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contents

China's Life Insurance Market:
Can The Foreign Entrants Compete?

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Introduction

Accession to the World Trade Organization "WTO" will further open the China financial services market to multi-national companies. Foreign life insurance companies, which do not yet have operations in China, are considering possible forms of entry to this potentially huge and lucrative market, researching potential partners and developing business models. As background for senior management reviewing various market entry strategies, we consider the following questions:

- How quickly is the market developing?
- What is the market potential?
- How are the existing foreign companies performing?
- What are the main implications of China's accession to the WTO?
- How do different market entry options compare?
- Which are the key issues to consider in establishing a joint venture?
- What is the future outlook for new entrants?

Pace of Market Development

In contrast to some other East Asian insurance markets where regulatory developments and product innovations have been negligible over the past decade, China's life insurance market might be likened to the proverbial hare. Indeed, some believe the pace of change is too fast. It is not that the China market is more developed than others, rather it is involved in a frenetic game of "catch up." In the last 10 years, since individual life agency business was first issued, it has developed more than some other markets have over the last 50 years. During the past three years product design, distribution practices and the ownership structures of some domestic insurers have undertaken dramatic change, as the list of market entrants continues to grow.

The first investment-linked product in China was launched by Ping An in late 1999. Prior to that all business sold had been traditional non-participating business, which was priced in line with current interest rates. Some long-term business sold in the mid-'90s had guaranteed interest rates of 9 percent and higher, although pricing rates for new business had been reduced to 2.5 percent by June 1999 after deposit rates plummeted. The rapid fall in interest rates limited the impact on companies' immature and rapidly growing in-force portfolios by forcing changes in pricing practices, increased risk awareness in the life insurance industry and accelerated the development of new product designs. The China Insurance Regulatory Commission "CIRC," was

Table 1: Long-Term New Business Mix in 2001

Line of Business	% of Business Premium
Traditional Non-Participating	39%
Participating	37%
Investment-Linked	24%

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established in late 1998 to guide the life insurance industry into the modern era.

When participating business was first permitted in March 2000, most companies preferred to develop participating products with cash dividends, subject to minimum surplus distribution rules prescribed by CIRC. Table 1 on the front page shows that participating business has grown to be a major product line in under two years. The proportion of traditional non-participating business can be expected to fall further as more companies move towards participating and investment-linked business. After an initial surge, investment-linked sales have been subject to an almost inevitable slow-down due to concerns about falling stock markets and aggressive selling techniques using optimistic sales illustrations. Despite this adverse publicity, there has been an increase in the number of foreign players launching investment-linked products recently and more are expected to follow. In addition, regulations on sales illustrations are likely to be introduced in the near future, which should result in more professional sales practices.

Tied agency remains the dominant distribution channel for individual life insurance business in China. Several new entrants in Shanghai have experienced problems in developing a successful agency force due to high turnover and poaching of agents, and the lack of well-trained, quality agents in the marketplace. Since 2000 a bancassurance channel has emerged involving exclusive distribution agreements between insurers and individual bank branches. Each branch of a particular bank is free to tie up with a different insurance company. Nevertheless, this resulted in significant sales growth in 2001, and for some companies bancassurance business comprises more than 10 percent of their total premiums. This channel is likely to grow further, particularly as new entrants such as Taiping Life aggressively expand, and the market share of agency business can be expected to decline in time as other channels including broker/IFAs emerge.

The domestic insurers have generally expanded rapidly throughout China while the foreign players have been restricted to a few cities. Although this expansion has been part of a "land-grab" strategy, capitalizing on temporary geographical and business restrictions imposed on foreign companies, it has also exposed the limited capitalization of the domestics, which has allowed some multinationals an alternative route into the market by acquiring equity stakes in national domestic companies. It can be expected that other multinationals will soon follow since the current foreign equity holding in some domestic life insurers is below the maximum permitted of 24.9 percent.

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Table 2: Life Insurance Premium Income from 1997 to 2001

Year	Premium Income	Growth Rate
1997	7.4	22%
1998	9.0	17%
1999	10.5	17%
2000	12.0	14%
2001	17.2	43%

Table 3: 2001 Life Insurance Premium Income (USD millions)

Company	Individual Business	Group Business	Total Business	Market Share
China Life	7,937.1	1,862.2	9,799.3	57.1%
Ping An	3,828.3	1,003.4	4,831.7	28.1%
China Pacific	1,055.8	674.8	1,730.6	10.1%
New China Life	129.9	149.0	278.9	1.6%
AIA	249.7	-	249.7	1.5%
Taikong Life	90.7	104.3	195.0	1.1%
Manulife-Sinochem	33.2	-	33.2	0.25
ING Pacific-Antai	25.3	-	25.3	0.1%
Citic-Prudential	14.6	-	14.6	0.1%
AXA-Minmetals	7.7	-	7.7	0.0%
Allianz-Dazhong	6.7	-	6.7	0.0%
China Life-CMG	0.8	-	0.8	0.0%
John Hancock-Tianan	0.6	-	0.6	0.0%
Total	**13,380.4**	**3,793.7**	**17,174.1**	**100%**

Market Potential

The China life insurance industry has achieved tremendous growth over the past decade, with a cumulative annual growth rate (CAGR) over 23 percent since 1997. Total insurance premiums are projected to grow at 12 percent per annum for the next five years, and life insurance premium growth is expected to be in the range of 15 percent to 20 percent per annum in this period. In 2001, the total life insurance premium income was over US$ 17 billion (RMB 8.29 to US$ 1) Despite the impressive growth rates, by international standards, the Chinese insurance market remains relatively under-developed and hence still represents a great potential opportunity. In terms of insurance density, measured by insurance premiums as a percentage of GDP, the ratio for China is only 1.8 percent compared to around 6 percent in Taiwan, 9 percent in Japan and 10 percent in South Korea.

Besides the low penetration rate, there are other drivers for this significant growth. The savings rate in China is very high, over 40 percent, compared to approximately 30 percent in Japan and less than 20 percent in the United States. One reason for this phenomenon is the lack of investment vehicles in China. Most people in China keep their money in bank deposits. Even a small portion of the country's total savings could generate a considerable volume of funds flowing into the life insurance market, and with bank deposit rates so low, competition for bank savings is intense. Furthermore, increasing affluence, financial education and awareness of insurance contributes to the continuing growth in life insurance premiums.

Performance Of Foreign Companies

Table 3 above illustrates that the life insurance market continues to be dominated by the

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Table 4: 2001 New Business Premium for Individual Life Business (USD millions)

Company	Premium	Market Share
China Life, Ping An, China Pacific	5,478.2	95.1%
Taikang Life, New China Life	145.7	2.5%
All Foreign Invested Companies	139.0	2.4%
Total	**5,762.8**	**100.0%**

Table 5: 2001 New Business Premium For Individual Life Business In Shanghai (USD millions)

Company	Year of Entry	Premium	Market Share
Ping An	1994	256.7	54.0%
China Life	Pre-1990	69.6	14.6%
China Pacific	1991	58.9	12.4%
AIA-Shanghai	1992	43.5	9.1%
ING Pacific-Antai	1998	20.4	4.3%
Manulife-Sinochem	1996	12.6	2.6%
Allianz-Dazhong	1998	5.6	1.2%
AXA-Minmetals	1999	5.1	1.1%
Taikang Life	2000	1.1	0.2%
New China Life	2001	1.0	0.2%
China Life – CMG	2000	0.7	0.1%
John Hancock-Tianan	2000	0.6	0.1%
Total		**475.8**	**100.0%**

Table 6: Historical Statutory Profits Of Foreign-Invested Life Insurance Companies (USD millions)

Company	1998	1999	2000	Retained Profit 2000 Year End
AIA-Shanghai	(5.2)	(2.3)	(6.8)	(12.5)
AIA-Guangzhou	(3.7)	(2.2)	(3.9)	(14.7)
AIA-Shenzhen	-	(0.1)	(2.1)	(2.2)
Manulife-Sinochem	(5.2)	(4.3)	(4.3)	(17.6)
Allianz-Dazhong	-	(1.1)	(2.4)	(3.5)
ING Pacific-Antai	(0.5)	(3.5)	(5.2)	(9.2)
AXA-Minmetals	-	(3.1)	(4.9)	(8.1)

largest three domestic companies—China Life, Ping An and China Pacific. However, since it shows total premium income in China in 2001 the gap between domestics and foreign-invested companies is exacerbated due to the latter group's inability to operate nationwide, limited business scope (currently individual life only) and the limited period in which the foreign players have been in business.

Table 4 on the previous page focuses on new business premium for individual life business only. It shows that in 2001 the top three companies accounted for 95 percent of total new individual life premiums in China, while the eight foreign-invested companies accounted for around 2.5 percent. AIA, which operated in several cities in 2001, accounted for more than half of the foreign total, since the other foreign players were restricted to one city.

The most relevant statistics when comparing foreign company performance relate to the Shanghai market, since all but one of the foreign players operating at the end of 2001 started business in Shanghai. Table 5 on the previous page illustrates that in aggregate they accounted for around 18 percent of the new premium income in 2001. AIA, the first foreign insurer to enter the market, achieved a 9 percent market share in Shanghai, accounting for almost half of all business sold by foreign-invested life insurers in the city. It is interesting to note that most foreign players sold more individual life business in Shanghai than the domestics Taikang and New China Life, but these two companies operate in many more regions and are active in the group market. It is even more interesting that ING-Pacific Antai, which commenced business in 1998 had the highest market share of any foreign joint venture in 2001, and its new business premiums exceeded the total of the four other joint venture firms that commenced operations between 1998 and 2001. It has recently been reported that ING Pacific-Antai achieved higher sales in April 2002 than AIA and is challenging AIA to be the top foreign life insurer in Shanghai. This can be partly attributed to rapid growth in its agency force to around 7000 agents.

Table 6 on the previous page illustrates the historic post-tax statutory profits of the foreign-invested life insurers. Not surprisingly the new entrants have reported losses due to the startup nature of the business. It is only in 2001 that companies such as AIA and Manulife have reported profits in Shanghai, indicating a six-to 10-year start-up period before breaking even on a statutory basis. This is not out of line with break-even periods in other Asian markets, and inevitably depends heavily on the level of sales growth and the cost structures of the new operations.

Most of the players in Table 6 have either increased or applied to increase the total paid-in capital above the minimum starting level of RMB 200 million (US $24 million). The primary reason for additional capital injections is planned expansion into additional cities and regions. Foreign joint ventures with paid in capital of RMB 500 million (US $60 million) are permitted to operate up to four branches in different regions.

Post-WTO Implications

The Chinese government has agreed to open up the insurance market gradually upon accession to the WTO, which was formally approved on December 11, 2001. There will be no fixed quota on insurance licenses. Foreign-invested life insurers are currently technically permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years, this will be expanded to Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. All geographical restrictions should be lifted on foreign-invested life insurers by December 2004. In fact, in 2002 Sun Life Everbright and AIA commenced business in Tianjin and Beijing respectively, which demonstrates some flexibility to negotiate on a case-by-case basis. Foreign joint ventures would also be allowed to provide group life and pension business from December 2004.

A new regulation, "Administrative Regulations on Foreign-Invested Insurance Companies," was issued in December 2001 and became effective on February 1, 2002. These regulations were promulgated to accommodate the need to open up the insurance market after WTO accession. The regulations stipulate, among other things, the procedures and requirements for establishing a foreign-invested insurance company in China. The major changes are highlighted below:

- Foreign insurers can now apply to establish a foreign-invested insurance company in China if they satisfy the "prudential criteria" specified in the regulations. Previously, foreign insurers would need to get the "green light" from the CIRC before applying for a license. The key prudential criteria can be summarized as follows:

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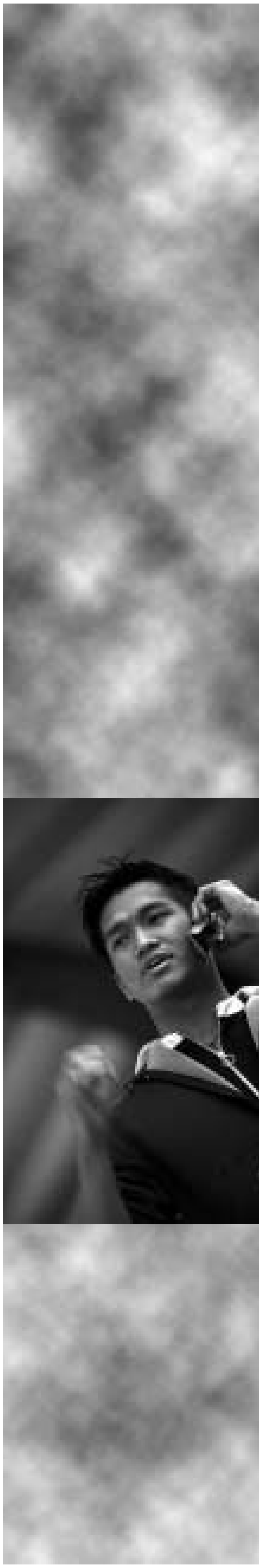

  - o 30 years of insurance industry experience
  - o A representative office in China for at least two years
  - o At least $5 billion of assets at end of year preceding application
  - o Sound insurance regulatory system in country/region where company is located
  - o Must meet solvency standards in country/region where company is located.

- An application for establishing a joint venture needs to be signed by both the foreign insurer and the Chinese partner. In other words, the foreign insurer needs to secure a joint venture partner before submitting the application. The foreign insurer can choose its own Chinese partner freely. This is different from past practice whereby an indication from the Chinese government was required before the foreign insurer could actively seek a local partner.

- The application process is now more defined and transparent. CIRC would make a decision within six months after the receipt of the complete application. Also CIRC would provide reasons in case of rejection. There is no mention of any waiting period before the applicant can re-submit the application if the previous application has been turned down.

- Finally, a foreign-invested insurance company may engage in reinsurance business, with limitations specified in the regulations.

The main implications would appear to be a greater urgency on the part of foreign companies to search for and select joint venture partners and more willingness from potential local partners to participate in serious discussions and negotiations. This could result in increased competition for the most attractive candidates, and a less orderly stream of new entrants in coming years, relative to previous years when a select few multinationals were given the "green light" each year.

One area where the "national treatment" WTO principle will not work to foreign-invested companies' advantage is tax equalization. Foreign-invested companies have until now enjoyed tax incentives in the form of a lower rate of enterprise income tax (15 percent) in the special economic zones and other regions, compared to the standard 33 percent rate applied to most domestic companies. Although the details of next year's tax reforms are not yet known, it is expected that in future a uniform tax rate will apply to both new foreign entrants and domestics. Existing foreign players may be hoping to be "grandfathered" so that they maintain their current tax advantage in the future.

Comparison Of Market Entry Options

There are currently two routes for foreign companies to gain access to China's life insurance market—apply for a license as a foreign joint venture or take a minority stake in a domestic insurance company. AIA is the only exception at present and has been permitted to establish wholly foreign-owned branches in several cities, although we understand this will not be permitted after establishing branches in Beijing, Suzhou, Dongguan and Jiangmen. At that time, AIA is expected to have formed form a joint venture company to conduct business in additional cities and provinces, in line with the requirements for all other foreign players.

Under the joint venture approach, a foreign insurer can hold up to 50 percent of the equity of the joint venture company. Most multinational companies have chosen this approach to enter the mainland market although the queue for joint venture licenses remains extremely long. The old application process was considered to be time consuming, uncertain and expensive. One license currently restricts operations to one city but this and other restrictions are scheduled to be eliminated over the next three years under the WTO agreement, as discussed in the previous section.

In October 2001 CIRC approved the applications of four domestic life insurance companies with unrestricted business scope, which, according to regulation, must set up joint ventures with foreign insurers. The four companies are Heng An in Tianjin, Minsheng in Beijing and Dong Fang (Eastern Life) and Sheng Ming (Sino Life) in Shanghai. At this stage, none of these companies have obtained a foreign joint venture partner. One reason often cited for this is that most multinationals prefer a passive partner from outside of the life insurance industry. This is discussed further in the next section.

Some multinational companies such as Winterthur, Zurich and Meiji Life have dipped their toes into the China life insurance market by acquiring minority equity stakes in domestic insurance companies. The insurance regulation limits the foreign equity investments to be less than 25 percent and the investment per foreign investor to be no more than 10 percent. However, a precedent was set when Fortis acquired 24.9 percent of Tai Ping Life in October 2001. In this case, an exemption was granted to allow Fortis to purchase more than 10 percent of Tai Ping Life, which is a domestic life insurer with national business scope.

Why would a multinational consider a minority investment in a domestic Chinese life insurer? Under this structure, the multinational has less management control relative to the joint venture option. However, the Fortis-Tai Ping deal showed that it is possible for the foreign investor to obtain a degree of management control, such as veto powers and rights to appoint senior management, and to be in a position to provide strategic guidance, training and technical support. Furthermore, the foreign insurer would gain immediate access to the national market with no limitations on business scope. This route could be particularly attractive to companies that don't currently meet the "prudential criteria", e.g. less than 30 years' life insurance experience, and therefore do not qualify for a joint venture license. Alternatively it may be a preferred option for multinationals that currently have limited presence and resources in the Greater China region, in that it offers an opportunity to build up local China market experience without the need to play an active management role. Furthermore, it does not necessarily preclude a foreign insurer establishing a separate joint venture company in the future.

It may therefore be of interest to some multinationals to know that the four new domestic companies referred to above might yet be permitted to seek foreign minority equity investment rather than form joint venture companies. This, however, has not been confirmed and would require high-level Government approval.

Valuation and due diligence are significant challenges for foreign investors considering a minority equity stake. Whether the domestic company is a greenfield or relatively new start-up or an established player with significant guarantees in its inforce portfolio, the main component of value will very likely be future business value. In a relatively new and rapidly developing market such as China, the valuation of future business is particularly subjective. Nevertheless, this has not prevented multinationals from paying substantial sums as summarized in Table 7 below, which shows the acquired stake and purchase price in recent transactions.

In May 2002, ACE Limited acquired 22 percent of Huatai Insurance, a national, domestic property and casualty insurer. We have included it in Table 7, since it is the largest stake acquired by a single foreign investor in an existing domestic insurance company (Tai Ping was a start-up) and would appear to indicate that a similar stake might be achievable in one of the domestic life insurers that do not currently have a foreign equity stake.

Key Issues To Consider In A Joint-Venture

There are many issues a foreign insurer needs to consider prior to establishing a joint venture life insurance company in China. Some key issues are briefly discussed here.

- **Joint Venture Partner**
  The most important issue in any joint venture is to find the right partner. Table 8 on page 8 shows a list of Chinese partners for existing and future foreign joint venture companies. It is interesting to see that several partners outside of the financial

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Table 7: Foreign Insurers' Minority Investment in Domestic Insurance Companies

Domestic Company	Foreign Insurer	Transaction Year	Purchase Share	Price (USD million)
Taikang	Winterthur	2000	10%	74
New China	Zurich	2001	10%	39
New China	Meiji Life	2001	4.5%	17
Tai Ping	Fortis	2001	24.9%	88
Huatai	ACE	2002	22%	150

Table 8: Foreign Joint Venture Life Insurance Companies

Foreign Insurer	Year of Est.	Chinese Partner	Industry Sector	Location
Manulife	1996	Sino-chem	Import/Export Trade	Shanghai
Allianz	1998	Dazhong	Non-Life Insurance	Shanghai
ING Aetna	1998	China Pacific	Life iNsurance	Shanghai
AXA	1999	Minmetal	Import/Export Trade	Shanghai
CMG	2000	China Life	Life Insurance	Shanghai
Prudential UK	2000	CITIC	Financial	Guangzhou
John Hancock	2001	Tian An	Non-Life Insurance	Shanghai
Sun Life	2002	Everbright	Financial	Tianjin
Generali	2002	China National Petroleum	Energy	Guangzhou
CGNU	N/A	COFCO	Import/Export Trade	Guangzhou
New York Life	N/A	Haierr	Manufacturer	Shanghai
ING	N/A	Beijing Capital Group	Financial	Dalian
Aegon	N/A	CNOOC	Energy	Shanghai
CNP	N/A	To be announced	-	Shanghai
Met Life	N/A	To be announced	-	Shanghai
Nippon Life	N/A	To be announced	-	Shanghai

Table 9: Statistics in Major Cities At The End of 2001 (USD billions)

City/Province	GDP	Number of Life Insurers	Premium Income	Insurance Density
Shanghai	60	12	1.7	2.8%
Beijing	34	5	1.2	3.7%
Guangzhou	32	7	0.7	2.3%
Shenzhen	24	4	0.3	1.4%
Tianjin	22	5	0.3	1.4%

services industry were selected. The current regulation does not permit banks or securities firms to have equity investment in an insurance company and this limits the universe of possible partners. A Chinese partner in the financial services sector can contribute in terms of local connections and financial expertise, brand name and distribution. Potential synergies can also be achieved by partnering with companies outside the financial services sectors but with a significant retail distribution component such as Haier, a household appliance enterprise.

While many foreign insurers appear to prefer a passive partner without life insurance experience, it is interesting that ING Pacific Antai—the fastest growing foreign-invested life insurer in Shanghai—is a joint venture between ING (previously Aetna) and China Pacific. The fact that both partners are from the life insurance industry does not appear to be impeding progress; more likely it has helped communication between partners and facilitated mutual learning. However, an ironic legacy of the pre-Aetna era is that ING has taken a 2nd partner, Beijing Capital Group, in Dalian. This raises questions as to how a multinational with multiple JV partners should expand into new regions, and how to deal with the conflicts this could create. ING is the precedent; it will be interesting to see if other foreign players follow suit, voluntarily or involuntarily.

- **Location**
  Shanghai and Guangzhou are currently the two most competitive cities for foreign-invested companies. As other cities open, foreign insurers entering China need to

select the location of their new ventures carefully based on economic and industry specific factors as well as company specific business strategies. Table 9 on page 8 shows that even for the more developed cities there is significant variation in economic activity and the level of insurance competition. Most companies are expected to adopt a geographic roll-out strategy starting in the more developed cities with higher wealth levels before expanding into less developed areas.

It is clear from Table 8 that Shanghai is still the first choice city for foreign entrants, although Manulife, ING and AXA will soon open their second branches in Guangzhou, which will reinforce it as the number two city for foreign life insurers. However, Table 9 shows that despite the lack of foreign participation, Beijing is the number two city for premium income and has a higher insurance density than Shanghai.

- **Corporate Culture and Management Control**
  Many joint ventures are experiencing growing pains due to the clash of two sets of corporate cultures and philosophies. It is common to share equally the seats in the supervisory board and executive committee between the two partners in a 50-50 joint venture. In such a venture, a dichotomy of views on both sides without an integrated management structure could significantly delay the decision-making process and detract from financial performance. Therefore, finding a partner with a similar culture and developing a clear decision-making hierarchy are both crucial to the success of the joint venture.

- **Expertise or Knowledge Transfer**
  Since the foreign insurer would typically have in-house expertise in areas such as product development and system infrastructure, the Chinese partner may expect the multinational company to contribute significantly in these areas. This may result in drawing resources from other operations in the Asian region. In many cases, the foreign partner has its own in-house administration systems, and it may be decided to install these systems in the China joint venture. One issue for consideration is whether this service and other expertise will be fully charged to the joint venture, or effectively subsidized by the multinational partner.

Future Outlook for New Entrants

We believe some of the key management issues and success factors for new entrants in China can be characterized as follows:

- Distribution Strategy – undoubtedly some companies will build successful agency forces as they have done in other East Asian markets, e.g., AIA, Manulife, ING/Aetna and Prudential UK, and these companies have all achieved initial success in China. However, it is unlikely in our opinion, that foreign entrants without a strong track record for agency distribution in the region will achieve success through a "me too" approach. These companies may be better served by exploring alternative, emerging distribution channels, e.g., bancassurance, which are currently not being fully exploited by the successful agency companies.

- Product Sophistication – while it has been argued that the market is not yet ready for more sophisticated products such as investment-linked savings plans, this is only partly true. There is a well-educated, financially-sophisticated middle class emerging, and it is not too soon to be targeting these customers. More to the point is that the average agent does not have the training nor education to sell the more sophisticated products in a professional manner, so this is perhaps more of an artificially imposed business model limitation rather than an absolute constraint. The undeveloped nature of China's capital markets and limited long-term investment opportunities is another barrier to be overcome for insurers moving up the product sophistication spectrum. However, given the pace of change and continuing easing of regulatory restrictions, these obstacles should not be insurmountable to multinational organizations commencing business in the next two to three years.

- Management Quality – the need for top quality senior management is frequently paid "lip service" but not always achieved in practice. The importance of Putonghua language skills, and the lack of experienced local managers, limits the potential pool of recruits in China to a greater extent than in other Asian markets. This will inevitably be exacerbated as more companies enter the

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market, and the demand for experienced expatriate staff will likely continue for at least five to ten years given the anticipated pace of expansion. Companies trying to limit costs in the early years of operation by sacrificing management quality, risk incurring a far greater "opportunity cost."

- Commitment to China – it would appear that some foreign insurers have joined the queue for a China license more as a formality rather than as a demonstration of serious commitment to the China market. Recently Swiss Life and Tower Life reviewed their global strategies and decided to withdraw from China before they had even commenced operations, in order to focus management resources elsewhere. While some might question the rationale of these decisions following years of funding representative offices and other investments in China, this strategy could be considered superior to a half-hearted market entry attempt, with inadequate resourcing and lack of management focus. The most successful foreign entrants to date have strong regional teams and typically provide support from a regional office based in Hong Kong.

- Differentiation – the limitations of the "me too" approach are evident in Shanghai where new entrants have struggled in a competitive market, in which most players sell similar products to the same customers through the same channels. With such a lack of differentiation it is not surprising that staff and agents have high job mobility from competitor to competitor, and turnover rates are high. The most obvious way to differentiate is by geographical location and several recent new entrants have favored Guangzhou, in addition to foreign companies moving to Beijing, Dalian and Tianjin. Furthermore, in Shanghai, and other markets experiencing greater competition, we expect to see higher levels of innovation, differentiation by branding, and a trend towards specialization in certain business lines or alternative forms of distribution. One potential example is the group pension savings market, which is believed to have enormous potential following the China pension market reforms, and we expect some of the future foreign entrants will aim to specialize in this area after 2004. The winners will ultimately be the leaders in their fields, rather than the followers.

- Partner Synergies – joint ventures around the world have a notoriously bad track record, and many partnerships are short-lived. The most successful joint ventures in China will combine technical expertise and management experience of the foreign partner, with the local know-how, connections and possibly distribution outlets of the local partner. Furthermore, both partners will share the same long-term vision. The result should be a single integrated entity that exhibits the reputation and financial strength of a top-class international organization with the domestic appeal and public relations skills of a leading local company. This is very difficult to achieve in practice, and instead the inertia and stagnation arising from political infighting and internal competition between joint venture partners can be the unfortunate outcome of a hastily conceived and poorly executed joint venture partner selection process. Happily, there have been some success stories already and we believe there will be more in future.

Going forward, we believe there are real opportunities for significant, profitable operations for both foreign and domestic companies. At the same time, there are real risks and challenges that should not be underestimated. The new entrants with no track record nor critical mass are most exposed to the risk of underperformance, yet are also in a strong position to develop and implement a successful strategy based on comprehensive research and strategic analysis of the market opportunities, while free of the legacies of outdated business models and systems. ☐

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