



CHINA BRIEFING

A Practical Monthly Guide For Practical China Business

April 2002

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BEIJING OLYMPICS PROJECT TENDERS

MANDATORY STAFF WELFARE PAYMENTS

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JUST IN CASE YOU GET SENT TO: SHENZHEN



THE DEZAN SHIRA CHINA GROUP

WE GET OUT THERE

Welcome to the April issue of "China Briefing" and to the subjects of tendering for Beijing Olympic projects, Staff Welfare Payments, Outsourcing your Assembly & QC and an overview of Truck Transport in China - all useful topics and we hope you find them of use in evaluating your China businesses. We have been busy as always conducting the groundwork and meeting the Chinese Government players who really matter in these issues - as the title says "We Get Out There" and our connections with the people who can get things done are especially a mark of our success and understanding of the China market --- something our clients share in and take advantage of over their competition as we update them with the very latest in policy and timeframe developments - if you need to know what is really going on you may want to call us.....kinda separates the men from the boys.

Meetings with State Tax Officials

With such a lot going on with WTO kicking in, the Olympics being awarded and various other regulatory regimes and changes taking place what better way to learn first hand the real deal by asking the Senior State Planning Officials directly. To this end we met with the Head of the State Tax Bureau, Zhang Zhiyang who in a frank and detailed meeting outlined the new policies and alterations in China's tax regime and how these are to be implemented, and over what period. We have always found China's Tax Bureau to be frank and courteous, and Mr. Zhang was the epitome of this. For further information on the latest developments of tax implementation please contact Dezan Shira & Associates at info@dezshira.com, or contact Chris Devonshire-Ellis directly (usually to be found in Shanghai for the next few weeks) (021) 6279 8658.

DSMR's New Warehouse Facility

Trading-wise our sourcing business, DSMR have recently invested in their own warehouse facility in South

China, offering re-packaging and stock consolidation facilities to our clients across the PRC for subsequent re-export overseas. DSMR specialise in product sourcing in China, and this new service gives us the ability to offer more than just sourcing services but real warehousing and consolidation facilities as well. If you need such facilities please contact DSMR's regional office at (0755) 366 4127 or email milreb@dsmrchina.com - their Managing Director Mike Bellamy will be pleased to assist with any enquiries.

Norac AS Establish WFOE in Suzhou

Norac AS of Norway recently established their WFOE in Suzhou manufacturing wet units for shipping vessels assisted by Dezan Shira & Associates Shanghai office. The venture was structured in such a manner to give a Chinese party equity in the Hong Kong holding company owning the WFOE thereby allowing better control of the venture from the foreign parties perspective, and access to foreign capital repatriation externally from the Chinese parties perspective - all in all a win-win situation. For structures involving Foreign/Chinese, or 100% foreign operations in China please contact Dezan Shira & Associates at info@demhira.com or view their extensive China website at www.dezshira.com.

China Briefing Online

If you want to forward copies of any of these articles to your overseas colleagues - we have set up an on-line edition -- just click on www.china-briefing.com and it is all there for your review. Need further help? Just email or call us? We are here to help.

China Logistics Domestic Shipments

Back to our China Logistics business, their Managing Director Jamie Gwynn has been very busy running around the country speaking at various seminars, so look out for him at local Chamber events or the big conferences -well



Tax update meetings with Zhang Zhiyang, Head of State Administration for Taxation, Beijing



DSMR's head of Operations Lion Liu (center) shows off DSMR's new warehousing facility in South China



Congratulations to Arne Borg of Norac AS of Norway - new factory in Suzhou.

worthwhile picking his brains over your China strategy and how to maximize the efficiency of your domestic operations. Their client Asian Express has been happy with domestic shipment services between Shanghai and Guangzhou on a daily basis - with our web track and trace we ensure goods are collected and delivered on time. For further information please contact China Logistics at: (021) 6279 7330, email to info@PRCLogistics.com; or visit their website at www.PRCLogistics.com.

Foreign Company Service Centers

These are the friendly services offered either in Free Trade Zones or in Foreign Investment Offices who process applications for Representative Offices, Wholly Foreign Owned Enterprises and Joint Ventures. As such they are very good at the application process and can offer such services at rock bottom prices being subsidized by the local Government. Understandably keen to secure your signature, there are points to be aware of when dealing with them: **Impartiality:** As part of the local Government, they may not offer the best advise as regards tax savings, cost reductions or expense minimization, nor offer advise contrary to the maximum ill-being of any Chinese investor.

Expertise in Profits Repatriation:

Essentially a tax structuring exercise, maximizing your profits (see last months issue of China Briefing) requires full

accounting training to international standards and. a thorough grounding in Chinese company law to obtain the optimum results.

In all cases we recommend seeking professional advise, Service Centres are good as mentioned at processing applications but do not expect in-depth legal or tax knowledge, nor any desire to explain the finer points of maximizing your investment. Split the process in two: Service Centers to handle applications, Professionals to review documentation and handle structuring. That extra money spent now will be repaid many times in a more efficient business.

Devon Energy China Ltd

Thanks to our long term client Devon Energy China Ltd who we originally began working with way back in their Santa Fe days - one of the few oil drilling companies in China to have done well and now pumping oil in the South China Sea. We have handled their tax 1 accounting for several years and thanks to them for their Chinese New Year Party invite - we had a great time ?

Have an enjoyable Spring?



Chris Devonshire-Ellis
Group Chairman



China Logistics' Jamie Gwynn with Asian Express's General Manager Sha Saleh (centre) and CL's Peter Li, a happy customer knowing their goods are collected and arriving on time and can now plan properly the international end of their operations. All this and they saved money too....



Dezan Shira & Associates Shenzhen CPA Emily Shao pictured here with Willie Chow from Devon Energy China Ltd - a successful long term accounting relationship.

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To demonstrate our commitment to the development of international trade and business with China, the Dezan Shira China Group produces "China Briefing" as a free monthly advisory service, for all companies and individuals interested in or actively participating in China commerce. With a print run of some 25 000, and significant costs in production and mailing, this is our way of putting something back into the China International business community. All that we ask is that our company services are considered when you are in need of China business assistance or advice. Ok, that is the deal - now how to get this free: if you are in Hong Kong or China, please just fill in the form and fax it to us, we will update our records and send it you free via post every month. For international (i.e. non-China or Hong Kong addresses) sorry, we will have to send you our email issue instead - send your details to us at publication@dezshira.com

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BEIJING OLYMPICS PROJECT TENDERS

By Chris Devonshire-Ellis, Dezan Shira China Group

With these now having been awarded to China there has been a great deal of preparatory activity taking place as regards project and infrastructure evaluations and the placing of officials in positions pertinent to assuring the Games long-term success. In what will be a series of updates we will bring you an overview of where China is with project bidding and what projects and timescales for completion have currently been defined. We have established and maintain excellent relations with the Beijing Olympics Preparatory Committee, statistics mentioned have come directly from meetings with them although these may be subject to later change as developments take place.

Infrastructure Projects for International Tender

These are currently being assessed and divided into the following categories: Preparatory Projects, Municipal Infrastructure and Sports Facilities. These are further divided into the following sub-categories, in order of development:

- Environmental Impact
- Transport Development
- Building Construction
- Security
- Culture
- Telecom / I.T.

China intends to provide state of the art I.T. facilities - meaning some consulting is required for tendering as 2008 is a long way ahead in this field and will almost certainly include technology not yet developed or available. All of the above areas will be opened for foreign companies to participate in bids for tends. A full

project tender list is due to be released in June this year - we shall of course be keeping our clients aware of opportunities, application procedures and providing strategic tender advise and support services.

Known Major Projects

Capital Airport: One additional runway. Increased passenger throughput to 48 million per annum from current capacity of 30 million.

City Rail: 3 new light rail lines being planned. 2 new additional subway lines.

Green Field: Olympic Park of some 1 sq km to be constructed in central Beijing, with lake and exhibition hall.

Stadia: 19 new stadiums to be constructed, 13 existing stadia to be fully refurbished.

We will be advising on matters relating to provision and examination of tenders, application procedures and other support issues to international contractors wishing to participate. Please contact Chris Devonshire-Ellis, Dezan Shira China Group's Chairman's Office for more information about these services at:

Tel: (86) 10 6462 2175

Fax: 10 6465 1240

Email: chris@dezshira.com

Web site: www.dezshirachina.com



Chris Devonshire-Ellis with Beijing Vice Mayor Liu De Hua, Head of Beijing Olympics Preparatory Committee



With Ping Yongquan, Head of Project Tender Assessments, Olympics Preparatory Committee



Madame Yuan Bin, Head of Olympics Marketing, Preparatory Committee.



Beijing 2008



MANDATORY STAFF WELFARE PAYMENTS

By Emily Shao, Emily Zeng & Alice Wei, Dezan Shira & Associates

Foreign Invested Enterprises (FIE's) engaging staff in WFOE's and JV's are liable for certain mandatory welfare payments to their employees. Representative Offices however, have this arranged for them via FESCO who will organize all these payments on the foreign companies behalf (See "China Briefing" December 2001 for further info on this). With WFOE's and JV's then essentially being responsible for payments, what funds must be paid, and in what percentage of salary? This article provides a guideline to what amounts to what funds to help keep you in compliance with labour laws. There are regional variations over the percentages and we list rates in a variety of different cities - please contact us if you need information on other locations.

Contributions listed are against basic salary, company contributions as a percentage of this first, the employee's contribution second.

Pension Fund

Rates vary dependent upon location, however the company may appoint a Chinese Insurance Company to manage these funds. Contributions are:

- **Shanghai:** Employer: 22% Employee: 6%
- **Beijing:** 19% + 7%
- **Tianjin:** 20% + 6%
- **Guangzhou:** 23% + 5
- **Shenzhen:** 9% + 5%
- **Wuhan:** 20% + 5%
- **Chengdu:** 20% + 6%

Medical Insurance Fund

Paid to the local Medical Insurance Centre.
Amounts:

- **Shanghai:** 12% + 2%
- **Beijing:** 6.4% + 0%
- **Tianjin:** 14% + 2%
- **Guangzhou:** 6.7% + 2%
- **Shenzhen:** 7% + 2%
- **Wuhan:** 0% + 0%
- **Chengdu:** 2% + 7.5%

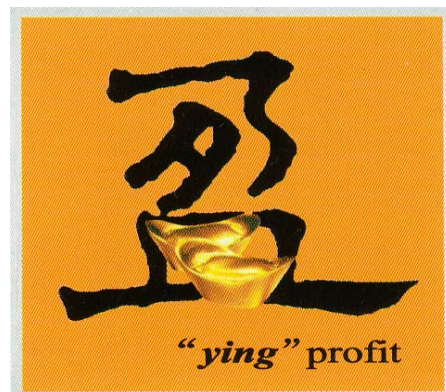
Unemployment Fund

- **Shanghai:** 2% + 2%
- **Beijing:** 1.5% + 0.5%
- **Tianjin:** 2% + 1%
- **Guangzhou:** 2% + 1
- **Shenzhen:** 1% + 0%
- **Wuhan:** 2% + 1
- **Chengdu:** 2% + 1

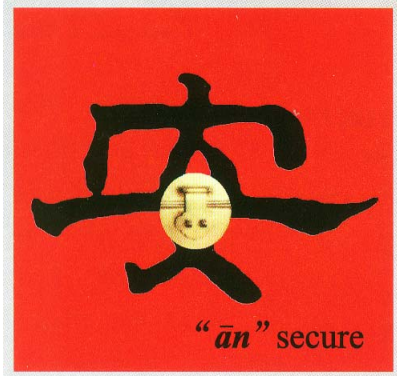
Housing Fund

- **Shanghai:** 7% + 7%
- **Beijing:** 10% + 10%
- **Tianjin:** 8% + 8%
- **Guangzhou:** 8% + 8%
- **Shenzhen:** not compulsory at present time
- **Wuhan:** 10% + 10%
- **Chengdu:** 6% + 6%

These are the extent of the mandatory payments, if you are being asked to make additional fund payments then these are optional. One other fund needs to be catered for which is relevant - the Labour Union Fund which is a minimum of 2% of total company wages (including foreign staff). This can remain under control of the company and the Union should provide a budget for expenditure of this fund to the board, which should be used for educational, cultural and sporting activities. For further advise on staff welfare payments or assistance with local accounting issues please contact us at info@dezshira.com or view our website at www.dezshira.com.



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**MEET OUR BIG SIX. SMALLER THAN THE BIG FIVE,
AND DEFINITELY MORE DOWN TO EARTH.**

Dezan Shira's Tax & Accounting Services Regional Managers are qualified CPA's as well as being Chinese Tax Inspectors. With an SME friendly billing approach and fully qualified additional supporting staff, shouldn't you be talking to us?



Dezan Shira & Associates Regional Accounting Service Managers (L-R): Emily Shao CPA, Shanghai, Emily Zeng CPA, Shenzhen, Alberto Vettoretti, Group F&A, Guangdong, Shirley Mao CPA, Shanghai, Chris Devonshire-Ellis, China Tax Law, Beijing, Alice Wei CPA, Beijing.



OUTSOURCING QUALITY CONTROL & ASSEMBLY WORK **By Mike Bellamy, DSMR Ltd**

In the last decade as Mainland China has become the assembly line for much of the world's manufactured goods; the gap in concepts of quality control between the East and West has narrowed. Only a few years back, Chinese factories competing solely on the labor cost advantage focused more on "producing cheap products" rather than "producing products cheaply". The difference is the Total Quality Concept that incorporates lower waste, less rejects and stability for both the buyer and seller rather than simply making the lowest cost product possible and accepting that significant defects are just part of the process.

Even today some may consider quality control in China to be an oxymoron, but it does not have to be. With the right steps taken before, during and after assembly, sourcing in China can be a pleasant and profitable experience. QC covers a lot of ground, but for the sake of this article the focus will be an overview of what QC tools are available to the small to medium sized purchaser who may not have their own on-the-ground presence in China.

Case Study "Outsource Everything"

Background

A British company decides to arrange assembly of a BBQ grill system in mainland China. Production involves 8 different sub-suppliers spread out across

the country. QC is a major concern as significant financial loss would occur should even a small percentage of final assembled good be defective as product is shipped direct to buyers in the US and EU. The task is complicated by the fact that the company has limited resources in capital, labor, China experience and has no interest in opening their own operations in China. But... how to effectively manage assembly on the other side of the world?

After hiring a local research company to identify qualified sub-suppliers the decision was made to go with a central warehouse/assembly/QC facility in Shanghai. There were five major factors that led to this decision and the eventual success of the operation.

1. When finding the right partner price is just part of the mix

The BBQ company could not afford to enter into a long term purchasing contract with only the hope that consistent levels of product quality could be achieved. The first step was to qualify sub-suppliers by price, sample quality, lead times. The second step in the selection process was evaluating QC systems in place; visiting with other customers and most importantly deciding to select the vendor that most clearly understood the overall picture- the importance of quality. The buyer was willing to pay

a bit more on the price side for a vendor that could clearly communicate the long-term advantages of a mutually benefiting total quality system.

2. Teamwork and Honesty

QC is more about management styles and communication rather than simple data collection and statistical analysis. In the case of the BBQ company, the UK company's involvement was not to simply dictate what needs to be done, but rather to work closely and educate the Chinese vendor about how to produce more efficiently and what production pitfalls can be avoided. This integrated system brings advantage to both parties and is based on cooperation and openness rather than conflict and the threat of legal action. Problems are brought up and dealt with early in the process long before the BBQ is packaged and sent overseas!

3. Limited Upfront Costs and Transparency

Rather than renting and managing a warehouse the company subcontracted these functions to the assembly plant (under the supervision of their Outsourcing Agent) paying a per-unit fee based on the labor and warehouse rent. Since they only had estimates of future production number, this per-unit figure allowed for easy cost calculations and flexibility of order size while limiting the upfront costs. Another advantage of this type of assembly contract is the transparency. The buyer had individual contracts with all 8 sub-suppliers and knew the exact costs of raw material and other inputs at every level. Additionally, if problems arise they have the flexibility to quickly make changes at every level of the supply chain.

4. Central Location for QC

Perhaps the biggest advantage of this assembly contract was the use of a central warehouse/assembly plant. With limited staff, the company was simply unable to perform daily QC on each of the 8 sub-suppliers. Basically the answer lies in having all 8 contracts stipulate that when the products are delivered to the assembly center they are to undergo testing. Only when the products pass are vendors paid and should defects be detected they are the responsibility of sub-supplier.

5. The QC Tool Box (Labs, Independent Auditors, Due Diligence)

Before, during and after assembly runs, important functions were outsourced to keep costs down. Independent internationally accredited testing labs were used to evaluate the consistence of product quality. What a lot of foreign companies do not know is that these US and EU labs are based in all the key production regions of China. It is a lot quicker and cheaper to have testing done right here! Once every few production cycles, independent Quality Assurance Auditors made random checks of the main-assembly plant and sub-suppliers. Contrary to what you may assume, they checks are welcomed by the sub-suppliers as it is a learning experience for them. They know that the buyer wants a long-term relationship and having these audits is a chance to gain tips on efficiency from a trusted partner rather than a scolding from some unknown third-party. Due Diligence also played a role. Professionals were brought in on occasion to make sure that all partners in the process were financially stable and qualified to continue doing business. (For a full report on Due Diligence in China, please visit the China Briefing Archive at <http://www.china-briefing.com/>).

Pitfalls

Regardless of your exact method of assembly in China there are some key pitfalls to be aware of.

1. This probably goes without saying, but don't be wined and dined into a partnership. Apply the same standards in China that you would in your home country. During a first visit to places like Dongguan, the differences can be overwhelming. Assistance is available if needed and don't be afraid to get professional advice.

2. Western managers tend to look at their suppliers as business partners with common long-term goals. However many Chinese suppliers are salesmen first and tend to promise the world in order to get your business. Be realistic.

3. There are an alarming number of cases of forged ISO and other certifications found in China. Take the time to have an independent audit verify these.

Conclusion

If you only take one suggestion from this article it should be that if you are interested in arranging assembly in China, spend the time before production starts to find the right partners who fully understand that QC is not a limited function in the assembly process but rather is a mindset and approach to business. This, communication is key in taking a proactive approach to limiting the cost of rejects and returns. This will be reflected in your bottom line.

For more information on arranging assembly and QC in China please contact DSMR Ltd at info@dsmrchina.com.



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TRUCK TRANSPORTATION ISSUES

By Jamie Gwynn, China Logistics Ltd



In a recent survey conducted by our sister company, DSMR, 91 % of Logistics Managers surveyed believe that they have negotiated the best possible Point “A” to Point “B” trucking rates in China. Additionally, 64% of these Logistics Managers were satisfied with the current service received by their truck service provider. So, why is there all of this fuss about the difficulties in trucking goods in China?

Problems Experienced with Trucking in China

1. Delays

The problem most commonly encountered according to our survey was delays. The reasons cited most often were “traffic,” “weather,” and “accidents.” However, less than 5% of shipments are actually reported as being “late.” The question arises as to the definition of “late.” Some measure late in terms of days, others in terms of hours. Whilst others determine “late” by when they look around their warehouse, need the product, yet it hasn’t arrived.

2. Overloading

Overloading is an issue that most anyone moving product in China will confront. Transporters, as a norm, are known to haul 50% in excess of their legal payload and sometimes as high as three times their legal limit. This is more the standard business

practice rather than the exception. Companies in China have been taking advantage of this cost savings despite the inherent problems that result. As a recent rise in police checks and fines is starting to jab at the status quo, companies in China are taking a harder look at these subsequent costs and time delays. Our most recent information has told us that the “crack down” has been mainly directed to shipments that were at least 30% overweight. For shipments less than 30% overweight, the savings experienced by gaining this extra 30% capacity has exceeded the costs of potential fines, delays, etc.

3. Load shifting

Particularly for LTL shipments, the people loading the trucks sometimes lack the training or the initiative to pack the trucks in the most effective and efficient manner. When the order is haphazard and the packing is not compact, goods tend to shift around more than they should offering more opportunities for damage.

4. Pallet standardization

The lack of a standardized pallet system in China results in truck loading and unloading times to increase thus adding costs to the network. Additionally, moving to more of a standardized pallet will help reduce the load shifting issues mentioned above.

5. Price/ service correlation

Some of the managers surveyed have found that they have received better service by paying a higher price. Obviously you must be able to quantify the value of that service to justify paying for it. Not having a customer call your mobile telephone at 4am asking where the ?*@# that truck is I'm sure has some value.

In order to increase service, some companies have taken the responsibility on themselves by training the truck companies and their drivers to ensure that they receive the grade of service they desire.

Whatever the case, virtually every manager that expressed dissatisfaction with his or her current service providers placed PRICE as their #1 decision factor for selecting a transportation provider.

Most Desired Services:

1. Door to Door

Shipping dry goods to top tier cities is by far the easiest and offers the lowest per unit rates based on the amount of kilometers traveled. Less than truckload (LTL) shipments of dry goods are also relatively easy to do between major cities. The problems come in when you get out there a bit or add some complexity to the equation such as transporting refrigerated or dangerous goods. A lot of times you have to purchase equipment on a round trip basis because the trucking companies lack the network reach to facilitate a "backhaul" to their primary point of origin.

2. Shipment Tracking

Managers have expressed a need/ desire to have a low cost method of tracking their goods in transit. For most shippers and trucking companies, the cost of installing a satellite tracking system is just not feasible. Fortunately, there have been improvements in other less costly areas of track and trace such as mobile locaters and telephone call monitoring.

3. Larger Coverage

Many of the larger manufacturers in China have wide territories to cover. In the fragmented Chinese distribution market, their logistics efforts are complicated by having to deal with numerous trucking companies to meet their needs. They voiced a desire to work with larger companies or 3PL's in order to simplify these issues.

How to Resolve Some of the Inefficiencies

Targeting improvements to certain inefficiencies that occur in China is a necessary step in order to lower our transportation cost per unit to a level that is globally competitive. China Logistics is putting together a group of non-competing manufacturers who are interested in cooperating in order to target certain initiatives. For more information about this group, please send us an E-mail at info@PRCLogistics.com or call our Shanghai head office at (021) 6279-7330.



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JUST IN CASE YOU GET SENT TO: SHENZHEN

Shenzhen lies just across the border from Hong Kong on the Southern Coast of Guangdong Province. A city of some 4 million, it is a Special Economic Zone (tax rate of 15% against national 30%) with a border of its own, requiring you to show a passport to enter. The first city to benefit from Deng Xiao Ping's economic reforms it has subsequently developed into a economic powerhouse of its own and is generally regarded as a "Southern Shanghai" - China's second stock exchange is here and it boasts a wealth of business and tourist facilities.

With many border crossings to Hong Kong and connections via sea and air to most international destinations, Shenzhen is fast becoming the Port of choice for those involved in international trading. Shenzhen is loosely divided into two areas, downtown Shenzhen just over the border from Hong Kong, with Five Star Hotels such as the Shangri-La (755 233 0888), Landmark (4755 217 2288) and Forum (0755 558 6333) all catering for business men, while Shekou, further West and also a major Port area in its own right has the Holiday Inn (0755 641 6688) and the seafront NanHai Hotel (0755 669 2888). Conveniently located near to Guangzhou (two hours by car, one by train), the factory base of Dongguan and Hong Kong, Shenzhen is home to many of China's young entrepreneurs. Fifteen years ago there was nothing here but paddy fields - now Shenzhen is an international city. Consequently, Mandarin -- and not the Provincial dialect of Cantonese - is spoken here and the city has probably the best variety of Chinese cuisine anywhere in the PRC - from Dongbei to Sichuan to great seafood, Shenzhen is a Chinese gourmet's paradise. However, there is more to Shenzhen than being just a base for business with good restaurants. The City possesses two major theme parks - the kitsch but fun "Windows of the World" with full and third size replicas

of famous international sites (a huge Eiffel Tower can be seen for miles) and the interesting "Cultural Village" just next door showcasing many of China's minority tribes, houses, food and arts and crafts. Additionally, towards the east is moored the huge Russian Aircraft Carrier "Minsk" which can be toured, sizable botanical gardens complete with cable car ride, and two large, clean beaches at Xiaomeisha and Dameisha - great for a weekends swimming and fitted out with shark nets and lifeguards.

Shenzhen nightlife is wild in Shekou, with many bars and clubs, including the "Snake Pit" on Tai Zi Lu - a legendary expat dive now into its 16 year - a disgusting drinking ritual and small fee to join but very cheap beer as a reward. Downtown Shenzhen meanwhile has a host of nightclubs popular with Hong Kong clubbers coming across for a weekend's parrying, China's first ever rave was held in "New York New York" and the city is regularly partying hard until Gam. Our fave nightspot? Goodfellas at 98 Zhen Hua Lu. No-one in Shenzhen comes from Shenzhen - everyone you meet is a migrant of some sort and this gives the city its unique flavour and ambience.

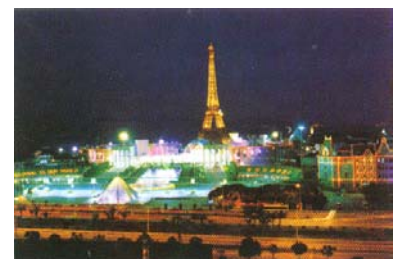
Getting there and away is easy - Shenzhen has a sizable international airport with regular connections to most China destinations, a good rail system linking Hong Kong and Cruangzhou (and from there into China's main rail network), with hi-speed ferries also to Hong Kong, Zhuhai, Macao and Guangzhou. also operating on a daily basis. Hong Kong is also accessible via a simple foot crossing over the border at LoWa in downtown Shenzhen and instant access to Hong Kong's KCR rail network - one hour to Central.



Shenzhen has become an attractive and clean city with good living environment.



Beaches at Xiaomeisha - cleaner than Hong Kong's - we saw Tiger Prawns in the shallows recently and a group of Red Necked Phalarope bobbing up and down jus last month...



Windows of the World -- a major tourist attraction and a lot of fir - the Cultural Village is just next door. Good enough to attract Disney's attention...