

**Subject:** China Investment: Don't Throw Baby Out with the Baby Toys

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## **Global View**

*Insights and Interviews from Granite Global Ventures*

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### ***China Investment: Don't Throw Baby Out With the Baby Toys***

*By Jixun Foo, GGV Managing Partner*

The buzz around China emerging as a global business player has been tempered by the recent string of product recalls—from pet food and toothpaste to lead paint in children's toys.

But in looking at the Chinese market, it's important to not throw the baby out, even as you toss the baby toys.

In many ways, China is where Japan was 40 to 50 years ago. Once viewed as a provider of cheap goods, Japanese companies such as Honda, Sony and Toyota are now standard bearers for quality consumer products around the globe. Similarly China is in the early adolescence of its economy, and as rapidly as it is developing, there are still growing pains.

The government in China has been actively working to mitigate those pains by addressing quality and safety concerns on multiple fronts. Recently it has, not only banned lead paint in toys, but also put into place systems of recall for unsafe food and toys targeted at both domestic and global consumption. These recall systems are closely modeled after the recall system China created for defective cars in 2005.

In 2006, China also passed two regulatory frameworks that are stricter versions of their European Union counterparts. The "Management Methods for Controlling Pollution Caused by Electronic Information" regulation is China's counterpart to the EU's "Reduction of Hazardous Substances" (RoHS) mandate. Similarly, the "Regulations on Recycling and Disposal of Waste and Used Household Electrical Appliances" complement the EU's "Waste Electrical and Electronic Equipment" (WEEE) directive. Both mandates affect products made in China or imported into the country.

At the same time individual companies, particularly those with an eye toward global commerce, are implementing rigorous standards and obtaining internationally recognized certification for business processes, safety, and quality. Two of the better-known quality Chinese brands are PC-maker Lenovo and Haier, the world's fourth largest white goods manufacturer. Our own portfolio companies are also examples of the many quality-driven companies emerging in China. These companies know that each day consumers vote on products with their dollars, yen and Euros—and that to win, Chinese products must be world class.

HiSoft, which provides software development services to leading global corporations, was the first Chinese software company to achieve enterprise-level CMM5 certification, the industry's highest quality standard. The ISO 9001-certified company also operates the first Global Development Center set up in China by General Electric.

Chaoli has a decade of experience producing heat exchange systems and electronic control systems for the automotive industry. It led the quality system authentication of TÜV for ISO/TS16949, passed the ISO 14001 review of environmental management system authentication, and earned the V1000 certificate for supplier quality systems.

BCD Semiconductor Manufacturing holds certification in ISO 9001/9002, ISO 14001 and ISO/TS16949. It also is a Sony Green partner.

Outside the manufacturing sector is Chamate, a popular chain of Chinese teahouses that serve meals. There, globally recognized restaurant best practices and systems are combined with fresh, local produce and connoisseur teas.

In China's emerging market, it can be difficult to sort out the pioneers in quality and safety from firms that have not yet adopted international standards. Moreover, there are many "diamonds in the rough" here that have great concepts and the right motivations, but need guidance on how to execute upon them.

Leading international retailers and consumer goods companies, such as WalMart and Mattel, that want to leverage China's competitive advantages also share responsibility for meeting the safety and quality standards their customers require. Most recently, Mattel has apologized to its Chinese suppliers for providing them with faulty designs featuring small magnets that could be dislodged from their toys. Mattel's acknowledgement of its role in the highly publicized toy recall is an important step that reflects the need to work in concert with Chinese partners to ensure children's toy safety.

China also needs venture capital investment in traditional industries, which are bolstering its economy's industrialization, urbanization and globalization, observes Andy Xie, a leading economist. He notes that venture capital investors, not only provide financial support, but also nurture businesses. Investors can help Chinese firms develop the good management and strong governance practices that will orient these companies toward building long-term corporate value versus short-term profit gains.

An integrated, international investment team provides Chinese entrepreneurs additional leverage. True value comes from investors who can work with firms in applying international standards, taking lessons from the US and other countries, and sharing their knowledge with Chinese companies on how to avoid making the same mistakes.

Employing an integrated global team also offers strategic advantages to investors. A local team is fine when Chinese companies compete only with other Chinese companies. But in cases where a business wants to compete worldwide, it's important to have teammates in the US, who can help raise the quality of services or products to international standards.

The rapid growth of China's domestic consumption is also fostering the adoption of higher quality standards. As consumers gain more disposable income, they also are redefining what quality means in everything from baby formula to solar panels to restaurants to autos.

It will take some years for quality and safety standards to become consistently adopted. But through the combined efforts of China's government, businesses, consumers and investors, the Chinese economy is on a fast track toward embracing—and in some cases improving upon—worldwide best practices.

*The Global View from Granite Global Ventures provides insights and interviews on expanding global innovation.*

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