

Companies brave the risks of China

Opportunities of an untapped market poised for growth balance the financial uncertainties

By KEITH RUSSELL
Staff Writer

In February, John Hooton III boarded a plane back to Nashville with plenty to celebrate.

After four years of planning and effort, Hooton's dream to stake his claim in China's booming industrial sector was finally coming true. A Chinese bank had just assured the Nashville businessman that it would lend him the money he needed to open an industrial tape-making facility in Suzhou, a city of 5 million people northwest of Shanghai.

In May, Hooton returned to Suzhou and learned how quickly life can change for those who buy a ticket on China's roller coaster ride from Soviet-style central planning to the world's fastest-growing economy.

Hooton's lender, Industrial and Commercial Bank of China, informed him that his loan was no longer approved. Despite being the largest commercial bank in China, managers at ICBC's Suzhou branch said they were now forced to follow new lending restrictions handed down by China's economic regulators.

The restrictions, one of several administrative measures designed to address inflation concerns and fears that China's economy is overheating, mean the bank will no longer accept Hooton's equipment as col-

lateral. Only local real estate — none of which Hooton owns — would secure the loan.

Now, Hooton is racing against time to find a new bank to lend him \$1.5 million by Sept. 1 — or risk seeing his dream business venture turn into a nightmare.

"What amazes me is how quickly the policy changes can take effect here," Hooton said in a telephone interview this past week from his office in Suzhou. "It literally happened overnight."

Though Hooton's tale may be the most dramatic, it is certainly not the only story that illustrates China's growing influence on businesses in Middle Tennessee, from rural cotton fields to the boardrooms of some of the area's biggest corporations.

▶ See CHINA, 4E

中国工业
生长机会
市集繁荣
智慧工作

SINO-TENNESSEE CONNECTIONS

Here are some of the Nashville-area companies that recently have developed stronger business ties in China.



Caterpillar Financial Services Corp.: Became second foreign company to receive license to offer industrial leasing services in China. Has opened small office in Beijing.



Dollar General Corp.: Opened subsidiary office in Hong Kong to expand its direct-import operations in Asia. The company directly imports approximately 15% of its goods from Asia.



Genesco: Hat World, a recently acquired operator of hat stores, has a licensing arrangement with a Chinese company to open as many as 200 Lids and Hat World stores in Hong Kong and mainland China in the next five years.



Gresham, Smith & Partners: The Nashville architecture firm has a handful of projects under way in China, including a large office tower in downtown Shanghai and an eye hospital in Shenzhen.



China: Firms brave the financial risks

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From one point of view, China is a vast market that can tantalize as much as it frustrates: a source of inexpensive imports and a stealer of the jobs U.S. consumers need to buy them.

The one thing China is not, to those who now feel its presence the most, is ignored.

Whirlwind of change

Hooton's financing difficulties speak to the challenges China must still overcome, in spite of the country's dramatic economic gains of the past 25 years.

After Chinese leader Deng Xiaoping introduced market reforms to the country's socialist system in 1978, China's economy quadrupled in size by the year 2000. Subsequent years have seen the country post near double-digit growth rates. By some statistical measures China's economy is now the world's second largest to the United States — and arguably its most dynamic.

"The pace at which they're changing is truly phenomenal," said David Parsley, a professor of international business and finance at Vanderbilt University's Owen Graduate School of Management. "I liken it to what was going on in Britain and the U.S. in the latter half of the 1800s."

But vestiges of China's socialist and authoritarian roots remain, particularly in the country's underdeveloped financial system. The lending restrictions now confronting Hooton are among several heavy-handed measures China's central bank is employing to stave off inflation running at or near 5%. As an analysis in *The New York Times* recently noted, while many countries tackle inflation through interest rate hikes, in China, "this could mean padlocks and handcuffs." The newspaper said other tactics, beyond lending restrictions, have included raising banks' reserve requirements and refusing to sign off on new commercial, residential or industrial projects that have yet to receive previously unnecessary permits.

In addition, the country's four large commercial banks, including ICBC, are saddled with non-performing loans handed out to struggling state-owned enterprises whose political connections can still give them access to credit even when it may be cut off from private customers.

The state-owned companies "are the ones with the bad loans, but they're making me suffer," said Hooton, a former vice chairman of the Nashville Area Chamber of Commerce's International Business Council. He still owns Industrial Tape Specialists, an industrial tape business in Nashville.

Hooton's is not the only business with local ties to feel the effects of China's recent efforts to slow its economy.

Kevin Kim, who heads international efforts for Gresham, Smith & Partners, said the lending clampdown had served to postpone construction of a large-scale retail and office project in Beijing designed by the large Nashville architecture firm. But Kim said other projects the firm was working on in China, including a large office tower in downtown Shanghai and an eye hospital in Shenzhen, remained on track.

"I think it's good and bad," Kim said. "It's bad because things slow down, but I think it's good for the long-term economy of China. It will weed out a lot of bad projects."

Navigating the lenders

Meanwhile, workers at Murray Inc.'s manufacturing plant in Lawrenceburg became alarmed last month after their annual summer vacation was delayed amid reports of a "crisis" at the outdoor power equipment maker's Chinese parent company, Shenyang Hejin Holding Co. Ltd.

Murray officials have said the decision to delay the plant's annual shutdown was unrelated to the challenges faced by Shenyang Hejin, which has seen its stock price drop 80% because of its ties to D'Long International Strategic Investment, one of China's largest private investors.

D'Long, which formerly owned Murray itself through an offshore holding company, has been at the center of a financial crisis that the firm in part has blamed on a cash crunch created by China's new lending restrictions.

For his part, Hooton remains upbeat about his own project. He plans to travel to Hong Kong this week to speak with banks in the former British colony, who he said have indicated a greater willingness to work with him than their counterparts on China's mainland. And he says the sales pipeline for



Cotton farmer Jimmy Newby talks about cotton as he stands in a 146-acre field in Elkton, Tenn. He has more than 1,900 acres in Giles County, with three-fourths of the acreage planted in cotton. Tennessee cotton exports to China have skyrocketed in the past year.

China awakens Tennessee trade

Tennessee exports to China have more than quadrupled through April of this year, thanks largely to a sharp rise in cotton sales, making China Tennessee's second-largest export market.

Tennessee exports (in millions of dollars)		
	2003	2004
Canada	\$1,352	\$1,493
		+ 10.5
China	\$165	\$735
		+ 345.4
Mexico	\$452	\$514
		+13.7
United Kingdom	\$220	\$203
		- 7.9
Japan	\$170	\$187
		+10

SOURCE: Nashville Export Assistance Center
CAITLIN HOPE WRIGHT/STAFF



In this photo taken a year ago, Henry Hagan puts together lawn equipment at the Murray Inc. plant in Lawrenceburg, Tenn.

China's appetite for cotton may not be long-lived

By KETH RUSSELL

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In a recent report, Cotton Council International, the export promotion arm for the U.S. cotton industry, said China accounts for 30% of worldwide cotton consumption, up from 22%-25% in years before 1999.

China's consumption is expected to reach 31 million bales this year, compared with less than 20 million bales in 1998.

"The increase in Chinese consumption is the direct result of the continuing growth in

China's textile industry," the CCI's report said.

CCI executive director Allen Terhaar said a World Trade Organization decision to eliminate complex import quotas of textile products in 2005 should only further the growth of China's textile industry. The quotas currently limit how much countries can export, and investors have poured money into China's textile mills on the belief the country will be the biggest beneficiary when the restrictions are lifted.

Despite the recent surge in

exports, it's not clear how much or how long of a boon China's appetite for U.S. cotton represents.

In addition to being its biggest consumer, China is the world's biggest producer of cotton and was actually a net exporter of cotton as recently as 1999. In fact, crop difficulties experienced last year by Chinese cotton growers is one reason cited for the huge jump in U.S. exports this year.

In addition, farmers have an eye on a WTO decision this past spring that government

subsidies to U.S. cotton growers violate international trade rules. While the Bush administration has said it will fight the ruling, any removal of the subsidy is likely to have a negative impact on the U.S. cotton exports, including to China.

Subsidy or not, Terhaar said China's huge role in the cotton market is bound to make life unpredictable for U.S. cotton growers.

"When your biggest customer is also the biggest producer, that's just made for volatility," he said. ■

WHAT THE CHARACTERS ON PAGE 1A MEAN:

China:	中国
industry:	工业
growth:	生长
opportunity:	机会
market place:	市集
prosperity:	繁荣
wisdom:	智慧
work:	工作
hope:	希望

products from Asia. Perdue won't say how much he would like that to rise, except to note that it probably won't reach the 30%-40% level he says some of Dollar General's retail competitors are now at.

In fact, Perdue believes Dollar General's focus on customers with lower incomes almost requires the company to carefully weigh how much it imports from overseas. He is cognizant that many of the small towns where Dollar General has stores are the same ones that have been hardest hit by manufacturers' decisions to leave in favor of moving production to low-wage countries such as China.

"We're trying to find the right balance," Perdue said.

Perdue concedes that Dollar General is in Hong Kong for another reason. He sees a day when Dollar General will not just be in China to buy product, but to sell it, as well.

"We certainly have it on the radar screen," Perdue said, while hastening to add that Dollar General has plenty of room for expansion left in the U.S. market before looking overseas. The company has more than 7,000 locations in 30 states.

Making the leap

Other Nashville companies are taking their first steps into China. Hat World, a headwear retailer recently acquired by Nashville-based Genesco Inc., announced in April a licensing agreement that will see a Chinese business partner open 200 Lids and Hat World stores in Hong Kong and mainland China over the next five years.

While none of Genesco's footwear retail chains has any plans to follow Hat World to China, Chief Executive Officer Hal Pennington said the venture was a reflection of China's potential as incomes grow among the country's population of 1.3 billion consumers.

"When you just look at the number of potential consumers," Pennington said, "it's pretty mind-boggling."

Meanwhile, Caterpillar Financial Services Corp. recently became the second foreign company in China to receive a license to lease industrial equipment. General Electric was the first.

The Nashville-based company's entry is part of a larger expansion effort into China by its parent company, Peoria, Ill.-based Caterpillar Inc. The world's largest manufacturer of construction and mining equipment, Caterpillar has indicated plans to quadruple its current annual revenues of \$500 million in China by 2010.

While acknowledging the opportunity China represents, Cat Financial President James Beard said he intended to move cautiously, all too aware of the challenges facing the country's financial system. He said an upcoming trip this September to Cat Financial's recently opened office in Beijing would give him a better idea of what awaits his firm.

Given the unknowns, Beard said it might even be a blessing if China's efforts to ratchet down its fast-revving economy succeeded.

"It'd much rather start out in a recession than in a boom," Beard said. "In a boom, everyone tends to wear rose-colored glasses." ■

his tape-making facility is starting to fill up with clients.

Scheduled to open in October, his facility would be the only domestic producer in China of a base material needed to make industrial masking tape used by automotive, electrical and other manufacturers. Hooton estimates the total market for the product in China stands at about \$60 million.

"It doesn't outweigh my optimism for the market here," Hooton said of his challenges. "I'm just learning you have to be very flexible. You have to be ready to quickly change how you do things."

A reluctant exporter

Unlike Hooton, Giles County cotton farmer Jimmy Newby has never been to China and doesn't plan on going anytime soon. But the country's influence in the global economy has forced him to do his own adapting.

"There's not a day goes by that China is not involved in my thought process," Newby said.

The bulls are just starting to emerge on the 4,700 acres of cotton that Newby grows near Elkton, Tenn., just off Interstate 65 on both sides of the Alabama border.

Overall, Tennessee currently accounts for nearly 60% of the \$1.5 billion in total U.S. cotton exports to China this year. While trade analysts believe Tennessee is almost certainly getting credit for cotton grown in neighboring states, the jump has singlehandedly made China Tennessee's No. 2 export market, behind only Canada and ahead of traditional trading partners Mexico, the United Kingdom and Japan.

Newby, however, has reservations about the flood of Tennessee cotton flowing to China.

"I hate for us to have to sell to China," Newby explained as he stood in one of his Elkton cotton fields on a hot July afternoon. "It tells me my own people in the United States textile mills are going out of business."

In the past eight to 10 years, domestic U.S. cotton consumption has fallen nearly in half as U.S. textile operations close in the face of competition from countries with dramatically cheaper labor costs, including Mexico, Central America, China, India, Pakistan and other parts of Asia.

U.S. cotton producers have had little choice but to follow the mills. Today, more than 70% of the 18 million bales of cotton produced annually in the United States is sold internationally. And increasingly, it is being sold to buyers in China.

Entering world's workshop

The textile boom in China behind Tennessee's cotton trade speaks to the country's oft-cited role as the "world's workshop," where laborers making as little as 5% of U.S. workers' wages put

together the toys, bicycles, shoes and sundry other products that wind up on store shelves around the globe.

For a discount retailer such as Goodlettsville-based Dollar General Corp., that makes China critical to its business plans.

Earlier this spring, Dollar General celebrated the grand opening of a new subsidiary office in Hong Kong whose mission will be to directly buy imports for the company, rather than rely on independent distributors.

"What we're trying to do is eliminate the middle man," said Dollar General Chief Executive Officer David Perdue, who in the 1990s lived in Hong Kong for three years while an executive for Sara Lee Corp.

Doing so, Perdue hopes, will not only help Dollar General lower prices for itself and customers, but also make it the first to hear of new product developments.

"It makes us faster, gets us involved in the early stages of product development and helps keep us in touch with what vendors are doing," he explained.

In public filings, Dollar General has estimated that it currently directly imports about 15% of its