China's Emerging Markets:

Dynamic Opportunities for U.S. Companies

By Arthur Pang and U.S. Commercial Service

Fifteen of China's second-tier cities account for 8% of the population but 54% of the total imports from the U.S. The numbers are in – China's second-tier cities provide some of the most abundant and lucrative opportunities for U.S. exporters.

Starting in April 2008, the American Chamber of Commerce in China and the U.S. Commercial Service will begin a series of articles and events that focus on entering second-tier city markets in China. The need for market expertise and guidance in these cities has been vociferous, including a profile in the February edition of the Harvard Business Review. In its "Breakthrough Ideas of 2008," China's Second-Tier Cities were featured highlighting their current success as well as their ensconced potential.

A Second Look at the China Market

China's commercial landscape is changing. While China's first-tier cities have maintained their economic importance, second-tier cities are incrementally taking a larger share of its growth. While much of China's wealth is still concentrated in the megacities of Beijing, Shanghai and Guangzhou, growth has taken root well beyond these cities. New emerging markets create a network of integrated economies between regions and industries that respond to expanding business and consumer needs. Recognizing the unmet demand in these markets is critical for foreign companies in the China market. Second-tier cities are changing the way global exporters are thinking about China.

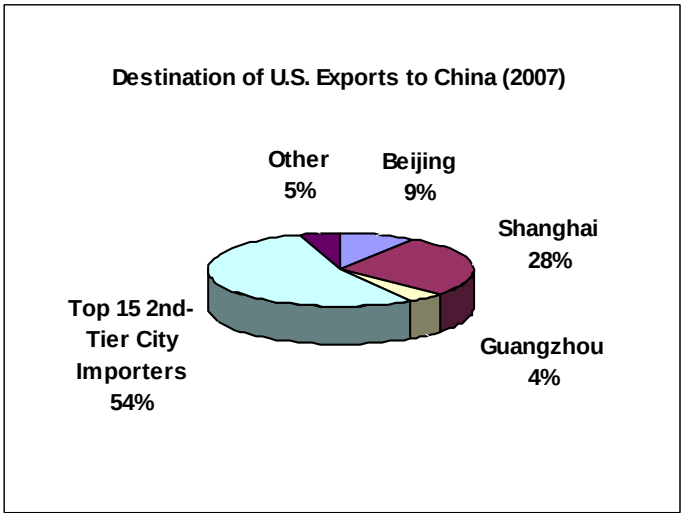


Figure 1

Second-tier cities in China can be defined as the economically top-performing cities beyond Beijing, Shanghai and Guangzhou. When looking at these cities in terms of buying U.S. exports, it becomes clear where U.S. companies are finding a majority of their success.

The top 15 second-tier city destinations of U.S. exports[1] account for only 8 percent of China's total population, but over 54 percent of China's total imports from the United States.[2]

[1] The top 15 2nd-tier Cities importing U.S. Products in descending order: Nanjing, Shenzhen, Tianjin, Qingdao, Huangpu, Xiamen, Ningbo, Dalian, Zhuhai, Chengdu, Hangzhou, Shijiazhuang, Fuzhou, Xi'an, and Wuhan.
[2] Source: U.S. Census Bureau, 2008 and World Trade Atlas, 2008.

Opportunities for U.S. Exporters

Second-tier cities are the new frontier for China's growth, and understanding them will enable U.S. firms to capitalize on over one-quarter of China's total import demand. Nanjing, formerly a middle-market city, has grown to become the U.S.' second-largest trading partner in China. Together with Hangzhou and Ningbo, these three cities comprise the Yangtze River Delta hub, which imports high volumes of electrical machinery from the U.S. Qingdao and Tianjin have also risen to become the U.S.' fifth and sixth-largest import destinations, surpassing the more recognizable Guangzhou. Along with Beijing, they have evolved into a northern megalopolis, importing products such as medical instruments and grains from the U.S. Wuhan, Xi'an, Kunming and Chongqing have also followed suit as hubs of central China, all with heavy machinery as their top import from the United States.[3]

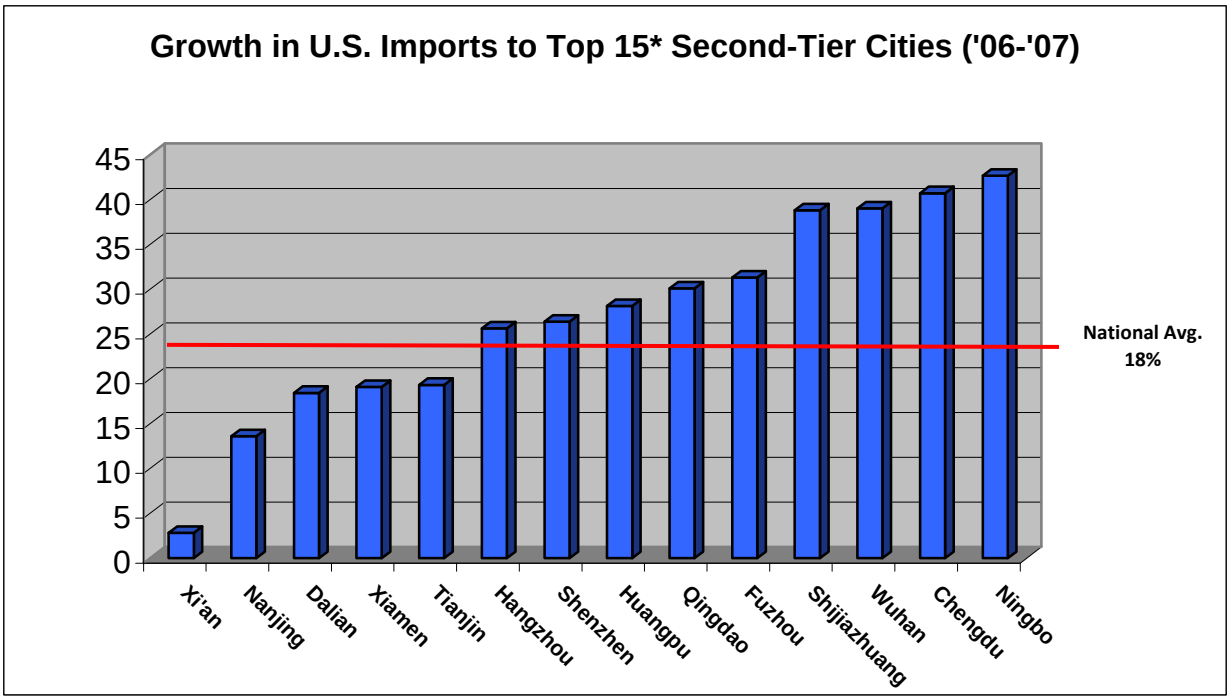


Figure 2

In 2007, U.S. exports to China increased to $69.9 billion, an 18 percent increase from $59.2 billion in 2006.[4] Of the total U.S. exports to China, over 47 percent went through the fourteen American Trading Centers (ATCs) in China. This should be no surprise considering 36 percent of global exports to China go to these second-tier cities.[5]

American Trading Centers provide customized trade representation for U.S. companies, and are fully supported by the U.S. and Foreign Commercial Service, the single largest representative of U.S. exporters, as well as the U.S. Embassy in Beijing and U.S. Consulates throughout China. Additionally, trade specialists from the U.S. Commercial Service work in partnership with CCPIT, China's national trade association, to help U.S. exporters identify potential markets, develop partners and distribution networks, and connect with key decision makers.

[3] *Ibid.* Customs, 2007.
[4] *Ibid.* Statistics, 2007.
[5] Source: China Customs, 2007.

*For the purpose of the global exports calculation, Shenzhen is not included because their 'imports' from Hong Kong are not representative of global exports. If included, Shenzhen would make up 42% of all of China's imports.

Three Reasons to Target Second-Tier Cities

1. Surging demand

In second-tier cities, demand reflects two prevailing opportunities for foreign firms. The first is to sell to businesses and government clients that are operating locally and building the infrastructure of these cities; the second is to tap into the private consumer base in these second-tier cities.

Many manufacturers in China are shifting operations to second-tier cities to cut costs on land, labor and energy. For example, the cost of top-grade office space in Wuhan is one-third of its cost in Beijing.[6] Featuring an average growth rate of roughly 11%, second-tier cities are not only producing more – they are buying more as well. Soaring investment in infrastructure and public projects has increased demand for B2B goods from the U.S., such as heavy machinery, high-tech products and medical devices.

The emergence of a vibrant business community in second-tier cities has also propelled the expansion of a resilient and expanding middle class with a commensurate disposable income. China's National Bureau of Statistics estimates its middle class will expand from 5 percent of the population to 45 percent by 2020. It is predicted that the middle class population will reach 350 million within ten years, a large percentage of which will live in these second-tier cities.[7]

2. Less Saturation, Less Competition

As second tier city growth reaches new heights, first tier cities are becoming increasingly stagnant due in large part to market saturation and existing business establishments. The result is a disparity of growth rates between first and second-tier cities. Shanghai's 14 percent growth and Beijing's 2 percent decline in U.S. imports have failed to keep up with second tier city rates like those of Shenzhen, Ningbo and Wuhan which have increased by 29, 33, and 44 percent respectively.[8]

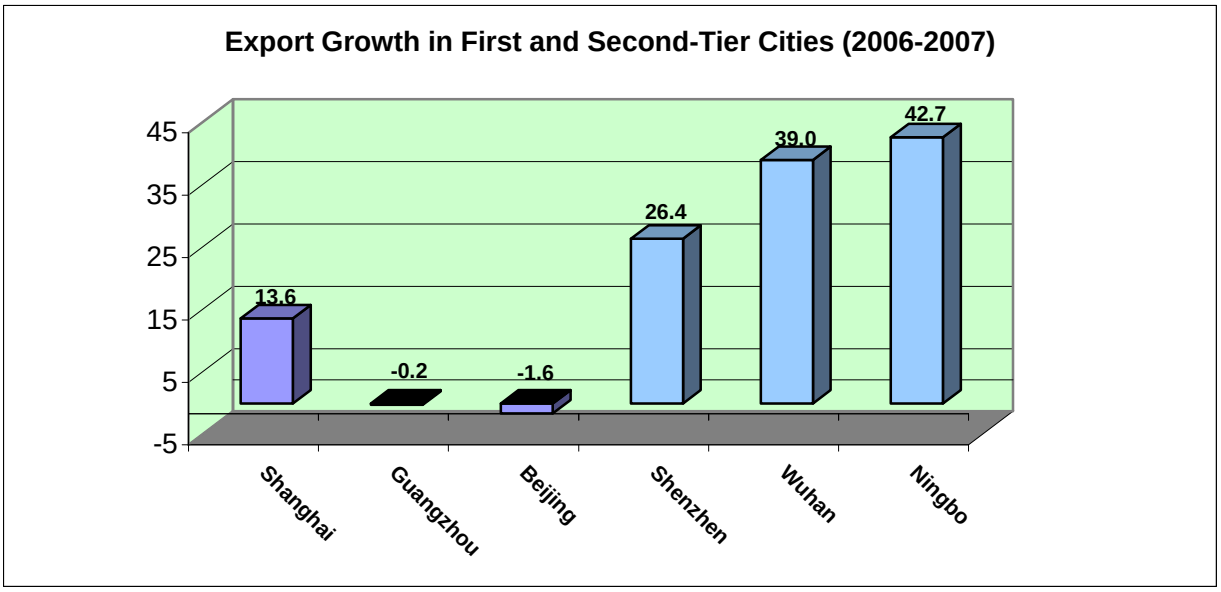


Figure 3

[6] Source: The Standard, 2006.
[7] Source: China Daily, 2006.
[8] *Ibid.* Customs, 2007.

As both individual and company wealth grows in second-tier cities, new buyers of foreign products are emerging. Additionally, as the capacity for consumption expands, so too does the need for infrastructure and the goods and services to support this growth.

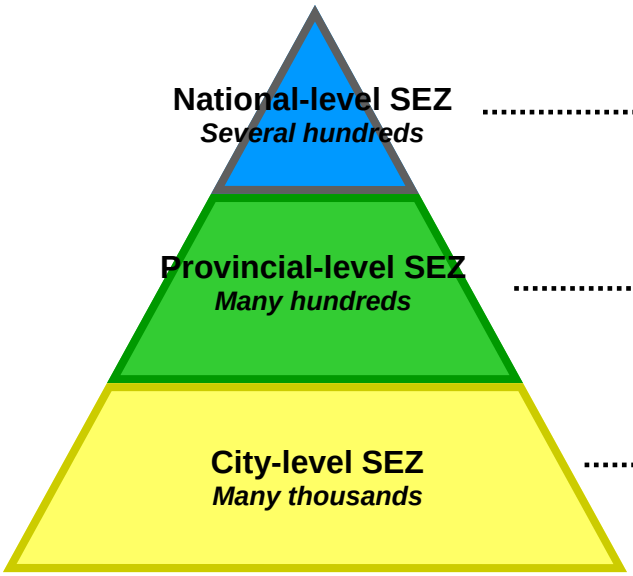
These unsaturated second-tier markets foster an environment with fewer competitors, higher demand and better access creating an easy gateway and a huge potential for prospective foreign companies. Such opportunities are palpable for U.S. companies that are among the first to tap into these markets. The advantage gives firms the chance to forge lucrative business partnerships and introduce quality American products.

3. Favorable Policy Shifts

The Chinese government recognizes that these second-tier cities are quickly becoming the economic rungs on the ladder of China's growth. As such, development of second-tier cities continues to be promoted through investment, targeted tax incentives and the establishment of economic and technological development zones. Special Economic Zones (SEZs) are an important component of second-tier cities as they play a guiding role in shaping business and economic development.

Special Economic Zones in Second-Tier Cities

Many foreign and domestic companies have been attracted to SEZs by their preferential policies, sound infrastructure and advantageous investment environment. Many SEZs are industry focused, and the concentration of companies represents good targets for U.S. exporters. SEZs are classified into three levels - national, provincial and city - each with their own characteristics and focus.



- **Approved by state council**
- **Includes high-tech zones, export processing zones, free trade zones, etc.**
- **Typically houses multinationals or very large Chinese companies**

- **Approved by provincial government**
- **Industrial parks or industrial zones, some are industry focused**
- **Houses both foreign and Chinese companies**

- **Approved by municipal government**
- **Typically focused on one or two industries**
- **Higher proportion of Chinese companies**

Courtesy of: The JLJ Group

Best Prospects

According to Alessandro Duina of JLJ Group, who has done significant research on second-tier cities with the U.S. Commercial Service, "China is more like a continent than country. Geographically dispersed, each second-tier city has unique characteristics and offers different prospects for foreign companies. U.S. exporters must research and assess the diversity and industry needs of these emerging markets in order to develop sound strategies to effectively leverage China's growing market." In the end, the key for U.S. companies is not whether there are opportunities in various second-tier markets for their products/services, but which markets are the most appropriate. Industries in second-tier cities rank among the most dynamic and rapidly developing in China. Here is a sample of a few of these industries:

U.S. Imports to Chinese Second-Tier Cities ('06-'07)

Product Description	City	% Increase	Millions of $USD
Optic, Medical Instruments	Chengdu	65	143
Organic Chemicals	Hangzhou	92	133
Chemical Products	Nanjing	136	186
Aircraft, Spacecraft	Shenzhen	166	622
Vehicles (not Rail)	Tianjin	68	616
Misc. Grain, Seed, Fruit	Qingdao	87	998
Photo/Cinematography	Xiamen	47	82
Plastic	Ningbo	111	336
Electrical Machinery	Dalian	35	92

Figure 4

Find Out More, Share Your Experience…

Though first tier cities have provided a firm basis on which to stabilize China's development, China's second tier cities hold the key to future growth. As the importing centers of their regions, second-tier cities have both the consumer market and business infrastructure to support foreign companies. The potential for U.S. companies is great, and the economic support and business avenues are developing. To help you learn more about second-tier markets and best practices, please join our regional specialists and companies on the ground in upcoming roundtables to be hosted by the AMCHAM and the U.S. Commercial Service. Specific dates and times will be advertised in AMCHAM and CS China publications, announcements and websites.

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