

# JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

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## NEWS FROM JESA! Saudi Arabia, new frontier?

*By Saro Capozzoli, Founder and GM of JESA Investment & Management Co., Ltd*

Even in a moment of crisis and general economic difficulties it is important to keep searching, monitoring and exploiting new opportunities. Thus also from China, still a country of lots of opportunities, we are keeping monitoring what is happening outside. In the research we found an interesting surprise represented by the Arab Peninsula.

In particular Saudi Arabia is not only desert and oil, but a country that is facing an important expansion. It is worth saying that the country is classified by SACE at the same level of risk of India or Brazil, where many European and Italian companies are investing. This is a country with wide opportunities of development in many industries, from energy consumptions productions to infrastructure development. The country is eager to attract know-how from different industries and create a production base that goes beyond the exploitation of oil.

Investing in Saudi Arabia is also ease by attractive financial tools put in place by the Government and the bank system, which sensibly decrease the extend of the investment a

company is required to forecast. Cost are still relatively low, considering the low costs for energy and oil, which allow the establishment of highly consumption productions. Moreover it is possible to rely on highly educated human resources with international background. At last, logistically speaking the country is located in a strategic position between Europe and Asia, close to Africa and easily accessible.

The evaluation of such and many other drivers might be important for many companies seeking to expand their activities in a strategic way, without narrowing their range of action to few, known and currently "fashion" countries.

Jesa is developing a solid partnership in the area with an important local industrial group aiming to support and cooperate in the development of new projects that may also involve cross-borders operations in Europe, China and Kingdom of Saudi Arabia.

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### ITALIAN VERSION

Anche in moment di difficoltà economica è importante continuare a cercare, monitorare e sfruttare nuove opportunità. Pertanto anche dalla Cina, monitoriamo costantemente cosa succede oltre confine ed in questa ricerca siamo

entrati in contatto con la realtà sorprendente del mondo arabo.

In particolare, l'Arabia Saudita non è solo deserto e petrolio, ma un Paese che sta affrontando un importante sviluppo. È importante precisare che tale Paese è classificato dalla SACE in termini di rischio allo stesso livello di India e Brasile, dove molte imprese straniere investono. L'Arabia Saudita è allo stesso modo un Paese con ampie possibilità di sviluppo in molti settori, dalle produzioni ad alto consumo energetico al potenziamento delle infrastrutture. Il Paese è inoltre desideroso di attrarre *know-how* proveniente da diversi settori e creare una solida base produttiva che vada oltre il semplice sfruttamento del petrolio.

Investire in Arabia è anche facilitato in parte dagli strumenti e dal supporto finanziario disegnato dalle autorità locali e dal sistema bancario, che diminuisce sensibilmente l'ammontare dell'investimento iniziale che un investitore è costretto a stanziare all'inizio del progetto. I costi sono ancora relativamente bassi, considerando l'irrisorio costo unitario di energia elettrica e petrolio, e ciò permette l'insediamento di produzioni ad alto e altissimo consumo energetico. Inoltre il livello di istruzione permette di trovare personale manageriale altamente qualificato e con

background internazionale. Infine, logisticamente Arabia Saudita si trova in posizione strategica tra Europa e Asia, vicino all'Africa e facilmente accessibile.

La valutazione di questi e tanti altri *drivers* può rivelarsi importante per quelle imprese che cercano di espandere le proprie attività in modo strategico, senza ridurre il raggio di valutazione e azione a quelle poche, conosciute e nazioni "ormai di moda".

Jesa sta sviluppando una solida partnership con un importante gruppo industriale locale per supportare e cooperare nello sviluppo di nuovi progetti che potrebbero coinvolgere anche operazioni *cross-border* tra Europa, Cina e Arabia Saudita.

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### **RMB "Non-resident-accounts": new instrument to settle cross borders transactions**

In the last 30 years China has embarked on one of the most fascinating economic development in the history of capitalism and in the second quarter of 2010 it surpassed Japan, becoming the world's second largest economy behind United States. China is currently the world's largest exporter (it overtook Germany in 2009)

and also the second major recipient of foreign direct investments (FDI), with an inflow of \$95 billion in 2009. Despite its preeminent role in the world economic environment, the Renminbi cannot be considered at the moment an international currency, mainly due to the fact that it lacks full convertibility. A currency becomes fully convertible when all controls on current account and capital account transactions are abolished. Key countries engaged in international trade mainly use their currency to invoice and price transactions: for example, between 1860 and 1914 about 60% of the world trade was invoiced and settled in sterling, reflecting the fact that Britain absorbed more than 30% of exports from the rest of the world.

In order to acquire an international status outside country's borders, a currency should be accepted by non-residents as: (1) a medium of transaction; (2) a unit of account and (3) a store of value. Usually currency policies have favoured first the full convertibility to subsequently stimulate and establish a certain degree of internationalization. The policy undertaken by China is following an unconventional path as it stimulates the internationalization of RMB without currently allow its full convertibility. As a consequence, foreign entities operating in China

are facing different problems: (1) enterprises who import products from China want to choose RMB to settle a foreign account within the country, however they were not allowed to do that up to now, (2) enterprises that export in China and don't know where to put money collected from transactions and finally (3) little chance of mitigation against the risk of exchange rate. A monetary impact could represent a main justification of such choice from the government: with full convertibility, the domestic monetary system will be eventually more vulnerable to external shocks.

Since Beijing have been trying to achieve currency internationalization under controlled convertibility, two strategies have been fulfilled in the past years. First officials, aiming to increase the use of national currency in international trade, allowed foreign businesses to set their transactions with Chinese firms in RMB. Secondly, they set up a RMB-offshore market in Hong Kong, with policies focused on providing instruments to hedge the currency risk and make RMB holdings more attractive to non-residents.

As clear evidence of the intent to further liberalize the use of China RMB by foreign entities, the People's Bank of China (PBOC) last September issued new guidelines

(Administrative Measures on Renminbi Bank Settlement Accounts Opened by Overseas Entities) allowing foreign entities to open bank accounts that can be used to accept and make payments denominated in RMB.

For everyone operating in China, dealing with Chinese counterparties or seeking an expansion in the country, the increased level of internationalization of the local currency could provide significant benefits, in terms of payments flexibility, collection and investment opportunities. After China removed restrictions blocking the flow of RMB to Hong Kong, it's now possible to open a RMB accounts in the former British colony. All types of denominated RMB loans can be granted to corporations and investment products in Chinese currency can be created.

Foreign entities can now decide whether to open a RMB account in Hong Kong (for payment and collection in Hong Kong and for cross-border trade settlement in China), or directly own a RMB non-resident account (NRA), to manage settlement with local counterparties. The second solution appears more attractive to foreign entities that use to accept and make payments in RMB as they would avoid to convert the currency. In this case they could also manage

simpler import/export procedures regarding customs.

Initially the program has been tested on a pilot basis started on July 2009, when banks in Shanghai and Guangdong began to allow overseas clients to collect in local bank accounts RMB from their Chinese trading partners.

The new Measures in RMB Account of Overseas Entities refer to bank settlement accounts opened in domestic banks or, in other words, in both domestic and foreign-funded banks that have the required qualifications to manage international settlement business in the country. An overseas entity is defined as one that is legally incorporated overseas, including the territories of Hong Kong, Macau, and Taiwan.

However non-resident accounts have restrictions in the use of their RMB funds: companies can use them only to make payments and collect money in RMB related to trades with their Chinese counterparties. Additionally, under China's capital controls, non-resident corporate are only allowed to transfer their foreign currencies freely into China for trade-related transactions. Nevertheless, the industry is still waiting for a clarification from the PBOC about regulations governing the conversion of the RMB by holders of non-resident accounts who switched back to their home currencies.

Despite the practical benefits that the reform aims to implement, foreign entities could gain advantage of holding RMB in local bank accounts for two reasons. First, NRAs provide higher interest rates on deposits (on September, a one-year time deposit offered onshore in China pays 2.25% compared with a deposit rate of about 1.05% offered to a corporate by an institutions such as Standard Chartered in Hong Kong). The central bank's new measures will give NRAs a current deposit rate of 0.36%, compared with a more attractive rate of 0.45-0.5% in Hong Kong in order to avoid arbitrage strategies. Secondly, in anticipation of higher interest rates and RMB appreciation, foreign companies engaged in cross-border RMB-denominated trade are more willing to put their Renminbi funds into mainland-based NRAs. Non-resident accounts have attracted more than 20 banks in the only city of Shanghai, both Chinese banks and foreign, locally-incorporated ones. Among the reasons there is the will to pitch settlement account services to non-resident corporate, to enable them to hold RMB funds onshore in China while earning the officially-set time-deposit rates. JP Morgan has been among the first international financial institutions to implement the new type of product and it has started offering non-resident account services to

corporate since last September. Other international banks that offer this service for clients operating in China are HSBC, Standard Chartered, Citibank and Mizuho Corporate Bank together with Italian banks Unicredit and Intesa San Paolo.

The Measures on RMB Accounts of Overseas Entities allow now overseas entities to establish RMB bank settlement accounts in China and this is a clear step of the Chinese government towards internationalization of the currency. Foreign companies can now trade in a simpler and more efficient way with Chinese partners, without facing the expenses of currency conversion and avoiding exchange rate risk. Shanghai, China's financial center, is capitalizing on its leadership in RMB bank settlement accounts for foreign companies. The local government has recently reaffirmed its support to the reform, by simplifying procedures to open accounts and expanding the allowable sources and scopes of use of RMB funds.

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### **News from China Customs: Classified Management of Enterprises**

After entering into the WTO and under the effects of the economic globalization, China has witnessed a constant increase in its import and

export volume. This inevitably requires higher Customs' standards in terms of strict surveillance and convenient clearance.

Taking into consideration such rising needs, in October 2010, the General Administration of China Customs promulgated the Decree No. 197, "Measures of the People's Republic of China on Custom's Classified Enterprise Management" (here after the "Measures"), which came into force on January 1st 2011.

The Measures has been formulated to ensure the safety and convenience in import and export trades, promote law-abiding behavior of enterprises, rationalize the Customs' administration resources, and implement effectively the Customs regulations.

The Customs executes corresponding administrative measures on the basis of the compliance of an enterprise with laws, administrative regulations, Customs rules, relevant provisions on honest and clean administration, and its business management as well as its performances as filed in the Customs supervision and statistical records, and in accordance with the assessment of the enterprise based on unified national appraisal standards and procedures for classified enterprise management as well as the principle of convenience for the law-abiding.

The Measures is applied to consignees and consigners of imports and export agent declaration enterprises that are registered with Customs

The Measures classifies enterprises into five categories: AA, A, B, C and D, of which:

- AA and A enterprises enjoy convenient Customs clearance procedures;
- B enterprises are subject to regular administration procedures;
- C and D enterprises, undergo strict inspection and supervision procedures.

Tables in the following page report the classification of the enterprises and the drivers for the definition of the category.

The positive cooperation between the Customs and the enterprises contributes to the transition from a former regulation-oriented government to a service-oriented one. The Customs should in fact strive to establish its cooperative partnership with the enterprises, broaden its service channels and encourage the self-discipline of the enterprises while understanding the problems encountered by enterprises in their international trades and facilitate safety and convenience for international trade.

**Classification of consignees and consigners of imports and imports (highlights)**

	AA	A	B	C	D
General requirement	Having been classified as Class A for more than one year	Having been classified as Class B for more than one year	1.None of the circumstances listed in Class C and Class D has occurred 2.Being registered for the first time or cannot meet the requirements for Class AA or Class A		
Error rate	Below 3%	Below 5%			
Smuggling activity	NA	NA		Been involved	Commit crime or Been involved twice
Violation of "Customs regulatory provisions"	NA	NA		more than three times or more than RMB 500,000 fines	
Penalty for (IPR) intellectual property rights	NA	NA		Twice	More than three times
Delinquent taxes, fines, confiscations payable	NA	NA		Less than RMB 500,000	More than RMB 500,000
Others	Customs management, the enterprise's operations and management, and trade security's requirement has been made	1.The total import and export volume of the previous year was more than \$500,000 2.Not having any bad record in administrative departments or institutions			

**Classification of Agent Declaration enterprises (Highlights)**

	AA	A	B	C	D
General requirement	Having been classified as Class A for more than one year	Having been classified as Class B for more than one year	1.None of the circumstances listed in Class C and Class D has occurred 2.Being registered for the first time or cannot meet the requirements for Class AA or Class A		
Amount of import and export declaration forms lodged	lodged more than 20,000 (5,000 for central and western areas in China)	more than 3,000			
Error rate	Below 3%	Below 5%		Above 10%	
Smuggling activity	NA	NA		Been involved	Commit crime or Been involved twice
Violation of "Customs regulatory provisions"	NA	NA		more than three times or more than RMB 500,000 fines	
Penalty for (IPR) intellectual property rights	NA	NA or assist Customs investigations when the goods declared are suspected		Twice	More than three times
Delinquent taxes, fines, confiscations payable	NA	NA		Less than RMB 500,000	More than RMB 500,000
Others	Customs management, the enterprise's operations and management, and trade security's requirement has been made	Not having any bad record in administrative departments or institutions		Having refused to accept or assist Customs investigations regulatory	

Note: Above drivers are updated yearly

## E-commerce evolution in China and new trends

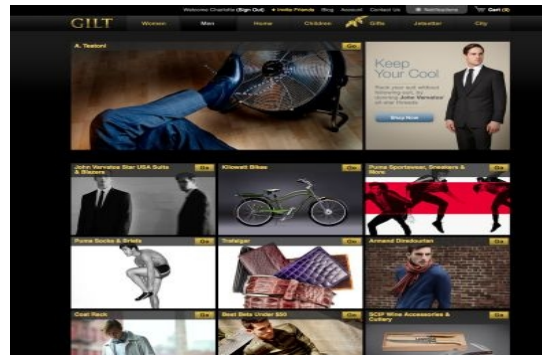
According to the 2010 report releases by CNNIC, the e-commerce in China increased by 32% in the first semester of the past year, reaching 142 million out of total 420 million internet users. The overall transactions volume of the first three months of 2010 hit an outstanding amount of US \$150 billion.

Even though the country is still far behind the United States in terms of total online purchasing, (with only 30% of web users shopping online, compared to a world average of 86%), China has an annual e-commerce growth rate five times higher than its American counterpart.

New trends, as well as new opportunities, are continuously evolving in the online industry. At the moment one of the most appetizing and challenging sectors is the luxury one. According to estimation, roughly 80% of the luxury consumers in China are under the age of 45 (compared to the 19% in Japan), thus they provide a more digitally native base of clients.

Historically the risk of jewels counterfeiting, especially for those sold through web auctions, has often represented a major concern for the industry's buyers, who usually do not trust to pay huge amount for online luxury items.

However international luxury brands believe it's time now to tackle into the opening market. Non price factors such as quality, brand awareness, excellent service and value for money are now raising among the Chinese consumers, who have started to discriminate when making their luxury purchases and they do not consider any more price as the main factor for their decisions.



Hence, the time is mature to launch an online retail for many well-known firms. Armani Group, for instance, played a leading role among the major luxury companies as it has launched its first Chinese totally online store "emporioarmani.cn", with China already weighting for 10% of the company's US\$2 billion global sales.

## Tuangou: A Chinese phenomenon

When addressing to China, foreign companies have compulsorily to take into consideration that "Internet Word of Mouth" (IWOM) is a drawing power in the country, because it mostly influences the stages of brand consideration and purchasing decisions.

One of the unique and most interesting phenomena that have been shaping the Chinese environment is the so-called "Tuangou" or Group purchasing. Nowadays it represents the biggest shift for retailers. Tuangou refers to a group of consumers who may not know one another and who get organized, through the use of electronic means like the internet, in order to get a common discount from the selected retailer. The visit to the shop is unique in Tuangou, and clients have to reach the targeted shop at a given time in order to make the purchase together on site. The origin of Tuangou and its popularity among Chinese is often attributed to the local rooted habits of bargaining and haggling down the price of all kinds of products. In addition the skepticism of the Chinese in buying goods from unknown sellers decreases, as individual members within the collective action could vouch

for a reliable retailer to the rest of the group, thus alleviating the mentioned preoccupation. The system in detail works as follow: an individual surfs the net seeking for others who want the same product, and starts to organize a flash mob. In the latter people agree to meet together at the entrance of a retailer , demanding for a group discount.



Clearly, these new relational attitudes have brought new challenges for all retailers, that lately had to adapt to the new dynamics of collective purchasing. Basically they find convenient to comply with a Tuangou to create a satisfying feeling among a wide group of customers, a reason why they usually accept to trade margin for volume and make the sell.

But despite that, many analysts suggested that different strategies should be taken by retailers when they meet Tuangou. They suddenly face several customers without previous notice and of course have still to consider their own individual situation when it's time to make a decision. Tuangou for instance should not be suitable for those retailers selling exclusive products targeted at high-value added consumers.

At the beginning, everything started in the chat rooms, but it has quickly encouraged broader solutions. Firms such as Groupon and LivingSocial have started to expand their networks of subscribers by penetrating the ever-popular social networking sites, alluring internet users through the promotion of those bargains they can access if enough people also sign up. It is amazing the example of a blogger that took just 2 weeks to find 54 other people to organize a Tuangou with a Toyota dealer, and they then acquired 55 vehicles of Yaris model at a discount of 30,000 RMB.

In the western countries, the trend is less marked and customers generally pay for a pre-defined deal with a retailer selected from the Group Buy site. Once the coupon holder enters the shop, he gets a discount valuing more than the price paid for the coupon, but on the other hand the broker keeps part of the difference. For

this reason, new measures have been contemplating for the time yet to come. Innovative mobile-phone software that put customers in alert in case there are flash mobs purchasing in their neighboring, seem so far to be the best solution .

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