

Jesa Consulting Ltd.

NEWSLETTER

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What is Jesa?

Jesa is a service company headquartered in Shanghai specializing in facilitating start-up of new industrial productions while providing reliable management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia). Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 engineers following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on each single commercial and technical issue. Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients save financial resources and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shot analysis) to verify performances in support to enterprises already established in China.

Decision Making on Whether to Enter the Chinese Market through a Direct Investment

There are many reasons why foreign companies may be willing to enter the Chinese market: diversifying risk, achieve economies of scale, scope or cost, obtain fiscal and legal advantages and exploit the market potential.

Nevertheless, there are several factors to be taken into consideration and carefully evaluated before making the decision on whether to start doing business in China.

First of all, it must be recognized that the Chinese market is composed by independent regional markets in competition with each other. Between different markets there are social, cultural, linguistic and regulatory differences that

might affect the way a company needs to implement its strategy.

Focusing on Italian Small and Medium Enterprises willing to penetrate the Chinese market, they have to face peculiar obstacles mainly due to:

- Dimension - Even if things are changing, the general idea is that a company has to be a certain size in order to invest in China, also because Chinese operators see Joint Ventures as a mean to establish partnerships with big multinational companies;
- Business ethics - The main difficulties in dealing with Chinese partners may reside in cultural, linguistic, regulatory differences and geographic distance;
- Increasing competition - Chinese competition, especially in mechanic and electronic sectors, is soaring, making it more difficult and costly to gain market share.

For these reasons a company that wants to operate in China must prepare a detailed entry plan, which answers to at least six main questions:

1. Are we ready?

Management has to have the necessary skills and be able to comprehend the Chinese market; moreover the company has to have the right information and be aware of possible entry barriers.

2. Do we have a defined strategy and business plan?

The company has to identify the best strategy in a long-term perspective and be able to raise sufficient capital for the initial investments.

3. Is our product competitive?

The product has to be well-positioned and it has to have a competitive advantage in order to suit the local market.

4. Do we have the appropriate organization?

The potential partner must be reliable and the organization has to be able to maintain a cooperative relationship with the locals, obtain and maintain control, communicate with other companies.

5. Are we compliant with the referential context?

The company needs the necessary licenses and authorizations according to the local laws and regulations and the staff must know the market and the local uses.

As regards strategy, Italian SME need to operate in a long- term perspective, integrating sales and after-sale support with a capillary presence nearby clients, and targeting the market high-end, which rewards quality and advanced technology.

An important issue is to decide whether to penetrate the market through a commercial activity or to make a capital investment in China.

The main forms of commercial penetration are:

1. Distribution;
2. Franchising;
3. Representative Office.

The main forms of investment are:

1. Direct investment through Wholly Owned Foreign Enterprise or Foreign Invested Commercial Enterprise - This kind of investment is feasible when the company is characterized by a unique and competitive business model and limited economies of scale. The main issue is how to access the market without a Chinese partner;
2. Joint-Venture with a local company: both partners bring experience and complementary goods, while the Chinese partner gives access to its network. This is the best option in case of barriers to foreign capital investments but the company needs to protect its know-how and be sure that the partner is able to provide access to market and distribution; A proper Due Diligence is mandatory in JV even in case of long time relationship with the partner.
3. Merger / Acquisition of a local company - it is feasible if the company has capital available and if the transaction allows the complete control of the acquired companies and their distribution channels. The strategic importance of acquired assets has to be carefully evaluated.

Direct investment is often the preferred option because production management allows a higher

market control compared to only exporting. It has to be recognized that China is an opportunity before being a market and in any case it is a market that must be helped to grow before being set upon.

The choice of the geographic area for the setting of production facilities has to be made according to the localization of the principal suppliers, clients and competitors. Moreover the conditions of the specific region must be considered, like the relationship with local politicians, the cost of the land and the production facilities, the presence of specialized personnel and the ease of recruitment, the cost of utilities. Taxation, which was a discriminating factor, has been recently uniformed and set at a flat 25% rate.

	Pros	Cons
WFOE or FICE	<ul style="list-style-type: none"> • Complete entry • Total control • Technical support 	<ul style="list-style-type: none"> • Large investment • Strict requirements • Operation cost
JV	<ul style="list-style-type: none"> • Quick approach to the market • Synergy of available resources 	<ul style="list-style-type: none"> • Dispute risk in the future • Risk of being copied • Countless failure cases • Wrong partner selection
M&A	<ul style="list-style-type: none"> • Immediate entry • Quick approach • Total control 	<ul style="list-style-type: none"> • Huge investment • HR issues

The New Economic Area of Guangxi

The Chinese government stated the green light for a new economic area which will be named "Guanxi Beibu Bay" and will be established in the Autonomous Region of Guangxi Zhuang. The Beibu Bay already host the economic zone, devoted to manufacturing processes, born thanks to agreement between China and ASEAN (Association of Southeast Asian Nations), but the approval of the plan by the Central Government will spur the development of the less exploited of the Chinese coasts.

In fact, even if traditionally the costal areas are the most prosperous, the economic boom concentrated in the three areas of the Yangtze

River delta, the so called "Bohai Ring", and in the Pearl River delta, leaving Guangxi Province almost untouched. The economic zone of the Beibu Bay will cover six coastal cities until the border with Vietnam for a total of 42,000 squared Km of land, 130,000 squared Km of sea water along 1,595 km of coast.

In the area live almost 12.5 million people and it represents a link not only towards Vietnam but also towards the Taiwan Strait and the Hainan Island, and it is developing a commercial port for the commerce with other ASEAN countries.



The ASEAN countries, as well as Japan and Hong Kong, for this reason, could constitute an obstacle for European investors. Data are clear: the foreigners that have the most important presence in the area are Japan and USA, and following France and Germany. Yet, there are good preference policies in the area to attract foreign investments: A part from big infrastructure, the foreign companies using new technologies, as well as those importing raw materials or components to be assembled for export or that invest in agriculture and breeding enjoy a custom taxes and VAT on imports exemption. Companies involved in agriculture can see the tax-free period doubled.

Negative elements are the extreme poverty and poor infrastructures. The interest of the Chinese government in Guangxi is demonstrated by its mention in the last five-years plan (2006-2010) in which the area is defined as "one of the

priorities in the development of the West of the country".

Environmental Awareness in China: Threats, Opportunities and New Developments

In recent years, China is keeping an eye on the environmental impact the recent growth of the country is bringing behind. The Chinese government is reinforcing pollution standards, making them stricter and, sometimes, more rigid than those of developed countries. If, from one side, these policies vary among areas, provinces and even industrial parks, a general trend of increased environmental awareness is becoming more and more evident. But, a part from a more efficient and judicious exploitation of the current amount of available energy, what about the government idea regarding new power sources? And, in particular, will these policies dim the impact the past environmentally incorrect Chinese growth is having on the rest of the world?

More and more venture capitalists and entrepreneurs around the world are focusing the attention on the one that could become a bright business: the one of clean and renewable energy in China. Even if this trend might not take the form of another .com bubble, it is to be said that China is applying this concept on a large scale. The last year, China added to its energy grid 3.4 GW generated through wind power and, within 2010, China will see its nuclear capacity grow by 400%, from 10 to 40 GW. At present, both for wind power and nuclear energy China holds a record of the highest growth rate in the world. On the other side, all this talking about China's progresses in renewable energy could deceive those optimistic who dream a future without coal. The growth rate of energy demand, in fact, is so speeding up that it could be satisfied only by the combustion of huge additional quantities of coal. The International Energy Agency estimates that, between 2008 and 2030, the increase in oil

consumption in China will reach the current total oil consumption of India.

The government's goal is to add 1,300GW of energy generation capacity by 2020, of which 25-30% should come from clean and renewable technologies. But, even if these objectives were reached, as a matter of fact about 70% of electricity in China would come from coal combustion anyway (nowadays this rate is 78%). The reason why China is so energy addicted is that, starting from 2002, the country embraced a growth pattern mainly based on heavy industries, such as cars, steel and aluminium production, all highly capital intensive businesses that need vast amounts of energy.

Five years ago the ratio between industrial output and GDP was 55%; the last year it reached 120%. As a result, China cannot be considered an efficient energy user and, taking into consideration the output for each consumed GW, it falls behind the US, Japan and other developed economies. With the aim to increase the efficiency by 20% in the next 12 years, the Chinese government ordered heavy industries to develop more judicious consuming strategies and local governments to implement the standard used in construction of new buildings and shopping centres to make them less wasteful. To do that, it is developing solar, wind and biomass so rapidly that some experts say the country could soon become a world leader in renewable energy. Even so, forecasts show these sources will amount to less than 4 percent of the energy supply by 2020.

But there is another reason for China's enormous need of energy. For tens of million Chinese, the middle-class dream is becoming true and they are buying their first cars, computers and other electronic appliances. As an explanatory example, consider the Three Gorges Dam project that created a new source of clean hydraulic energy by moving millions of peasants living in the areas now submersed by water: according to estimations of the Beijing's Sustainable Energy Program, the energy demand coming from air conditioning appliances purchased by Chinese

during 2008 will exceed the total energy capacity of the three Gorges.

In conclusion, even if from one side China is making efforts to develop new and renewable sources of energy with remarkable results, these policies will result only in a small contribution to energy production due to the insatiable power bulimia of the country. But, anyway, the new direction China's policy is taking could affect also foreign companies seeking to invest in China. One suggestion to those players is to keep an eye on future development and evaluate carefully the environmental impact of the company's operations before selecting the location of investment remembering that, despite what foreigners may think about China, sometimes environment protection policies lead to standards stricter than in the rest of the world.

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