



China Business Handbook

2013



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COMMERCIAL
SERVICE**

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Department of Commerce*

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China Business Handbook

2013

A Resource Guide for Doing Business in the People's Republic of China



With contributions from **DEZAN SHIRA & ASSOCIATES**
Corporate Establishment, Tax, Accounting & Payroll Throughout Asia



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Demographic Consulting



China's GDP tripled between 2001 and 2011, while U.S. exports to China rose 542 percent. China being our second largest trading partner, the U.S. and Chinese economies are intricately intertwined. While China's GDP has "dipped" to around seven percent this year, some economic volatility may result as China's economy shifts to consumption-driven from export-driven, and we try to read the tea leaves about where China's new leadership wants to take the country, China will continue to be a desirable market for U.S. businesses for the foreseeable future.

U.S. small and mid-sized enterprises (SMEs) in particular are major beneficiaries of China's economic growth and increasingly consumer-oriented society. With a rapidly rising middle class and intense urbanization, SMEs are meeting China's demand for American goods. SMEs represented 92 percent of all U.S. exporters to China, and 78 percent of the total value of goods exported to China in 2010.

China's emerging markets in second, third and fourth tier business centers – from Harbin in the north to Kunming in the south, from Qingdao in the east to Urumqi in the west – are growing faster than the traditional Beijing, Shanghai, Guangzhou markets. Emerging markets account for over 50 percent of China's U.S. imports, and are where the major healthcare reforms, airport expansions, and myriad of other infrastructure projects provide superb opportunities for U.S. exporters.

An opaque regulatory environment, weak rule-of-law, and intellectual property rights violations continue to challenge U.S. business. So risks are not insignificant. But the potential rewards merit serious investigation to identify and cultivate opportunities while building a strategy to minimize those risks.

The China Business Handbook looks closely at important e-commerce trends, explores buyer behavior, provides data to better forecast and target opportunities, reviews key industry sector developments, and discusses key considerations for making sound business decisions.

Take advantage of the opportunities that the knowledge and expertise this Handbook provides as you enter or expand your China business. And contact U.S. Commercial Service staff and other service providers listed in the Handbook for advice from seasoned trade experts. The opportunities are there – we can help you benefit from them.

Regards,

William Zarit
Minister for Commercial Affairs
U.S. Commercial Service, China
U.S. Embassy, Beijing

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Ch 1 Market Overview

By the U.S. Department of Commerce, U.S. Commercial Service

The Chinese economy is roughly half that of the United States with a comparable land mass. Following more than three decades of economic growth, fueling an industrial and urban boom, China claims 171 cities with populations of 1 million or more, while the U.S. has nine such cities.

While China's GDP growth is slowing, it remains among the world's top performers expected to reach 7.5 percent in 2012, with analysts targeting similar growth in 2013. In response to this growth, U.S. exports to China have increased 468 percent since China's 2001 World Trade Organization (WTO) entry, and it is likely to maintain its position as the third-largest buyer of American goods after Canada and Mexico in the coming year. Small and medium-sized enterprises (SMEs) are the leading exporters to China, representing 92 percent of American businesses exporting to China (35 percent of value), with overall export product categories led by machinery, computers and electronics, chemicals, transportation equipment, and waste and scrap.

China's economy has seen enormous benefits from fixed asset investments. This investment-led growth, however, is widely perceived as non-sustainable and China's leadership addressed this concern in its 12th Five-Year Plan (5YP), which came out in 2011. The plan continues through 2015 and aims to increase consumer spending from approximately 35 percent of GDP to 50 percent by 2015. In comparison, about 70 percent of the United States' GDP is derived from consumption, whereas 63 percent of Brazil's GDP is driven by consumption. The rebalancing of China's economy should create opportunities for U.S. companies that provide consumer products and services. Environmental protection, energy efficiency, high-end manufacturing, biotechnology, are also areas of high priority in the 12th 5YP.

U.S. exports to China stood at US\$70 billion¹, January-August 2012, suggesting a slight end-of-year increase over the 2011 total of US\$103 billion. The U.S. trade deficit with China widened to US\$295 billion in 2011. U.S. agricultural, fishery, and forestry exports to China in 2011 reached a new high of US\$21.9 billion, up 13 percent from 2010. China is the largest U.S. overseas market for agriculture, fish,

¹ US\$1 = RMB6.35

and forestry exports. Just five years ago, China was the fifth largest destination for the U.S.. Given China's rising incomes and demand for raw materials and finished foodstuffs, the U.S. Foreign Agriculture Service forecasts that China's imports will continue to grow well into the future.

China's inbound foreign direct investment (FDI) reached US\$116 billion in 2011, and stood at US\$83.4 billion for the first three quarters of 2012, down 3.8 percent from a year earlier, according to China's Ministry of Commerce. Meanwhile, China's outbound direct investment (ODI) in the first nine months of 2012 totaled US\$52.5 billion, up 28.9 percent year-on-year. China's 2011 investment in the U.S. amounted to US\$3.8 billion according to the Bureau of Economic Analysis. In 2012, analysts expect Chinese investment in the U.S. to surpass all previous annual totals. China's Ministry of Commerce reports that ODI is expected to register an annual growth rate of 17 percent from 2011 to 2015, reaching US\$150 billion in 2015.

China's rapid economic growth, especially in the urban areas, has led to a booming consumer market for high-end goods and services, including tourism and education. China will account for about 20 percent of global luxury goods consumption by 2015, or US\$27 billion. About 80 percent of people buying luxury items in China are 45 years or younger, whereas that percentage is only half for the United States. By 2020, China's middle class is expected to account for around 45 percent of the population, or approximately 700 million people.

Despite these remarkable changes, China is still a developing country with significant economic divisions between urban and rural areas, albeit one with vast potential. The number of migrant workers remains high. In 2011, the urban population exceeded that residing in rural areas for the first time, with 691 million urbanites (more than double the U.S. population) versus 657 million rural dwellers. As of 2011, the per-capita disposable income of urban residents was US\$3,454 and the per-capita disposable income of rural residents stood at US\$1,105.

Market Challenges

In addition to large multinationals, many of which continue to earn impressive returns on their exports to and investments in China's market, American SMEs are very active in China. The U.S. Department of Commerce's Commercial Service (CS) counsels American companies to thoroughly investigate their specific market niche, take heed of product standards, take measures to protect intellectual property,

*Two of the primary objectives of U.S. policy with regard to China are:
(a) creating jobs and growing the American economy by increasing exports, and
(b) ensuring U.S. companies' ability to compete on a level playing field.*

and carefully pre-qualify potential business partners. Stumbling blocks that foreign companies run into while doing business in China often relate to these broad issues.

- China often lacks predictability in its business environment. China's current legal and regulatory system can be opaque, inconsistent, and often arbitrary. Implementation of the law is inconsistent. Lack of effective protection of intellectual property rights is a particularly damaging issue for many American companies. Both those that already operate in China and those that have not yet entered are well advised to assess their IP risk exposure and develop a plan to mitigate that risk. Guidance is available at www.stopfakes.gov.
- China has made significant progress toward a market-oriented economy, yet it continues to rely heavily on an export-led growth model. For this reason, parts of its bureaucracy still seek to protect local firms, especially state-owned enterprises, from imports, while encouraging exports.
- China retains many characteristics of a planned economy, with five-year plans setting economic goals, strategies, and targets. Provincial and local officials are accountable for delivering on the 5YP and their priorities reflect that mandate. In addition, the State and the Communist Party directly manage the only legal labor union.
- The scale and complexities of China can stress a firm's capabilities, resources and patience. Well-targeted and informed efforts and a network of contacts at various levels across a broad range of organizations are often linked closely with market success and ability to resolve problems.

Market Opportunities

China will remain an important and viable market for a wide range of U.S. products and services for years to come. China's on-going infrastructure development, investment in healthcare reform, and booming urban populations will drive demand for U.S. exports in energy, chemicals, transportation, medical equipment, construction, machinery and a range of services. Branded products supporting lifestyle expenditures show great potential. With growing numbers of Chinese traveling abroad for education and leisure purposes, China's contribution to U.S. educational institutions and the tourism industry is increasingly important as well.

More detailed information on commercial prospects in a number of leading sectors can be found in Chapter 5, with extensive market research also available in the U.S. Commercial Service market research library at export.gov.

Market Entry Strategy

A company should visit China in order to gain a better perspective and understanding of the market potential for its goods or services. Given the scale and rapidly changing nature of the marketplace, a visit to China can provide great insight into the country's business climate and its people. Chinese company representatives respect face-to-face meetings, which demonstrates a U.S. company's commitment to working in China. Prospective exporters should note that China has many different regions and that each province has unique economic and social characteristics.

U.S. companies commonly use agents in China to initially create relationships, advise on product standards, perform business development, and offer marketing support. Local agents possess the knowledge and contacts to better promote U.S. products and break down institutional, language, and cultural barriers. The U.S. Commercial Service offers a wide array of services to assist U.S. exporters in finding Chinese partners through a network of five offices in Beijing, Shanghai, Shenyang, Guangzhou, Chengdu, and a partnership with the China Council for the Promotion of International Trade (CCPIT) to provide business matchmaking and related services in 14 other major cities in China. U.S. companies are strongly encouraged to carefully choose potential Chinese partners and take the time to fully understand their distributors, customers, suppliers, and advisors.

Success in China requires a strong understanding of your business capabilities, development of long-term relationships, and an in-depth knowledge of this challenging market. Before making a decision to enter China, potential exporters should consider their own resources, past exporting experience, and willingness to commit a significant amount of time assessing and cultivating opportunities. Successful market entry strategies typically demonstrate regionally targeted efforts, application specific product positioning, well-qualified partners, measures to minimize non-payment risk, and a game plan for intellectual property protection.

The U.S. Commercial Service developed a toolkit to help exporters understand some of the demands of market entry via the "Are You China Ready" assessment, available at www.export.gov/china/doingbizinchina/index.asp.

Develop a China market entry plan with the help of your local U.S. Commercial Service Office www.export.gov/eac

Selling U.S. Products and Services

Distribution and Sales Channels

In recent years, China liberalized its distribution system to provide full trading and distribution rights for foreign firms in most industry sectors. New laws removed earlier restrictions on size requirements for trading and distribution firms, thus paving the way for competition from small businesses. While the outright prohibition of foreign invested firms to directly import, export and distribute goods in China has improved, the licensing and approval process remains difficult, time consuming and highly opaque. Rather than take on these functions directly, SMEs typically use alternative distribution and sales channels in their initial market entry.

Sales channels available to foreign companies selling in China include trading companies, distributors, and local agents. Trading companies with import/export rights take care of customs formalities; distributors build sales channels and handle stock and inventory; and local agents retail products to consumers. Chapter 4 presents types of China operational structures for firms looking at greater investment to hire staff and directly manage product distribution, inventory and other elements of China business activities.

Using Agent or Distributor

Unlike large international companies that establish operations for branding, marketing and various business activities in China, SMEs with limited budgets often start with fostering a sales network through regional agents or distributors. This approach enables exporters to more effectively compete where local discrepancies of business practices exist. Sales agents and distributors are well positioned to assist in keeping track of policy and regulation updates, both locally and nationally, collecting market data, and quickly responding to changes. In addition, local agents and distributors offer existing networks and help promote new products and technologies.

Trading Company

Following China's 2001 entry into the WTO, U.S. exporters are not required to import through a trading company. Local distributors can have import rights as part of their business license. However, with careful selection, training, and constant contact, a U.S. exporter can obtain good market representation from a Chinese trading company, many of which are authorized to deal in a wide range of products. Some of the larger companies have offices in the U.S. and other countries around the world, as well as a network of offices and affiliates in China. These firms are experienced in customs clearance formalities and typically have strong, established distribution networks.

Local Agents

China is witnessing an explosion in local sales agents who handle internal distribution and marketing. Many of these firms do not have import/export authorization. They are the next layer down the distribution chain, buying foreign products and importing these goods through entities that have an import/export license by paying a commission. They may be representative offices of Hong Kong-based or other foreign trading companies, or domestic Chinese firms with regional or partial national networks.

Given China's size and diversity, as well as the lack of agents with wide-reaching capabilities, it may make sense to engage several agents to cover different geographic areas, and to be cautious when granting exclusive territories. China could be viewed as five major regions: the South (Guangzhou), the East (Shanghai), the Central/North (Beijing-Tianjin), West China and the Northeast.

Select Selling Factors

Localization

Though Chinese customers welcome U.S.-made products in general, they still generally prefer to have localized customer support from a manufacturer, such as on-site training, service centers in China, local representatives, and catalogues and manuals in Chinese. While a rapidly growing percentage of the management workforce in first-tier cities speak English, U.S. exporters should understand the limits of English language proficiency in China and do their utmost to see that all materials are in Chinese. On a similar note, certain modifications must be made to accommodate local tastes, customs and systems.

Pricing

Most Chinese consumers are highly sensitive to price. The 9.1 percent annual inflation on food items in 2011 demonstrates this steep rise in prices. Industrial and government procurement purchasing decisions are also often focused primarily around price points and less around product and service quality. With carefully packaged service programs, however, Chinese industrial buyers can be convinced to pay a premium for higher quality products.

China could be viewed as five major regions: the South (Guangzhou), the East (Shanghai), the Central/North (Beijing-Tianjin), West China and the Northeast

Sales Service / Customer Support

The ability to provide adequate after-sales service is an important selling point and can distinguish a company from its competitors. Wholly-owned service companies and foreign-invested enterprises are now able to provide sales service and after-sales customer support in China. Heightened consumer awareness has given U.S. companies with strong international brands an advantage in the Chinese market, as American products and services are generally considered to have superior sales and customer support standards. This, of course, requires a certain degree of localization, and a commitment to training the local sales and service force.

Trade Promotion

Two important vehicles for identifying prospective representatives are trade shows and trade missions. There are thousands of shows across China, and the number held in smaller cities continues to grow between 15 to 20 percent annually. In general, exhibitions can be excellent venues to gauge market interest, develop leads and make sales. Most are sponsored or co-sponsored by government agencies, professional societies, or the China Council for the Promotion of International Trade (CCPIT). Some shows are organized by American, Hong Kong or other foreign show organizers.

Show participation costs are sometimes high and pricing options for booth space available to foreign companies often limited. Some shows may reach only a local audience or cater primarily to Chinese exporters despite being described as Import/Export Fairs. Therefore, companies are advised to scrutinize shows carefully before confirming participation.

In 2013, the U.S. Commercial Service will recruit and organize U.S. Pavilions at 45 trade shows around China in 23 different industry sectors. The U.S. Pavilion concept is part of the U.S. Department of Commerce's initiative to promote American goods and services in key Chinese markets. Updated information about these shows can be found at www.export.gov/china. In addition, upcoming Department of Commerce trade missions can be found at www.export.gov/trademissions/.

Much more information on doing business in China is available through the U.S. Commercial Service's China Country Commercial Guide, including market entry approaches specific to various sectors, trade financing, selling to the government, due diligence, protecting intellectual property, trade regulations, customs and standards, and more.

Ch 2 Consumers, Ecommerce and Media in China

By CTR Market Research

A Glimpse at Shopping Behavior in China

Fast Moving Consumer Goods

China is home to the world's second largest market for consumer goods, surpassing Japan and trailing the United States. In 2011, the fast moving consumer goods (FMCG) market surpassed RMB900 billion (US\$141.73 billion), an increase of 17.9 percent over 2010.

Throughout China, the consumers spent an annual average of RMB386.3 (US\$61) on fast moving consumer goods online, up 9.8 percent from 2010. However, through traditional shopping, the average consumer spent RMB7,099.9 (US\$1,118) annually on fast moving consumer goods in 2011. This was an increase of 11.9 percent compared to the level in 2010.

Two major differences between online and offline shopping behavior for FMCG products are the number of shopping trips and the amount spent per trip. In 2011, the average shopper for FMCG products in China made a total of three shopping trips online throughout the year, compared to an average of 97 offline shopping trips over the same period. However, the average online transaction amount per trip was RMB133.7 (US\$21), over 80 percent larger than the average transaction amount for offline shopping trips of RMB72.8 (US\$11.50). Still, a large number of shoppers in China are spending less than RMB50 (US\$7.90) per trip (in 2011, 38.8 percent and 61.8 percent of transaction sizes for FMCG products were of RMB50 or less for online and offline shopping trips, respectively).

Additionally, in most situations, as the average Chinese shopper purchases more frequently in a category, they also tend to purchase a more diverse number of brands. However, this does not indicate that brand is not an important characteristic in China. According to studies conducted by Kantar Worldpanel and Bain & Company, more than 60 percent of shoppers listed brand as one of the top considerations in

the purchase process. However, recent studies have shown that while brand is an important characteristic, most Chinese shoppers do not necessarily think of any single brand when they make a purchase. This indicates that the heavy shoppers of Brand A are likely also the heavy shoppers of Brand B.⁷

Although this behavior is the trend for most product categories, in a few product categories, shoppers exhibit significantly greater brand loyalty. These categories include infant formula, baby diapers, beer, milk, carbonated soft drinks, and chewing gum. Two major factors contribute to this. The first factor is brand concentration, where only a limited number of brands are available in a product category. The other is routine consumption. Products such as milk, which are bought on a regular basis, usually have higher brand loyalty.⁷

The Ecommerce Revolution

Ecommerce has seen tremendous growth in recent years in China due to favorable market conditions, increasing consumer acceptance of and comfort with shopping online, as well as the advantages ecommerce brings to retail in China.

Market Conditions for Ecommerce

In November 2011, the number of internet users in China surpassed 500 million.⁸ China's high number of internet users and rising disposable incomes are creating favorable conditions for ecommerce to develop. Chinese shoppers, for a number of reasons, are beginning to shift heavier focus to ecommerce channels.

Consumer Perceptions of Ecommerce

The main factors that need to be addressed in regards to ecommerce development in China are the attitudes and perceptions of Chinese consumers. The China National Resident Survey (CNRS-TGI), the largest continuous survey on urban residents in China designed to reflect the country's entire urban population, provides some insights into how Chinese consumers are perceiving ecommerce.

To begin, the internet has been accepted as an information gathering tool in China. In the first half of 2012, 61.5 percent of respondents agreed or somewhat agreed with the statement: 'The internet is the first place I go when I need information.' This trend was most prevalent in residents between the ages of 15-44, and with at least some college education. Search engines and brand websites are two of the primary sources where Chinese consumers are finding information, and being influenced for consumption.

⁷ Kantar Worldpanel and Bain & Co., 'What Chinese Shoppers Do But Will Never Tell You, China Shopper Report, Series 1' (2012)

⁸ Melanie Lee, 'China's Internet users breach half billion mark' Reuters (11 January 2012)

Additionally, for planning shopping trips, in the first half of 2012, 16.5 percent of respondents agreed or somewhat agreed with the statement: 'I often use the internet to help plan my shopping.' Demographics for this statement followed a similar trend to the statement regarding using the internet as an information gathering tool, although differences in respondents' educational backgrounds were less significant. Shoppers in China are mostly concerned with price, quality, and appearance when they are using the internet to research products and plan shopping. By utilizing the internet to plan shopping, consumers can not only find information on these three factors, but can also plan logistically.

Looking more specifically into attitudes directly related to ecommerce, in the first half of 2012, 29.9 percent of respondents agreed or somewhat agreed with the statement: 'Shopping online has made my life more relaxed.', and 17.9 percent of respondents agreed or somewhat agreed with the statement: 'It is safe to make purchases online.' over the same period. As more Chinese consumers become comfortable with ecommerce and feel more secure making online purchases, the potential for the ecommerce market will become more tapped.

Please visit http://www.ctrchina.cn/ctrwebsite/en/new_Dongcha_rank.php for more marketing reports and trends.

Advantages of Ecommerce

Ecommerce brings a number of new opportunities to Chinese consumers. In the online marketplace, consumers can find a wide assortment of goods; many of which cannot be immediately found through traditional retail channels. Many categories of goods that may be difficult to find, such as imported foods, books, and international brands not yet established in local markets, are readily available for purchase through ecommerce platforms.

Regarding the key drivers of ecommerce in China, two factors stand out as leaders. First, shopping online as opposed to shopping through traditional retail channels is generally a time saver. The second standout factor is price. Prices for items through ecommerce channels in China tend to be lower than prices for identical items in traditional retail shops.

Barriers to Ecommerce

Although ecommerce holds a number of advantages compared to traditional retail, certain barriers exist. First, Chinese consumers are still cautious regarding the safety and security of shopping online. Not only are consumers concerned with the possibility of identity theft, but they are also hesitant in that they may not receive purchased items after payment. Online retail markets have addressed this issue by

implementing escrow systems and creating intermediaries to facilitate transactions. Another concern of China's online shoppers is that items purchased online might not be the same product as the one that is delivered or advertised. This is a major concern in product categories that can be dangerous when counterfeited. Such product categories include medicine, tobacco, and alcohol. Chinese shoppers also hold this concern with other product categories, such as apparel, where the item received may be of significantly lower quality and value than that ordered. Online retailers are addressing this concern by implementing stricter controls on supply chains and vendors.

Beyond these issues, some product categories have been found to be difficult to market through ecommerce. Such categories include fresh produce, fresh meats, and confectionery. Shopping for fresh produce and meats usually requires shoppers to individually select items based on their size and quality, a shopping behavior that is difficult to implement in ecommerce markets. Also, many local produce and meat markets exist in traditional retail in China. Small purchases, such as confectionery, are usually not planned purchases, making ecommerce a relatively difficult platform for sales.

Ecommerce Markets in China

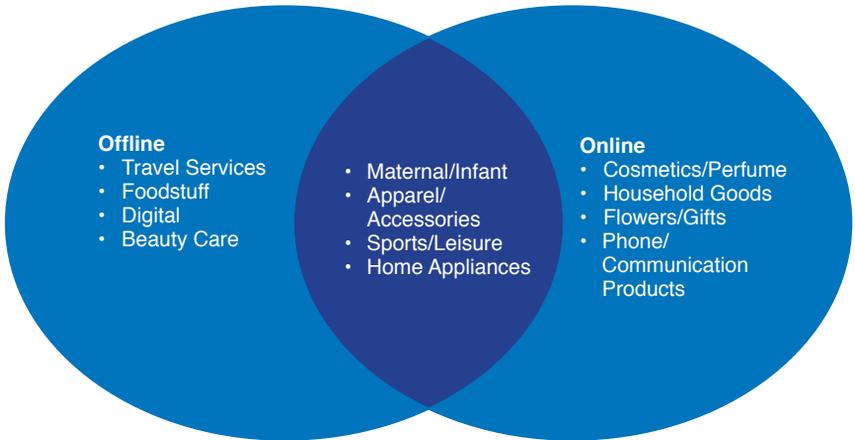
In 2010, the ecommerce market reached a total value of RMB498 billion (US\$78 billion). Over three quarters of transaction value came from the C2C market. However, the B2C sector has been growing rapidly in its proportion of ecommerce transaction value, and is expected to reach about 40 percent of the total market value by 2015.⁹ In 2011, the leading online marketplace in China by revenue for the C2C market was Taobao, with an estimated market share of 90 percent. According to Taobao, in H1 2012, the ecommerce platform had 3.7 million active sellers, 800 million product listings, and 60 million daily unique page views. Taobao also has a high awareness and consumer preference among Chinese consumers.

Part of the success of Taobao can be credited to Alipay, a secure payment method acting as an escrow service between buyers and sellers. Another part can be credited to Ali Wang Wang, an instant messaging tool connecting buyers and sellers to communicate about such things as product listings and delivery methods. Both Alipay and Ali Wang Wang are leading tools in the ecommerce market in China.

In the B2C market, Tmall led the marketplace in 2011 with an estimated market share of about 50 percent. According to Tmall, transaction volume in 2011 reached RMB100 billion (US\$15.75 billion), contained about 70,000 brands, and had an average of over ten million daily unique page views. Tmall has rigorous procedures for brand registration, which has helped them ensure products marketed on its platform are authentic.

⁹ iResearch Inc.

Fastest Growing Retail Categories for Online and Offline Shopping in 2011



Source: CNRS-TGI

Some specialty B2C ecommerce markets are also successful in China. A good example is the online store of electronics retail giant Suning, China's leading electronics retailer in 2011.

Top Five Fastest Growing Categories in Online Sales Revenue		
Rank	Category	H1 2012 vs. H1 2011 Growth Rate
1	Home Appliances	65%
2	Cosmetics/Perfume	48%
3	Household Goods	45%
4	Flowers/Gifts	15%
5	Sports/Leisure	11%

Source: CNRS-TGI

In the first half of 2011, apparel, including clothing, shoes, and bags, was the largest category in terms of online revenue, with an estimated share of 26.5 percent. The electronics, computers, and home appliances category had a share of revenue of 24.2 percent over the same period, making the category the second largest in terms of revenue. In all, more than half of ecommerce spending in China came from these two categories.

The apparel category has been met with success in ecommerce partly due to its

after sales service. Consumers can shop for apparel online while being generally confident that they will be able to return items with which they are not satisfied.

Other reasons for the success of apparel in ecommerce in China are browsing convenience and brand abundance. Through online platforms, shoppers can quickly and conveniently browse and compare apparel items from different brands. Some brands that may not be locally established through traditional retail channels can be found through online counterparts, creating a larger marketplace online than traditional retail can offer in a single location.

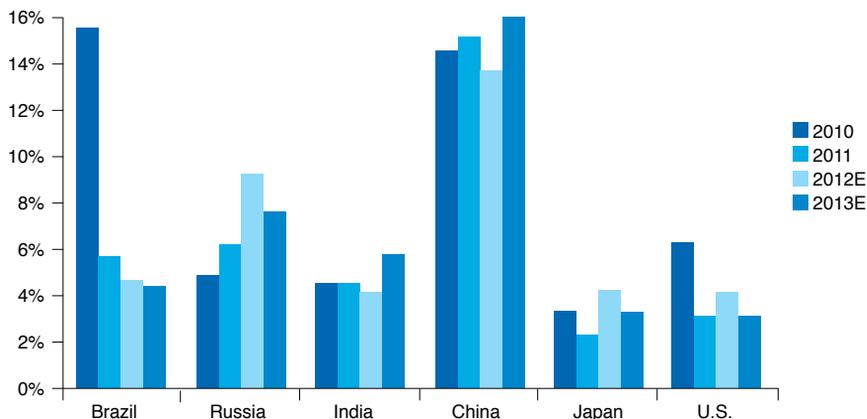
In terms of revenue growth, home appliances led the market in H1 2011. Other categories, such as cosmetics/perfume and household goods, also experienced rapid growth over this period.

An Overview of Media in China

A Glimpse at Global Advertising Markets

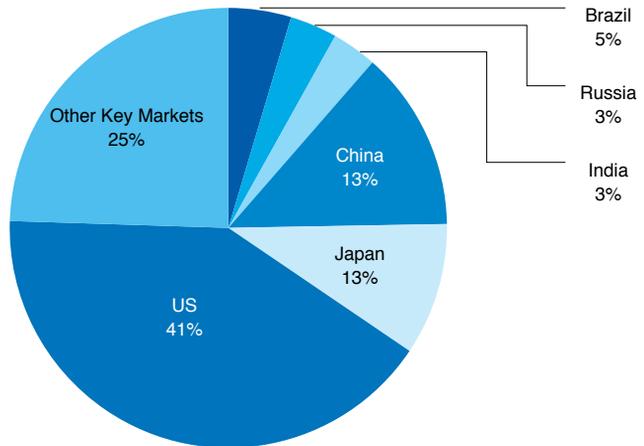
China was the fastest growing traditional advertising market by adspend with a growth rate of 15.1 percent (PPP) in 2011, and has experienced double-digit growth since 2008. In fact, since 2008 China's astounding growth in traditional media has only been surpassed once among key global markets (by Brazil in 2010), and is expected to remain the growth leader in 2012 and 2013. In the period from 2009-2011, China posted an average annual advertising market growth of 13.9 percent, while the BRIC nations (Brazil, Russia, India, and China) grew at an average rate of 5.7 percent. This growth is a combination of an increase in the amount of advertising resources as well as inflation from more intense competition.¹

Adspend Growth from 2010-2013E in Key Global Markets¹



¹ Data provided by Warc. © 2012 Copyright and database rights owned by Warc

Key Global Market Share of Ad Spending in 2011



In terms of overall market size, China has held the second largest market share of global advertising expenditure since 2009, when it surpassed Japan. In 2013, China's overall share of adspend is expected to surpass 15 percent. This combination of market size and rapid growth can lead to numerous opportunities and challenges for advertisers.

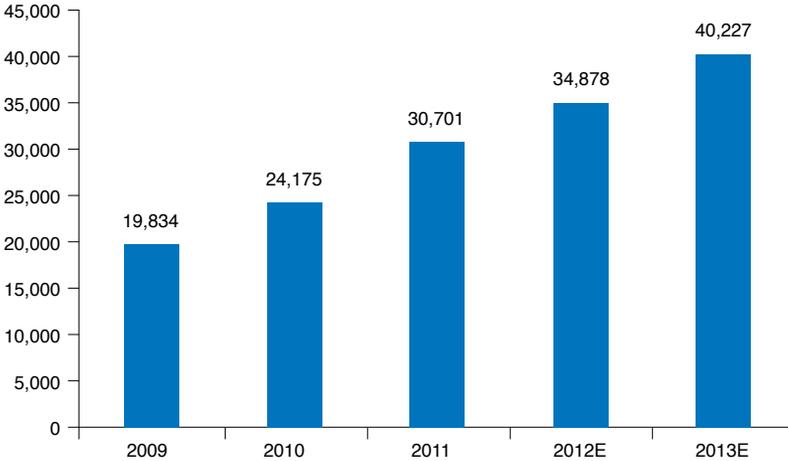
Traditional Media Markets in China

The ad markets in China have seen unparalleled growth in recent years, and its overall size in terms of adspend is the second largest in the world as of 2009. However, traditional media is experiencing change. The period from 2005-2007 can be referred to as the "golden period" for the China media market, characterized by growth in both advertising resources and competition among advertisers. Since 2008, traditional media markets have been on the path to more steady and stable growth.

Television

From 2009-2011, TV experienced an average year-on-year growth rate of 13.3 percent, remaining dominant among advertising mediums in terms of total advertising expenditure. This is mostly due to the broad reach that TV brings to advertisers on a daily basis, the breadth of which remains far ahead of other mediums. In 2012, the source of growth for advertising expenditure on TV began to shift, becoming increasingly concentrated on provincial satellite and provincial terrestrial level stations.

Traditional Adspend in China: 2009-2013E (US\$m)²



However, during the 2012 prime time advertising auction event of China Central Television (CCTV), China's national television network, the total auction value of primary advertising slots reached nearly 14.3 billion yuan (US\$2.3 billion), an increase of 12.5% over the previous year and a record high in the event's 18 year history.² This event, held annually, consists of bidding for traditional advertising slots as well as billboard slots within news and weather broadcasts. Its ever-intensifying competition may help explain why the source of aggregate growth for TV advertising has begun to become less concentrated at the national broadcast level.

Radio

Among traditional media platforms, radio has been the leader in growth with a rate of 21.6 percent year-on-year from 2009-2011. This growth is mostly driven by growth in the auto industry, which has been critical in developing radio listenership. As disposable household incomes continue to rise and consumers continue to demand more personal vehicles, this trend should persist.

The big three telecommunication companies - China Mobile, China Telecom, and China Unicom - have been essential in the development of radio advertising. These three brands have continually been among the top positions in terms of radio advertising expenditure, with China Mobile consistently spending the most.

² CTR Media Intelligence; He Wei, 'CCTV ad auction draws record bids', China Daily (11 November 2011)

Newspaper

Although from 2009-2011, year-on-year growth in advertising expenditure reached 12.3 percent, in H1 2012, advertising expenditure began to diminish. Year on year growth in 2010 soared at 21.9 percent, compared to -7.3 percent in H1 2012. This is partly due to the cooling down of the real estate industry, which had been one of the top five categories for newspaper adspend for many years. Also, newspapers are diminishing in terms of ad resources. As newspapers continue to make transitions from print-based platforms to online-based platforms, this trend will continue.

Magazine

Over the period from 2009-2011, magazine advertising expenditure grew at an average rate of 11.0 percent year-on-year. However, year-on-year growth has fallen from 20.5 percent in 2010, to 10.0 percent in H1 2012. One of the factors for this drop is the change in audience media contact habits, as more readers move to digital reading through the internet, mobile phones, and tablets.

Out-of-Home

From 2009-2011, out-of-home (OOH) adspend grew at an average rate of 10.3 percent year-on-year. OOH experienced the fastest growth in 2010 at a rate of 22.8 percent year-on-year. This was due heavily to significant resource expansion. During this period, Shanghai completed a number of new metro lines, creating new resources for advertising in preparation for the 2010 World Expo, for which it was the host city. However, in H1 2012, OOH grew at a much lower rate of 2.4 percent over the same period in 2011. This is partly due to new regulatory policies at the local level.

Primary Growth and Development Factors

Growth and development in the media and advertising markets in China are mostly driven by three primary factors: macro-economic development, industry-related conditions, and government policy.

Macro-Economic Development

Expansion and contraction of media and advertising markets correlates closely to GDP. Historically, the ratio between global GDP and the development rate of advertising is about 1.00:1.50. Between 2008 and 2011, China's real growth rate of GDP grew by an annual average of 9.6 percent.³ Comparing that to the 13.9 percent growth rate in advertising markets over the same period, the ratio between the real growth rate of global GDP and the advertising market development rate was

³ National Bureau of Statistics of China

1.00:1.45. As China has experienced economic expansion at a rate far above the global real growth rate of GDP (annual average of 2.8 percent from 2008-2011),⁴ it is not surprising that the nation's development rate of advertising is presently outpacing all other key global nations.

Industry Related Conditions

Growth in H1 2012 was greatly influenced by the alcohol industry, providing a good example of industry growth factors in advertising and media in China.

For 2012, China Central Television (CCTV) issued a new advertising policy permitting only two advertisements promoting alcohol products during its prime time news broadcasts, and a total of 12 ads of this kind throughout the day. This new policy created fierce competition, which dramatically increased bid sizes for advertising slots among competing entities in China's white spirit industry during CCTV's bidding event for prime time ad slots.

In contrast, other industries have suffered dramatic cutbacks in adspend on traditional media. Such industries include tobacco and real estate. Tobacco, which in recent years has seen heavy restrictions related to a new advertising policy issued by the central government that greatly restricted the tobacco industry's ability to advertise, posted a drop of 49.6 percent between October 2012 and October 2011. As the once booming housing market began to cool in 2012, the real estate industry, where advertising expenditure reacts strongly to market fluctuations, experienced a drop of 11.5 percent between H1 2012 and H1 2011. This is a dramatic change from its 33.8 percent growth rate from 2010 to 2011. Other industries that are directly related to the real estate market, such as household products and home electrical appliances, have also experienced dramatic drops in adspend.

Another factor affecting the advertising expenditure for home electrical appliances was the expiration of a 2011 government policy allowing consumers to recycle their outdated electrical appliances in exchange for a reduced price on new models. This played a significant role in the 18.1 percent drop between H1 2011 and H1 2012 for this category.

Please visit http://www.ctrchina.cn/ctrwebsite/en/new_Dongcha_rank.php for the current ranking of the top categories and brands in China by advertising expenditure.

⁴ <http://www.indexmundi.com/g/g.aspx?c=xx&v=66>

Top Five Industries by Year-on-Year Adspend Growth – H1 2012 vs. H1 2011		
Rank	Industry	2012 vs. 2011 Growth Rate
1	Alcohol	24.8%
2	Computer & Office Automation Product	18.3%
3	Agriculture	14.4%
4	Personal Items	12.6%
5	Post and Communication	11.9%

Top Five Industries by Year-on-Year Adspend Growth – H1 2012 vs. H1 2011		
Rank	Industry	2012 vs. 2011 Growth Rate
17	Industrial	-9.9%
18	Real Estate & Construction Industry	-11.5%
19	Cleansers	-17.5%
20	Home Electrical Appliance	-18.1%
21	Tobacco	-49.6%

Government Policy in Media and Advertising

Media and advertising markets are regulated by the State Administration of Radio, Film, and Television (SARFT).

Explanation of the Governing Body

As the affiliated administration department of China's State Council, the State Administration of Radio, Film and Television (SARFT) is responsible for:

1. Planning the development of radio, film and television and its policies, to ensure creative orientation is in accordance with public opinions and visual works.
2. Drafting the legal regulation for the audio-visual services provided by radio, film and television organizations, enhancing the structure's reformation.
3. Undertaking important radio, film and television projects, and their construction, coordination, organization and development.

SARFT consists of internal, affiliated and provincial management departments. There are 17 internal departments: General Office, Regulation Division, Propaganda and Management Division, Motion Picture Authority, Drama Management Division, Media Organization Management Division, Internet Audio-Visual Program Management Division, Science and Technology Division, Planning and Finance Division, Department of International Cooperation (Hong Kong, Macau and Taiwan Offices), Personnel Division, Defence Division, Commission of Communist Party,

Administration of Union, Retired Personnel, Discipline and Inspection Group, Supervision Bureau, and Administration Audit Office. There are 34 affiliated units, including China Central Television (CCTV), China National Radio, and China International Television Corporation (CITVC).⁵

For further details of these divisions, please refer to the SARFT website, <http://www.sarft.gov.cn/catalogs/zjjg/index.html>.

Foreign Media Guidelines and Policies

SARFT policy reference for foreign media is derived mainly from Order No. 27 Measures for the Administration of Landing of Foreign Satellite Television, which was put into effect August 1, 2004. Concisely, this policy restricts the landing broadcast of foreign satellite TV channels in mainland China with the following policies:

1. Approval and eligibility of broadcast applications.
2. Restricting broadcast range, with allowable broadcast ranges including international hotels three stars and above, foreign residencies and offices, and other specified ranges.
3. Restricting the valid period of broadcast qualification to 1 year, (i.e. annual renewal of broadcast qualification is required).
4. Endorsement of the qualifications of media, on the principles that only one landing channel is permitted per media, foreign news channel applications are not accepted, and if domestic broadcast organizations and/or their related departments, enterprises, groups, or individuals establish a satellite station abroad, the satellite's TV landing applications are not accepted. Special approval is required for these media to apply for landing.
5. Ensuring that foreign media broadcast content abides by the Laws and Regulations of The People's Republic of China.⁶

⁵ For further details of these divisions, please refer to: <http://www.sarft.gov.cn/catalogs/zjjg/index.html>

⁶ The details of the measure can be referred to by following:

<http://www.sarft.gov.cn/articles/2004/08/01/20070922170544580662.html>

Ch 3 China's Expanding Marketplaces

By Demographic Consulting

The People's Republic of China's more than 1.3 billion people—nearly one fifth of the world's population—are a major source of potential new consumers for multinational retailers and manufacturers. Entering this huge, complex market is especially challenging because access to current, geographically-detailed data about China's numerous markets is limited. In recognizing that the China marketplace is changing rapidly, an understanding of the massive population shifts and changing socio-economic environment are critical components for successful entry.

Because local data about micro markets is particularly difficult and costly to obtain, business leaders must often make expansion and marketing decisions with less-than-optimal information. However, access to nationwide demographic and business data is improving, giving researchers a better picture of China's complexity.

Updating official government population census counts is challenging, but new techniques incorporating satellite-collected remote sensing data can be used to monitor expanding urbanization and population growth in new areas.

One element adding to the complexity is how geographic regions are defined in China. China is primarily divided into provinces, prefectures, counties and townships. Cities in China can be composed of different administrative divisions, and according to the administrative divisions of the People's Republic of China, there are three levels of cities, namely municipalities, prefecture-level cities, and county-level cities.

China's Administrative Divisions		
People's Republic of China Census Geographic Levels	Approximate Count in Mainland China*	Comparable United States Census Geographic Levels
Province, autonomous region and municipality city (such as Beijing, Shanghai, Chongqing, and Tianjin)	31	State/District of Columbia/Puerto Rico
Prefecture, prefecture level city, and autonomous prefecture	345	Metropolitan and Micropolitan Statistical Areas
County, County Level City, Urban district, and autonomous county	2783	County, County equivalents
Town, township and Jiedao	50,500	Census Tract, Census Place or Township

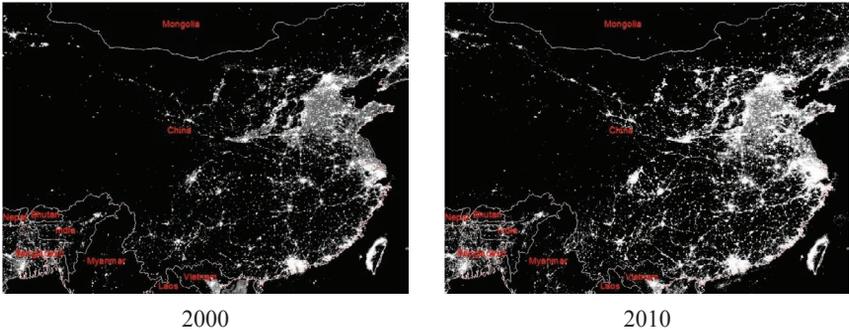
**Geographic definitions can change over time. These counts relate to the 2000 PRC Census in Mainland China, and include some unofficial geographic areas used for reporting PRC Census data. The U.S. geographic levels are not strictly comparable to China's, and are used as an approximate reference.*

Our goal in this chapter is to help businesses bridge some information gaps about the rapidly changing Chinese market and be more effective in planning as they expand in China. In this chapter we describe China's urbanization and growth at a macro level. We then report new information on China's Tier 1, 2, and 3 cities, followed by an examination of population growth and concentration occurring in smaller geographic areas within cities. Finally, we demonstrate how small area data can assist in examining neighborhoods and screening potential retail sites within a city.

China's Nighttime Lights Show Urbanization Trends

Satellite-collected images of nighttime light intensity (provided by the U.S. National Oceanographic and Atmospheric Administration) shows trends of urbanization over time. The following images show a wider geographic distribution of nighttime lights in 2010 than 2000. This pattern is typically associated with increased urbanization, new construction and population increase.

Comparison in Nighttime Light Intensity, China, 2000 to 2010



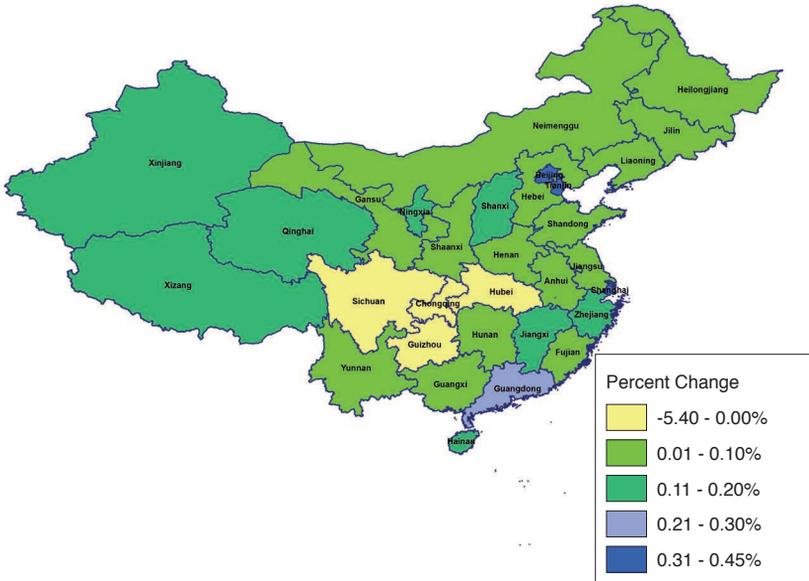
This type of satellite data can be combined with other information to update China's population census data, which is collected every 10 years. The most recent census was in 2010, but only limited information from that census has been made available as of this printing.

China's Growth by Region

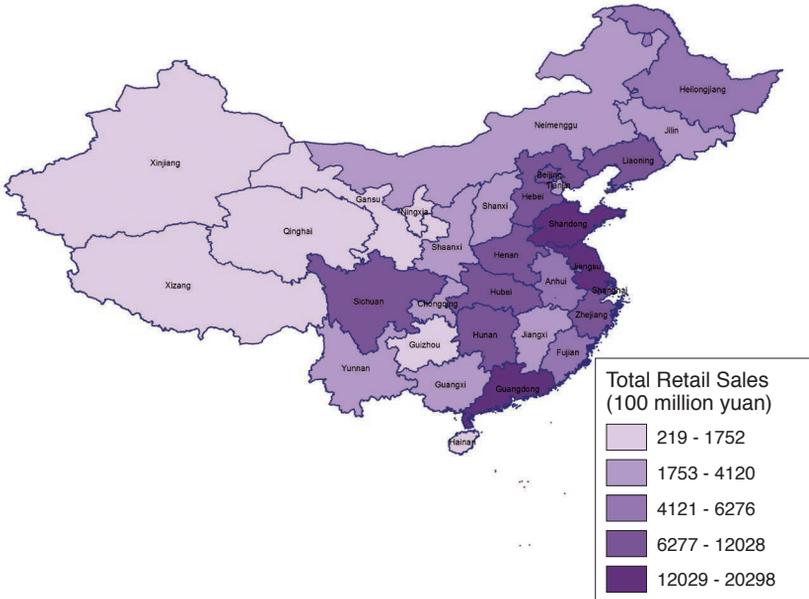
Following decades of positive economic growth, China has firmly established itself as the world's manufacturing center, but that growth is not uniform across the whole country, nor even the eastern seaboard where the most intense development has occurred. Using official and comprehensive data from the National Bureau of Statistics of China, it is possible to rank the 31 provinces, municipalities and autonomous regions in terms of urban growth, migrant population, retail sales, and economic growth.

The following series of maps show where some of the growth is occurring based on different measures. By examining such information, businesses can better evaluate and target possible regional opportunities to investigate further. For example, the province of Shandong has high retail sales relative to a comparatively low migrant population, which implies a greater ratio of permanent residents. These permanent residents may have home ownership needs, school children requiring activities and services, and healthcare demands. Migrant workers, by comparison, traditionally send their earnings home, are not eligible for social services, do not own homes, and have less discretionary "lifestyle" consumption.

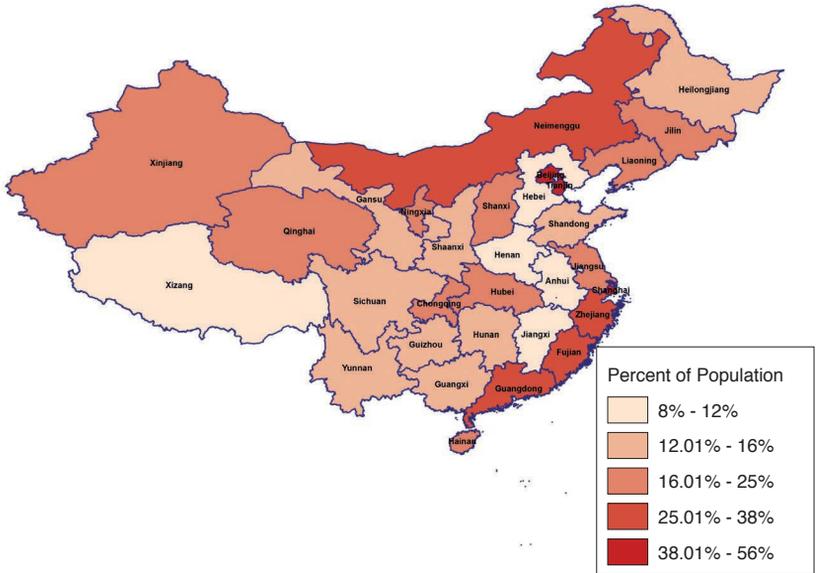
Province Population Growth 2000 to 2010



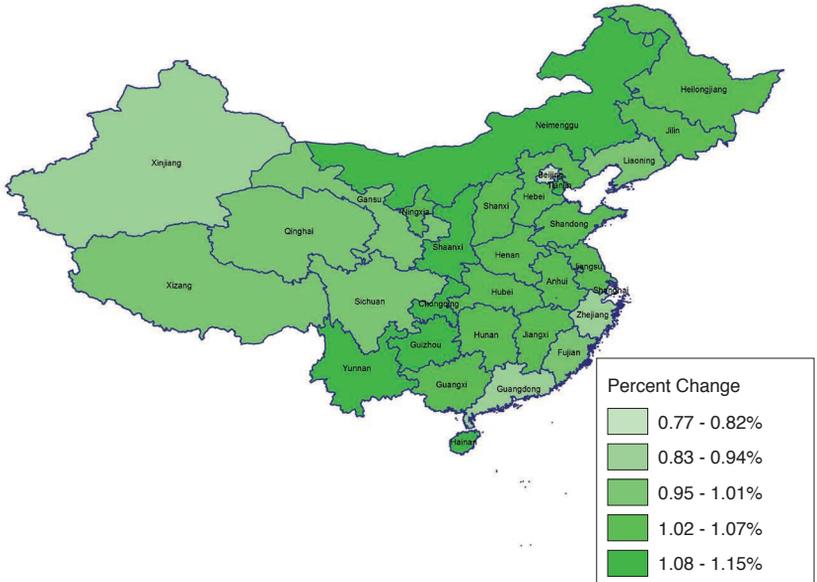
Province Retail Sales of Consumer Goods 2011



Province Migrant Population 2010



Province Gross Regional Product Growth 2007 to 2011



Selected Demographic and Economic Measures by Province

Province	Permanent Pop. 2010	Pop. Change from 2000	% Change from 2000	% Migrant Pop.	Total Retail Sales of Consumer Goods 2011 (100 million yuan)	Per Capita Consumer Goods 2011 (yuan)	Consumer Goods Sales Growth 2007 to 2011	Gross Regional Product Growth 2007 to 2011
Beijing	19,612,368	6,043,174	45%	35.9%	6,900	35,184	82%	65%
Tianjin	12,938,693	3,089,962	31%	23.1%	3,395	26,240	112%	115%
Hebei	71,854,210	5,169,791	8%	2.0%	8,036	11,183	102%	80%
Shanxi	35,712,101	3,240,859	10%	2.6%	3,903	10,930	104%	87%
Neimenggu	24,706,291	1,382,944	6%	5.8%	3,992	16,157	110%	124%
Liaoning	43,746,323	1,921,911	5%	4.1%	8,095	18,505	101%	99%
Jilin	27,452,815	650,624	2%	1.7%	4,120	15,007	106%	100%
Heilongjiang	38,313,991	2,076,415	6%	1.3%	4,750	12,398	104%	77%
Shanghai	23,019,196	6,611,462	40%	39.0%	6,815	29,605	77%	54%
Jiangsu	78,660,941	5,617,364	8%	9.4%	15,988	20,326	104%	89%
Zhejiang	54,426,891	8,496,240	18%	21.7%	12,028	22,099	94%	72%
Anhui	59,500,468	500,520	1%	1.2%	4,955	8,328	106%	108%
Fujian	36,894,217	2,796,270	8%	11.7%	6,276	17,011	97%	90%
Jiangxi	44,567,797	4,170,199	10%	1.3%	3,485	7,820	107%	102%
Shandong	95,792,719	5,820,930	6%	2.2%	17,155	17,909	103%	76%
Henan	94,029,939	2,793,085	3%	0.6%	9,454	10,054	106%	79%
Hubei	57,237,727	(2,271,143)	-4%	1.8%	8,275	14,458	105%	110%
Hunan	65,700,762	2,426,589	4%	1.1%	6,885	10,479	105%	108%
Guangdong	104,320,459	19,095,452	22%	20.6%	20,298	19,457	92%	67%
Guangxi	46,023,761	2,169,223	5%	1.8%	3,908	8,492	106%	101%
Hainan	8,671,485	1,112,450	15%	6.8%	760	8,759	110%	101%
Chongqing	28,846,170	(1,666,593)	-5%	3.3%	3,488	12,091	110%	114%
Sichuan	80,417,528	(1,930,768)	-2%	1.4%	8,045	10,004	100%	99%
Guizhou	34,748,556	(499,139)	-1%	2.2%	1,752	5,041	113%	98%
Yunnan	45,966,766	3,606,677	9%	2.7%	3,000	6,527	115%	86%
Xizang	3,002,165	385,836	15%	5.5%	219	7,295	96%	77%
Shaanxi	37,327,379	1,962,307	6%	2.6%	3,790	10,153	110%	117%
Gansu	25,575,263	450,981	2%	1.7%	1,648	6,444	98%	86%
Qinghai	5,626,723	803,760	17%	5.7%	410	7,295	97%	109%
Ningxia	6,301,350	814,957	15%	5.8%	478	7,579	105%	129%
Xinjiang	21,815,815	3,356,304	18%	8.2%	1,616	7,409	91%	88%

China's Cities

The growth of cities in China has been remarkable. To illustrate the sheer size and potential of these emerging urban centers, the following table summarizes the number of cities in China with populations exceeding the population of the three largest US cities.

Chinese Cities with Populations Exceeding that of the U.S.'s Three Largest Cities		
U.S. City	Population (2011 Estimate by U.S. Census)	Number of China Cities* with a Greater Population (2012 Estimate)
New York	8,244,910	27
Los Angeles	3,819,702	141
Chicago	2,707,120	209

**Cities are defined as municipalities, prefecture-level cities, and county-level cities*

While the megacities of China – Beijing, Shanghai, Guangzhou and Shenzhen, remain common points of market entry, Tier 2, 3, and even 4 cities offer many competitive advantages for U.S. businesses. With established infrastructure, burgeoning middle class, access to local officials and decision makers, receptivity to western products, and positive consumer consumption patterns, these cities offer numerous advantages to U.S. firms as a point of market entry, and market expansion.

Comparing and Sizing up Cities - City Consumption Power (CCP)

Under China's administrative classifications, there are various types of cities, including provincial-status cities, sub-provincial cities, provincial capitals and prefectural cities (other than provincial capitals). But these administrative classifications do not adequately reflect the characteristics of the consumer market as consumption levels widely vary. Owing to differences in economic development, location, living standards, urbanization rate and population growth, there can be huge differences between cities within the same administrative level. So assessing a city's potential as a consumer market solely on the basis of its administrative level is problematic.

A variety of methods have been used to categorize China's cities into groupings or "Tiers" to aid in understanding and summarizing the Chinese market.

All China Marketing Research (ACMR, Beijing) has developed city spending power indicators, which are used to derive an index of consumption levels for cities and regions. This comprehensive index of a city's potential per capita spending power (PCP) utilizes many inputs: total urban population, GDP, total consumption

(including purchases by institutions as well as consumers), per capita disposable income, savings and other consumer spending indicators. These factors are given different weights depending on their influence on the PCP. The result is a segmentation of markets based on a multi-factor approach.

City Consumption Power (“CCP”), is a comprehensive evaluation index, marking the city’s overall consumption power. It is calculated by multiplying Urban Per Capita Consumption Power by urban population. Urban Per Capita Consumption Power (PCP) consists of the following indicators: urban population, GDP, total retail sales of consumer goods, urban per capita disposable income, consumption expenditure, etc.



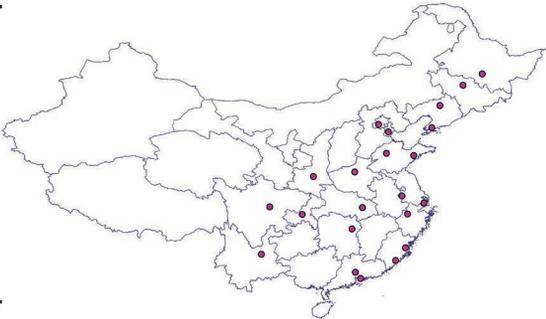
Using this index, cities can be segmented into the different tiers as follows.

Characteristics of City Consumption Power Tiers							
CCP Tier	CCP Tier	Description	Number of Cities	% Urban Population	Average Urban Population ('000)	Total CCP (billion RMB)	Per Capita Consumption (RMB)
1	1a	CCP> 300 billion (BJ, SH, GZ, SZ)	4	84%	13,052	1,620	31,031
	1b	CCP>50 billion, vice province city or above	18	79%	4,263	1,907	24,846
2	2a	CCP>15 billion, or other vice province city	30	67%	1,887	1,306	23,080
	2b	CCP>10 billion	39	77%	1,044	821	20,166
3	3a	CCP>6 billion	67	69%	708	777	16,390
	3b	CCP>3 billion	104	54%	447	710	15,270
4	4a	CCP>1 billion, or other district city	168	44%	307	627	12,178
	4b	Other county city	227	41%	244	437	7,889
5	5a	City Population >150 thousand county	445	27%	176		
	5b	Other county	1,195	21%	60		

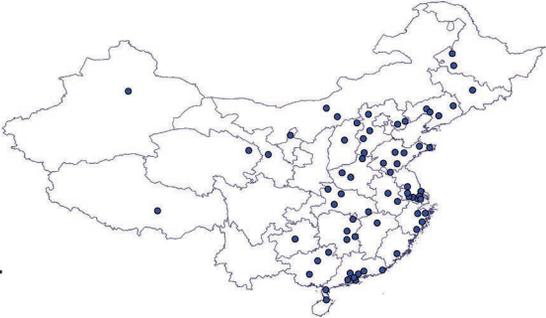
Top 52 Chinese Cities by City Consumption Power and Region

CCP Tier	Northeast	North	East	Middle	South	Northwest	Southwest
1a		Beijing	Shanghai		Guangzhou, Shenzhen		
1b	Changchun, Ha'erbin, Dalian, Shenyang	Tianjin	Qingdao, Jinan, Hanzhou, Nanjing, Fuzhou, Xiamen	Zhengzhou, Changsha, Wuhan		Xi'an	Kunming, Chengdu, Chongqing
2a	Anshan, Jiilin	Baotou, Tangshan, Shijiazhuang, Huhehaote	Changzhou, Suzhou, Zibo, Ningbo, Hefei, Wuxi, Wenzhou, Yantai, Taizhou,	Nanchang	Dongguan, Shantou, Zhuhai, Haikou, Nanning, Foshan	Lanzhou, Wulumuqi, Taiyuan, Yinchuan, Xining	Guiyang

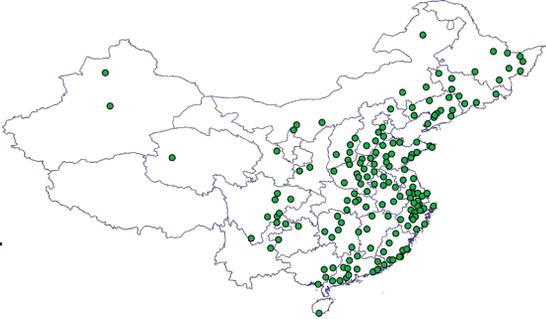
**City Consumption Power
Tier 1a and 1b Cities**



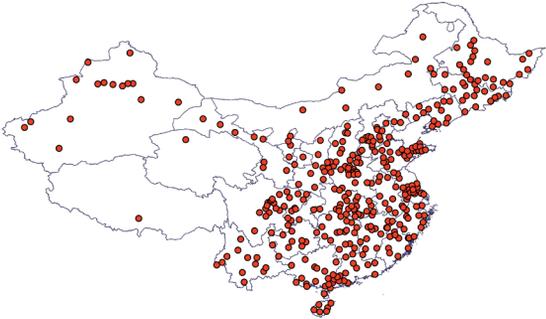
**City Consumption Power
Tier 2 Cities**



**City Consumption Power
Tier 3 Cities**



**City Consumption Power
Tier 4 Cities**



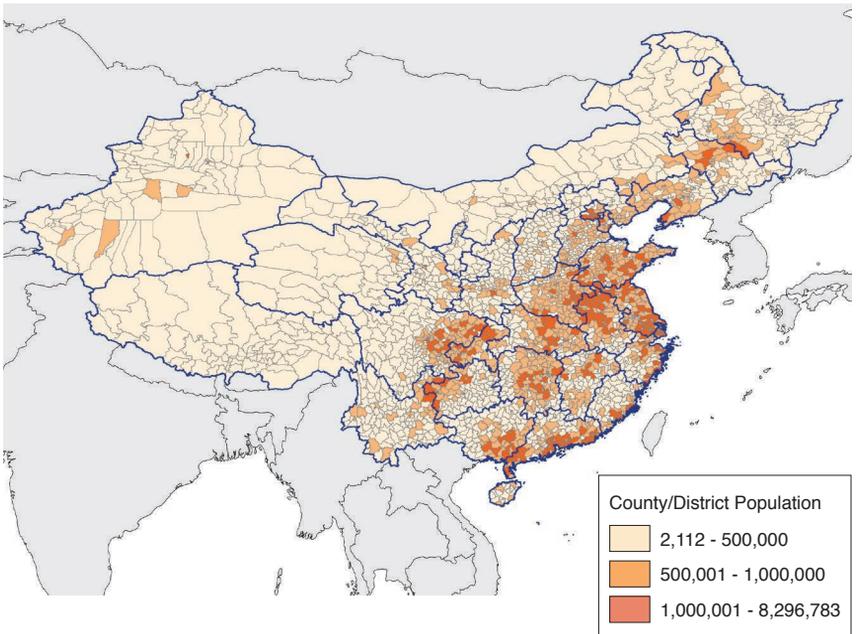
Within China's Cities - Finding Local Opportunities

Fast Growing Counties and Districts

The next smaller geographic level in mainland China is comprised of counties, county level cities, urban districts, and autonomous counties. Grouping these types of areas together gives us a “wall-to-wall” picture of China that we can analyze. For the purpose of this discussion, we refer to these areas as “county level units.” Unlike in the United States, these areas in China are often smaller than cities, and this level of data can give the next step of detail in understanding the Chinese market.

The map below shows individual counties, districts, etc. (“county level units”) shaded to display the estimated number of permanent residents in each area. There are large concentrations of population geographically dispersed throughout the eastern half of China.

Estimated 2012 Population by Counties/Districts



Similar to the many large fast growing cities in China, there are also many large rapidly growing counties within the larger cities. Of 2,847 counties, there are 110 counties with over one million estimated permanent residents in 2012 (source: Demographic Consulting, Inc.) that have grown by more than 10 percent since the year 2000. There are 24 counties that have grown by 50 percent to 150 percent.

The map below displays these 110 highly populated fast-growing counties.

Counties/Districts with Population over 1 million (2012) and Growth over 10% (2000-2012)



Some of these fast growing, large county level units are within the four CCP Tier 1a cities (Beijing, Shanghai, Guangzhou and Shenzhen) mentioned earlier in the chapter, but many are in lower tier cities. Populations in five of Guangzhou’s twelve county level units (Baiyun, Fanyu, Haizhu, Tianhe and Zengcheng) have grown by 22 percent to 39 percent between 2000 and 2012 and have permanent populations over 1 million people. Similarly, in Wuhan, a CCP Tier 1b city in Hubei Province, two of the 13 county level units (Hongshan and Wuchang) have over 1.2 million residents in 2012, with growth of over 25 percent since 2000. Wenzhou (in Zhejiang province), a CCP Tier 2a city, has 5 fast growing, highly populated county level units.

China’s urban expansion is widely dispersed, and is occurring both within and around hundreds of cities. This challenges us to go beyond understanding cities, and delve into the detail within them.

Case Study - Retail Site Screening Analysis and Comparison

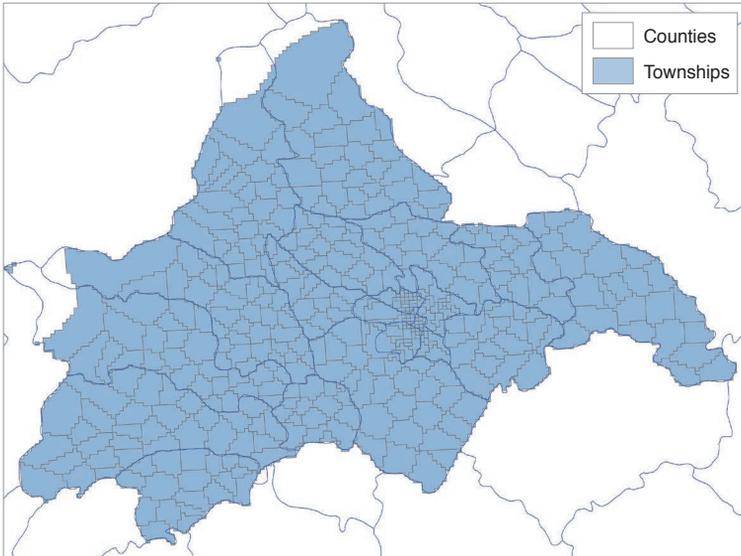
Choosing the best possible new locations within a city is challenging, particularly in China's Tier 2, 3 and 4 cities. However, advances in data availability and spatial analysis tools for China are finally enabling cost-effective analysis of large numbers of potential sites within a city.

Apportioning techniques, township data and estimates of the population by grid areas within townships can be used to help companies looking to expand strategically, efficiently focus on targeted areas, reduce site screening costs, evaluate store performance, develop and refine logistics and distribution centers, support predictive models and conduct competitive analysis.

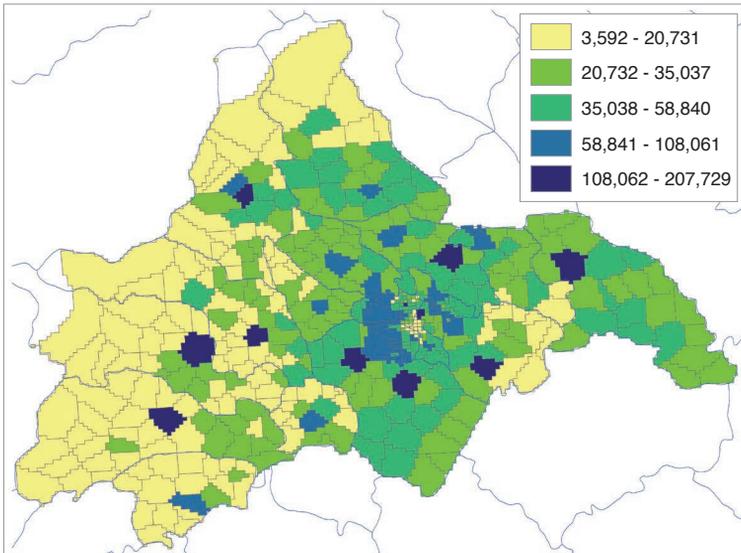
Trade area analysis offers a “practical way to compare and evaluate locations based on surrounding factors that drive store sales. Trade areas (also known as trade zones or catchments) can be used to aggregate demographic information, delineate optimal spacing for stores, observe impact to sales from changes in competition or from the influences of advertising campaigns, and aid in the calculation of sales forecasts and profitability,” as a white paper by Tango Management Consulting puts it (Not Your Father's Trade Area). Trade area or site analysis is routinely used in the U.S., Canada, and Europe, where researchers enjoy access to extensive and geographically-detailed information about the people, businesses, and consumer behavior in the vicinity of a store or new location.

In this case study, we examine Chengdu, the capital of Sichuan province located in Southwest China with an estimated population of over 13.6 million. It is comprised of 19 county level units (districts and counties) within about 412 township level units (jiedaos, towns and townships). The population and size of each township level unit can vary as shown in the following maps.

Counties and Townships in Chengdu, Sichuan

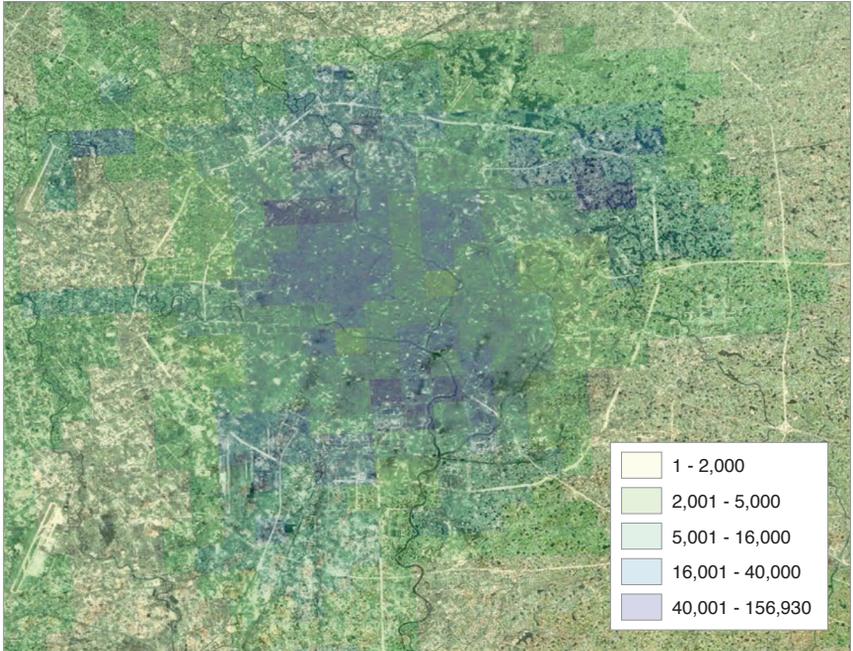


Estimated 2012 Population of Townships in Chengdu, Sichuan



Using mapping applications, we can zoom into a particular area in Chengdu and show the 2012 estimated population by 1 km square grids. The blue areas indicate areas of higher population.

Chengdu Population by 1 sq km Grid



When analyzing prospective sites for business locations, it is helpful to have summarized information about the neighborhoods surrounding each site. In the example below, we examine 6 different locations within Chengdu. We assume that most customers will reside within 1 km of the location, yielding a trade area with a 1 km radius. The summary population data for each circular trade area are calculated using the township level characteristics and the smaller grid-level population estimates.

The following map shows the estimated 2012 population within a 1 km trade area of each site. The red areas are sites with a higher estimated population, and the yellow areas have a much lower population.

Chengdu Population within 1km Radius of Select Trade Areas



We can now compare and rank the six sites. It is immediately evident that some sites have substantially greater population density than others, and may be better prospective sites. Using this approach, sites with high concentrations of people matching target customer demographic characteristics can be identified.

Demographic Comparison of Each Site									
Rank	Trade Area Name	Total Pop.	Households	Males per 100 Females	% Pop. Age 0 to 14	% Pop. Age 15 to 64	% Pop. 65+	Median Age	Pop. Per Sq Km (Density)
1	Jin He Bin Guan	90,638	33,127	102	9.5%	77.3%	13.2%	41.0	30,212.7
2	Sheng Wu Dao Xue Xiao	66,754	22,832	109	10.9%	78.8%	10.3%	37.3	29,712.1
3	C h e n g Du Da Jiu Dian	64,200	24,852	100	9.3%	77.4%	13.2%	41.7	21,475.6
4	Dian Zi Ke Ji Da Xue	51,529	17,330	105	11.8%	81.2%	7.0%	38.9	16,934.5
5	Shi Er Yi Yuan	30,840	11,762	104	8.9%	77.7%	13.4%	41.7	10,940.3
6	Kou Qiang Yi Yuan	23,162	9,006	102	8.6%	75.9%	15.5%	42.3	7,720.7

This type of location-specific information can be extremely useful in correlating existing store sales performance with characteristics of the surrounding trade area. Sales forecasting models can be developed to predict sales performance for new sites. Automated software and better access to township level data for China is becoming more available, although this software and data is not yet as comprehensive or detailed as in the United States.

Conclusion

U.S. businesses often rely heavily upon local Chinese representatives to advise on demand trends and opportunities. Geographically-detailed data on population growth patterns, demographic characteristics and the business environment can help shape forecasting and representative sales targets. This data can also be an indicator of sales force needs, or otherwise guide the planning and resource allocation for a business' China activities.

Ch 4 Establishing and Running a Business in China

By Dezan Shira & Associates

What are my options for investment?

Foreign investment into China can come in several foreign-invested entity (FIE) forms, and choosing the appropriate investment structure depends on a number of factors, including planned activities, industry, investment size, etc.

Key points that differentiate investment structures include:

- **Business scope**
Business scope is the one sentence description of the business activities in which a business will engage. The business scope must be approved early on in the establishment process, as the approved scope will appear on the business license. The business can only conduct the business activities in its business scope and any amendments to the business scope require further application and approval, and can be quite time consuming.
- **Registered capital**
Registered capital is the initial investment in the company that is required to fund the business operations until it is in a position to fund itself.

In practice, the official requirements for registered capital vary by industry and region. The absolute minimum capital requirements under Chinese law are RMB30,000 (US\$4,724) for multiple shareholder companies and RMB100,000 (US\$15,748) for single shareholder companies.

Registered capital contributions can be made in cash or in kind, as a lump sum or in installments. Locally obtained RMB cannot be injected as registered capital - it must be sent in from the overseas investor. The payment schedule of the registered capital needs to be specified in the company's Articles of Association.

After the registered capital has been contributed, this amount cannot be wired out again freely. If a company wishes to expand its scope of business later on, there may be a requirement to increase the amount of registered capital.

In addition to the registered capital, a total investment figure also needs to be specified. The total investment quota is the total amount of funds planned to be contributed to the project over its lifespan. The difference between registered capital and total investment represents the debt of the investment and can be made up by loans from the investor or foreign banks.

Mandatory Total Investment – Registered Capital Ratios	
Total Investment (US\$)	Minimum Registered Capital
3 million or below	7/10 of total investment
Above 3 million and below 4.2 million	2.1 million
4.2 million to 10 million	1/2 of total investment
Above 10 million and below 12.5 million	5 million
12.5 million to 30 million	2/5 of total investment
Above 30 million and below 36 million	12 million
36 million or above	1/3 of total investment

- Legal personality liability

A company in China is an enterprise legal person. An enterprise legal person bears civil liability for the operational activities of its legal representatives and other staff. The company is liable for its debts to the extent of its entire property. The shareholders of a company with limited liability status assume liability towards the company to the extent of the capital contributions subscribed by them respectively.

Representative Offices

A representative office (RO) is an attractive way for foreign investors to get a feel for the Chinese market, as it is the easiest type of foreign investment structure to set up and has no registered capital requirements. The defining characteristic of an RO is its limited business scope; an RO is generally forbidden from engaging in any profit-seeking activities and can only legally engage in:

- Market research, display and publicity activities that relate to company product or services; and
- Contact activities that relate to company product sales or service provision and domestic procurement and investment.

An RO has no legal personality, meaning it does not possess the capacity for civil rights and conduct, cannot independently assume civil liability, and is limited in its hiring ability. Local employees can only be hired through government HR agencies and no more than four foreign employees can be hired per RO.

Wholly Foreign-Owned Enterprises

A wholly foreign-owned enterprise (WFOE), the most commonly used foreign investment structure, is a limited liability company wholly owned by foreign investor(s).

Since China joined the World Trade Organization in 2001, WFOEs can do almost any type of business in China. The Foreign Investment Industrial Guidance Catalogue, the most recent version released in 2011, divides industries into three categories: encouraged, restricted and prohibited for foreign investment (industries not listed in the Catalogue are generally permitted). The catalogue also specifies industries in which foreign investment can only be done as part of a joint venture (described next).

A foreign-invested commercial enterprise (FICE), which can be set up either as a WFOE or a joint venture, is a type of company for retailing, franchising or distribution operations. A WFOE or JV can be established exclusively as a FICE, or can combine FICE activities with other business activities, such as manufacturing and services.

Joint Ventures

A joint venture (JV) is a company owned partially by foreign investor(s) and partially by Chinese investor(s). There are two types of JVs in China, which differ primarily in terms of the way in which profits and losses are distributed.

1. Equity JV (EJV)

- Profits and losses are distributed between parties in proportion to their respective equity interests in the EJV
- The foreign partner should hold at least 25 percent of the equity interest in the registered capital of the EJV
- Limited liability as a Chinese legal person

2. Cooperative JV or Contractual JV (CJV)

- Profits and losses are distributed between parties in accordance with the specific provisions in the CJV contract
- Can operate either as a limited liability company or as a non-legal person

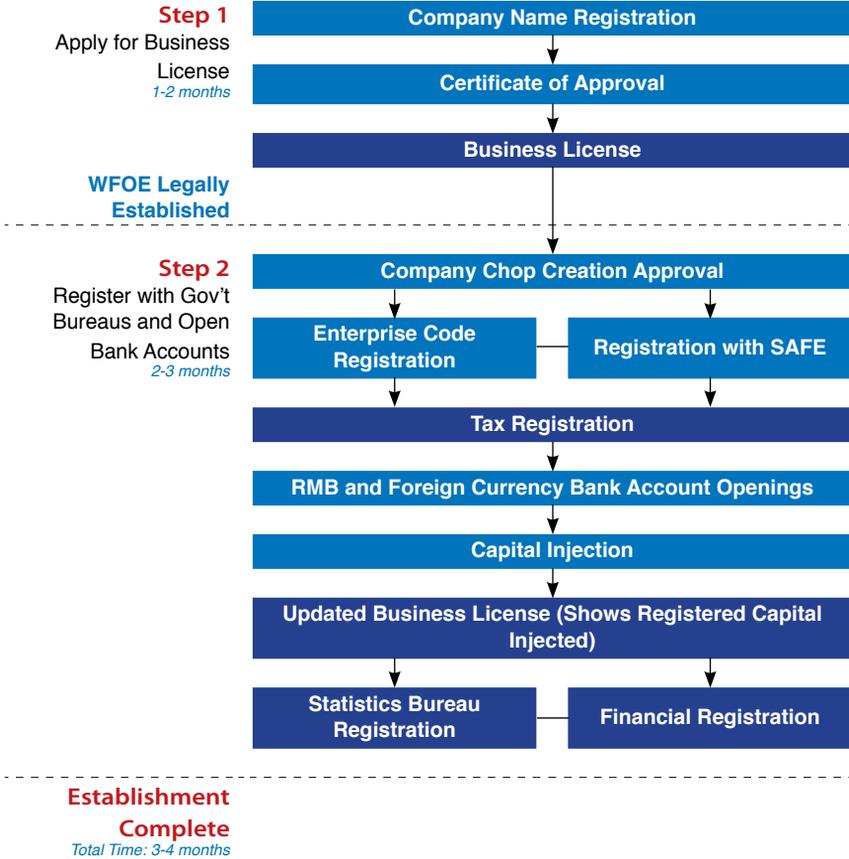
Common Purpose(s), Pros and Cons by FIE Structure Type				
FIE Structure Type		Common purpose(s)	Pros	Cons
Representative Office	RO	<ul style="list-style-type: none"> Market research Liaise with home country companies 	<ul style="list-style-type: none"> Easiest foreign investment structure to set up No registered capital requirement Paves way for future investment 	<ul style="list-style-type: none"> Cannot invoice locally in RMB Must recruit staff from local agency, no more than four foreign employees
Wholly Foreign-owned Enterprise	WFOE	<ul style="list-style-type: none"> Manufacturing Service provision Trading (if a FICE) 	<ul style="list-style-type: none"> Greater freedom in business activities than RO 100% ownership and management control 	<ul style="list-style-type: none"> Registered capital requirement Lengthy establishment process
Joint Venture	JV	<ul style="list-style-type: none"> Entering industries that by law require a local partner Leveraging a partner's existing facilities, workforce, sales/distribution channels 	<ul style="list-style-type: none"> See common purpose(s) 	<ul style="list-style-type: none"> Split profits Less management control than a WFOE Technology transfer/IP risks Inheriting partner liabilities
Foreign-invested Partnerships	FIP	<ul style="list-style-type: none"> Investment vehicle Service provision 	<ul style="list-style-type: none"> Allows for domestic and foreign ownership Easier setup (does not require registered capital verification) Substantial tax savings 	<ul style="list-style-type: none"> Unlimited liability of the general partner Newness of structure (potential challenges with taxation or foreign currency exchanges)

How do I establish a company?

Establishing a foreign investment structure in China generally takes between 3 and 6 months.

The establishment process varies based on the foreign investment structures and the planned business scope. For example, manufacturing WFOEs will require an environmental evaluation report, and WFOEs involved in trading will need to undergo customs/commodity inspection registration. Registered capital requirements also differ slightly, with service WFOEs officially requiring >RMB100,000 (US\$15,748) and FICEs generally requiring >RMB500,000 (US\$78,740) for value-added tax purposes.

Establishing a WFOE



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What are China's major taxes?

Tax planning is a complicated matter as China levies different taxes at different tax rates depending on your location and your scope of business. When structuring your investment, detailed attention needs to be paid to turnover and income taxes.

Here, we discuss the major taxes on companies:

- Corporate income tax
- Business tax
- Value-added tax
- Withholding tax

Corporate Income Tax

The new Corporate Income Tax Law, which took effect in 2008, unified the tax rates for foreign and domestic enterprises. The income tax rate for all companies in China today, both foreign and domestic, is 25 percent.

Corporate income tax (CIT) is calculated against the net income in a financial year after deducting reasonable business costs and losses - in other words it is effectively a tax on profits. CIT is settled on an annual basis but is often paid quarterly with adjustments either refunded or carried forward to the next year. The final calculation is based on the year-end audit.

Business Tax

Business tax (BT) is a tax payable against turnover by all enterprises and individuals undertaking the following businesses:

- Providing taxable services, including communications, transport, construction, finance and insurance, telecommunications, culture, entertainment and service industries;
- Transferring intangible assets; and
- Selling real estate.

Rates of BT vary from 3-20 percent, depending on the industry. BT applies to services performed where either the service provider or the service recipient is located in China, without regard to where the service is actually being rendered. BT is usually calculated, filed and paid to the local tax bureau every month. As part of the current Five Year Plan, VAT will replace BT, a transition that is already underway with VAT pilot programs.

Value-Added Tax

To resolve the issue of duplicate taxation on goods and services and support the development of the modern service industry, a pilot project has been launched to replace business tax (BT) with VAT in the transport and certain modern service sectors. Shanghai was the first location to implement the pilot project in January 2012 and the reform is expected to be implemented nationwide in 2013. Under Shanghai's current pilot scheme, VAT is applied at an 11 percent rate to transport services and at a 6 percent rate to modern services excluding tangible movable property leasing services.

Enterprises and individuals engaged in the following are required to pay VAT:

- Sale of goods,
- Provision of processing, repairs and replacement services, and
- Import of goods in China

VAT taxpayers are divided into general taxpayers and small-scale taxpayers. Taxpayers with an annual sales value exceeding the annual sales threshold for small-scale taxpayers must apply to the tax department to be recognized as general taxpayers. The VAT rate for general taxpayers is generally 17 percent, or 13 percent for some goods. VAT payable relies on two figures: output VAT and input VAT. Output VAT is that payable on the services and goods sold by a company.

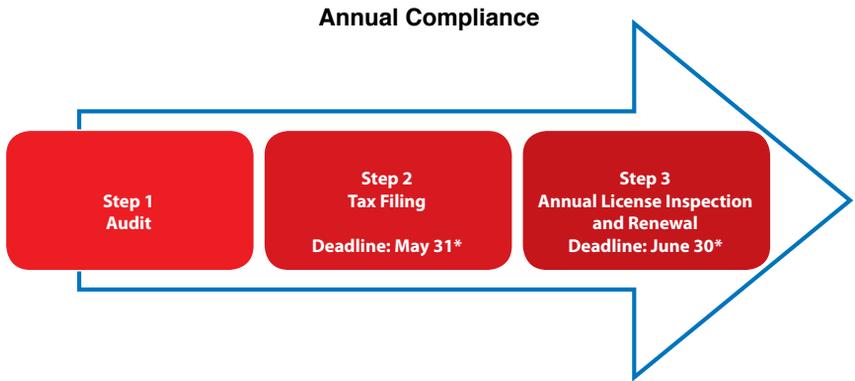
Input VAT is that payable on the goods and services a company buys from another supplier. The input VAT is used as a credit against the output tax levied on selling the goods. The VAT payable is the output VAT for the period, after deducting the input VAT for the period, i.e. $\text{VAT payable} = \text{output VAT} - \text{input VAT}$.

The current VAT rate for small scale taxpayers is 3 percent. Taxpayers cannot deduct input VAT, the formula is as follows: $\text{VAT payable} = \text{sales value} * \text{tax rate}$ (i.e. 3 percent)

Withholding Tax

Withholding tax is a PRC tax levied on passive income (i.e., dividends, bonuses, other equity investment gains, interests, rentals, royalties, transfer of property) received by non-resident enterprises from China. The withholding income tax rate is currently 10 percent. If a foreign party is a tax resident of a country or jurisdiction that has entered into a double tax treaty with China that includes reduced withholding tax, the foreign party can enjoy these reduced rates upon approval from the designated tax bureau. The China enterprise remitting the fund overseas should be the withholding agent.

How do I repatriate profits?



** Deadlines can vary depending on the locality of the enterprise and FIEs should consult their local tax authorities in charge.*

Prior to distributing and repatriating profits, FIEs must complete annual compliance, involving three steps: audit, tax filing and annual license inspection and renewal. These procedures are not only required by law, but are also a good opportunity to conduct an internal financial health check. Annual compliance procedures and key considerations vary slightly by region and entity type, with annual compliance for ROs different from those for JVs and WFOEs.

First, the audits required by the region in which the FIE is based should be conducted. These may include a financial audit, foreign exchange audit and tax verification audit. Second, all FIEs need to submit the annual taxation reporting package to the tax bureau by the end of May each year. This reporting package verifies all the taxes payable, including CIT, VAT, BT, consumption tax and other taxes on the basis of the audit result.

Should the audited tax figure be lower than the figure paid, the FIE would need to apply for a tax adjustment for the fiscal year in question. Should the audited tax figure be higher than the paid tax, the FIE will need to pay the balance due to the tax bureau upon submitting the report.

Following audit and tax filing is the annual license inspection and renewal, or

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“annual cooperative examination,” jointly conducted by all relevant government departments, including the local office of the Ministry of Commerce, the Finance Bureau, the Administration of Industry and Commerce, the Tax Bureau, Customs, the State Administration of Foreign Exchange and the Statistics Bureau to ensure that FIEs conduct business in compliance with legal requirements.

Third, following inspection, FIEs shall submit a signed annual cooperative examination report and other prescribed financial information, including the report, the audited financial statements and other materials (all signed and stamped), to the governing administrative body by the end of June.

Following the annual audit and completion of tax payment, a net profit figure can be derived. Your planning for declaration of dividends for repatriation and/or reinvestment of profits will depend on the current situation of your Chinese company and its parent company abroad. Repatriation of profits may be preferable if your organization requires the funds for re-investment abroad or to be returned to shareholders.

Not all profit can be repatriated or reinvested. A portion of the profit (at least 10 percent for WFOEs) must be placed in a reserve fund account. This is treated as part of owner’s equity on the balance sheet. This account is capped when the amount of reserve funds equals 50 percent of the registered capital of the company. In addition, the investor may choose to allocate some of the remainder to a staff bonus welfare fund or an expansion fund, although these are not mandatory for WFOEs.

The remaining net profit is available for redistribution. Following a resolution of the board of directors, an application form for the repatriation of funds can be submitted to the tax bureau to authorize the bank to disperse funds.



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How do I hire and pay employees?

Contracts

The vast majority of employees hired in the private sector in China are given fixed-term contracts. A fixed-term contract can be for any length of time (with the legally permissible probation period depending on length of time), but can only be renewed once; on the occasion of the second renewal, the contract effectively becomes an open-term contract, which is very difficult to terminate. Other types of contracts include job contracts and part-time contracts, which can only be used in limited circumstances.

Dispatch of staff, or “secondment,” when the employer pays an employment agency to dispatch one of their own employees, is another hiring option. ROs do not have the ability to hire staff directly, so Chinese staff can be outsourced or can be “seconded” from an employment agency. The most commonly referenced term to describe secondment agencies is FESCO (Foreign Enterprise Service Company Organization), which is not actually a company but a generic term used by dozens of local HR companies around the country.

In addition to labor contracts, the employee handbook is a critical piece of documentation explaining the rules of the company and the degree of severity of various infringements. For it to be an effective tool for the company, employees should be asked to sign it to prove that they have received it.

Withholding and Paying Individual Income Tax

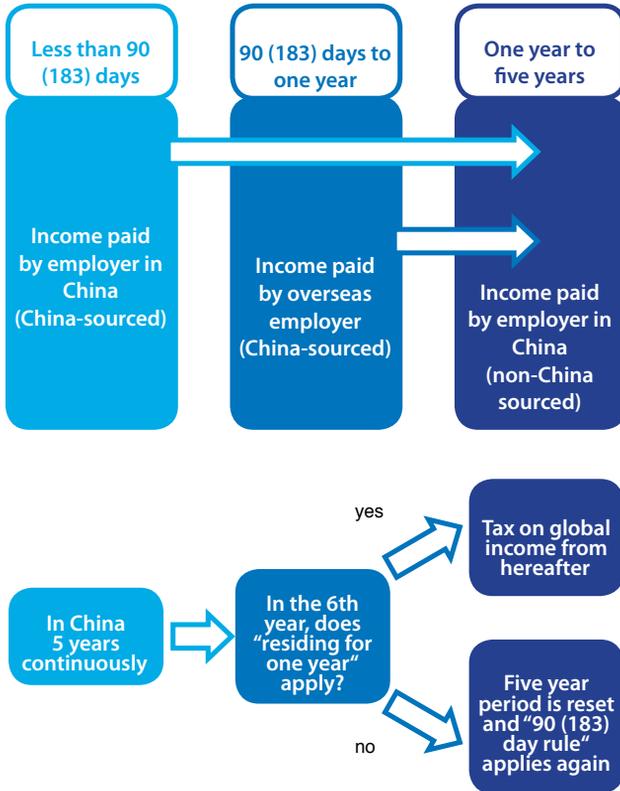
IIT is normally withheld by the employer from wages or salaries by employers and paid to the tax authorities on a monthly basis (within 15 days of the end of each month). Income from wages and salaries is taxed according to progressive rates, ranging from 3 percent to 45 percent of monthly taxable income.

Individual Income Tax Rates and Deductions		
Monthly Taxable Income (RMB)*	Tax Rate	Deduction (RMB)
1,500 or less	3%	0
1,500 < TI ≤ 4,500	10%	105
4,500 < TI ≤ 9,000	20%	555
9,000 < TI ≤ 35,000	25%	1,005
35,000 < TI ≤ 55,000	30%	2,755
55,000 < TI ≤ 80,000	35%	5,505
> 80,000	45%	13,505

* RMB6.35 = US\$1

If an individual is paid by a China-based entity, any income derived from working in China will be taxable. For non-China sourced income or income paid by overseas employers, tax liabilities for foreigners generally depend on the period of time an individual spends in China.

China Residence and IIT Income Source Applicability Timeline



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Contributing to Social Insurance Funds

Social insurance (also called “social welfare” or “mandatory benefit”) payments are mandatory contributions to government-run funds made by both the employer and the employee (whose contribution the employer is responsible for withholding each month). There are five social security funds: pension, unemployment, medical, occupational injury, and maternity. In addition, there is a mandatory housing fund that is not strictly considered a type of social welfare.

While employees must also contribute to several social insurance funds, the portion contributed by the employer is normally higher than the portion contributed by the employee. In fact, social security payments typically add an approximately additional cost of between 30 and 45 percent of an employee’s salary each month.

Mandatory contribution rates are stipulated by local governments and exact calculations of social security payments are quite complicated. Percentages are not technically based on the employee’s monthly salary, but rather on a theoretical “base” salary calculated based on a given formula.

In late 2011, the government clarified that foreigners are included in the social insurance system at the same rates as Chinese citizens (housing fund aside), but implementation varies by region. Given the complicated requirements for social insurance contributions, many companies choose to outsource their payroll processing and related human resources administration services. This ensures continuity (which can falter if an HR manager is absent or suddenly resigns), transparency and the confidentiality of salary information.

Social Security Fund Contributions		
Fund	Approximate Contribution (% of employee’s monthly salary)	
	Employee	Employer
Pension	8% ¹	10-22% ²
Unemployment	0.1-1%	0.2-2%
Medical	2% ²	7-12% ²
Occupational injury	N/A	0.4-3% ³
Maternity	N/A	0-1%
Housing Fund	Normally matched with employer	7-13%
Total	10.1%+	24.6-53.0%

Source: Dezan Shira & Associates

1 Uniform nationwide

2 Much lower in some cities

3 Also depends on the degree of danger during work

Ch 5 Industry Opportunities

By JIJ Group

This chapter discusses opportunities in the following industries:

- Food and Beverage
- Pharmaceuticals
- Renewable Energy
- Environmental Infrastructure
- Luxury Goods
- TV and Film
- Education

Food and Beverage

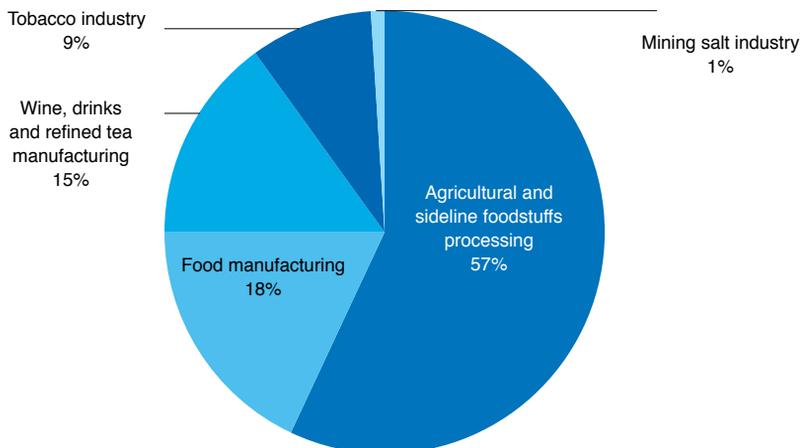
The Chinese food & beverage (F&B) industry grew at a CAGR of 29 percent from 2006 to 2011. The total production value of the F&B industry in 2011 exceeded US\$1.2 trillion, a 32 percent year-on-year increase over 2010, and full-year production value in 2012 is expected to reach nearly US\$1.6 trillion.

China is a net importer of F&B products. In 2011, China imported US\$73 billion of F&B products, a 28 percent year-on-year increase over 2010, and exported US\$53 billion of F&B products, a 23 percent year-on-year increase over 2010. Soybeans accounted for ~41 percent of total value of F&B imports, while dairy, pork, and sugar are also main imported products.

About one third of F&B enterprises are located in the eastern region, generating about 43 percent of the industrial value in this region. The top 10 provinces in terms of F&B production value are Shandong, Henan, Sichuan, Guangdong, Liaoning, Jiangsu, Hubei, Hunan, Jilin, and Fujian, which cumulatively account for around 66 percent of the total production value in the industry.

By the end of 2011, there were over 31,000 above-scale F&B industrial enterprises. However, 18 percent of the total production value is a result of the 255 largest companies.

Breakdown of China's Total F&B Production Value (2011)



Source: JIJ analysis on multiple sources including China's National Statistics Bureau

The Chinese government has issued many laws, regulations, and standards for all F&B products sold in the China market. Key laws / regulations for all F&B products include: Food Hygiene Law, General Rules for the Amount of Use of Additives, and General Rules for the Labeling of Prepackaged Foods. The overall structure of China's food regulations is similar to those of the U.S.; however, in general, U.S. regulations are more detailed than China's.

The Ministry of Agriculture set the development targets and control strength of key sectors in the industry in The 12th Five-Year Development Plan of the F&B Industry. Some key sectors will undergo rigid regulatory changes for market/product entry (e.g. examination and verification on dairy and corn refiners, etc.) and have higher market entry thresholds (e.g. edible vegetable oil processing, meat and meat processing, beverages, and fruit and vegetable processing).

China's F&B industry is facing two key challenges: increasing costs, and mistrust of food safety. Increasing production costs (such as labor, raw materials, transportation and land) are driving up food prices, with the additional cost being transferred to consumers for the most part. Domestic consumer prices for F&B products increased by 12 percent in 2011 over 2010, which is the highest rate among all product and

Top 10 F&B Companies

China Overseas Food Corporation (COFCO)
Wahaha
Yili
Maotai
Jinluo
Bright Food
Wuliangye
Qingdao Beer
Yurun
Sanquan

Source: JIJ Analysis

service categories (e.g. apparel, services, etc.). Second, the Chinese public has lost confidence in domestic F&B products, such as milk, baby formula, etc. after several incidents occurred in which food/beverages were tainted with chemicals such as clenbuterol and melamine. This lack of consumer confidence is driving some Chinese consumers to purchase imported products or products manufactured by foreign companies in China.

Top 10 Provinces Based on F&B Production Value



Source: JIJ Analysis on multiple sources

Conclusion

The Chinese F&B industry has been growing significantly over the past decade as incomes increase. Local food production is not able to keep up with demand, which results in China becoming a net importer of food and F&B products. Additionally, the constant exposure of food safety issues of domestic food products in recent years has caused a great deal of public concern, driving many consumers to purchase imported products when possible. Therefore, significant opportunities exist for U.S. F&B companies in the China market, including exporting F&B products, establishing a joint venture in China, or establishing a wholly foreign-owned enterprise to import and distribute F&B products in the China market.

Pharmaceuticals

The total output value of the Chinese pharmaceutical industry reached US\$232 billion in 2011, a 29 percent increase over 2010. China is expected to be the world's second largest pharmaceutical market (following the United States) by 2015.

From 2007 to 2010, healthcare expenditure per capita had a CAGR of 19 percent, and in 2016 expenditure per capita is expected to reach US\$437 a year. In March 2009, the Chinese central government launched a Healthcare Reform Plan, which aims to build up a comprehensive national healthcare system by the end of 2020. From 2009 to 2011, the first phase of the reform plan was implemented in which Basic Medical Insurance (BMI) was provided to 95 percent of the population. Additionally, healthcare services have improved and the average prices of basic pharmaceuticals decreased by about 30 percent. The expanded coverage of BMI is expected to further drive demand for pharmaceuticals in China. Other drivers for China's pharmaceutical industry include a large aging population (China is expected to have 350 million people over the age of 65 by 2050), growing middle class, and government support.

In terms of subsectors, over-the-counter (OTC) drugs had a market size of US\$22 billion in 2011, accounting for around 17 percent of China's pharmaceutical market. Multinational products take prominent positions among OTC drugs sold through retail pharmacies. The China pharmaceutical market is highly fragmented, with the top 10 players accounting for only ~25 percent of the market share. Among the top 10 companies, almost half are foreign. Zhejiang, Guangdong, Shanghai, and Jiangsu are key provinces where a large number of pharmaceutical companies cluster.

Additionally, new high manufacturing standards have taken effect in March 2011, which are known as "China's Good Manufacturing Practice for Drugs" or "GMP 2010." GMP 2010 is expected to eliminate over 500 unqualified manufacturers from the market, while qualified companies will need to invest more in upgrading their manufacturing facilities, which presents opportunities for manufacturers of this

equipment. Besides GMP 2010, the 12th Five-Year Plan for Medical Science and Technology sets biomedicine, new chemical drugs, Traditional Chinese Medicine (TCM) as key sectors.

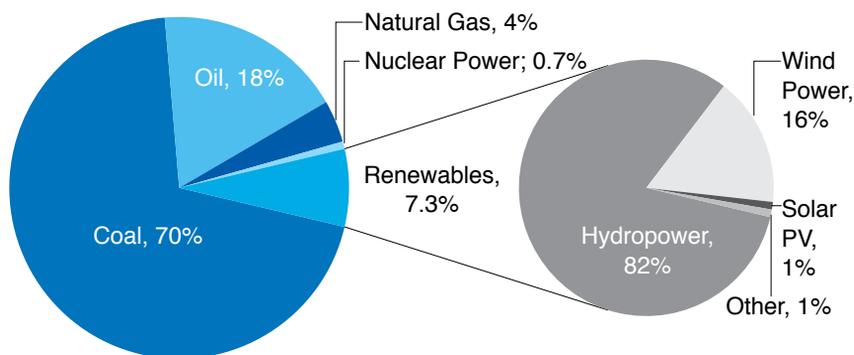
Conclusion

China's pharmaceutical industry is experiencing fast growth in recent years given the large population, increasing needs for healthcare, and ongoing healthcare reform. Opportunities exist in various sub sectors such as OTC, prescription drugs, bio-medicine, and equipment related to drug manufacturing and R&D. However, the regulatory environment for pharmaceuticals can be a challenge for companies and it is important for U.S. companies to understand how China's regulations pertain to their particular products or services.

Renewable Energy

China's energy consumption grew 7 percent in 2011 over 2010, accounting for around 20 percent of world energy consumption. However, non-fossil energy (including hydropower, wind power, solar power, bio-fuels, etc.) accounted for less than 8 percent of China's total primary energy consumption in this time period.

China's Primary Energy Consumption Breakdown by Fuel Type, 2011



The 12th Five-Year Plan (2011-2015) sets the targets for 15 percent share of primary energy to come from renewable sources and aims to reduce carbon intensity of GDP by 40-45 percent by 2020. The Mid-Long term Development Plan for Renewable

Energy aims to increase hydropower installed capacity to 300 GW, wind power to 150 GW, solar PV to 20-30 GW, and biomass power to 30 GW by 2020. Additionally, the updated Renewable Energy Law, which took effect 2010, will gradually resolve the challenges facing the sector such as grid interconnection issues and improve the utilization of renewable energy.

Hydropower

In 2011, China's hydropower installed capacity reached 230 GW, increased by 10 percent year-on-year, with another 55 GW under construction. The installed capacity of nine large-scale newly-opened hydropower stations, including Nuozhadu Dam, reached 12.6 GW. Over 65 percent of exploitable hydropower resources are concentrated in Sichuan, Yunnan, and Tibet, followed by Hubei, Qinghai, Guizhou, and Guangxi provinces.

China's largest hydropower operators include China Yangtze Power, SDIC Electric Power, Guangxi Guiguan Electric Power, and Guizhou Qianyan Power. Large domestic equipment suppliers include Harbin Electric, DEC Dongfeng Electric and Chongqing Water Turbine. Many international hydropower equipment suppliers entered the China market early via setting up joint ventures (JVs) with Chinese companies, including GE (USA), ALSTOM (France), VOITH (Germany), Fuji (Japan), Toshiba (Japan), and CGE (Canada).

Wind power

China's wind power installed capacity reached 47 GW and is ranked number one in the world. About 80 percent of exploitable wind power resources are concentrated in Northeast China (Heilongjiang, Jilin, and Liaoning), North China (Hebei and Inner Mongolia) and Northwest China (Gansu, Qinghai, Tibet, Xinjiang, etc.).

China's largest wind farm operators include, Longyuan Power, Datang Renewable, and Huaneng Renewables. The world's largest wind farm operator Iberdrola (Spain) has invested in China's wind power fields since 2006. China has become the largest wind turbine market in the world. Currently ~60 wind turbine suppliers produce 1.5-2 MW turbines, while ~20 companies have started R&D for 3-6 MW turbines (offshore). The three largest domestic manufacturers of wind turbines include Sinovel, Goldwind and Dongfang. Key international manufacturers of turbines include Vestas (Denmark), Gamesa (Spain), GE (USA), Siemens, Suzlon (India), etc. The wind turbine blade segment is fairly concentrated with ~80 domestic and international manufacturers, including AVIC Huiteng, LM (Netherlands), and Mitsubishi (Japan).

Solar PV

Solar PV power generation maintained strong growth, with an installed capacity of 3.6 GW in 2011, a 300 percent increase over 2010. China is now the largest manufacturer of solar PV, with production accounting for almost 50 percent of global solar PV production in 2011; about 90 percent of PV panels were exported. There are about 1,000 solar PV companies in China, with over 60 percent of them concentrated around the Yangtze River Delta (especially Jiangsu), which produced about 18 GW of solar cells in 2011, far exceeding the current market demand. The top-three Chinese producers are GCL, Trina Solar and Suntech and key international players include First Solar (USA), CSI (Canada), and Motech (Taiwan).

Biomass power

Biomass installed capacity reached 7 GW in 2011, a 27 percent increase over 2010. However, biomass power is relatively nascent in China and the major biomass resources are concentrated in the rural areas. Currently, the total number of biomass power companies exceeds 200, and includes key players such as Kaidi Electric, National Bio Energy, and CECIC, as well as Guangdong Shaoneng and Top Resource Conservation. International players have also started showing interest in China's biomass power market. For example, Future NRG (Malaysia) invested US\$42 million in its first wholly-owned biomass power project in Shandong in 2010. However, lack of capital, raw materials (e.g. straw) and talent are key challenges for the development of biomass power in China.

Conclusion

China still faces many challenges in expanding renewable energy. Rather than market forces driving the industry, clean energy is primarily driven by government targets on installed capacity. Additionally, many government projects tend to favor domestic companies or joint ventures, making it difficult in some cases for wholly foreign-owned enterprises to operate in some sectors. However, opportunities may exist for U.S. companies with advanced technology and/or operational experience.

Environmental Infrastructure

China has undergone massive urbanization and industrial development over the last three decades. Such growth has been coupled with significant challenges in regard to environmental protection; China has some of the world's most polluted, lakes, rivers, and cities. In 2011, investment in pollution treatment exceeded US\$6.3 billion, with a CAGR of ~5 percent from 2000 to 2010; most investment is in waste gas (47 percent) and wastewater treatment (33 percent). Investment is expected to increase significantly as China's central government plans to invest ~US\$581 billion on environmental protection during the 12th five-year period (2011-2015).

Wastewater treatment

China's water resource per capita is among the lowest in the world. Additionally, there are severe regional water imbalances as about 80 percent of the water supply is in the South, while Northern and Western China experience regular droughts. Moreover, only 61 percent of China's seven largest watersheds reach the water

Top Six Provinces for Wastewater Discharge



Source: JIJ Analysis on multiple sources

quality requirements of Type III or above. Both the water scarcity and water pollution have made wastewater treatment extremely important for China's environmental infrastructure.

China's municipal wastewater treatment rate has reached 83 percent, and about 95 percent of industrial wastewater met discharge standards. In 2011, the total amount of wastewater discharged in China was 65 billion tons, municipal wastewater made up 62 percent and industrial wastewater made up 38 percent. The top 6 provinces for wastewater discharge are Guangdong, Jiangsu, Shandong, Zhejiang, Henan, and Guangxi, which in total discharged 44 percent of the domestic wastewater in 2010.

By the end of 2011, China had over 3,000 municipal wastewater treatment plants, about 72 percent of which are small-sized (daily treatment capacity less than 50,000 tons) and 19 percent are medium-sized (daily treatment capacity between 50,000~100,000 tons); with total daily treatment capacity reaching 136 million tons.

Despite the increasing number of wastewater treatment plants and increasing treatment capacity, the actual volume of treated wastewater is much lower than the designed treatment capacity. China's wastewater treatment designed capacity increased by 108 percent from 2005 to 2010, while the treatment rate only increased by 48 percent. Municipal wastewater treatment growth has been limited due to insufficient operational funds, insufficient piping networks, etc. For example, because the length of the piping network in Jilin is only 35 percent of that designed, three wastewater treatment plants are not operating.

The Chinese government has planned to invest ~US\$71 billion in municipal wastewater treatment and ~ US\$68 billion in industrial wastewater during the 12th Five-Year Plan period (2011-2015). The four key focal areas for investment include: wastewater treatment facilities, water reclamation, sludge treatment and disposal, and piping network construction.

Currently, about 40 percent of companies in this sector are foreign-invested and mainly engage in providing integrated wastewater treatment services and advanced technology. Key foreign players include Veolia, Suez, Dais and Sembcorp, etc.; key domestic players include Shenzhen Water Group, Beijing Capital Group, and Tianjin Capital Environmental Protection Co., Ltd., etc.

Solid waste treatment

China is the world's largest country in terms of solid waste generation, with total solid waste exceeding 2.6 billion tons in 2011. Industrial waste accounts for 94 percent of solid waste, with the remainder is municipal waste. For overall industrial solid wastes, utilization rate was about 67 percent and treatment rate was 24 percent.

Overall, the treatment rate of municipal solid waste reached 78 percent by 2011, with 628 plants, and a daily treatment capacity exceeding 387 thousand tons.

The industry is mainly dominated by domestic players, with a small number of foreign players, such as Pall, Alstom, and Keppel Seghers. Key domestic players include Jingjiang Group, Zhejiang Weiming Environment Protection Co., Ltd., Everbright International, Nanhai Development Co., Ltd., and Jinzhou Environment Co., Ltd.

Conclusion

Both opportunities and challenges exist in China's environmental infrastructure sector. Key opportunities include technology/equipment sales, plant management services, etc. However, there are significant challenges in the market as well as most of the larger global players are already established in the market and many larger infrastructure projects go through a relatively non-transparent bidding process.

Top Five Sectors of Solid Waste Production			
Sector	% Share	Utilization rate	Treatment rate
Mining and processing metal ores	27%	30%	53%
Production and supply of electric power and heat power	24%	83%	8%
Smelting and pressing of ferrous metals	17%	88%	9%
Mining and washing of coal	12%	77%	20%
Manufacture of raw chemical materials and products	6%	71%	19%

Source: JIJ analysis based on National Statistics Yearbook

Luxury Goods

In 2010, China became the second largest luxury goods market in the world, with an estimated market size of US\$13 billion. Between 2008 and 2011, the luxury market grew at a CAGR of 14 percent, with over 60 percent of purchases generated by new luxury customers. The growth of China's luxury industry is expected to remain strong, and by 2015, China is expected to account for roughly 20 percent of global sales.

The majority of luxury goods sales in China are concentrated in Beijing, Shanghai, Guangdong, Jiangsu, and Zhejiang provinces, which are highly developed markets for luxury goods, and account for ~65 percent of total luxury sales in China. However, these developed markets are highly saturated and competition is fierce as most global

luxury brands have an established presence. Therefore, many major luxury brands (e.g. Louis Vuitton, Cartier, etc.) have begun to expand into developing provinces, such as Yunnan, Chongqing, and Sichuan, for future market growth.

Most of the major global luxury brands, such as Louis Vuitton, Cartier, Chanel, Rolex, etc., already have a strong presence in China, having entered through both direct stores, as well as an expansive dealer network. China has become one of the most important markets for many luxury brands, such as Ferrari, Bentley, and others, as China sales rival or exceed sales in their home markets. There are not many Chinese luxury brands; an example of one is Moutai, a maker of a luxury alcohol.

In Tier 1 and Tier 2 cities, especially developed markets, key motivations for buying luxury goods include gaining recognition, self-pampering, and appreciation; while in lower tier cities and developing markets, key drivers are more about self-rewarding and showing off. Consumers most often get product information in premium magazines and on the internet (e.g., official brand websites and social web tools such as Weibo).

Purchasing overseas is not uncommon, as prices tend to be lower than in China, primarily due to the taxes in China that can be in excess of 40 percent. Additionally, product offerings overseas tend to be much more expansive than in China stores. The recent trend among Chinese consumers is to travel to Hong Kong, Europe, or the U.S. to purchase luxury goods.

Conclusion

China's luxury market is developing rapidly and has a very different consumer profile than many other markets, i.e., the majority of luxury consumers are below the age of 45. Developed markets are highly saturated and competition is quite fierce in most product categories; however, there may be some opportunities in the developing provinces. Brand awareness is extremely important in China and can take several years to build if a brand is not internationally known. For example, Tiffany & Co. is a relatively recent entrant into the market; but the brand has done well given that brand awareness was high even before the company entered the China market.

TV and Film

TV

China has a TV audience of over 1.2 billion people and the country's broadcast coverage, especially in rural areas, continues to grow. Broadcasting revenues increased to US\$43 billion in 2011, a 30 percent year-on-year growth; advertising revenues made up nearly 40 percent of the total revenues.

The main regulatory body of the TV industry in China is the State Administration of Radio, Film, and Television (SARFT), which regulates and censors TV shows and commercials. The content allowed on Chinese TV was liberalized after China entered the WTO in 2001, but even today allowable content must not be considered politically sensitive or inappropriate. Furthermore, foreign investment is not allowed to exceed 49 percent in a company in China's TV industry.

China Central Television (CCTV), Shanghai Media Group (SMG) and Hunan Broadcasting System (HBS) are the largest Broadcasting companies in terms of revenues in China. Foreign satellite TV channels such as CNN, BBC and MTV are only able to enter China by obtaining broadcasting landing rights.

In the past decade, internet usage has grown significantly to 513 million users as of 2011. Younger generation audiences lean towards new media such as internet and mobile TV over traditional television; however, traditional TV still remains the leading media outlet due to the large audience base.

In general, there is demand for American TV dramas, especially in Tier 1 and Tier 2 cities, where audiences are relatively more open to western culture. However, because of a strict censorship process, it can take an average of 2 years or possibly longer before Chinese audiences are able to see American dramas on TV. Therefore, American dramas in China are mostly viewed on the internet or via pirated DVDs.

Film

In 2011, China produced 791 films and box office revenues reached US\$1.9 billion, a 29 percent increase from 2010. About 54 percent of revenues were generated from domestic films, while 46 percent of revenues were generated by imported movies. 3D/IMAX films contributed to 40 percent of total film revenue.

The China film market is also regulated by SARFT, which regulates and censors the content of movies released in China. Foreign companies are restricted in film production and distribution in China, and among legal entities, only representative offices are allowed to be established. There is still a quota on the number of foreign films imported into China (21 revenue-sharing films and 38 flat-fee films), but

this quota is expected to be gradually increased or cancelled in the future. China Film Import & Export Company, a subsidiary under China Film Group, is the only authorized company to import films into China.

The market is dominated by several large domestic players, such as China Film Group, Huayi Brother, PolyBona, with such companies usually engaged in the entire supply chain from production, distribution, to exhibition. The most common way for foreign players to enter the China market is through importing films or engaging in joint production movies, which are not counted towards the current film import quota. Twenty-one out of the total number of imported films in 2011 came from the U.S. and U.S. films continue to dominate the market in terms of foreign films screened in China.

In the 12th Five-Year Plan, the Chinese government expressed plans to promote the culture industry (e.g. films, plays, etc.) and to increase the industry value to 5 percent of GDP by 2015, with an annual growth rate of 15 percent between 2011 and 2015.

Conclusion

China's film and TV industries are highly regulated by the government, which has strict controls on all forms of media. Additionally, the government is focusing on growing the domestic industry and uses various policies (some considered protectionist) within its power to do so. For example targets are set for the percentage of revenues generated by domestic films versus imported films. Additionally, the government provides incentives for the development of domestic technology development, such as a domestic Chinese version of IMAX. However, there is significant potential in China's TV and film industries as the number of screens and TV audience base continues to grow. Opportunities for U.S. companies may be found in co-producing films, post production of films, or in other film/TV technologies.

Education

The market value of the education industry is expected to reach US\$155 billion by the end of 2012, and has been growing at 12 percent CAGR from 2009-2012. Private education accounted for ~44 percent of the entire industry, and has been growing at 15 percent CAGR from 2009-2012. The central government has re-emphasized education as a pillar industry in the 12th Five-Year Plan (2011-2015) and its goal of increasing government spending on education to 4 percent of gross domestic product (GDP). Additionally, the government implemented the National Mid - to Long-term Education Reform and Development Plan 2010-2020 in 2010, which shall further drive the industry through to the next decade.

Pre-school education

The limited number of public and private pre-schools and kindergartens cannot meet the demands of the ~108 million children between the ages of 0-6, among which ~10 percent are urban children between the ages of 0-3. Key pre-schools and kindergartens include Etonkids (Beijing), Red Yellow Blue Education (Beijing), Gymboree (USA), S&S Worldwide and Color-Me (USA), and Great Man (HK).

Primary and secondary education

The number of primary schools has decreased by over 60 percent from 628,800 in 1997 to 241,200 today, while secondary schools decreased by ~20 percent from 66,200 to 54,100 over the same period. A large portion of these schools were closed due to the inability to compete in terms of teaching resources, educational products, and services.

Higher and vocational education

Higher education is facing pressure from the decreasing number of student applicants due to China's one-child policy and increasing number of students applying for education overseas. Chinese students enrolled by U.S. academic colleges and universities increased by 26 percent from just over 106,000 to nearly 134,000 from 2010 to 2011. As of 2010, over 400 Sino-foreign academic JVs and joint education programs have been legally approved, e.g. Shanghai Jiao Tong University SJTU-UM Joint Institute, established by Shanghai Jiao Tong University and University of Michigan (USA).

Conclusion

With the regulatory support of the central and local governments and increasing government spending on education, especially in Central and West China, opportunities exist for U.S. companies in many segments, including pre-school, vocational, joint education programs and institutions. Cities in Eastern China still have an attractive (and competitive) market. For example, Shanghai's local government plans to increase the number of joint education programs and institutions from the current 220 to 400 by 2015.

Summary of Key Industries

Sector	Market Assessment	Forecasted Growth
Food & Beverage	High	High
	<ul style="list-style-type: none"> • Fast growing market with a CAGR¹ of 29 percent from 2006 to 2011 • Highly fragmented market with a large number of small and medium sized companies • Food safety is a key concern for Chinese consumers, especially after the exposure of a series of food safety issues, such as clenbuterol and melamine. 	<ul style="list-style-type: none"> • Production value is estimated to reach US\$1.6 trillion at the of 2012, a 28 percent increase over 2011 • Both import price and volume continue to increase, e.g. import value increased by 28 percent in 2011 compared with 2010
Pharmaceuticals	Moderate	High
	<ul style="list-style-type: none"> • An aging population and an increasing awareness of health is a key driver for the sector; China is expected to have 350 million people over the age of 65 by 2050 • Over-the-counter (OTC) drug sector is prospective as China is expected to be the world's second largest OTC market by 2020 • For prescription drugs, the demand for hypertension drugs is expected to double by 2014 • Biomedicine sector has been targeted as a strategic pillar industry by Chinese government • In recent years, foreign pharmaceutical players have expanded their presence in China, being in manufacturing, marketing or research 	<ul style="list-style-type: none"> • Projected CAGR of 20 percent by 2014 • 2009 Healthcare Reform is ongoing, which increases domestic demand for pharmaceutical products • China is expected to be the world's second largest pharmaceutical market by 2015
Renewable Energy	Low	Moderate
	<ul style="list-style-type: none"> • Despite the rapid development of renewable energy sectors, renewable energy still only accounts for around 8 percent of the total primary energy consumption • Government policy is the key driver for renewable energy rather than market forces; installed capacity much higher than then utilized capacity • Many large clean energy projects have a non-transparent bidding process and the government tends to favor domestic or joint venture companies • However, it may be less challenging for companies offering advanced components or management services 	<ul style="list-style-type: none"> • Wind power and biomass will likely continue to grow fast, ~30 percent • Hydropower will likely maintain modest growth, ~10 percent • Production in the solar PV sector has exceeded market demand and industry reorganization and technology upgrading will be a primary trend • Government policies encourage renewable energy sectors through financial subsidies and preferential taxation, which should further drive industry development

¹ CAGR – Compound Annual Growth Rate

Environmental Infrastructure	Moderate	High
	<ul style="list-style-type: none"> Installed capacity exceeds utilized capacity (e.g. wastewater treatment designed capacity increased by 108 percent from 2005 to 2010, while the treatment rate only increased by 48 percent) due to insufficient operation funds, serious lag in piping network construction, inadequate sludge disposal systems, and other auxiliary systems Opportunities may exist in plant management, technologies and equipment Industrial solid waste accounts for 94 percent while municipal only accounts for 6 percent; major treatment method is landfill 	<ul style="list-style-type: none"> Key municipal wastewater treatment investment are in wastewater treatment facilities, water reclamation, sludge treatment and disposal and piping network construction Tier 2 and lower tier cities, as emerging market, will grow faster than tier 1 cities, which tend to be saturated in terms of facility installation Annual production value of solid waste treatment is expected to increase to US\$79 billion by the end of 2015
Luxury Goods	High	High
	<ul style="list-style-type: none"> China is the second largest luxury goods market in the world, and is one of the key markets for top luxury brands such as Louis Vuitton, Dior, Ferrari, etc. Opportunities to establish brand image in emerging markets (lower tier cities), as potentials in developed market (Tier 1 and Tier 2 cities) are nearly saturated 	<ul style="list-style-type: none"> China luxury market is growing at CAGR 14 percent Growth is driven by middle class and high net worth individuals,² with new luxury customers accounting for 60 percent of sales Significant growth opportunities in emerging provinces and lower tier cities that have yet to see a significant number of brands enter
TV and Film	Moderate	High
	<ul style="list-style-type: none"> Opportunities remain in project based co-operation and through import Quota on imports are expected to be increased, however the government still has tight control over the number of films entering China Domestic investors are more interested in 3D/IMAX movies (able to earn large premiums) However, the government currently implements policies to promote the domestic film and TV industry and encourages the development of domestic technologies 	<ul style="list-style-type: none"> China has the largest TV audience (>1.2 billion) TV and film both had a 30 percent year- on-year growth in 2011 With the development of digital media and government support in promoting China's culture industry (as mentioned in the 12th Five-Year Plan), the industry is expected to have tremendous growth in the near future
Education	High	Moderate
	<ul style="list-style-type: none"> Chinese are very focused on advancement through education and tend to take education very seriously, both pre and post graduation from high school China is the largest education market in terms of student size and market demand; the market value of education is expected to reach US\$155 billion by the end of 2012 	<ul style="list-style-type: none"> The market value of education is expected to maintain year-on-year growth of 12 percent over 2011 Pre-school and online education will likely continue to experience rapid growth into the near future Eastern China is relatively saturated in terms of foreign education and training institutions; however there are still growth opportunities in China's lower tier cities

² High net worth individuals are those with over RMB10 million (~US\$1.5 million) in individual investable assets

Ch 6 Using Hong Kong as a Gateway

By Orangefield ICS Limited

Hong Kong, conveniently located at the southern entry point to China's prosperous Pearl River Delta region, is the ideal gateway to China. By virtue of the post-1997 "one country, two systems" principle, Hong Kong has the unique advantage of being both a Chinese city and a global trading center with an independent judiciary, low taxes, world-class infrastructure and a free flow of information, capital and labor. As a result, Hong Kong is consistently acknowledged as a city from which to do business in China.

Its historic, western orientation makes Hong Kong an excellent middle ground between the complexities of China and the way business is done in the West.

Hong Kong's Advantages

Excellent legal system

Common law system and an independent judiciary

Hong Kong's case-based, common law system is modeled on the British legal system and has remained largely unchanged since the handover to China in 1997. The system is guaranteed until 2047 under Hong Kong's mini-constitution, the Basic Law.

In comparison with China's developing legal system, Hong Kong offers a familiar common law environment that is well-versed in local and international law and is characterized by stability, transparency and a completely independent judiciary. A fair, speedy and transparent legal system that does not provide local firms with a home team advantage is an excellent place from which to do business.

In July 2006, China and Hong Kong signed a Mutual Legal Assistance Agreement to make civil and commercial judgments delivered in each other's courts enforceable

on both sides of the border. By ensuring that a fair trial in Hong Kong can result in enforcement actions in China, this move further enhances Hong Kong's role as the primary gateway to China.

Hong Kong is also extremely well regarded as an international arbitration and dispute resolution center with a broad range of arbitrators, many of whom are experts in their fields.

A firewall against undue actions

Using a Hong Kong company as a base from which to develop your business interests in China creates a corporate and legal "firewall" between the U.S. parent company and any Chinese companies or investments. In the event of a legal or regulatory challenge in China, the Hong Kong limited company will be the entity involved in litigation and the "face" of the issue rather than the parent company, entitling you to legal protection in Hong Kong rather than in China.

Change in shareholding

Unlike China, it is extremely easy to change shareholders to a Hong Kong company, thereby facilitating the addition or removal of shareholders. There are no residency requirements for local shareholders or directors.

Advanced financial infrastructure

Preeminent international finance center

Hong Kong is one of the world's preeminent international financial centers, and is host to 142 licensed banks and 82 representative offices of banks from 38 countries. With oversight from the Hong Kong Monetary Authority and the Securities and Futures Commission, Hong Kong's banking system and securities and futures markets are well regulated.

Due to the structure of the local economy, Hong Kong based banks have a solid international focus, with particular strengths in trade and project finance. Since there are no capital controls or restrictions on foreign exchange, managing a multi-currency trading business is straightforward and efficient. Hong Kong banks have real multi-currency accounts, transactions can be conducted in foreign currencies and telegraphic transfers can be executed on the same day or overnight.

Holding funds in Hong Kong to facilitate operations in China enables foreign operations to enjoy the freedoms, transparency and speed of one of the world's best and truly business-friendly banking systems.

Financing flexibility

With a broad range of banks, term lenders, private equity and venture capital firms operating in Hong Kong, a broad range of lending and investment options exist.

Many of these fund providers are familiar with the business environment in China and can provide valuable assistance, in addition to financing.

In addition, the presence of international banks and the lack of foreign exchange controls make transferring funds internationally a quick and simple process.

As taking security in Hong Kong is relatively easy, it is possible to obtain financing that would not be available in China.

Hong Kong offers offshore RMB settlement

RMB currency risk is an issue for many Chinese exporters and for US firms looking to do business in China. Currently, many banks in Hong Kong offer their clients RMB accounts that provide greater flexibility in payments to and from China. The availability of RMB banking makes it easier to negotiate with Chinese customers or vendors. In addition, the extensive, offshore RMB market makes it much easier to look for sophisticated, hedging solutions to currency risks.

Beneficial tax regime

Territorial taxation

Hong Kong operates a simple, territorial basis of taxation whereby it imposes tax on profits only where the transaction has a local source, while foreign sourced income, even if remitted to Hong Kong, is not liable to tax. As a result, transactions can be booked through a Hong Kong company and not be taxable in Hong Kong.

Non-existent or minimal taxes

Hong Kong corporate tax is 16.5% for transactions that originate in Hong Kong, while offshore transactions are not subject to any profits tax. Salaries tax is a modified flat tax rate of 15% of gross income. Hong Kong does not have any capital gains tax, withholding tax on dividends or interest, inheritance tax, real estate tax, sales tax or value added tax. Dividends received by your Hong Kong company from your China company are not taxed in Hong Kong and the remittance to the US parent is also free of withholding taxes.

Capital gains

Hong Kong does not tax capital gains, making it a desirable place from which to hold assets or dispose of shares.

Reduced withholding tax on dividends

Dividends paid by a Chinese company to a Hong Kong entity are subject to a 5% withholding tax rate, provided that some conditions are met. Dividends from China to the US directly are subject to a 10% dividend withholding tax rate.

To qualify for this reduced tax rate, companies must fulfill certain requirements laid

out by China's State Administration of Taxation, in which case the resulting tax rates are some of the lowest provided under China's tax system. With Hong Kong's 0% tax on dividend income and 0% withholding tax rate on dividends remitted overseas, Hong Kong is the ideal conduit through which to repatriate dividends.

Repatriation of other income

In addition to applying to dividends, the 2006 double taxation agreement between Hong Kong and China also reduces the withholding tax rates on royalties and interest. Furthermore, with the proper repatriation structures built into the articles of association of your China subsidiary, fees received by your Hong Kong subsidiary from your Chinese one are tax free, although there is a withholding tax of 7%, which is less than the rate of 10% if the shareholder of the China subsidiary is not in Hong Kong.

These factors further enhance Hong Kong's role as a base for foreign investors when doing business or investing in China.

Outsourcing Elements of Your International Trade

Managing and coordinating your international trade from halfway around the world can be a laborious and costly process. Differences in time zones, currencies, languages and protocol are just the tip of the iceberg. For U.S. companies that sell into China, one solution is to outsource elements of your international trade by changing the sales location from the U.S. to Hong Kong. This can be achieved by selling directly from your U.S. company to your Hong Kong subsidiary, which then sells to the Chinese buyer.

The process works in the following manner. First, you set up a Hong Kong limited company—a wholly owned subsidiary of the U.S. parent company. This Hong Kong subsidiary buys from the parent company or directly through the parent's suppliers and then in turn sells to the Chinese buyer, invoicing the sale through Hong Kong. Your Hong Kong company pays the cost of goods sold (either to the supplier or to the parent) and receives payment from the Chinese buyer, with all profit sent back to the Hong Kong company in the form of a dividend, management fees or by cost of goods sold from the parent company. This way, only a small profit is recorded in Hong Kong, and there are a number of ways to move that profit back to the U.S. in an easy, tax-efficient manner.

Setting up this structure is easy using a Hong Kong-based service provider that specializes in precisely this sort of arrangement. By outsourcing most functions related to international trade, you can focus on the key elements of your vendor or customer relationship, such as vendor or customer selection, pricing, production or local distribution, while leaving the paperwork aspects of the relationship to the service provider you've chosen.

Hong Kong is the ideal gateway to China, for the reasons stated in a previous section. It has long been a center of international trade and there are legions of companies and people in Hong Kong that understand how trade, trade documentation, logistics, shipping and risk mitigation work.

The benefits of structuring your international trade in this manner are as follows:

- *RMB bank account*

Hong Kong is the world's premier offshore RMB business center, and opening and maintaining an RMB account is relatively straightforward. Since RMB payments are becoming more prevalent when doing business in China, maintaining an RMB account in Hong Kong is a huge advantage. With customers paying directly in RMB, currency risks are removed and, due to the sophistication of the banking industry in Hong Kong, currency risks can even be hedged to your advantage.

- *Flexibility*

Regardless of the scale or size of your U.S. operations, establishing a Hong Kong subsidiary immediately allows you to position yourself either as a U.S. or a Hong company when making a sale. Depending on the buyer, this might have an impact on whether or not you make the sale due simply to perception or, more crucially, to the fact that some buyers may be required to buy locally. Having a Hong Kong subsidiary would allow you to position yourself in whatever manner fits the situation.

- *Financing options*

Having a Hong Kong subsidiary makes it easier to obtain credit locally. With over 150 international banks in Hong Kong, there is almost always a lender available. Moreover, due to Hong Kong's long-standing position as a hub of trade, Hong Kong banks understand trade credit better than U.S. banks. For companies that need trade credit, need to confirm a Chinese letter of credit or need letter of credit processing, it is more likely that they will receive better financing terms in Hong Kong than in the U.S.

- *Export credit insurance program*

The Hong Kong Export Credit Insurance Corporation, which is wholly owned by the Hong Kong Government, provides insurance protection to Hong Kong exporters. If your Hong Kong subsidiary, rather than your U.S. parent, is the exporter of record for goods into China, you are eligible to get ECIC to insure your receivables to your Chinese customers.

- *Invaluable Asian base*

Your Hong Kong subsidiary can deal with Chinese buyers or distributors in the same time zone and in the same language. Moreover, they are well-versed in regional business etiquette, which is crucial to establishing and building strong relationships with China-based customers.

- *Tax advantages*
Hong Kong's laissez-faire business environment means there is no VAT, sales tax or import duties through Hong Kong (see previous section – “Beneficial tax regime”).
- *Logistical edge*
Situated at the mouth of the world's industrial hub, Hong Kong has long been a leader in logistics. This translates into world-class inventory and transportation options, including the option of shipping on a just in time basis or setting up warehouses in either Hong Kong or Southern China.

Dividend Repatriation from China to the U.S.

There may be tax advantages to repatriating profits via a Hong Kong intermediate holding company as there is a lower dividend withholding tax rate from China to Hong Kong to the US than from China to the US directly. As a caveat, it is essential that proper tax advice is sought before embarking on any arrangement.

Dividend withholding from China to the U.S.: 10%

Dividend withholding from China to Hong Kong: 5%

Dividend withholding from Hong Kong to the U.S.: 0%

The double taxation agreement signed between Hong Kong and China in 2006 reduces tax rates on repatriated profits taking the form of interest, royalties and dividends. This means that repatriating dividends via Hong Kong entitles you to preferential tax rates that would not be available if you directly repatriate dividends from China to the U.S.

To discourage ‘treaty shopping’ and the establishment of shell, holding companies as a means of reducing tax, the Chinese authorities have issued Circular 601 which lists various tests to determine if the Hong Kong intermediate company is a shell or has real substance.

What this means is that the company should have as many tangible footholds in Hong Kong as possible. Factors that the Chinese tax authorities will consider include whether the Hong Kong holding company has other business activities apart from the investment holding in China, the ratio between assets, operations and staff to the amount of income received and also, the amount of profits tax paid in Hong Kong.



U.S. Commercial Service

The United States Commercial Service is the trade promotion arm of the International Trade Administration within the United States Department of Commerce.

The U.S. Commercial Service consists of a network of International Trade Specialists in U.S. Export Assistance Centers in 108 locations throughout the U.S. Overseas, our Commercial Officers, Specialists, and other staff are located in U.S. Embassies and Consulates in more than 112 cities in 75 countries.

Our mission includes promoting U.S. exports of goods and services, supporting U.S. commercial interests abroad, and promoting investment into America. In China, the U.S. Commercial Service has locations at the U.S. Embassy in Beijing and at our Consulates in Chengdu, Guangzhou, Shanghai, Shenyang, and Hong Kong. We also have partners in 14 additional cities to help you take advantage of the emerging markets in China's dynamic second tier cities.

To support U.S. companies, the Commercial Service in China offers a range of services including partner identification and due diligence, support for U.S. exhibitors at select trade shows, individualized counseling and advocacy.

export.gov/china
twitter.com/chinabicgov
weibo.com/fcschina
chinabic@trade.gov



CTR Market Research

CTR is a leading market research and insight provider in China. Founded in 1995 as a joint venture company between CITVC and Kantar, CTR is the market leader in the continuous research sectors of media intelligence, media and consumption behaviour, and consumer purchasing behaviour.

As a foremost provider in China, CTR integrates local expertise with cutting-edge research technology and innovative thinking to meet client needs. CTR's research profile is comprised of 3 continuous sectors and 12 areas of expertise.

CTR's goal is to be the preferred research partner and market leader in delivering value-added marketing information and insights, to help clients make more effective business decisions.

Beijing Office

No.5 Dewai Avenue, Xicheng District,
Beijing, China 100088
Tel: (86 10) 8201-5388

Shanghai Office

17/F, Greentech Tower, No.436 Hengfeng
Road, Shanghai, China 200070
Tel: (86 21) 2221-7888

Guangzhou Office

22/F, Yueyun Mansion, No. 3, Zhongshan
Rd2, Yuexiu District, Guangzhou, China
510080
Tel: (86 20) 3762-1900

Fuzhou Office

North 1708, 22nd Floor, Jinzuan Building,
136# Wuyizhong Road, Fuzhou, China
350004
Tel: (86 591) 8332-5409

Hong Kong Office

Unit 1932, 19/F., Star House, No. 3
Salisbury Road, Tsimshatsui, Kowloon,
Hong Kong
Tel: (852) 2111-8819

www.ctrchina.cn

ctr@ctrchina.cn

<http://weibo.com/chinainsight>



The JLJ Group

The JLJ Group was formed to assist international companies and organizations with their China market initiatives. We combine the expertise of in-house specialists to provide services critical to our clients' China operations, including: Market Research & Consulting, Corporate Formation, and Accounting.

JLJ Consulting's main services include market research & assessment, consumer and competitor research, and market entry/growth strategy development.

Our team is a balanced mix of Chinese and Western professionals with many years of industry and consulting experience in China, the U.S., and Europe. Our professionals have gained experience at top international consulting firms and have extensive business networks both in and outside China.

Shanghai Office

Suite 603-605, Oriental Center
699 West Nanjing Rd. /31 Wujiang Rd.
Shanghai 200041, China
Tel +86 21 5211 0068
Fax +86 21 5211 0069

Beijing Office

Suite 2002, Building 1
Blue Castle International Center
3 West Dawang Road
Beijing 100026, China
Tel +86 10 6582 0268
Fax +86 10 6582 0251

www.JLJGroup.com
info@jljgroup.com

Orangefield ICS

Orangefield ICS represents the Hong Kong office of Orangefield Group. Formerly ICS TRUST, Orangefield ICS is a trusted leader with over 30 years of experience in assisting international corporations and high net worth individuals with corporate, commercial and trust services.

Orangefield ICS offers an integrated solution to help clients enter the China market in an efficient, compliant and ultimately profitable manner. The services are designed to remove the issues of doing business in an unfamiliar country and mitigate the risks of doing business in China.

Language capabilities of Orangefield ICS include English, Mandarin, French, Dutch, Spanish, German and Cantonese. Our multilingual staff provides integrated business solutions for corporations doing business in China or using Hong Kong as a Gateway to China and a base for Direct Import/Export Programs, as well as businesses seeking to establish Wholly Foreign-Owned Enterprises (WFOEs) or Representative Offices in China.

Orangefield group

Orangefield is a global full service corporate service provider and fund administrator, with more than 30 years of experience, providing a wide range of fund administration, management, administrative and trust services to funds, corporate clients and private clients all over the world. Orangefield is ISAE 3402 Type II (previously SAS 70) compliant, demonstrating the rigorous controls and attention to detail expected in all accounting, cash management, investor reporting and compliance responsibilities.

Orangefield Group has a strong global presence with offices in Europe, Asia, Africa and the Caribbean. Orangefield Group headquarters is located in Amsterdam.

Hong Kong Office

33 Garden Road
Central Hong Kong
Tel: (852) 2854-4544

Shanghai Office

Suite 1503, Finance Square Building,
333 Jiu Jiang Road, Shanghai, China
Tel: (86) 136-0174-7009

www.orangefield.com www.icstrust.com
ofics@orangefield.com



Demographic Consulting

Demographic Consulting

Demographic Consulting develops information products suitable for market evaluation and retail site analysis in China. Available information includes nationwide population updates at the township and 1 square kilometer grid level, with coverage throughout the entire PRC. Our information is used by companies seeking to expand in China, particularly as they move from the largest cities into the “smaller” Tier 2, 3 and 4 markets. Using our data and analyses, companies can make better-informed decisions for their China operations.

Our data has already been successfully tested and used by major companies expanding in China in the following industries:

- Mass merchandise
- Consumer Packaged Goods (CPG)
- Electronics
- Apparel
- Retail
- Entertainment
- Banking

Our Demographic and Business product offerings include:

- Yearly Population Estimates and Projections at County, Prefecture, Township and 1 km2 Grid levels
- 2010 Population Data by Province and City
- Complete 2000 Population Census – About 2,000 data items
- Over 2,800 Counties and Districts, Over 50,000 Townships, Over 7.4 million 1 km2 Grids
- Current POI (Point of Interest) Summary Count data of over 170 categories at 1 km2 grid level

What is unique about our data:

- Smallest geographic level available nationwide
- Geo-Spatially enabled (for use in GIS)
- Legitimate access to data

Demographic Consulting collaborates with the China Data Center (University of Michigan) and All China Market Research (Beijing) who work with PRC’s National Bureau of Statistics.

- Established in 1997, China Data Center (University of Michigan) is an international center for advancing the study and understanding of China. CDC serves as the primary data source for China research and education.
- All China Marketing Research Co. Ltd. (ACMR) is a leading provider of business information and market research, focusing on collecting, studying and analyzing data and information on the macro economy, industrial sectors, enterprises and business markets in China.

www.geodemo.com
info@geodemo.com
Tel: (86 714) 558-1529

DEZAN SHIRA & ASSOCIATES

Corporate Establishment, Tax, Accounting & Payroll Throughout Asia

Dezan Shira & Associates is a specialist foreign direct investment practice, providing corporate establishment, business advisory, tax advisory and compliance, accounting, payroll, due diligence and financial review services to multinationals investing in emerging Asia. Since its establishment in 1992, the firm has grown into one of Asia's most versatile full-service consultancies with operational offices across China, Hong Kong, India, Singapore and Vietnam as well as liaison offices in Italy and the United States. Dezan Shira & Associates' experienced business professionals are committed to improving the understanding and transparency of investing in emerging Asia.

Beijing

beijing@dezshira.com
+86 10 6566 0088

Dalian

dalian@dezshira.com
+86 411 8459 5011

Guangzhou

guangzhou@dezshira.com
+86 20 3825 1725

Hangzhou

hangzhou@dezshira.com
+86 571 5685 9956

Ningbo

ningbo@dezshira.com
+86 574 8733 8682

Qingdao

qingdao@dezshira.com
+86 532 6677 5461

Shanghai

shanghai@dezshira.com
+86 21 6358 8686

Shenzhen

shenzhen@dezshira.com
+86 755 8366 4120

Suzhou

suzhou@dezshira.com
+86 512 8686 8717

Tianjin

tianjin@dezshira.com
+86 22 8787 7998

Zhongshan

zhongshan@dezshira.com
+86 760 8826 9592

Hong Kong

hongkong@dezshira.com
+852 2376 0334

www.dezshira.com
china@dezshira.com



Beijing - Office

U.S. Embassy
No. 55 An Jia Lou Road,
Chaoyang District
Beijing 100600, China
Tel: (86-10) 8531-3000
Fax: (86-10) 8531-3701
Email: Office.Beijing@trade.gov

Chengdu - Office

4 Lingshiguan Lu, Renmin Nanlu Section 4
Chengdu, Sichuan 610041, China
Tel: (86-28) 8558-3992
Fax: (86-28) 8558-9221
Email: Office.Chengdu@trade.gov

Shanghai - Office

Shanghai Center, Suite 631
1376 Nanjing West Road
Shanghai 200040, China
Tel: (86-21) 6279-7630
Fax: (86-21) 6279-7639
Email: Office.Shanghai@trade.gov

Shenyang - Office

52 Shi Si Wei Road, Heping District
Shenyang, Liaoning 110003, China
Tel: (86-24) 2322-1198
Fax: (86-24) 2322-2206
Email: Office.Shenyang@trade.gov

Guangzhou - Office

14/F China Hotel Office Tower, Room 1461
Liu Hua Road
Guangzhou 510015, China
Tel: (86-20) 8667-4011
Fax: (86-20) 8666-6409
Email: Office.Guangzhou@trade.gov

Hong Kong

26 Garden Road, Central
Hong Kong (SAR)
Tel: (852) 2521-1467
Fax: (852) 2845-9800
Email: Office.Hongkong@trade.gov

