

# JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

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**NEWS FROM JESA! New Chinese Challenges**

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

During the years, Jesa has developed a complete range of services for foreign enterprises that invest in China (from investment analysis to company development support).

We therefore decided also to support the companies in identifying suitable staff, available to work in foreign companies, often small size realities, but with high potentialities, often managed by managers commuters or from Italy with the "remote control". This means that companies need to find independent, reliable and trustable people, which must be educated, but they also need to be paid.

We often have to cool down the enthusiasm of those companies that, during the first meeting, explain us "they have heard that the salary of a Chinese GM is about 600 Euro per month": we help them to understand the real value of what they are looking for. This is not an easy process and often we crash into the firm belief that China is a low cost country. Everybody knows that actually China is no longer a low cost country especially in the East Provinces, where most of the foreign investment are concentrated. In some internal areas, there are still some unexploited low cost advantages, but the language barrier is still though. Balancing these issues is mandatory and companies should be ready to take brave and sometimes unpopular decisions, even "going West" and closer to the biggest emerging market. China has to be approached

because of the Market and the opportunities that will continue for decades, before that India, Africa or South American can be considered comparable markets. More than 15 Chinese cities will have more than 25 million inhabitants: this will affect the strategies of the companies, and those who will not have a structure in the Country will miss the chance forever or will be forced to enter at higher costs. If the driver of the investment is only production costs reduction, Jesa always suggest to look closer, to Serbia, Tunisia, Algeria, Turkey, etc.

In order to provide our readers and clients with an overview of the salary level in China, mainly at managerial level, a document has been elaborated and can be downloaded from the website <http://www.jesa.com.cn/reports.html>.

\* \* \* ITALIAN VERSION \* \* \*

Negli anni Jesa ha sviluppato una gamma completa di servizi per le imprese straniere che investono in Cina (dalla definizione dell'investimento a supporto durante l'operatività dell'impresa).

Abbiamo quindi deciso di supportare le imprese a nche nell'identificazione di personale idoneo a lavorare con aziende straniere spesso di piccole dimensioni, ma con ottimi potenziali, spesso gestite da manager pendolari o dall'Italia con il "telecomando". Questo implica la necessità di trovare persone a tutti i livelli che possano essere indipendenti, affidabili e responsabili. Cose rare in Cina che vanno coltivate ma anche pagate.

Cerchiamo quindi di raffreddare le aspettative di quelle imprese che, ai primi incontri, dicono di aver sentito dire che in

Cina un GM cinese prende 600 euro al mese: cerchiamo di aiutarli a capire il reale valore di quello che cercano e vogliono.

Questo non è un processo facile e ci scontriamo spesso con la convinzione che la Cina sia ancora solo un paese a basso costo. Sappiamo tutti che non lo è più come prima soprattutto nelle aree costiere dove gli investimenti stranieri si concentrano ancora in gran numero. È un paese a basso costo ancora in alcune aree, meno sviluppate, dove però la barriera linguistica è ancora molto forte e le difficoltà inevitabili. Il bilanciamento di questi aspetti è indispensabile e le imprese devono essere disponibili a fare scelte coraggiose ed eventualmente impopolari, rivolgendosi verso l'interno della Cina, e avvicinandosi sempre di più al vero mercato emergente cinese.

Quello che l'impresa dovrebbe ricercare in Cina è il Mercato, e le opportunità di sviluppo che si protrarranno ancora per decenni, prima che India, l'Africa o il Sud America possano rappresentare mercati simili. Più di 15 città cinesi avranno oltre 25 milioni di abitanti: questo peserà non poco sulle strategie delle imprese e chi non sarà strutturato in Cina, potrebbe restarne escluso o essere costretto ad entrare a costi molto più elevati. Quando il basso costo è il solo driver dell'investimento, Jesa suggerisce di guardare più vicino, in Serbia, Tunisia, Algeria, Turchia, etc.

Per dare una panoramica ai nostri lettori e clienti della situazione salariale in Cina, soprattutto a livelli manageriali, è stato preparato un approfondimento scaricabile dal sito internet, <http://www.jesa.com.cn/reports.html>.

## ABC goes public: the alphabet of the biggest listing ever

Agricultural Bank of China (ABC), the only bank among the Big Four that had yet to get listed, has recently decided to come out, announcing its listing request to Stock Exchange in Shanghai, coupled with the willing to float its shares on the Hong Kong Stock Exchange. Though the quoting move by the Beijing-based bank was straightforwardly taken for granted by all the financial operators internationally, not all of them might have foreseen it to be the world's biggest initial public offering ever. With 41 domestic branches and eight overseas institution, ABC assured to provide a widely established portfolio of products and services across the *mainland*, not surprisingly attracting proposals from 21 underwriters as of April 7, 2010. One of the country's most recognized state-owned commercial banks, ABC narrows in providing services to *agricultural, industrial, transportation* firms throughout the state, packed with a number of appealing offerings of personal banking, credit cards and foreign exchange services. As for its listing milestones, ABC placarded one week later a roster of 10 investment banks picked to handle its IPO, expecting to raise around \$23 billion, among which Goldman Sachs, Deutsche Bank and China International Capital are hoped for taking command of global roles serving the cause. ABC's recourse to international strategic partners came somehow out of the blue, as most sources close to the Bank have been constantly counseling the bank to introduce

only one domestic strategic advisor, again differentiating this listing from China's three other major lenders'. From a national perspective, conversely, the selected Chinese partners undoubtedly fit for the lender's premise, having played a major and valuable role as financial advisors in the past restructuring, therefore gaining a winning starting point for the deal.

### Financial reasoning

Even though it might have resembled a typical financial honeymoon since the very beginning, the bank has only recently wiped off around 900 billion yuan in bad assets, leading net assets up to a record number of more than 290 billion yuan the last year, scaring an astonishing sharp rise of 225% over the last two-year period. Moreover, the latest strategic moves of the lender's governance have lessened its bad loan ratio from 23.5 percent at the end of 2007 down to 4.35 right the year after and 2.91 in 2009, laying the groundwork for the upcoming financial restructuring and IPO. What's more, the provision coverage and capital adequacy ratios turned pretty stabilized lately, causing, somehow accordingly, the net profit to rocket to 65 billion yuan, marking a record jump of more than 20% from 2008 onwards.

Furthermore, as oftentimes happens in China, in the grooming phase of the IPO, earlier on November 6, 2008, ABC has got a major leg up by Central Huijin Corp, the domestic investment branch of China's *sovereign wealth fund*, which poured around \$20 billion, worth it 50% of ABC shares.



Nevertheless, the underwriting mandate of ABC has been capturing the interest of the main foreign investment banks, whose representatives were seen to be most frequently visiting Beijing latterly. This last being far from surprising, given the predictable craving of overseas investors for Chinese banking shares, due to inspire a fast economic growth.

Yet, the slowdown scenario depicted above has warned off the investors, dampening their enthusiasm for the share sale for a while. As a result, according to the latest price consultations as of June 29, 2010, Agricultural Bank of China might only aspire to net a maximum of \$23.1 billion in its dual listing, eclipsing anyway Industrial and Commercial Bank of China's IPO in 2006. The A-shares, due to be placed in the Shanghai Stock Exchange, were ranged at a lower price than expected, between 2.52 yuan (37 USD cents) and 2.68 yuan each, far below the 3 yuan expectations of the underwriters for the Chinese wing. Unlike, the H-shares last week were priced at

\$HK 2.88 to \$HK 3.48 apiece, keeping to market forecasts. Cornerstones opted to buy into an IPO before the pre-marketing phase, raising the attractiveness of its solid financial ground, in change of preferential treatments and shares. Besides, due to the impressive scale of this IPO, underwriters keep asking for longer binds, seeking a one-year commitment that would eventually unclench the financial investors, eager to expose themselves to longer term proceeds.

On the other hand, it is widely acknowledged the extent to which ABC's *former state-owned* history has been playing a prominent role in the success of the operation itself, together with the *proximity* of the Chinese government's rural policies and special care. Oppositely, with regard to the timing of the operation, ABC's IPO came at a downhill period which displays the benchmark Shanghai Composite as the worst index among the world Top 10, marked with a tumble of around 23%.

1: SSE Composite Index (Sep 09- June 10)



Notwithstanding, ABC enjoys an widespread network of stakeholders in China and a massive strategic presence in the main rural areas, on which the government seems to be counting on a big scale.

Hence, in spite of the weak market sentiment, many so-called cornerstones are betting on the upcoming quotation, Chinese IPOs have challenged and nosed out the dive in the global market, making a U-turn in contrast with the huge number of companies (around 30, according to *Bloomberg* experts) which have postponed or definitely overridden their first-time sales, as displayed by an average 29 percent gain in their first trading month. Likewise, ABC's governance reasonably flexes its muscles, well-aware of the huge chances to meet the targeted dauntless fundraising, but this time with a clear burden: to exercise the *overallotment option*, meant to sell extra shares, with the aim of increasing the IPO by 15 percent to accomplish the excess and latent demand.

### Rising wages: unrest in Southern Chinese factories

#### China's sweatshop conditions: the suicides at Foxconn

Taiwanese-owned Foxconn is the world's biggest electronics outsourcing manufacturer, operating 20 plants and employing more than 800,000 workers in China. The Shenzhen plant in Guangdong province houses 400,000 workers, making

products from iPhones and iPads to PlayStations for international brands like Apple, Sony, Hewlett-Packard and Dell. Analysts estimate that about 70 percent of Apple's products are manufactured there.

Like other export oriented companies, Foxconn's basic monthly wage of 950 RMB (\$US 140) is in line with Shenzhen's official minimum wage. Employees must work hours of overtime each day to make about 2,000 RMB to meet basic needs. In addition Foxconn's a military-style regime, which is typical of export factories in China, creates working and living conditions that are impossible to tolerate, both physically and psychologically in the long run.

Twelve workers committed suicide this year at Foxconn because they were unable to bear the stress, alienation and humiliation they experience daily. They come from a second generation of migrant workers who, unlike their rural parents, have much higher expectations of urban life. They have access to the Internet and mobile phones and constantly see the vast new wealth that they help to create, but do not own.

The workers have got a 33% pay rise after the suicide incidents, but this precedent started a series of strikes in the region. Later the company announced it was planning to raise wages further: the new monthly average would be 2,000 RMB— about \$US 300, at current exchange rates. Analysts estimate that this wage increase will translate at least into a 20% reduction in Foxconn's company earnings this year.

Another incident: Honda	Reactions	Implications for the future
<p>Workers at a lock factory in south China that supplies Honda Motor challenged managers shortly after the Foxconn incident, demanding higher pay and freedom to form independent unions, banned in the export powerhouse. This has been the third factory supplying Honda Motors to strike in a row.</p>	<p>The strikes pose a dilemma for China's authoritarian government which has warned foreign businesses must expect to pay higher wages as China moves up the manufacturing value chain, but is allergic to any kind of organized demonstration or people power.</p>	<p>Analysts believe that a doubling of China's manufacturing wages over the next five years – as expected - won't deter foreign investment because Asian rivals such as India and Indonesia lack comparable infrastructure. Even if China's workers are getting a break for the first time, the economy remains in a "sweet spot" and the country will continue to be the most popular hub for foreign manufacturers because of its superior infrastructure.</p>
<p>The unrest is a worry for the Communist Party, which has long discouraged independent worker action and punished protesters. President Hu Jintao and Premier Wen Jiabao have vowed to lift the incomes of hundreds of millions of farmers and workers, but officials are also trying to boost exports, which rely on cheap migrant labour drawn to Guangdong from poor villages inland. The rising demands of those workers, especially pressure for autonomous unions, could present hard choices for the government, which treats such demands as a threat to precious stability. Workers are demanding the right to form a trade union separate from the government-controlled national federation of trade unions, which has long focused on maintaining labor peace for foreign investors. Striking workers want their own union that will represent their views.</p>	<p>As a reaction to the strikes, Beijing announced that it would raise the city's minimum monthly wage by 20 percent, to 960 Renminbi, or about \$US 140. Many other cities are expected to follow suit.</p>	<p>The same position points out that it would be probably useless overreact to the wage increases, since the adjustments to labor costs are a 'catch up' because wages were frozen during the global financial crisis."</p>
<p>As for the wages, the final offer, was an increase of about \$44 a month in wages and benefits, less than half what the workers had been seeking when they walked off the job. Workers at the factory currently earn a base salary of \$117 plus a housing allowance and bonuses.</p>	<p>Foxconn's president Terry Gou, who made a company visit in Shenzhen after the suicides, announced that the company would prevent such tragedies from happening again. At the same time the company move most of the activities from Guangdong Province to Hebei Province in the attempt to reduce the labour costs as the company has started planning in 2007. Moreover the company is to build a new plant in Henan Province. In both cases the number hired workers is huge and the expected gross wages are close to 2.000 Renminbi. The hope is that the stikes will not only cuase the relocation of the plants but will also push the company to apply more human and acceptable work conditions.</p>	<p>On the other side of the coin, the wage increases will increase the spending power of the Chinese and boost tourism. Infact boosting salaries will help Premier Wen Jiabao's government increase domestic consumption and move the economy away from a reliance on exports for growth.</p>
	<p>In the meantime Honda is trying to set up a system that will enable a flow of communication from workers via managers to Japanese company officials and Honda's management team.</p>	<p>All in all, the Chinese labor market has come to a turning point with wages rising, where companies and the government should focus on other aspects, like infrastructure as well to remain competitive as the main manufacturing hub in the region.</p>

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*Invitation to donate part of the taxes for an association that takes care of medical treatments for immigrants without medical rights in Italy and for the start up of an hospital in Rwanda*

Jesa sostiene la causa dei Medici Volontari Italiani ed invita anche voi a donare il 5 per mille.



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