Bordering on a boom

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CHERYL DIAZ MEYER/Staff Photographer

Parking attendants Yuan Yuhua (left) and Wu Gai Ping chat at a Pizza Hut in Beijing. The chain has 171 restaurants in China.

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Call it the gold rush of the 21st century.

A growing number of North Texas companies are catching China fever, eager to capitalize on the accelerating economic development of the world's most populous country.

They're pouring millions of dollars into manufacturing plants, setting up sales and distribution networks, and investing in energy and other projects half a world away.

"You can make big money on frontiers," said Patrick Jenevein III, president of Dallas-based Tang Energy Group, which is attempting to build China's biggest wind farm near Beijing.

Although U.S. multinationals have invested in China for decades, the Asian giant is attracting companies that previously never gave much thought to crossing the Pacific.

What's different? Rising prosperity has generated a Chinese middle class with a thirst for goods as varied as Starbucks lattes, Louis Vuitton handbags and Buick Regals.

"The biggest change over the last 10 years is the creation of a consumer market," said Roger Nanney, a Deloitte & Touche USA vice chairman who led the Greater Dallas Chamber's first trade mission to China last year.

For Dallas-based 7-Eleven Inc., catering to Chinese tastes means selling rice balls instead of Big Bite hot dogs.

Pizza Hut of Addison has enjoyed success in China with its Seafood Catch pie. Toppings include a seafood mix, crab sticks, green peppers and pineapples.

Even Richardson-based Fossil Inc., which has long used China as a manufacturing base, is examining how to boost sales there.

The buzz of activity reflects a new business reality. Increasingly, experts say, China is affecting all industries, altering the dynamics for prices, production and sales.

"Is China becoming enough of a factor that it is going to impact directly or indirectly a wide swath of American business? I think the answer absolutely is yes," said Kenneth Lieberthal, a University of Michigan professor.

Wide impact

But China isn't just about market opportunities. Low-cost Chinese manufacturers threaten many Western businesses.

And China's rapidly changing market conditions and Byzantine government rules often cost firms millions.

Mobile phone distributor CellStar Corp. of Carrollton, for example, is losing money in China, partly because of government efforts to slow down the economy's torrid pace.

Despite the challenges, China's potential and its rapid growth make it impossible to ignore. Its impact is rippling through the U.S. economy in myriad ways:

- All kinds of companies are turning to China to expand sales and launch businesses, not just multinational giants such as Exxon Mobil Corp.

"Investing in China is really shifting to companies that are going global for the first time," said Albert Tan, a partner at Haynes and Boone LLP who helps firms entering China.

- Many firms are becoming increasingly dependent on Chinese factories. Last year, U.S. manufacturing employment reached its lowest level since 1958.
- China's appetite for basic commodities is affecting worldwide prices of oil, steel, cotton and other raw materials. That's a boon for commodity firms but hurts auto suppliers and other manufacturers.
- Chinese companies are setting up sales offices in the United States. A few — such as Lenovo Group, China's largest maker of personal computers — are snapping up U.S. brands.

All of this comes as China is playing a greater role in the North Texas economy. It has been Dallas-Fort Worth's biggest trade partner for the last two years.

Consumer class

The rise of an affluent Chinese consumer market coincides with

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slowing growth prospects for many firms in the United States and Europe. That makes China critical for future expansion.

7-Eleven is on a rapid growth curve for its convenience stores.

By the time the 2008 Summer Olympics kicks off in Beijing, the chain could boast as many as 500 stores in China's capital — up from just 10 today.

Licensees in China already operate 188 7-Elevens in the Guangzhou area of southern China.

7-Eleven receives royalty payments, based on a percentage of sales, from its international licensees. Today these payments account for a fraction of the chain's revenue, but that could change over the long term.

"The biggest challenge has been educating the Chinese about what a modern convenience store is," said Bob Jenkins, 7-Eleven's international vice president.

Stores in Beijing offer an array of Chinese, Korean, Japanese and Western foods. But they don't offer gasoline — only air pumps for bicycle tires.

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Pizza Hut is also gaining ground. It operates 171 mostly sit-down restaurants in 43 cities in China. Sales at stores open at least a year there rose 6 percent last year, compared with 5 percent in the United States.

The chain is testing home delivery service, a novel concept for most Chinese.

Pizza Hut's parent company, Yum Brands Inc., ranks China as its second most profitable market, eclipsed only by the United States.

"One day China will be bigger than the United States," Yum chairman David Novak told investors and analysts in December. "There's no doubt in our mind that we are sitting on a major, major growth opportunity that we've just begun to scratch the surface on."

For the energy industry, the market could be even more lucrative. China consumes more oil than any other nation except the United States.

In China, Irving-based Exxon Mobil operates a network of factories that produce chemicals, lubricants, resins and other products, a power plant and 20 gas stations.

It is awaiting final government approval for a $3.5 billion project to expand an oil refinery in the province of Fujian and build a


Fossil Inc.

Richardson-based Fossil assembles watches at one of its four factories in the Shenzhen area.

chemical complex. Exxon will own a 25 percent stake in the development.

The oil giant also wants to supply China with natural gas from a project off the coast of Russia. And it's scouring the wilderness of northwest China for untapped sources of oil.

Sourcing from China

Even as Exxon and other firms stake out their positions, some Dallas-Fort Worth companies have turned China into an integral part of their operations.

Fossil, which sells and designs watches, has used China for sourcing since its launch in the mid-1980s. It used a network of factories in Hong Kong and, later, in mainland China.

A little more than a decade ago, Fossil purchased its first factory in China.

Last year, its four factories in the Shenzhen area, across from Hong Kong, assembled 75 percent of the 19 million watches it sold worldwide. Other Chinese factories produced the rest.

"It's impressive how smoothly the logistics work," said Mike Barnes, president of Fossil's international and special markets division.

The company has yet to experience any serious supply interruptions, he said, and quality has improved dramatically.

Exporting to India

Richardson-based Lennox International Inc. has also discovered how valuable China can be.

In August 2000, it opened a factory in Wuxi to produce refrigeration racks for Wal-Mart, Carrefour and other big supermarket chains opening stores in China.

In January, the factory, whose 50 workers earn less than a dollar an hour, began exporting the equipment for the first time — to India.

"China absolutely is an area we are focusing on as a high-growth opportunity for us," said Michael Schwartz, president of Lennox's Heatcraft Worldwide Refrigeration division. "The whole supermarket industry is just at its early stage."

Big companies aren't the only ones capitalizing on China. Tiny Equimed of Dallas Inc., a 3-year-old medical equipment firm in Coppell, is rapidly expanding its sales, courtesy of China.

Equimed buys Chinese-made patient monitors that are used in hospitals to track heartbeats, oxygen levels and other vital signs. It sells the devices to distributors in 35 countries outside the United States.

"Some people are reluctant to use Chinese equipment," said Roberto Conti, Equimed's president. But, he said, the monitors recently won approval from the U.S. Food and Drug Administration, helping sales nearly double.

Without its Chinese suppliers, Equimed wouldn't be able to sell the monitors at all. The U.S.-made ones cost too much for the firm to turn a profit, Mr. Conti said.

Feeling threatened

For all the optimism about China, there's also plenty of fear.

In the West Texas cotton fields near Lubbock, 650 workers at the American Cotton Growers denim mill in Littlefield worry that their jobs may become a casualty of Chinese competition.

Low-priced jeans and denim shirts from China are already flooding the market, thanks to the Jan. 1 elimination of quotas on apparel and textiles. To compete, jeans makers in Mexico and Central America, the mill's customers, could be forced to move to lower-wage Asia.

The mill is slashing costs, improving quality and trying to stay a step ahead of the Chinese in product innovation. "We're ask-

CHERYL DIAZ MEYER/Staff Photographer

7-Eleven opened 10 stores in Beijing last year and expects to have 500 stores in the city by the 2008 Olympics.

ing more of our people today than we've asked before," said Bryan Gregory, the mill's general manager.

The challenges aren't limited to this hemisphere. U.S. companies trying to gain a foothold in China face rapidly changing market conditions, strong local competition and other difficulties.

For seven years, China has been CellStar's best market as millions of Chinese bought cellphones for the first time.

But the mobile phone distributor is now losing money in China and trying to resolve accounting issues in its Asia Pacific division.

Cellphone makers in China have begun to subsidize the sale of their phones, cutting into profit margins for wholesalers such as CellStar.

And government efforts to keep the Chinese economy from overheating led to a slowdown in sales and a glut of phones, said Robert Kaiser, CellStar's chief executive.

CellStar had planned to take its China operations public on the Hong Kong Stock Exchange. But the 2003 crisis with severe acute respiratory syndrome delayed the initial public offering, which has now been put on hold because of the downturn in sales.

"Who would have predicted SARS?" Mr. Kaiser asks. "A world-renowned disease breaks out in your biggest market at the time you are trying to do an IPO."

This year, CellStar plans to move into the retail market in China by investing in five joint ventures with distributors.

As CellStar's experience shows, success in China doesn't come easily. Nevertheless, plenty of U.S. companies are willing to invest there.

Tang Energy employs 150 workers in China and three at its Dallas headquarters. In addition to the wind farm, Tang owns part of a power plant at the western end of the Great Wall of China.

Tang's president, Mr. Jenevein, had looked at building a power plant in California, only to discover that obtaining government approvals was a seven-year process. In China, it would take two years.

"There's so much to do in China that we don't worry much about our competitors," says the longtime energy executive, who flies to China every other month. "China is improving the lives of its people."

TIPS FOR SUCCESS IN CHINA

Advice from the experts:

- Talk to others who have been there, done that.
- Establish relationships.
- Be as careful picking a business partner as you would be in the United States.
- Take the time to build trust.
- Don't underestimate how competitive Chinese companies are.
- Do your homework – it makes a big difference.
- Be aware of regional variations. Consumers in Beijing may not like the same things as consumers in Shanghai.
- You'll need approvals for everything.
- "Maybe" usually means no.
- E-mails and conference calls can help bridge the distance, but there's no substitute for being in China.
- Be adaptable.
- It may take you longer than you think to get your investment capital back.

SOURCES: Patrick Custer, China Access Partners; Albert Tan, Haynes and Boone; Kenneth Lieberthal, University of Michigan; and Patrick Jenevein III, Tang Energy Group