

JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

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In this issue:

- **News from Jesa: Partnership for Italian Enterprises in China**
- **Labour revolution still in progress**
- **What can Italian companies learn from Davinci case?**

NEWS FROM JESA! Partnership for Italian enterprises in China

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

SACE, the Italian insurance and financial group that support the growth and competitiveness of Italian enterprises abroad, and Jesa Investment & Management Co. ("Jesa") have announced a partnership agreement that will help Italian enterprises to penetrate the Chinese market.

The agreement was signed in Hong Kong by the COO of SACE, Raoul Ascari, and the general manager of Jesa, Saro Capozzoli. Under the partnership Jesa will provide strategy, consulting and administrative services to back SACE's offering of insurance and financial instruments, and expertise in risk assessment and management, thus extending the range of services available to companies wishing to export to or invest in China.

Companies planning and implementing expansion projects in China will be able to take advantage of SACE's international network, which also includes an office in Hong Kong, and have the support of Jesa's in-depth knowledge of legal requirements and operational procedures in China, where it has offices in Shanghai, Hong Kong, Shenzhen and Chongqing.

"Under this partnership with Jesa we will be able to offer companies the integrated service they need to operate in a complex market like China. This country

offers great potential for penetration by Italian exporters although, mainly due to the high level of liquidity, growth in exports is not as dynamic here as in the emerging Asian markets," stated Raoul Ascari.

"There are still too few Italian companies in China considering the vast potential offered by this market and the overall volume of foreign investments, which exceeded US\$ 100 billion in 2010", remarked Saro Capozzoli. "There is ample room to expand trade and mutual investments between the two countries and help Italian companies seize the opportunities offered by the Asian market. The partnership agreement between Jesa and SACE is another instrument that can help Italian enterprises face up to the challenges of this country".

* * * ITALIAN VERSION * * *

SACE, il gruppo assicurativo-finanziario italiano che sostiene la crescita e la competitività delle imprese italiane all'estero, e Jesa Investment & Management Co. ("Jesa") annunciano la finalizzazione di un accordo di partnership per sostenere la penetrazione delle imprese italiane nel mercato cinese.

L'accordo, firmato a Hong Kong dal Chief Operating Officer di SACE Raoul Ascari e dal General Manager di Jesa Saro Capozzoli, permetterà a SACE di ampliare l'offerta di servizi dedicati alle imprese che intendono esportare o investire in Cina, affiancando alla gamma di strumenti assicurativo-finanziari e al *know-how* maturato nella valutazione e gestione dei rischi, i

servizi di consulenza strategica e amministrativa offerti da Jesa.

Nel pianificare e implementare i propri progetti di espansione in Cina, le imprese potranno quindi avvalersi dell'assistenza della rete di SACE, che presidia il mercato asiatico attraverso il proprio ufficio di Hong Kong, e della conoscenza del contesto normativo e operativo locale di Jesa, presente in Cina con uffici a Shanghai, Hong Kong, Shenzhen e Chongqing.

"La partnership con Jesa – ha dichiarato Raoul Ascari – ci consentirà di offrire alle imprese un servizio integrato capace di rispondere con efficacia alle esigenze di un mercato complesso come quello cinese, dove, a causa soprattutto dell'elevata liquidità, il nostro livello di penetrazione offre un ampio potenziale e non riflette ancora a pieno il crescente dinamismo delle imprese italiane nei mercati emergenti asiatici".

"La presenza delle aziende italiane in Cina – ha dichiarato Saro Capozzoli – è ancora troppo limitata considerando le grandi potenzialità offerte dal mercato e il volume complessivo di investimenti esteri che hanno ormai superato USD 100 miliardi nel 2010. Ci sono quindi ampi spazi per incrementare sia gli scambi tra i due paesi che gli investimenti reciproci, aiutando le imprese italiane a cogliere i vantaggi offerti dal mercato asiatico. L'accordo di partnership tra Jesa e SACE offre quindi uno strumento in più alle aziende italiane per affrontare le sfide del paese".

Labour revolution still in progress

Considering that China is the destination of investments of many foreign companies and the development of its labour environment affects all companies that have any kind of relationship with China, this topic has been often treated.

From a land without particular protection of the workforce, China gave its first strong signal with the Labour Law of 2008 that entitled employees of wider rights.

Since then it became more and more clear, that China has not anymore to be considered a low cost country and the local production may not be so competitive as before.

The development of the labour market had a huge impact on the increasing of the production costs and its development is still undergoing and this time has the shape of the new **Social Insurance Law** that entered in force on July 1st.

This is the first comprehensive law in China's social welfare system that covers urban as well as rural residents, applies to state-owned enterprises, joint ventures, private companies, foreign invested enterprises and their employees in the country.

It marks an important step is the unification of the system at a national level in terms of treatment and definitions, keeping only small

differences in terms of rates among different areas, which it is not clear whether they will be readjusted.

Taking Shanghai as example, the contribution rates of basic pension, basic medical insurance, unemployment insurance for employee are 8%, 2%, and 1% respectively, while that for employer are 22%, 12%, 2% and 0.5% for work-related injury and maternity insurance. Instead in Nanjing (Jiangsu Province) the corresponding contribution rates for employees are 8%, 2% and 1% too, while for employer are 20%, 9%, 2% 0.8% and 0.5%-1.2% respectively.

The new law facilitates the mobility of human resources within the country allowing to transfer their pension, medical and unemployment insurance when they relocate in different cities for new employment. The law also empowers the social security collection body to exercise more power to supervise the contributors, especially when an employer fails to make complete payment till the possibility to apply to People's Court to detain, seize and auction off employer's assets.

Under the new Law, rural residents are now eligible to participate in social insurance programs enjoyed by urban employees. In the past, rural residents working outside of urban areas

did not have the right to contribute to social insurance. Further, while rural residents working in cities could participate in social insurance programs, the programs for rural residents were inferior to those enjoyed by their urban counterparts and were not transferable.

The new social insurance program effectively allows rural residents the option of upgrading to an urban social insurance scheme. Upon cessation of employment, rural resident employees can choose to transfer back to their rural social insurance program. As a result of this coverage, the discrepancy in benefits for rural residents as against urban residents has been considerably narrowed. Taking Shanghai as example, more than 4.5 million migrant workers will be able to enjoy the new system. It is estimated that before the Law the employer needed to pay less than 300 Yuan (US\$ 46.36) in social insurance a month for one migrant worker, while the new Law requires also the contribution of the employee and increase the contribution of the employer: from July, the latter has to pay nearly 600 Yuan a month for one migrant worker, while the worker pays one-third of that amount. The 600 Yuan amount is a figure amount for a transition period of 5 years, after which it is expected to increase to 800 Yuan a month (in 2016). This will surely bring more pressures on local businesses and it is

hard to predict how the policy will affect the local job market for migrant workers.

The Law also includes a **guidance on foreign nationals' participation in the social security system** is one of the biggest news and concerns. This is the first time China has imposed a requirement that foreign nationals participate in its social insurance programs.

In June 2011, the Ministry of Human Resources and Social Security issued draft measures governing the participation of foreign nationals in China's social insurance programs and solicited comments on the draft measures from interested parties.

- Scope: foreign employees are required to participate in the same five social insurance programs applicable to PRC national employees: pension, medical insurance, unemployment insurance, occupational injury insurance, maternity insurance
- Definition: foreign nationals holding work permits, foreign expert certificates and foreign journalist identity card. It includes also foreigners employed outside China and assigned to work in China
- Rates haven't been specified yet but it is likely to be the same as RC nationals
- When "leaving" china foreign nationals can either maintain pension accounts in China or

cashing out the portion of the account that was funded by employee.

As an estimation, if foreign national employees were required to participate in all social insurance programs, at the current contribution rates, the maximum annual employer contribution per employees is about RMB 49,000 for employees working in Beijing and about RMB 52,000 for employees working in Shanghai. Employees would pay maximum about RMB 16,00 in Beijing and RMB 15,000 in Shanghai.

It is still unclear how the provisions relating to social insurance contributions by foreign nationals working in China will be implemented. Some local officials reportedly have said that they will make participation by foreign nationals voluntary. Depending on how it is implemented, the Law may increase the cost of doing business in China for foreign investors.

Both domestic and foreign-invested enterprises should monitor implementation of the Law to be able to comply with the requirements and to assess the potential impact of the Law on their cost structure.

What can Italian companies learn from Davinci case?

In the latter days there has been some buzz in the major Italian and Chinese newspapers about the "Davinci case". The Chinese retailer of luxury furniture is alleged to have deceived some customers by selling them low-quality Chinese-made furniture in place of an expensive imported Italian products.

The peculiarities of this case provide a good basis for a more profound discussion on the current situation of the Chinese furniture market and, in particular, of the challenges and opportunities for Italian companies doing business in China.

THE FACT

DaVinci is a Shanghai-based retailer of high-end furniture brands (of which many Italians) currently operating in Singapore, Indonesia, Brunei, Malaysia, Hong Kong, and China.

The company is in the process of being listed in the Shanghai Stock Exchange, with an initial price of about 40 times the net revenues of 2010, leading to an IPO value of at least 400 million Euro. Operating since 1994, the company is the leader in the high-end luxury furniture sector in China.

Davinci has been accused of selling, together with original pieces, other fake products sold under the label of popular Italian high end.

The trickery was made possible by transporting the fake furniture, manufactured in the Guangdong province, through the Shanghai's Waigaoqiao Free Trade Zone. Here this could be labeled as "imported" and immediately sent to the Davinci's warehouse in the Qingpu District (Shanghai), ready to be dispatched and sold as a "Made in Italy" piece.

The fraud was first made public by a CCTV report, which also showed the defects of the fake products, and was then confirmed by the Shanghai Industrial and Commercial Administrative Bureau. Davinci denies the allegations stating that the fake furniture was intended for a different brand owned by the company and that no Chinese customer received non-original products. The main partners of Davinci, among which some Italian companies, have showed support to the CEO Doris Phua and expressed confidence in a positive solution of the case, in the hope that what represents their main partner and sales channel in China will continue selling their brands with profit.

As for now, Davinci has been prohibited from selling the brand under which the fake products were labeled and, should the allegations be

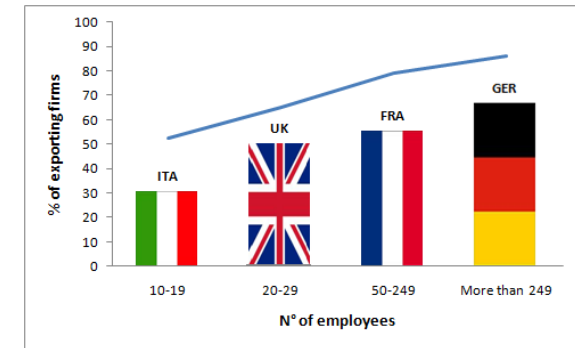
confirmed "they will not only give refunds, but also give cash compensation of the same price of the furniture," as Zhao Jiaoli, secretary general of the commission, said to the press.

CONCLUSIONS FOR ITALIAN COMPANIES

What can Italian companies learn from this story? A first conclusion can be drawn from the observation of the effects that this scandal can have on the whole Italian furniture industry exporting in China. Some manufactures from Brianza, the same area of the incriminated brand, are showing concerns that this event can contribute to the creation of a negative image of the Italian furniture in China, leading in turn to a reputational damage for all the operators of the area. To avoid this from happening again, they are considering putting their efforts together and create a unique entity representing the "Made in Brianza" furniture in China. Reaching a bigger scale would probably allow them to gain independence from a Chinese retailer as well as from any link between them and the final customer, on which they have little or no control. Indeed, as it is possible to see from the graph below, the extent to which companies export is directly proportional to their size. Having Italian companies a smaller size on average than their European peers (the columns in the graph represent the average size of companies in each

national market), it is advisable for them to increase the scale of their operations.

Diagram 1: Percentage of exporting firms per size



A second important feedback of the Davinci case is that the "Made in Italy" is actually seen as a quality benchmark by the Chinese customers, and it receives the legal protection it deserves to keep this valuable image up also in the future.

To conclude, Italian companies have the "national" brand image and the legal protection they need to succeed in China. With a market potential estimated in 40 billion USD per year (2010) and about 5 million families buying brand new homes to be furnished in the same time frame, the Chinese market is an opportunity not to be missed. A more localized entry-strategy developed under the prerequisite of a bigger scale is an advisable approach.

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