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## China, Peoples Republic of

## Market Development Reports

## China Logistics Profile

## 2003

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**Report Highlights:**

Although the Chinese government has invested heavily in the development of transportation infrastructure, China still lacks an integrated logistics industry at the national level.

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## I. Logistics In China

### I.A. Introduction

China's rapid economic growth and burgeoning trade, both internal and external, is placing increased pressure on the country's logistics and distribution systems. According to a report by the Economist Intelligence Unit (EIU), the volume of containers passing through Shanghai alone has grown by an average of 27% per year over the past decade. Even this figure may understate the pace of growth: current forecasts place China's total port capacity for 2003 at 47 million twenty-foot equivalent units (TEUs), an increase of 37% over 2002. Although China boasts a number of ports, domestic news sources calculate that Shanghai and the southern port of Shenzhen account for the largest share of the total.

The government of China has made substantial investments in upgrading its transportation infrastructure over the past decade, however logistics and distribution remains fragmented. According to EIU, the total cost of China's logistics industry in the year 2000 exceeded US \$200 billion, or one-fifth of the GDP and twice the cost of logistics spending in the U.S. The American Chamber of Commerce in Shanghai reports that logistics makes up at least 16% of overall product costs, compared with less than 4% in many more developed countries. These problems are affecting both imports and domestic products such as soybeans. Foreign investment in the sector remains relatively limited, due to limits on foreign ownership and other barriers to entry.

### I.B. Overview of China's Logistics Industry

The development of an integrated, nationwide logistics industry is hampered by three sets of problems. The first, and most obvious, is China's unfriendly geography. In addition to its extreme size, China is criss-crossed by major mountain ranges that cover over half of its territory, and is host to a range of special problems such as extreme altitudes

Figure 1. Map of China with selected cities



and permafrost (Tibet), deserts of shifting sand (Xinjiang, Gansu and Inner Mongolia) and seasonal flooding (the Yangtze River valley).

Second, transportation networks are heavily fragmented, with regulatory barriers that prevent consolidation. Local governments frequently protect local transportation companies by erecting barriers to outside companies, including licensing requirements, fees and inspections. In addition, the current licensing system for logistics companies is complicated and costly. Various governmental bodies require licenses to run logistical operations, including the Ministry of Communications (MOC), Ministry of Foreign Trade and Economic Cooperation (MOFTEC), the Civil Aviation Administration of China (CAAC) and the State Postal Bureau. After obtaining licenses, foreign companies must form a patchwork of partnerships with local logistics and transportation operators to build some kind of distribution network. Few licenses have been granted for nationwide operations, and even holders of those are subject to protectionist measures on the part of local governments. As a result, third-party logistics providers (3PLs) have emerged as a popular choice for multinational companies seeking to move product across the country.

Third, logistics capabilities are limited and continue to lag behind more developed nations. Key problems include inferior equipment and poorly trained workers. China's history of state ownership in this sector has left a legacy of poor management and an infrastructure geared toward the movement of bulk commodities. As a result, the system is poorly equipped to handle perishable or sensitive goods, track shipments or handle containerized shipments over land.

In short, China's logistics industry faces major operational obstacles. Government planners are now playing 'catch-up,' and the government has given logistics a high priority in its current investment plan (the 'Five-Year Plan'). Increased foreign participation is also likely to help, as China is scheduled to ease many of the barriers to foreign entry in this sector over the next few years.

## II. Major Modes of Transport

### II.A. Rail Transport

Logistics and distribution managers in Shanghai agree that rail is a good option for moving non-perishable goods. However, for consumer foods and other temperature-sensitive products, rail is a poor choice. Although heavy subsidization has ensured that rail remains the cheapest form of overland transport, several serious shortcomings make the rail industry incapable of meeting the demands of an increasingly competitive logistics industry.

First, handling practices in the rail industry are extremely poor. Goods shipped by rail are much more likely to be damaged than those shipped by road. Damage usually occurs during handling when goods are transferred between rail cars and local truck transport. Across the board, distribution and transportation workers are often not adequately trained in handling sensitive goods. At best, poor handling compromises the quality of the end product.

Table 1. Transportation Volumes (100 million tons/kilometer)					
Mode	1998	1999	2000	2001	2002
Rail	12517	12838	13663	14575	15516
Road	5483	5724	6129	6330	6783
Water	19406	21263	23734	25989	27511
Air	34	42	50	44	52
Sources: China Statistical Yearbooks, 1999, 2001, 2003					

Second, representatives from Shanghai-based Dazhong Transportation Group report that cargo has a low priority in the rail system relative to passenger traffic, which leads to delays and unpredictable delivery times. These reports are confirmed by representatives of oil crushing mills in North China, who prefer imported to domestic soybeans in part due to the unreliability of domestic rail transportation. These mills also report that extra payments may be demanded by local rail line operators to make box cars available or to give priority to a cargo during high traffic periods. Bureaucracy, poor scheduling and low speed rail lines also cause delays. According to the EIU's *China Hand*, shipments on less congested routes work within a one-week arrival window, whereas for congested lines, the arrival window stretches up to four weeks. Some cross-country deliveries can take up to 60 days. For perishable products such as meat, dairy, frozen foods and produce, shipment by rail is simply too slow and unpredictable.

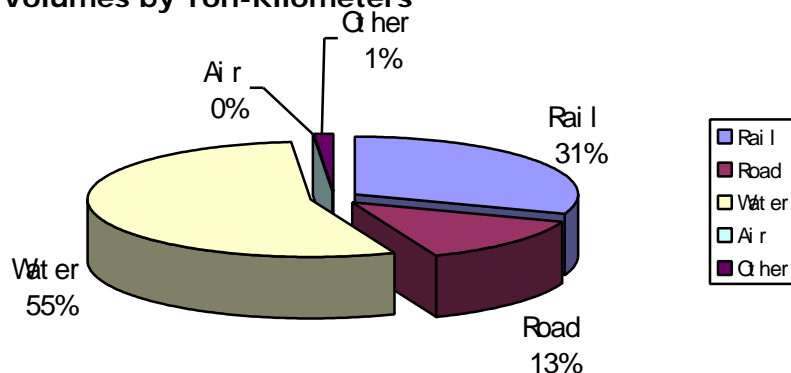
A third problem is that goods shipped by rail must be shipped in bulk. A minimum ten-ton requirement is usually attached to most shipment orders. The cargo sizes for many small and mid-sized distributors are often not large enough to be shipped in such high volume.

Fourth, theft of rail freight is an endemic problem. Security measures can be strenuous and sometimes even require the manufacturer to employ its own security guards on trains to safeguard its goods. Poor circulation of information also means that goods shipped by rail are almost impossible to track.

In light of these shortcomings, the Ministry of Railroads (MOR) is taking steps to improve the rail system and coordinate operations with foreign shipping firms. The 7,000 km track construction scheme mandated in the Tenth Five-Year Plan, dubbed as the "eight verticals and eight horizontals," constitutes 16 lines that cover a wide expanse of China's geography. The MOR is consulting with overseas logistics firms in an effort to streamline China's movement of cargo and resolve inefficiencies. For instance, many Chinese railway containers are still incompatible with those used by overseas shippers, requiring the unloading and reloading of cargo. In addition to upgrading the infrastructure, the MOR is modifying stations to handle foreign containers.

The government continues to promote foreign investment in rail construction as a means of financing its gargantuan infrastructure plans. At present, MOR claims that over 100 joint-venture railway lines are running across the country. WTO commitments are also encouraging foreign investors to enter into the sector. By 2004, foreign majority shares in rail freight JVs will be allowed, while the entire domestic rail cargo sector will be fully opened to foreign investment by 2006. Currently, Maersk of Denmark, Orient Overseas Container Lines of Hong Kong, U-Freight of the U.S. and German-run DHL operate trial joint ventures with state-owned companies. JV rail services allow for improved tracking of goods and faster customs clearance times. Additionally, foreign rail operators can offer specialized services and technology, such as refrigerated container services.

**Figure 2. Freight Volumes by Ton-Kilometers**



While a foreign presence in the goods transport chain helps minimize some of the pitfalls common to shipping by rail, inherent shortcomings in the infrastructure mean that rail is still an undependable option for the distribution of perishable and time-sensitive goods.

## II.B. Road Transport

Heavy government spending since the mid-1990s and the unreliability of the rail system have positioned road transport as foreign and domestic companies' most popular choice for the distribution of goods, especially consumer food products. But because the trucking industry is extremely fragmented and has never been organized on a national basis, no single trucking firm can offer truly national coverage.

As China's entry into the WTO stimulates ever greater volumes of trade each year, the road transport sector has struggled to keep up with higher demand. Logistics managers and road transport providers have identified several issues common to trucking. First, from a provider's standpoint, truck prices are rising due to more stringent emissions standards and the need for more sophisticated technology. Higher capital costs equal even greater financial barriers for local companies trying to upgrade their equipment. Second, truck maintenance is sub-standard. Although trucking companies are technically required to undergo inspections on a regular basis, in practice they rarely do. Only one-fifth of China's freight trucks are containerized, which means that the majority of cargo is vulnerable to damaged as it sits unprotected on flatbed, open-backed vehicles. Third, overloading of goods is a typical way through which companies try to cut costs. Transporters are known to haul some 50% in excess of their legal payload, sometimes even higher. A recent increase in police checks and fines is encouraging companies to heed capacity limits, however, overloading is still rampant and often results in delays and higher costs. A fourth problem with trucking stems from city authorities' inclination to protect local businesses: Non-local trucking firms are often prevented from entering city limits during the day. In Shanghai, for example, trucks greater than 1.5 tons are permitted to enter downtown areas only between 7 pm and 7 am, and only on even or odd days, depending on their license plate numbers.

Despite these shortcomings, the construction of several new expressways has expedited run time, especially on longer-haul routes, and therefore has increased competition. Long-distance truckers are less vulnerable to local government regulations on these expressways, enabling them to operate inter-city routes. The emergence of hundreds of state-owned and private long-distance trucking companies has led to competitive prices and higher incentives to deliver goods more quickly, especially along the busy east coast corridor. Thanks to the newly constructed expressways, the trip from Shanghai to Guangzhou can be completed in as little as 36 hours with two drivers, whereas it used to take three to five days.

Newly constructed roads are also changing the nature of the rural economy. In rural areas where refrigerated freight is still lacking, speed of delivery is vital. With the rise of new expressways connecting rural provinces to coastal regions such as Shanghai, farmers are now able to ship their crops directly to urban markets in a much shorter time. This has allowed them to diversify into more perishable but higher-value products such as fruits and vegetables, which are in high demand in China's coastal cities. Notwithstanding the Hong Kong 'gray channel' and other means of transporting imported fruit and other agricultural products into the country, the growing road network is helping domestic farmers by linking scattered Chinese production to urban markets and ports, thereby raising rural incomes.

An estimated 2.7 million trucking providers offer services across the country, transporting roughly 10 billion tons of goods annually. Sinotrans, China's largest provider, has a registered fleet of 3,000 trucks and specializes in long-distance service, while local operators can offer cost-effective short-distance service. In major cities, consolidation in the form of

joint ventures is a growing trend. Sinotrans, for instance, has roughly 50 subsidiaries and nearly 270 joint ventures. Firms also are increasingly expanding from traditional freight forwarding to comprehensive logistics services, offering warehousing facilities, ships, railway storage areas and/or port terminals.

### II.C. Water Transport

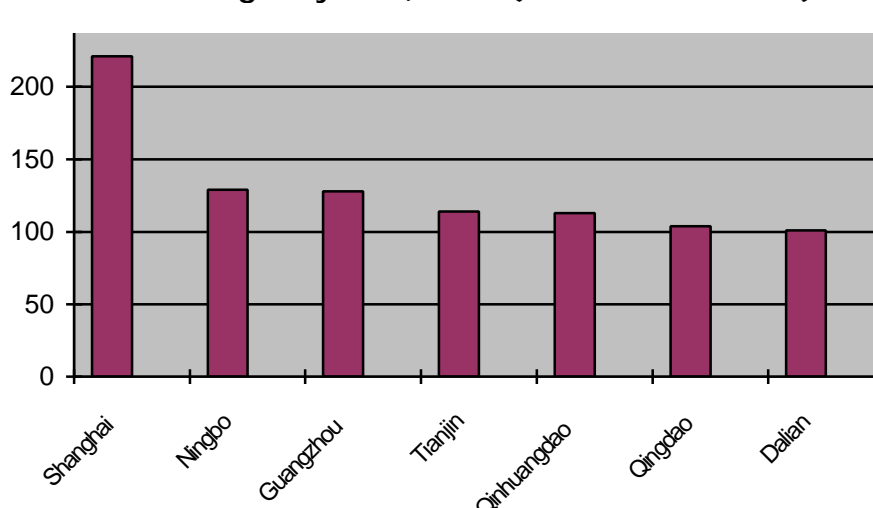
Shipping, both coastal and inland, has been used in China for thousands of years and today accounts for over half of all domestic freight traffic. Barge costs are generally low, and bookings are easy to obtain. Shipping by vessel is best suited for moving bulk commodities rather than distributing final products; about two-thirds of local barge traffic is comprised of commodities for industry and agriculture, such as coal and grain.

According to the MOC, navigable inland waterways total 122,000 km in length. With over 18,000 km of coast, China also has three major rivers that provide access to inland regions. The Yangtze River (or *Chang Jiang*) is China's longest navigable river, at 6,300 km. Shipping by barge is cheap, comparatively safe from pilferage, and the industry is dominated by large local companies with cross-border operations.

Although China's vast collection of inland waterways has allowed it to use water transport for centuries, lack of investment has contributed to a growing list of shortcomings. Outdated equipment, inadequate IT systems and obsolete inland port infrastructure place barge transport at a disadvantage with newer competitors such as road and rail.

As with other forms of inter-modal transport, China's port infrastructure suffers from several shortcomings in terms of efficiency and service. First, mainland wharves average between 22 and 27 crane moves per hour, compared to 30 per hour in Hong Kong. Second, bottlenecks are common as containers are slow to transfer from port to trains or trucks, often requiring at least two crane movements per connection. Bureaucracy serves as a third and familiar problem that hampers efficiency. Shipping companies must obtain regulatory permission from Customs; the State Administration of Quality Supervision, Inspection and Quarantine; the State Administration of Foreign Exchange and various other government bodies. Fourth, cargo losses are higher in China than in Hong Kong or Singapore, due to theft and damage. Finally, shipping is still a relatively restricted sector, with foreign companies allowed to hold only a minority stake in Chinese port facilities.

**Figure 3. Volume of Freight by Port, 2001 (million metric tons)**



Source: China Statistical Yearbook, 2003

Since neither a lack of barge capacity nor waterway congestion present major problems, the government is keen to upgrade the infrastructure for water transport. According to the MOC, China's principal ports handled more than 26.5 million TEUs in 2001, up 20% from 18.7 TEUs in 2000. Currently, China has more than 1,200 ports offering berths for 33,000 vessels, including 800 deepwater berths capable of handling 10,000 ton vessels. Major increases in containerized handling capacity are planned for 2005. Despite restrictions, foreign companies are making inroads into the industry. The MOC and other government agencies have entered into talks with international shipping companies and have committed themselves to developing regulations that require shipping lines to file freight rates. All of these are signs of increasing transparency in the industry.

The government is also capitalizing on foreign interest in port construction. The Shanghai Port Authority has already begun work on a 20-year, US \$14.5 billion project that aims to build 52 berths along a 13-km waterfront with a draught of at least 15 meters at the Yangshan Deepwater Port. Hamburg Port Consulting, a subsidiary of Germany-based Hamburger Hafen und Lagerhaus-AG Group, is designing the mainland container terminal. The first phase, construction of the deepwater berths, is due for completion in 2005 at a cost of US \$1.5 billion. The second phase will see the construction of a 30-km 4-lane bridge for the transportation of cargo to Shanghai from the islands of Dayangshan and Xiaoyangshan—the base of the new port. The final phase will involve the connection of all port utilities.

#### **II.D. Air Transport**

China's airfreight sector's annual value stands at US \$500 million per year, with three domestic airlines controlling roughly 60% of the market. The cargo divisions of China Eastern, Air China and China Southern have all entered into domestic joint ventures and offer a diverse array of services.

However, for the distribution of consumer products, including food and other sensitive goods, airfreight is almost never used, since trucks can reach most destinations within a few days and at far lower cost. Furthermore, the infrequency of flights to more outlying cities cancels out airfreight's time advantage over ground transport. The sector is further constrained by low cargo capacity and an underdeveloped airport infrastructure. According to a local aviation newspaper, China has just 13 airports per 10,000 km.

As with other sectors in the logistics industry, the government's Five Year plan outlines a major development program for air infrastructure. By 2005, the CAAC plans to add 400 aircraft and increase the number of airports to 170, raising air cargo handling capacity from 2 million tons to 5.6 million tons. The presence of international courier companies in China is also growing. DHL World Express, United Parcel Service (UPS), Federal Express (FedEx), TNT Express Worldwide, and Japan's OCS all have joint venture operations that allow them to carry international express letters and packages into and out of China. Additionally, most international airlines provide cargo flights in and out of China.

#### **III. Logistics Services**

##### **III.A. Third-Party Logistics Providers**

In the U.S. and Europe, consumer goods firms generally outsource logistics needs to third-party logistics providers (3PLs). Although 3PLs control a small share of the overall logistics market in China, they are growing in importance for multinational companies and organizations looking to set up or expand operations on in China. 3PLs are essentially supply chain managers who subcontract some of their logistics requirements to container lines,

trucking firms and airfreight companies. Many own assets such as distribution centers, warehouses and trucking fleets, and a growing number of providers are expanding to offer across-the-board services. For consumer goods companies looking to move their product into or around China, outsourcing to a 3PL can mean lower supply chain costs.

According to Morgan Stanley, while 3PLs currently handle just 16% of final products in China, more foreign and local 3PLs will enter the market over the next five years. The emerging 3PL industry in China may be categorized into four types:

- *Large SOEs* (such as Sinotrans, COSCO and China Post) with extensive transport and warehousing assets, broad national networks, and strong relationships with central and provincial governments. These firms already enjoy a monopoly in several areas of trucking, shipping and postal services.
- *Medium-sized domestic logistics providers* (generally privately owned), which focus on one or two key industries.
- *Logistics divisions of manufacturers and processors*, primarily providing services to internal customers, but sometimes offering 3PL services to outside companies. The Shanghai Fruit Distribution Center is an example of a subsidiary company that has sought to internalize logistics needs. However, as an SOE, the division is struggling to update its facilities and compete with private counterparts.
- *Foreign logistics providers*, including multinational firms, new Wholly Foreign Owned Entities (WFOEs) and smaller firms working in niche markets.

China's leading 3PLs are large foreign companies licensed to operate as WFOEs. Also growing in importance are foreign companies that are currently restricted to operating as joint-venture partners or through free-trade zones (FTZs). In 2001, the government of Shanghai's Pudong New Area lifted all restrictions on warehousing and logistics companies setting up operations in the Wai Gao Qiao Bonded Zone, equalizing their position with trading companies in the zone. Foreign companies are now allowed to operate these warehouses themselves to store a wide variety of raw materials, parts and other finished goods for onward sale and shipment into China. In Wai Gao Qiao, foreign operators generally maintain high-standard warehouses at their manufacturing facilities, which can double as regional distribution centers. A growing number of providers are "one-stop-shops" that offer wide-ranging import distribution services that extend beyond logistics.

By 2004, all of these firms will be permitted to operate as WFOEs, and will be free to offer a wide array of services, provided they obtain the necessary licenses. An outline of the status of the different services and their licensing authorities is given below.

<b>Table 2. Regulatory framework for foreign participation in distribution</b>		
<b>Sub-sectors</b>	<b>Foreign participation</b>	<b>Authority for license approval</b>
International freight forwarding	Regulated	MOFTEC
Airfreight forwarding	Regulated	CAAC, MOFTEC
Logistics center	Encouraged	MOC, MOFTEC
Domestic trucking	Regulated	MOC, MOFTEC
Consolidation	Regulated	MOC, MOFTEC
Warehousing	Encouraged	MOC, MOFTEC
Customs brokerage	Heavily Regulated	CGA, MOFTEC
Shipping line	Regulated	MOC, MOFTEC
Airline	Heavily Regulated	CAAC, MOFTEC
Source: Hong Kong Trade Development Council, EIU		

From the logistics provider's standpoint, both foreign and local 3PLs are faced with two choices in the growing commercial economy: invest up front in a national network and wait for clients to come; or claim national coverage and struggle to meet subsequent client demand. Most 3PLs outsource most of their logistics operations to local firms, encouraging 3PLs to choose the second option. In the short term, that choice is more palatable, allowing businesses to oversee operations without having to invest heavily in equipment and personnel upfront.

However, 3PLs offering domestic supply chain management face a hard sell in China because their high costs put them out of reach of most local companies. Based on the table above, it is evident that 3PLs also fall between the cracks of China regulatory bureaucracy, at least for the time being.

### **III.B. 3PLs and Intermodal Transport: A Case Study**

Xintiantian Distribution Center, a subsidiary of Shanghai Food Group, is one such distributor that entered into a three-way joint venture with Shanghai's Dazhong (a trucking/transportation company) and Mitsui O.S.K. Lines, a Japanese distributor, on October 1, 2003. Xintiantian is a typical example of a delivery center that evolved from a larger SOE and now offers specialized logistics services. Xintiantian provides refrigerated storage and distribution services, with 12,000 tons of cold storage capacity (or 4% of Shanghai's total 325,000 ton cold storage capacity). The aggregate cold storage capacity of Shanghai Food Group and its subsidiaries amounts to 130,000 tons, or 40% of Shanghai's total. Xintiantian offers three basic services: cold storage, simple manufacturing (including packaging and labeling) and delivery of refrigerated goods to retail outlets. The company services a variety of foreign and domestic clients, including hypermarket chain Metro and convenience store chain Alldays. A synchronized computer system allows Xintiantian, its suppliers and store branches to view the status of orders in real time. The company presently has a registered fleet of about 40 refrigerated trucks (some equipped for transportation of frozen goods and some for fresh or perishable goods).

### **III.C. Cold Chain: Refrigerated Storage and Distribution**

Refrigerated shipment and storage of goods is relatively undeveloped in China, notwithstanding technical advances and increased investment in the coastal areas in recent years. Refrigerated trucks and warehouses are still quite rare, even in coastal areas, and different goods may require different cold storage arrangements, which many of the existing refrigerated storage facilities have difficulty providing. For example, fresh and chilled goods may be stored between 0 and 10°C, while frozen goods such as ice cream must be kept at – 18°C. As a consequence, some foreign food companies, such as Haagen-Dazs, handle cold storage and distribution responsibilities themselves, to ensure the safety and quality of the product. Most manufacturers, however, do not have the manpower or resources on the mainland to maintain such expensive equipment, and choose instead to hire 3PLs to take on the task for them.

A small but growing number of specialized firms, such as Xintiantian, serve as 3PLs, covering the movement of temperature-sensitive products. There are also a growing number of foreign-owned or managed logistics providers such as E-Merge Logistics, based in free-trade zones. A number of these have access to bonded, temperature-controlled facilities, in addition to providing a wide array of services such as inventory control, customs clearance and foreign currency exchange.

#### IV. Current and Planned Improvements to Logistics Infrastructure

The Chinese government recognizes that transportation and logistics limitations have the potential to become a bottleneck for future economic growth. This is reflected in the heavy commitment made toward modernization and expansion of the transportation infrastructure in the government's main investment planning document (the Five Year Plan). In setting its plans, the government has identified three key tasks. 1) Development of infrastructure for waterways, roads and rail. 2) Standardization of regulatory requirements. 3) Increased foreign participation in logistics and distribution.

Infrastructure development must include improvements to the conditions of waterways, roads and railways. To expand the capabilities of waterways, the government's plans include the construction of 135 new deepwater berths and upgrades to 45 existing berths, adding at least 20 million TEUs to China's national container handling capacity. In particular, Shanghai seeks to increase its container-handling capacity. Shanghai has moved from being the world's 6th largest port in container-handling capacity in 2000, to become the 3rd largest behind Rotterdam and Singapore.

<b>Table 3. Top ten international ports for container traffic, 2000 (1999)</b>		
<b>World ranking</b>	<b>City</b>	<b>Total TEU (millions)</b>
1 (1)	Hong Kong	18.10
2 (2)	Singapore	17.04
3 (4)	Pusan, South Korea	7.54
4 (3)	Kaohsiung, Taiwan	7.43
5 (5)	Rotterdam, Netherlands	6.28
<b>6 (7)</b>	<b>Shanghai, China</b>	5.61
7 (8)	Los Angeles, US	4.88
8 (6)	Long Beach, US	4.60
9 (9)	Hamburg, Germany	4.25
10 (10)	Antwerp, Belgium	4.08
Source: Containerization International, <i>Business China</i>		

The Shanghai Port Authority has also launched a long-term dredging program to increase the depth of the Huangpu River (Shanghai's main river), but current plans do not yet provide a permanent solution to the problems of heavy silting and the river's relative narrowness and shallowness. Nevertheless, after port expansion, Shanghai will only trail Singapore (and possibly overtake it) in worldwide TEU handling capacity.

For land transportation, the government's plans allocate RMB 1 trillion (US \$120 billion) for highway construction. By 2005, about 200,000 km of roads will be complete, bringing the national total to about 1.5 million km. Some of the major plans include the 2,000 km Shanghai-Chengdu Highway and the 2,500 km Beijing-Zhuhai Expressway.

The government has invested RMB 350 billion (US \$42 billion) to build new railways, upgrade the existing network and improve the speed of delivery. This budget is earmarked to add a total of 7,000 km of new track to the existing total of about 75,000 km. These ambitious plans require the construction of about 3,000 km of track per year, as compared to an average of just 700 km of new track per year over the past ten years. To achieve its targets, the Ministry of Railways has actively solicited consultants, suppliers and investors, both domestic and overseas.

China's government is relying on foreign participation to help lower costs and increase competition. Under its WTO accession agreement, Beijing committed to open the distribution

and logistics sectors to foreign participation by 2006. Increased foreign competition is expected to hasten consolidation within the industry, and hopefully will work to reduce long-standing problems of inefficiency, substandard equipment, poor management and poorly trained labor.

The Mainland/Hong Kong Closer Economic Partnership Arrangement (CEPA) is a special free-trade agreement in which China agreed to allow preferential access to China, above and beyond WTO commitments, for goods and services suppliers in Hong Kong. Thus, CEPA is designed to provide Hong Kong companies, which would include Hong Kong subsidiaries of non-Hong Kong multinationals, an additional competitive edge over non-Hong Kong companies that receive only the general benefits of China's WTO accession.

<b>Table 4. Market access restrictions in logistics services</b>	
<b>Sector</b>	<b>Limitations on market access</b>
Road	-Foreign majority stake of up to 75% in JVs currently permitted; wholly foreign-owned enterprises (WFOEs) permitted by 12/11/04 -CEPA allows WFOEs from 1/1/04
Rail	-From Jan 1, 2003, foreign majority stake permitted; WFOEs permitted from 1/1/06 -CEPA allows WFOEs from 1/1/04
Maritime	-Minority shares allowed in JVs, degree depends on sub-sector of maritime transport services -CEPA allows WFOEs from 1/1/04 in most areas, depending on sub-sector
Storage and warehousing	-WFOEs permitted by 12/11/04 -CEPA allows WFOEs from 1/1/04
Freight forwarding	-Foreign majority stake of up to 75% in JVs currently permitted; WFOEs permitted by 12/11/05 -CEPA allows WFOEs from 1/1/04
*CEPA agreements apply to "qualifying Hong Kong service suppliers," which can be taken to include Hong Kong permanent residents and juridical persons such as corporations, trusts, partnerships, joint ventures, sole proprietorships or business associations organized under the relevant laws of the Hong Kong SAR.	
Source: US-China Business Council; Access Asia; Baker & McKenzie	

The government's ambitions, as laid out in the Five-Year Plan, in accordance with the implementation of WTO and the Sino-U.S. bilateral agreements, deem the next few years as crucial to the development of an integrated logistics and distribution industry. Accordingly, the central government continues to encourage state-owned firms to form alliances with both domestic and foreign partners.

## V. Business Hints

When devising a distribution strategy, firms should bear in mind the rapidly changing nature of China's developing economy, and be as flexible as possible in dealing with unexpected setbacks or opportunities. It is important to remember that China is a unique market: it is a mistake to assume that experience in other markets, even post-communist ones, will smoothly translate into success in China. Shortcomings in transportation infrastructure, the constantly evolving legal environment, limited business expertise at the local level and arbitrary enforcement of commercial regulations can combine to complicate matters on the ground. One key measure that businesses can take to reduce their risk is to conduct their due diligence: the Chinese partners that a company works with are often the key to success or failure.

Manufacturers and exporters should also consider the following when crafting their distribution strategies in China:

- *Focus on achieving depth, rather than breadth, of market penetration.* This may mean limiting activities to a single city or region. Fragmented local logistics systems make distribution across large areas more difficult and expensive. In addition, China's vast size and economic and cultural diversity make it nearly impossible to enter all markets simultaneously.
- *Carefully consider the regulatory risks.* Although enforcement of commercial regulations at the national level has become more transparent under WTO, local enforcement remains arbitrary. Some rules are not widely publicized, while others are vague and open to interpretation. Reliance on a favorable interpretation of the regulations is dangerous. Companies should be aware of where the potential risks lay, and consider preparing a strategy to cope with an unfavorable change in interpretation. Since many of the rules are not publicized, identifying them will require working closely with an experienced Chinese partner.
- *Exercise caution in the selection of Chinese partners.* As noted before, Chinese partners can be the key to success. A partner with prior experience in the area will be able to identify potential pitfalls and will have the network of business and government contacts needed to do business in China. To remain adaptable in China's ever-changing markets, it is advisable not to become overly reliant on a single partner. Ideally, partnership arrangements should give the Chinese partner a clear stake in the success of the venture.

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