role the government currently plays. Currently, the Chinese government holds a heavy currency control policy, disallowing the Chinese Yuan to fluctuate past certain exchange rate pricings. While this strategy has allowed China to control inflation and maintain steady growth in recent years, China's emergence as a global power has brought it under intense scrutiny, mainly from the United States. Furthermore, the International Monetary Fund has recently agreed with this undervaluation opinion, claiming China must reconsider its stronghold on the currency for world benefit.[6] While China has let the Yuan devalue over the past decade and has adopted somewhat looser constraints on the currency for the time being, large fluctuations in this currency could threaten any investment. Producing firms in China could lose the key advantage of cheaper labor costs and consumer purchasing power; while on the other alternative imports from China could increase in price, making them less attractive. Taxes also pose a financial threat, especially to foreign firms. Moreover, the Chinese banking system provides large threats as well. Holding trillions of debt in US currency, these banks also remain susceptible to currency change threats. However, the largest threat is the outstanding loans and lending system banks institute in China.

Over the past five years, Chinese banks have averaged around a 20% growth in outstanding loans per year, with little sign of slowing.[7] This new loan growth provides a strong risk of investment due to the still developing economy in China and the risk that these loans will default. Poor rating standards and ill-advised loans could cripple future supplies of capital. Many of these loans also go to support underperforming state owned enterprises as well. Furthermore, because the government has such a heavy investment in the banking system, huge defaulting loan debts could be crippling for the entire nation. As it has been seen in the United States, Italy, Greece, and now Ireland, poor banking systems and defaulting loans can cause great turmoil.

A final economic risk to be cautious of is competition and employee relations. Because China has been such an attractive investment site, there has been a huge inflow of capital and a large increase in firms. Competition can be dangerous if the Chinese business landscape is not known, as there are numerous risks involved in legal documents, land ownership, and manufacturing. Without adequate knowledge of the market, investments could be susceptible to losses due to comparative inefficiencies with the competition. The government of China also poses an economic competition risk through its subsidizing and beneficial policies for domestic firms, which could pose a dangerous foreign threat. Furthermore, investments can be hindered by poor employee relationships, choices, and communications. Hiring the incorrect people can result in critical errors and losses. Tim Clissold, an experienced investor in China, would contend that hiring managers and employee issues could be one of the most pivotal decisions made in Chinese investment.[8] So it becomes apparent that while the strong growth and continued potential of China remain bright, the country still faces possible financial instability and operational threats.

Economic Industry Analysis: Locating the Proper Industry for Investement

After looking at economic risks and opportunities in a broad sense, further investigation into four key industries will provide a strong short and long term investment strategy. While the restaurant offers strong immediate gains, coupled with the tea industry, it also offers steady long term growth and returns. On the other hand, the steel industry and Chinese financial institutions provide too great of risks for investment.

The Restaurant Industry: Untapped Growth Opportunties

The restaurant industry in China has seen growth around 13% the past 5 years and with no strong market leader, this industry, specifically the fast food industry, offers a premium short term investment gain with long term growth.[9] Due to the steady growth in GDP and growing purchasing power, the Chinese consumer should look to spend income on more meals out. Currently, 50% of Chinese prefer eating in restaurants, creating a population market opportunity of nearly half of a billion consumers.[10] Furthermore, the restaurant industry can seize the opportunity cost of cheap labor and resources. In China, the wage rate will not only be relatively lower, but Chinese farmers have recently seen a boom in production and supply of ingredients/materials could be very advantageous.[11] Also, in 2006 there were only 7,000 chain restaurants in China, less than 5% the number in the United States.[12] This number shows that while there is competition, no firm has supreme market share and this threat is minimized.   With movements in cities towards convenience, seen in the addition of drive-thrus recently to McDonald's, fast food chains could provide immediate returns.   A strong name to invest in China is Yum! Brands, which owns chains KFC and Pizza Hut, already in China. By investing in an already successful and established brand, this will minimize the risk of employee issues and poor hiring decisions. Brands like Yum! Brands have begun to master investment in China. Investment details in Yum! Brands will be discussed in detail later in the proposal. Finally, the risk of financial currency fluctuations and downfall remains strong in the restaurant industry, similar to any investment in China.

The Tea Industry: Low Risk, Long Term Reward

Despite being one of the oldest industries, tea industry sales growth has continued around 7% for the past 5 years, once again taking advantage of the GDP growth of China.[13] Furthermore, due to the relatively cheap price of local teas and the history of tea in China, almost the entire population enjoys tea. For these reasons, Unilever has been able to take over an industry historically run strictly by Chinese firms. Furthermore, Unilever has done well to take advantage of growing internet and social networking sites, reaching a growing number of Chinese through sites like QQ.com. [14] Unilever has also benefited from the opportunity of local tea suppliers and relationships, keeping costs extremely low to compete with so many smaller local firms. Similar to all industries, financial banking and monetary risk is dangerous to the tea industry and hedging is necessary. Again, by investing in an American firm with established success in China, risk of employee issues and poor management can be deterred to minimal risks. The tea industry however has numerous competitors and continues to see more, as many Chinese are being flooded with options of soft drinks and the establishment of firms like Starbucks.[15] However, an investment in a firm like Unilever minimizes this risk to only a small to moderate risk, as it currently is the only firm with a substantial market share. Successful tea copmanies also deters this risk through heavy investment in R&D to develop drinks for ever changing trends, with Unilever proving this thought through 70% of all Lipton brand sales coming through China.[16] This steady growth and powerful market share makes Unilever a strong, steady investment for the long term. However, the $1 billion investment should not be dispersed amongst every strong industry in China.

The Steel Industry: Dangers of Inefficiency

The steel industry seems to present a great economic opportunity, but due to its poor efficiency and heavy reliance on government funds for operations, it should be avoided due to economic threats. The Chinese steel industry has been booming for over a decade, specializing in lower quality steel and producing 37.7% of the world's steel needs.[17] The steel industry also has taken advantage of the giant Chinese workforce. However, companies like Angang Steel continue to have issues needing to supply not only a large number of current employees, but also benefits to retirees.[18] Angang has also taken advantage of lower supply costs by producing steel at a cheap price, but consequently producing lower quality steel. Also, due to heavy government investment, many steel firms supported by the government receive heavy tax benefits. But, the financial risks described above cause even higher threats to domestic firms like Angang, which is a state owned enterprise. Due to this business structure, Angang is heavily funded by Chinese bank loans and is a main defaulting culprit, hurting not only itself, but the banks and government as well.[19] Employee hiring and business structure also have created major issues for Angang and other state owned enterprises in the steel industry, with many being inefficient and hemorrhaging profits. These issues are evident as the top ten steel companies in China, many of which are SOEs, have lost market share from 49% to 33% in the past ten years.[20] This drop also shows the competition threat is rising in the steel industry as more smaller firms are entering to compete with inefficient government supported firms. This competition threat also remains stronger than the restaurant or tea industry due to a lack of a healthy firm with major market share and comparatively higher start-up and operation costs. Entering this industry would be very risky due to this competition and government support for inefficient competitors, despite possible opportunities.

The Chinese Bank: A Dangerous Future?

Another industry that should be avoided for investment is the Chinese banking system, specifically investments in Chinese bonds and bank securities, due to poor lending and government intervention. The enormous growth in GDP and booming economy may make it seem that the banks in China would be a strong investment through bonds and securities. While the government currently has a large hand in banks, if investment opportunities opened, they should be avoided. International investment increases also should provide a positive outlook for the banking system. However, the main economic threats for investing in Chinese bonds and securities through the banks, as mentioned above, is poor lending and reliance on the government. As stated, bonds issued have increased over the past 5 years around 20% a year, a strong growth rate. In 1999, the Chinese government estimated 25% of loans were underperforming.[21] While the number of outstanding loans not performing has dropped near 2%, the continued large issuance of bonds still leaves the banks in enormous threat of collapse.[22] With heavy government intervention as well, the banking system could need continual bailouts to stay afloat should these bonds in failing companies pile up. The repercussions of this needed bailout, again, can be seen in recent crisis in the US, Greece, and Ireland. Competition and management remain very small risks for the banks, with the government having heavy control. However, the enormous financial risk of failing bonds deters me from recommending an investment in Chinese bank bonds, or even domestic firms with large amounts of corporate bond debt, as a banking failure could cripple an investment.

Industry Summary

Economically, the only dangerous threats to restaurant and tea industries chosen for investment are the financial risks associated with China as a whole due to possible poor lending decisions and currency undervaluation. With already strong relationships and knowledge of the economy, Unilever and Yum! Brands help to reduce this risk to minimal. With growing GDP, strong market shares, and enormous potential markets, these two investments provide a solid return with little economic risk. Due to heavy government intervention and inefficient systems, the steel industry and banking sector should be avoided due to economic risks, despite possible immediate gains.

China: Policy Risk Dangers

While economic issues may provide the most clear financial implications, policy risks can also harm short and long term gains. In the same way that the United States government provides policy risks to foreign investors, so too does China. While certain policy risks, such as national security risks, provide little threat to the restaurant and tea industries, other policies such as intellectual property rights and health regulations could provide major risks. When investing in China, policy risks must be taken into account to ensure the company is in a position to continue profits into the future. Furthermore, it is essential to analyze if policy risks can be mitigated or relieved through efforts such as lobbying or direct government interaction should the investment be threatened. After further analysis, policy risks in the restaurant and tea industry are not sufficient enough to deter investment due to already strong established relationships and brands through Unilever and Yum! Brands.

Restaurants and Tea: Minimizing Policy Risks

The most dangerous risk applying to the industries chosen to invest in, restaurants and tea, threaten the trademarks of Unilever and Yum! Brands and the costs to meet health standards. It can be argued that the Chinese culture has thrived on piracy for decades and morally, sees little wrong with such piracy. Government enforcement of piracy laws has been less than adequate. According to the 2010 AmCham Report, while 89% of companies believe piracy protection is important to some degree, only 26% feel that the government does an adequate job in protection.[23] With numerous companies already in both industries, piracy replicating Lipton brands or similar restaurant logos could be detrimental to this investment. For example, Shanghai McCormick has seen numerous competitors replicate its spices packaging colors of green and white to entice consumers.[24] Moreover, the government, while currently slacking on regulation, has made efforts in the tea industry with trademark protection for the "Longjing" tea trademark in certain provinces.[25] Internet policy risks, mainly regulation and the Chinese Firewall, could also provide difficult marketing and brand maintenance through online avenues. However, both firms seem to have already addressed this issue and are unlikely to be firewalled. With already established brands for both investments, this risk has been downgraded to low to moderate, making this investment much safer than a start up brand company.

The second most influential policy risk towards this investment is health regulations, with both investment entities providing food products to consumers. While this risk currently does not provide a high risk, future considerations must be taken as this policy morphs. Membership in the WTO could provide a jumpstart to changes, as international influences will begin to expedite possible changes. For example, the European Union raised complaints about from 7 issues to 349 issues in the past ten years on Chinese tea import quality.[26] While Chinese exports of tea are not major cash cows currently, these issues show international influence could cause health code regulation updates in the future. For this reason, this risk currently is relatively low, but could upgrade in the next 5 years. However, being international firms, Yum! Brands and Unilever should have the resources to handle any changes in policy, making it less likely to have a damaging effect. While exporting regulations are already moving in this direction, importing policies could provide risks to these two industries as well. Due to a reliance on agricultural imports for supplies, these two industries remain open to import tariffs, with foodstuffs often facing higher tariffs and taxes.[27] Strong ties to suppliers in China mitigate this policy risk, but it remains a key factor.

This import of products and exporting as well, leads directly into the currency exchange risk these two companies will face. The Chinese government, as mentioned in the economic risk section, heavily controls and monitors its currency, much to the dismay of the global economy. President Obama and other leaders and economic groups have constantly urged China to increase the value of the Yuan, claiming it is severely undervalued. According to the Big Mac Index, a measure for currency valuation, the Yuan is indeed undervalued .[28] In recent years, the Chinese government has increased the value of the Yuan at times, and has moved away from a US peg to a basket peg, possibly better valuing it in the world economy.[29] While the world economy looks to discover the best way to value currencies, China continues to come under pressure to change its own value, especially as it continues to influence the world on a greater scale. With Chinese banks holding well over $2 trillion USD in foreign reserves, the US government has only increased pressures recently for a change in policy.[30] This change provides a strong risk towards both industries, as changes in currency value will change costs of labor, imports, exports, and payment procedures. This risk, while unavoidable, must be taken into account and provides perhaps the greatest immediate threat to investment.

Financial Policies: Too Dangerous for Steel

These financial risks and the bond and loan markets of Chinese banks provide the major policy risks for choosing to not invest in the steel industry and Chinese banks. As stated, the Chinese banking sector and steel industry have heavy governmental interaction. The banking system, for this reason, continues to heavily provide capital in bonds, with bond issuance growing at a steady rate due to government pushes. A top political scientists in the banking industry believes that this issuance of bonds at such a rate is due to a trickle-down effect from Beijing .[31] Perhaps more of a risk, of these outstanding loans, 55% of them are from state-owned banks.[32] While bad loans by percent have increased, as mentioned above, with growing loan issuance and such a heavy concentration in state owned banks, this risk could greatly threaten those firms holding these bonds. It is also possible that all bad loans haven't been recognized yet and more could develop. It has been argued that many loans are in long term companies, such as railroads, who will not make positive returns for years, increasing probably of default.[33] This policy risk deters any recommendation for investing in the steel industry or banks, as both heavily rely on these state pushed bonds and loans. This financial risk provides a moderate risk to Unilever and Yum! Brands as well, but is reduced due to oversea parent companies that handle investing strategies and financing affairs.

Fighting Back: Dealing with Policy Risks

Finally, because these risks can affect this investment, avenues for mitigating policy risk and overturning unfavorable litigation must be analyzed. Lobbying in China has continued to develop, with direct lobbying being the primary avenue. Encouragingly, the influence of foreign firms in lobbying has risen in recent years. According to an RCCPB survey, over 95% of foreign companies interact directly with state and local officials. Furthermore, 72% of those surveyed agreed that foreign firms have influence in lobbying.[34] These numbers are encouraging for lobbying efforts should the government begin to heavily influence these markets or to make an unfavorable policy. Currently, the government holds little unfair litigation in these two industries. However, an Economist Corporate Report reveals that it is in a global firm's best interest to entice local officials and uphold strong relationships in order to better ensure a mitigation of risk.[35]

Policy Risk Summary

In terms of policy risks, there are currently numerous policies that will provide some level of investment risk. However, a majority of intellectual property right, strong brand image, high health standards, and foreign parent companies mitigate most risk. While these risks can be mitigated to an extent, the possible unstable future of currency fluctuation and bank loan defaulting could become major threats to all firms in the future. Finally, with seeming advances in foreign firm lobbying in China, these risks become slightly less risky or likely.

Political Risk: Labor, Law, and Losses

These policy risks all must go through the governmental process, which brings about the final threat of political risk to this investment. Political risk seems to be the most dangerous risk, as well as possibly the most likely to cause a threat. However, despite high corruption, non-uniform local governance, and the risk of mass movements, political stability and development continues to grow, giving confidence in the success of this investment opportunity.

Guanxi: The Danger of Corruption

Although masked under the name “guanxi”, corruption remains a major political risk in Chinese business. Currently, there are anti-bribery laws in place in China. These laws makes it clear that it is illegal to bribe state officials with money or property. However, the terms of what gifts are illegal is quite ambiguous, with bribes of sex and school admissions not falling under these categories.[36] Further complicating the matter, local officials often create inopportune business environments by taking large bribes, such as those seen in the film *China: Unleashing the Dragon*.[37] These incidences of bribery make investing in China much more dangerous. It is important to clarify if corruption in China is indeed comparatively excessive. According to the Corruption Perception Index, China actually has jumped a full point, but still remains highly corrupt.[38] This risk holds a moderate rating, but will very likely become an issue at some point in the investment term. This risk becomes difficult to handle at times due to the unclear role of local governance, and knowledge of the business system must be had to reduce losses due to corruption.

Local Governance: Not Always the Beijing Way

Due to the distance from the capital and large local power for local governments, both the state and local governments provide a potential risk. The state government provides the obvious risks stated above, with a key roles in policy and economic development. However, many local officials run their positions differently, many adopting the theory of “the sky is high, and the emperor is far away”.[39] This motto can create discrepancies in local officials enforcement of laws, implementation of new policies, and different overall governance goals. A good way to explain this risk is through the comparison of the governments in Suzhou and Hainan. In Suzhou, the government officials work closely with foreign investors, hoping to harbor in growth and future jobs. In contrast, in Hainan economy sees businesses come and go on a daily basis, due to government influence on low taxes. However, the incentive for these low taxes seems to be counteracted with the large bribes these Hainan officials are known to take. Obviously, this risk could affect both the tea and restaurant industries. Deciding to locate or do business in multiple areas provides different political situations in each. Each location of a factory or restaurant could provide different handling of officials and even different taxes or law enforcement. This risk also remains very likely and potentially a high risk should a poor location decision be made. This difference in policy enforcement and law also provides the risk of an ever-changing legal system.

A Democratic Rule of Law?

The legal system in China continues to develop, grow, and become more efficient. Currently, this development presents a moderate risk to this investment. However, improvements are encouraging and some argue that eventual democracy may even be reached. In the past and still today, Chinese citizens have settled most disputes through mutual negotiation and cooperation. However, recent numbers show an increase in legislation and court usage, as well as higher satisfaction when using these avenues.[40] This increase in usage and satisfaction shows an increasing ability to clearly state the law and reach fair verdicts. However, contrary to this optimism, there seems to still be numerous flaws in the system. Specifically applying to this investment, a look at the China International Economic and Arbitration Committee, whichdelivers verdicts for foreign companies, should be had. A former active worker and member on this committee comments that while this committee performed well previously, it now needs to improve both efficiency and transparency, key issues for successful legal systems.[41] While these views differ, it seems that China is moving in a more democratic direction, possibly decreasing this risk in the future.

A move towards democracy would benefit these two investment vehicles due to their parent subsidies in the United States and familiarity with the democratic process. With increased voting not only in rural but urban areas, an increase in education, and a movement towards more usage of courts and legislation seem to suggest a possible move towards democracy. These points are argued by Stanford professor Henry Rowen to imply this movement will most likely occur, and will result in a much transformed and freer political landscape.[42] This movement is not a risk, but more of a possible political opportunity. While unlikely in the near future, with already established ties and networks, a move towards democracy could open up freer trade and more fair treatment of minority foreign firms.

Labor Risks: Power to the People

A movement towards democracy would create an opportunity, but also would help to better handle the final political risk of labor rights and mass movements. While lower costs of labor was earlier discussed as an economic opportunity, poor handling of workers or unlawful wages can result in protests, lock outs, and even mass movements. Over the past decade, employment in China has steadily increased, approaching 780 million people. With this increase in employment, wage have also steadily risen to approximately $4500 USD a year.[43] Being foreign firms invested in China, this risk is moderate to high due to global activism, expectations of these firms, and increased transparency. Firms run a greater risk when 100% wholly owned investment is not utilized, as many labor infringements may slip under the radar. For example, it has been argued that companies are not increasing their wages for Chinese workers, but simply improving in their efforts to cover up low wages. Some suppliers for firms like Black & Decker and Williams Sonoma were found to even hold specially written falsified books for audit and inspection purposes.[44] While the most obvious major risk here would be risks of legal action and public image issues, labor uprisings are also not completely uncommon in China. Despite the government enforcing strict policies and quick action to quell any potential uprising, mass movements still exist, such as those apparent in Tibet and amongst the Uyghur people. In the case of business, these labor protests often can lead to a sort of domino effect, with such a mass of people bonding together.[45] However, this risk loses some likelihood due to the seemingly high Chinese acceptance of current rules and regulation practices. Labor unions are also solidifying in China, though still far from efficient. This labor risks likelihood should be relatively low, as Unilever and Yum! Brands have faced minimal issues in the past. However, the risk remains relatively high as it could impede operations, hurt public image, and cause major implications for future workings in China.

Political Risk Summary

In conclusion, political risks remain both relatively likely and can provide minimal to heavy repercussions. By far the most probable threats are corruption and the ever-changing legal system. Doing business in China is different, with “guanxi” being utilized frequently and often times with no moral questioning. The legal system also remains fuzzy on these rulings, as well as many others. Tim Clissold would most likely attest to this risk, realizing the legal inefficiencies and ambiguity of the current legal system. However, it appears that all areas of political risks are improving, yet slowly. Labor unions are becoming more cohesive, the legal system being utilized more often, and corruption (while still high) has improved on the rating index. In the end, an overall move towards democracy would most likely be the best political opportunity for both of these foreign firms. However, this transition will take much time, if it happens at all.

Investment Proposal: Harnessing Long Term Returns

Analyzing the economic growth of China appears to create a fantastic investment opportunity. However, after considering policy and political risks, investment in China becomes much more difficult. While the country has made giant steps towards improving standards and efficiencies, the country it still emerging. Furthermore, the country is venturing into unchartered territory. China has become one of the largest international economies at an outstanding rate, all through a much more different government system then the world is used to seeing in an economic power. This rapid growth provides great short term investment opportunities. However, due to the unstable outlook and still high probability of policy, economic, and political risks, investing in long term firms right now will lock in short term above average returns, while creating a steady, long term investment. This billion dollar investment should be invested half in Unilever Lipton brand through direct investment, and half invested directly into Yum! Brands in China and into the opening of new Yum! Brand franchises. After a brief overview, Unilever’s plan will be outlined in detail, followed by the investment plan for Yum! Brands.

The attractiveness of the tea industry provides a strong long term investment opportunity. With such a strong history and cultural ties to tea, the country has shown little slowdown in consumption, despite numerous alternatives such as Starbucks mentioned above. Similarly, Yum! Brands has been well established in China for a much shorter period of time, only since the 1987. However, it has seen tremendous growth, making China its number one market while opening over 3,000 restaurants in 120 cities.[46] The company has shown no signs of slowing and can provide immediate excess returns while also being a reliable long term investment. The greatest strength of both of these firms has been their ability to establish strong brands and to adapt to Chinese cultural differences. Yum! Brands has offered restaurant alternatives and tastes, while introducing Western eating habits, which continue to grow as China's purchasing power increases. Furthermore, American restaurant chains in China have seen even higher returns than in the United States, showing initial returns should be great. Finally, with an already giant market share compared to local Chinese companies, Unilever provides very little long term risk. Yum! Brands has already begun to grow in market share and looks to be in a prime position to continue this growth. According to an Economist survey, over 57% of managers in China believe market share is the best way to measure their success, showing the stability of these firms (economy).[47] This fact plays greatly into supporting this Unilever investment.

Unilever: An American Firm Controlling a Chinese Pastime

The stability of Unilever and its projected growth make it a strong long term investment through direct investment of $500 million dollars. While its long term stability has been emphasized throughout this paper, Unilever Lipton brands are planning for new expansion. In 2002, Unilever moved all offices to a Hefei industrial park and in 2009, extended a contract to expand their operations, increasing capacity and storage.[48] This recent heavy investment by Unilever shows their desire to expand their market share and sales volume, as well as their need currently for capital. This expansion also could allow it to acquire numerous small domestic firms in the future, as this market is over saturated with small, local firms. By investing now in this expansion and gaining a percentage ownership in the Unilever Lipton operations in China, this investment will be able to reap the benefits of this planned expansion. Furthermore, an investment in Hefei seems bright, with low costs and wages, central distribution to China, and its ranking by the 2010 China White Paper's as one of China's top 20 emerging cities.[49] This investment obviously shows great potential for returns. However, Unilever's stability and experience make it the most attractive long term investment due to its ability to mitigate and minimize risks.

While taking advantage of economic opportunities, Unilever combats investment risks in China due to its experienced financial staff, its strong government ties and relationships, and its clean track record of operations in China. Economically, this investment seems to be project strong returns. Competition remains a non-issue with

Unilever as the only firm in the industry with double-digit market ownership.[50] Unilever also continues to dwarf the competition in R&D and the development of new brands to meet ever-changing Chinese consumer tastes. Moreover, Unilever has taken advantage of cheap labor costs and supply chains to lead the industry in cost cutting, while still maintaining quality products. Keeping these costs low is only further improved with the Hefei location, with wages in the area only around 2,000 RMB a month, much cheaper than former locations in Shanghai.[51] Strong established suppliers in China continues this trend of cost savings. Exchange rate risk cannot be avoided. However, with a giant multinational like Unilever with great experience abroad, the financial system of Unilever should be able to hedge this risk through currency futures/forwards contracts and other derivative securities. Policy risk exposure again returns to brand name. With a trademark brand, piracy risk and trademark infringement can be reduced to minimal risks. Consumers know the Lipton brand and obviously have developed a loyalty to it. As stated, health regulations could provide major issues in the future. However, this risk has been discounted due to the high health standards Unilever holds its products to across the globe. Obviously with such a long tenure in China, the suppliers being used have been able to supply adequate quality product. This investment in Unilever will also minimize Unilever's risk for the possible defaulting of Chinese banks bonds. With foreign capital supplying their financing, they will not have to rely on Chinese domestic funding. It is a risk suppliers will default and go out of business, but this can't be avoided, only minimized through proper research and smart decisions. Finally, should policy risk begin to cause new issues for Unilever, a long term presence in the country and growing effectiveness of lobbying and legal systems downgrades a majority of these risks.

Politically, strong ties minimize risks, but Unilever must continue to recognize Chinese business norms to proceed with these strong ties and growth. The improving legal system only provides benefits to Unilever's stability. The firm has been in place long enough to have a relatively strong understanding of the system to avoid possible confrontations. The major political risk, specifically for Unilever, is to keep employee satisfaction high. With a move to Hefei, wages have been saved to keep costs low. However, if the city emerges as one of the top 20 growing cities in China, wages could rise. Unilever must meet these requirements and keep any possible risk of rebellion low. It is recommended to provide these workers with adequate living conditions and no issues will arise. For example, the Broad Air Conditioning company imposes strict employee regulations, but has no issues because it provides adequate pay and benefit systems.[52] The expansion in Hefei, again, could provide political risk due to local governance differences. However, the firm just signed a long term extension with city officials to reserve land for Unilever over the next five years.[53] Obviously, the local government has a strong desire to keep Unilever long term and to lock in jobs for local Chinese. When handling government officials, it is imperative to meet local norms, as long as these remain ethical. The practice of “guanxi” should not be avoided, as it is customary in China when doing business. While it may seem strange at times, it is recommended that “guanxi” be utilized to ensure smooth relationships and future transactions. With these minimizations of political risks, Unilever Lipton investment should generate strong returns.

Yum! Brands: Emerging as a Leader

Yum! Brands may be a relatively more risky investment, but will most likely return greater immediate profits. Half of the investment should be issued towards Yum! Brands, with 50% being used to invest directly into the company, and the other 50% used to open new franchise locations, specifically KFC and Pizza Hut locations, over the next 10 years. As stated, Yum! Brands has been growing at a rapid pace, opening almost a store a day. This great increase in development should allow Yum! Brands to capture part of the restaurant market that lacks any real leader. With only 1% of the restaurant market owned by US chains, this growth should show a great short term and long term opportunity.[54] Economic risks are apparent, mainly due to the possible tax and cost implications of ingredient supplies. Furthermore, competition provides more of a threat to Yum! Brands due to the over saturation of the market and lack of large market share currently held. Because of franchising opportunities, employee hiring can also be an economic risk. It is recommended to work closely with Yum! Brands experienced workers to ensure proper hiring of managers. It is further recommended that part of the investment is used to hire current Yum! Brand employees as consultants for franchise operations. Through this hiring, this investment looks very promising through risk mitigation and experience.

Policy and political risks will provide the largest issues for this investment. The policy risks that most affect this investment, again, are trademark and health regulations. However, strong branding diminishes this trademark risk. Health regulations also do not currently present a major risk due to lack of strong government oversight. Being an international firm with strong standards elsewhere, changes in these policies should be met quite easily. Political risk most endangers this investment risk due to the locations and legality of franchise locations. The hired consulting group mentioned above should be able to advise on many of these issues. However, local governance issues again need to be minimized through strong relationships and the use of "guanxi", as long as it remains ethical. The development of the legal system will benefit the long term investment, but remains a relatively dangerous risk. This risk though should have a low impact since the franchising is being done through an American firm though, since representation will be done through the Yum! Brand legal department. Finally, labor risks are very dangerous to this investment. Wages must be comparable and should vary from location to location based upon local wages. Employees should be provided benefits equivalent to other restaurants in the area as well. Working closely with the advising hires and retaining happy employees should help to mitigate these risks as this investment makes strong returns and emerges as a leader.

Domestic Investment: An Unclear Future

While there may be stronger immediate and long term returns available through the establishment of new firms or investing in Chinese companies, this recommendation suggests that these investments are too risky due to corruption, legal system issues, and possible poor financing. Corruption here refers not only to the standard definition, but also to possible corruption in management and hiring issues. Looking at the memoir *Mr. China*, the most major issues that came about from investing in domestic Chinese firms were miscommunication and corruption amongst local managers. It is imperative to have a heavy input into the daily operations of the investment and the need to be informed at all times. By working with American companies abroad, issues should be clearer and less risk of corruption should occur. This partnership with American firms also makes legal issues less risky than investing in domestic Chinese firms. While legal ramifications may be more severe for international firms, this investment is less likely to be affected due to the fact legal issues would travel through the parent companies of Unilever and Yum! Brands. This partnership will provide legal muscle and knowledge necessary to survive in the evolving Chinese legal system. Furthermore, it should be noted that investing directly in non-domestic firms could result in more unfavorable rulings that would more directly affect the investment. Finally, this proposal has constantly been skeptical of the Chinese banking and loaning system. Because an investment in a domestic firm could very likely be financed through these banks, this risk becomes much more dangerous and deters a recommendation for domestic firm investment currently.

Investment Conclusion

In conclusion, economic growth is not the only factor to consider. Economic, policy, and political risks all provide few opportunities but many risks going into China. By investing in strong American firms with established presences in China, this investment will minimize these risks while maintaining steady profits in the long run. While greater gains could possibly be made through domestic investment, the unclear future of financing in China suggests this investment too risky currently. These avenues should again be revisited possibly in the future, should stability become clearer. Through this investment of $1 billion, an opportunity will be seized to enter one of the world's still fastest growing economies, harnessing this growth for long term returns.

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