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Economy

'China must rely on innovation to achieve continuous and healthy economic growth'

China's President Xi Jinping, December 2014

China is the world's biggest manufacturer and the world's biggest economy in purchase-power-parity terms.

In 2014, the Gross Domestic Product (GDP) in China was worth 10360.10 billion US dollars. The GDP value of China represents 16.71 percent of the world economy.

The annual GDP growth rate in 2014 amounts to 7,3%, and was recently readjusted from 7,4% to 7,3%. The GDP per capita amounted to 3.866 USD.

The New Normal

In the past 3 decades, China's economy has grown at breakneck speed, with a compound annual growth rate at around 10%, and an even higher one in Central and Western China. China's gross domestic product growth rate reached its climax in 2007, with a growth rate of 14.2%.

The economic model that led to this spectacular growth was one that was investment-led and export-driven. When the world economy was hit by the financial and economic crisis in 2008, China realised that it needed to shift to a more consumer-led economy, based on products and services with a high added value.

The new mantra adopted by the Chinese government is 'the New Normal', an era characterized by lower, but more qualitative economic growth.

Permanent slowdown offering new opportunities

The Chinese economy is faced with the onset of a permanent slowdown.
China's GDP growth dropped to 7% in the first half of 2015, the lowest level since 2009. According to the latest projections growth will be 6,9% in September 2015. Financial leverage is precipitously high, with total debt having ballooned to 282% of GDP in 2014.

China's total trade declined by 6,9% in the first half of 2015 and aggregate productivity of China's economy is also at a significant low. China's imports sank by 14,3% in August year on year.

European companies have reported for the third year in a row that their earnings before interest and tax (EBIT) margins are more likely to be greater outside of China than they are inside China. The 4 successive interest rate cuts from November, 2014 to mid 2015, and the volatility and the sharp declines in the Chinese stock market in 2015, point towards increasing misgivings over whether China actually retains the capacity to meet its projected economy growth targets.

The Chinese government has indicated its desire to shift to more "smart" economic growth, which seeks to reduce reliance on energy-intensive and high-polluting industries and rely more on high technology, green energy, and services. China also has indicated it wants to obtain more balanced economic growth, which requires China to turn its growth model away from current reliance on investment towards greater domestic consumption.

Investments

United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2015 revealed that China became the world's largest recipient of FDI in 2014, with inflows reaching $ 129 billion, a 3.7 percent increase compared to 2013. The report indicated that European Union investment in China registered a slight increase. Though inferior to FDI inflows, China's 2014 FDI outflows grew faster (up 15 percent), reaching $ 116 billion last year. UNCTAD reported that foreign acquisitions have become key for a number of Chinese financial institutions, as indicated by a series of cross-border merger and acquisitions in the US, Belgium, the Netherlands and South Korea between October 2014 and February 2015.

Challenges

Together with the economic growth, China's development faces many challenges still. Rising housing prices, corruption, pollution, food scandals and many other problems emerge as well. While the new leadership of President Xi Jinping, Premier Li Keqiang and their team seem to be working on these problems. Hopefully China has the right leadership to skilfully guide the country towards sustainable development.

Business opportunities

Healthcare Market

China's healthcare market is booming as a result of Chinese growing disposable income, big ageing population and increasing government support. As the country with the largest population in the world, China already had become an "ageing society" as defined by the UN by the early 2000s. The percentage of China's ageing population (those 60 years and above) will rise from 12% in 2010 to 17% in 2020. By 2050, one in every three Chinese is forecast to be aged over 60.

The lack of competent and decent services for the growing needs of its ageing population offer promising business opportunities for both domestic and international companies in elder healthcare industry. Chinese government has been a major force in driving the development of healthcare industry. With the determination to enhance social welfare system, it decided to invest heavily in Chinese healthcare system during China Healthcare Reform 2009. Particularly, Chinese government has formally announced a set of policies concerning biotechnology industry. The 12th Five Year Plan also set forth a government strategy to invest CNY 40 billion (about US$ 6.6 billion) in bio-pharmaceutical industry. The 13th Five Year Plan is to be decided upon late 2015.

The sector mainly engages three categories: medical devices, pharmaceuticals and healthcare service market.

Since 2005, China has been the third largest medical device market in the world. In 2014, its total sales value reached 36 billion EUR, a year on year increase of 20%. In 2014, China imported medical devices worth around 13,7 billion EUR from overseas and EU is the largest contributor as it took up 39% followed by USA with 32% and Japan with 25%.

Chinese pharmaceutical industry is enjoying a steady growth and will become the world's second largest market by 2015. Its total sales were more than US$ 39.7 billion in 2009 and grew at a compound annual rate of 20.5% between 2005 and 2009. It is forecast that the growth rate will be around 16.9% between 2010 and 2014. As people's living standards improve, Chinese healthcare services market is becoming one of the largest in the world. In 2009, healthcare spending in China reached US$ 215 billion. China spent an equivalent of about 4.5% of GDP on healthcare services in 2010, which means per capita annual spending about US$ 159, much lagged behind by developed countries. This implies for a big potential market.

Food and Beverage

China's food and beverage (F&B) imports have shown strong growth in recent years and it has been significant factor in the overall strong growth of China's grocery retail market. China became the world's largest market for food and grocery retail in 2011. The Chinese F&B industry grew at an average rate of 30% from 2006 to 2014, and the annual total production value of the industry is in excess of US$ 1.2 trillion. The market is estimated at 440 billion EUR.

China is the world's fourth largest importer of food after the EU, the US and Japan. As a net importer of F&B products, China in 2011 imported US$ 73 billion (28% YOY increase) and exported US$ 53 billion (23% YOY increase). Exports of EU food and beverages to China tripled between 2006 and 2011 from €0.9 billion (US$ 1.2 billion) to €3.3 billion (US$ 4.4 billion) respectively. Looking into specific product sectors, it is meat products, alcoholic drinks and dairy products that are leading EU exports to the China market, with a combined total of 66% of all EU food and drink exports in 2011. In terms of Chinese exports to the EU, top of the list are fish, fruit and vegetable products.

Despite fragmented distribution infrastructure and growing local competition, opportunities for European SMEs to sell their products in China are likely to grow, driven by increasing disposable income and urbanisation, an improving logistics system, growing concerns on food safety as well as a growing taste for foreign foodstuffs. EU SMEs can expect to find opportunities in a variety of areas, including wine, cheese, dairy products and premium ice cream, pasta, spaghetti sauce and other tomato products, olive oil, beer, chocolate, high-end confectionery, pre-packaged biscuits and snacks, breakfast cereal, coffee, baby food / infant formula as well as frozen meat and seafood.

China is not a single market but a jigsaw puzzle of overlapping markets separated by geography, culture, cuisine, demographics and dialects. Opportunities in the food and beverage market lie in China’s urban centres rather than rural areas: First-tier cities such as Beijing, Shanghai, Guangzhou, Shenzhen, and increasingly Chongqing and Chengdu, have seen the greatest exposure to imported food and beverages. Multinational retail expansion has intensified competition in the richer coastal areas, but opportunities still remain. Income is growing rapidly in second and third-tier cities, creating a new range of opportunities.

Luxury Products

Despite the global economic slowdown and its subsequent impact on the luxury sector, China’s consumer continues to demonstrate huge growth potential. The demand for luxury goods in China is booming driven by a number of positive factors such as growing number of affluent and middle class, rising household disposable income and higher luxury spending, and increasing number of travelling Chinese. China is the No. 1 luxury spender worldwide, and global sales of personal luxury goods are expected to jump 13% to 253 billion euros. The lucrative China market has presented abundant opportunities for global luxury players to further establish their presence across the country.

More than two-thirds of luxury spending by Chinese mainlanders was made overseas in 2013, an increase from 2012. Chinese consumers are engaging using online forums to discuss and research luxury brands. Digital media has been a tool used frequently to engage Chinese high-end consumers. Women are an important target market for luxury players, as their purchasing power rises and as they start to seek a wider range of products.

Household disposable income in China has grown consistently over the years. According to the National Bureau of Statistics of China (NBS), growth of household disposable income has been most prominent in the highest income segment, followed by the high income and upper middle income segment, all registering double-digit compound annual growth rates of 14.5%, 12.8% and 12.1% respectively. These groups of individuals often have a voracious appetite for luxury goods and are the biggest spender on luxury goods. It is expected that the household income will continue to rise as the Chinese government strives to double the per capita household income by 2020 to stimulate domestic consumption.

Chinese individuals with more than RMB 10 million (US$ 1.6 million) broke through the one million mark for the first time in 2012, reaching a record 1,020,000 individuals, an increase of 3% over the previous year, according to Rupert Hoogewerf, founder of the Hurun Report, a luxury magazine which publishes China's annual rich list. China is also home to 63,500 super-rich, defined as individuals with RMB 100 million (US$ 16 million), an increase of 5.8% from that of last year. On the other hand, the burgeoning middle class is one of the major forces driving luxury consumption in China. The middle class, which is more sophisticated and westernized, has higher income to support their international and sophisticated life style. McKinsey & Company projected that the number of middle- and high-income urban households in China will increase from 181 million in 2012 to 472 million in 2020.

Chinese government has been focusing on promoting the development of small- and medium-sized cities and towns in recent years. Smaller cities with population less than 1.5 million will be the major force driving China's economy growth in the next two decades and they can form strong clusters with huge economic potential. The rising consumption in these cities will create huge demand for luxury goods. In fact, many luxury companies have already stepped into those cities. While in tier 1 cities, people prefer low-key brands instead of household names. This trend opens a door for new but unique European brands.

Green Technologies

In the face of its huge and growing energy needs and its environmental and energy security challenge, China needs to develop green technologies that will help the country to produce cleaner energy and to consume it more efficiently.

Driven by growing urgencies in energy security, food and water supply, and pollution on an immense scale, the green tech industry has become the top priority among China's strategic industries. To sustain economic growth while reversing its negative impact on the environment, China is pushing ahead with its green tech policies and spending. Within just a few years, china has emerged as a green tech leader at the centre of almost every green tech market. By the end of 2010, China became the world’s largest investor in clean energy at CNY 354 billion (US$ 58.3 billion), installed 44.7 GW of wind power and built 8,358 kilometers of high speed rail. China is making ambitious moves, not only seeking to securely meet domestic needs but also to capture global green tech markets.

Common to the initial stage of the green tech industry in many countries, effective policies and enforcement of these policies are still in their early stages in china. In this fast growing and changing green tech market, the main market opportunities for EU SMEs will be found in areas where the large SOEs or multinationals have not yet invested and where SMEs can leverage their know-how and technologies. China is welcoming highly advanced technologies regarding environment protection and energy saving from outside world. Advanced products / services for niche demand, close monitoring of green tech policies and good relationship with provincial governments are key to success in this challenging market.

Types of business entities in China

China's *Company Law* mainly regulates two types of business entities: limited liability companies and companies limited by shares.

Companies

1. Limited Liability Company (LLC)

This type of entity requires a minimum capital of RMB 30,000 with less than 50 shareholders. The capital contributions may be made in the form of cash and of non-currency assets that can be appraised and denominated in currency and are legally transferable such as in kind contributions, industrial property or land use rights.

A limited liability company is liable for its debts to the extent of its assets, while the liability of its shareholders is limited to the amount of their respective capital contributions.

2. Company Limited by Shares (Joint Stock Company) (JSC)

This type of entity is to be set up by promotion or share offer with a minimum share capital of RMB 5 million. For incorporation, no less than two promoters are required. If the company is established by promotion, the promoters must hold all of the shares. If it is established by a share offer, the promoters must subscribe to at least 35% of the shares and offer the rest to the public. Establishment by share offer is subject to the approval of China's securities regulator.

A company limited by shares is liable for its debts to the extent of its assets, while the liability of its shareholders is limited to the amount of their respective shareholdings.

Foreign Investment Entities

China recognises a wide range of business vehicles, some of which are only open to domestic investors. Foreign investors are allowed to set up the following types of business entities:

1. Cooperative Joint Venture (CJV)

A CJV has the option to register as a legal person with limited liability. The parties in a CJV have the flexibility of choosing whether to operate the enterprise as a limited liability company or to operate it as an unincorporated entity under which partners bear unlimited liability. The profits of a CJV are allowed to b shared by participants as specified in the joint venture contract, and not necessarily in proportion to their capital contribution. As a result, this type of venture is ideal when the foreign investor is only looking for a short-term project. After obtaining a fair or premium return on investment, the foreign investor returns the majority or full ownership of the enterprise to the Chinese partner.

2. Equity Joint Venture (EJV)

An EJV is the most common and preferred method of doing business in China. It is a limited liability company and is required to be registered as a legal person. The main feature is that the joint venture parties take responsibility for losses and profits according to the ratio of their equity stake. The minimum level of foreign participation is an EJV is 25% of the registered capital in general. The registered capital is not limited to financial capital but may also encompass non-financial assets such as intellectual property rights, buildings, materials, or machinery if approved by the government.

3. Wholly Foreign-Owned Enterprise (WFOE)

A WFOE is a 100% wholly foreign-owned subsidiary doing business in China. The foreign company has sole responsibility for its profits and losses. It is required to register as a legal person who is restricted to certain businesses. The enterprise is able to implement strategies that effectively conform to the interests of the parent company abroad. Moreover, technology and know-how are given better protection. One effective use of a WFOE is to replace the foreign enterprise representative office (RO). Whereas foreign enterprises previously involved in a joint venture would establish ROs in China to manage the administrative aspects of the venture, some have resorted to setting up WFOEs to handle the same responsibilities.

4. Company Limited by Shares with Foreign Investment (CLSFI)

A CLSFI may adopt the promotional method or share float method for its establishment. A CLSFI set up by means of promotion shall have no fewer than two but no more than 200 initiators, of whom half or more shall have a domicile in China. At least one of the promoters has to be a foreign shareholder. An EJV, CJV or WFOE may apply to convert to a CLSFI through a share flotation. A CLSFI established by a share flotation will need to have a track record of being profitable in the recent three consecutive years prior to the offer. The minimum registered capital is RMB 30 million. The minimum level of foreign participation in a CLSFI is 25%. A CLSFI can be listed either locally or abroad.

5. Build-Operate-Transfer Project (BOT)

BOT projects provide enterprises with concession to key industrial or infrastructure projects in China, such as bridges, railways, industrial parks, power plants, airports, subways and expressways. After financing and building the project, the enterprise either immediately transfer the project to another party or continues to operate it for a number of years. When the agreed-upon equitable return on investment is achieved, the enterprise is required to transfer full ownership and control to the government. The terms, limitations, rules and regulations pertaining to BOT projects are often established on an ad-hoc basis.

6. Holding Company

The number of approved holding companies in China is increasing. A holding company is an umbrella-structure arrangement which enables a foreign company to hold together its joint ventures and WFOE investments in China. A holding company can be either an EJV or a WFOE. Generally, the government allows a foreign company to set up a wholly foreign-owned holding company in China if it has a good reputation, financial strength, high technology, and the projects it undertakes are in line with the state production plan.

7. Representative Office (RO)

Before actually investing in China, many foreign investors choose to set up representative offices (ROs) to engage in market research and to learn more about the country. An RO is optional before making an actual investment in China and is not an independent legal entity. It must confine its activities to promotion or acting as a liaison office on behalf of its parent company. An RO is not allowed to generate revenue, solicit business, engage in warehousing or sign contracts with customers. It can hire local staff through approved employment agencies. It should engage in activities that service the head office directly.