

JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

OCTOBER 2011

In this issue:

- **News from Jesa: Location, location, location**
- **Social Security Law took effect on October 15th**
- **Third quarter economic data: the slow down?**

NEWS FROM JESA! Location, location, location

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

In 2011 we have witnessed a new approach to Foreign Direct Investment in China. Italian companies seem to be more mature in the approach to the market and they are more oriented to the internal demand their peer companies in the past years.

Nonetheless, during our discussion with Clients, we still face, in several cases, resistances and myopia in the selection of the location, especially when establishing manufacturing plants. We have always believed that this is a crucial point with the same importance of the understanding of the market of destination.

We tend to suggest our Clients to carry out an independent evaluation of the location that takes in consideration many factors, such as logistics, human resource availability and turnover, governmental support, presence of related industry and plans of future development. This analysis aims to avoid that factors specifically related to the time of investment affect the decision blurring the understanding of future needs of the company development. There are many different industrial and development zones all around China, and just for reference in Jiangsu Province there are 12 National level development zones and 124 provincial level zones. While in Zhejiang Province they are 6 and 65 respectively and

in Chongqing Municipality 2 and 22, and many of them may offer comparable solutions.

It happens often that Clients have already heard about a particular zone, where other companies from the same industry and same country are already successfully located. At this point it is very difficult to let the client understand in an objective way whether that zone is really the most suitable for the business and future plans and sometimes the decision taken without comparison with other area has later slowed down the development of the activities and sometimes has been also necessary to move the entire plant somewhere else. Our suggestion is to avoid being attracted by those areas where there is a concentration of companies located there without following industrial or commercial logic, often negatively affecting the primary goals of the company and its costs and risk evaluation.

Bearing this in mind, Jesa supports foreign companies in all steps of analysis and implementation of their business in China, considering the long term targets of the project and not only those that seem interesting in the short run.

* * * ITALIAN VERSION * * *

Nel 2011 abbiamo constatato un nuovo approccio delle imprese straniere agli investimenti in Cina. Le aziende italiane sembrano ora più mature nell'approccio al mercato e sono più rivolte alla domanda interna dei loro *competitors* in passato.

Ciò nonostante, durante gli incontri con i Clienti, troviamo ancora resistenza e miopia nella selezione della *location*, soprattutto quando si tratta di stabilimenti produttivi. Abbiamo sempre sostenuto che tale decisione sia cruciale e di pari importanza alla comprensione del mercato di destinazione.

Tendiamo a suggerire ai nostri Clienti un'indipendente valutazione di diverse aree che prenda in considerazione fattori quali logistica, disponibilità e turnover di personale locale, supporto del governo, presenza di aziende in settori correlati e piani di sviluppo futuro dell'area. Tale analisi ha l'obiettivo di evitare che fattori specifici al momento dell'investimento offuschino la comprensione dei bisogni futuri e dei piani di espansione dell'attività. Ci sono tantissime aree industriali in Cina, e solo per fornire un esempio nella sola Provincia del Jiangsu ne sono presenti 12 di livello nazionale e 124 di livello provinciale, nella Provincia dello Zhejiang rispettivamente 6 e 65 e nella Municipalità di Chongqing 2 e 22 molte delle quali possono offrire alternative perfettamente comparabili tra loro.

Spesso avviene che i Clienti abbiano già sentito di una particolare zona, dove società simili hanno già investito con successo. A questo punto è spesso difficile far capire al cliente in modo oggettivo se tale area è davvero idonea ai piani futuri e spesso tali decisioni si sono dimostrate motivo di rallentamento nello sviluppo del progetto se non addirittura di investimento da zero in

una nuova area. Il nostro consiglio è quello di non farsi attrarre da zone dove ci sono pool di aziende spesso aggregatesi in zone non tanto per criteri industriali o commerciali ma solo per fare gruppo, spesso a scapito degli obiettivi primari dell'azienda stessa e a costi e rischi più elevati.

Tenendo questo ben presente, Jesa supporta le imprese straniere in tutti gli step di analisi e implementazione delle attività in Cina, tenendo conto degli obiettivi di medio-lungo termine del progetto e non solo di quelli apparentemente interessanti nel breve.

Social Security Law took effect on October 15th

The New Chinese Social Security Law, as already reported briefly in our July Newsletter, took effect on October 15th 2011. For Chinese nationals the new law represents no dramatic change, indeed to a large extent it merely codifies existing practice. The same is not true, however for foreign nationals working in China, which will enjoy retirement, work injury unemployment and maternity benefits similar to those for Chinese citizens.

According to the new Law, all registered foreign workers with valid work permit in China will be covered. Considering that the latest 2010 census recorded nearly 600.000 foreigners living in China, it is estimated that approximately 231.700 will take part into the new social

security. This represents a milestone, as up to know only certain local regulations (e.g., in Shanghai for medical, pension and work related injury insurance) provided voluntary options for foreigners to participate in the Chinese social insurance system.

When the new law was issued in July 1st 2011, it caused havoc in many companies hiring foreign staff and in foreign workers. The main concerns were about:

- **Rising costs** for employer of about 37% and **shrinking salary** of 11% for the employees. It is true that most cities implement a ceiling on contributions, which is usually three times the average monthly social salary over the previous year, so corresponding maximum contribution for employers and employees will be about 4,400 RMB per month and 1,400 RMB per month respectively on average. Even though this seems to be the current situation, this is a topic to bear in mind because it may be subject to future changes.
- **Real benefits for foreigners:** it is not clear whether foreigner will be able to get the money in their pension account when leaving China and it is not clear how the unemployment fund and maternity fund will work for foreigner workers. Also, it remains to be seen how contributions will be treated if foreigners permanently leave China before being entitled to draw a pension. (Currently, these benefits can be drawn by females starting at the age of 55 and males at 60, provided a minimum contribution period of 15 years was

achieved.) The current understanding is that foreigners can only claim reimbursement of contributions made to their personal social insurance accounts. (Contributions are allocated between a personal account for each individual and a pooled account for the entirety of the insureds.) Given these uncertainties, more detailed regulations governing these matters are expected.

- **Double taxation:** Another relevant concern comes from the concrete possibility to be taxed both in China and in the country of origin (in case of foreigner workers assigned to China by overseas registered companies).

With reference to the latter point, another implication arising from the new law is that China will probably enter into new bilateral social insurance agreements with other countries in order to avoid the necessity of dual participation in social insurance programs in China and the foreigner's home country. Thus far, only a few such bilateral agreements exist, for example, with Germany and South Korea. On this extent China should negotiate and sign social insurance agreements with more countries to avoid foreign workers being double charged and to better protect their rights. At least 10 countries included Unites States, Japan and Russia are starting a negotiation table with Beijing.

On a strategic and long term point of the move could discourage multinationals from sending foreign workers

to China in the future, while employees will be concerned about another raid on their salaries. Income tax in some cities in China is already charged at 45 per cent at the top tier. Given China's hunger for foreign talent, especially in cities such as Shanghai, it has been quick to promote the benefits for foreign workers, but consider the rising costs, several employers may prefer to limit the presence of expatriates in the Country.

This is surely a move that makes China much similar to more developed countries where the regulations and treatment of social security for foreigners are already in place since long and where foreign workers are allowed to opt-out of local social insurance payments if they are contributing into a similar scheme in their home country. Of course China needs time to adjust and identify the most suitable way to implement such regulations and surely new details will be released in the near future.

We will closely watch the development of this regulation and consequences of it.

Third quarter economic data: the slow down?

China's economy is unlikely to experience a double-dip growth pattern as third-quarter growth remained stable: gross domestic product in China managed to expand 9.1% from a year earlier between July and September, only a slight slowing from 9.5% in the second quarter and

9.7% in the first three months.

The economic output in the first three quarters thus rose to 32 trillion yuan (US\$5 trillion), up 9.4% year on year.

Surely it is not easy to achieve such a growth under the global economic situation but thanks to a stable investment and increasing consumption China's economy is more likely to continue stable growth. The main reason behind this lower GDP growth was export slowdown because of global situation and tight monetary policy. Export, which was the main driving force of its economy, was slowed significantly in the last quarter because of lower demand from the western developed economies. China exports grew by 17.1% year on year, and this is the lowest growth rate since February, while imports increased by 20.9%.

According to analysts' opinions China's economy performed slightly better than expected in the third quarter, mainly thanks to solid domestic demand. With a global economic downturn in sight and inflation still high, China needs to keep its policies consistent while flexible.

China not only possesses a huge consumer market, it also has high demand for commodities and energy-related goods, thanks to its rapid economic growth and limited resources. Retail sales in September gained 17.7% from a year earlier to 1.58 trillion yuan, up from 17% a month earlier.

At the same time, tight monetary policy by the Central

bank of China to tame inflation has led to high borrowing cost which has also affected the industrial and economic growth in the same quarter. In spite of continuous rate hike by the central bank, Chinese inflation was still at much higher level of 6.1% in September.

Recent reduction of inflationary pressure has made it possible for China to adjust its monetary policies in a bid to support growth. The Consumer Price Index, the main gauge of inflation, rose 6.1 percent year on year last month, moderating for a second month from August's 6.2 percent and July's 6.5 percent.

With lowering export demand and higher inflation, the GDP growth is expected to fall further in the coming quarters. Many economists predicted that the nation could see GDP growth of about 9% for the whole year, compared with 10.4% in 2010.

Despite strong growth in domestic investment, analysts said that the nation should make renewed efforts to boost domestic demand as global economic prospects continue to dim. The country is still capable of implementing a stimulus to shore up the economy if required. But any stimulus would be smaller than the package of 4 trillion yuan (\$627 billion) introduced in 2008. That's because the country has learned the lesson that the earlier package was too large and too rushed.

CONTRIBUTORS

Scott Sun (supervisor)
Saro Capozzoli

For inquires and suggestions regarding this newsletter or for any other concerns, please contact us anytime at:

elena@jesa.com.cn
francesca@jesa.com.cn

And please visit our website:

www.jesa.com.cn

Our Newsletters:

<http://www.jesa.com.cn/newsletter.html>

ADDRESS IN SHANGHAI



HOUSE 4, LANE 112, FENYANG RD.
200031 SHANGHAI - CHINA

Tel +86 21 64331555
Fax +86 21 62880072

LEGAL NOTICE

The content of this newsletter is composed and written by JESA, and thus it is not reproducible and cannot be diffused indiscriminately without JESA's consent. The purpose of this newsletter is to keep our contacts informed about important changes occurring in China; any use of it that differs from the initial purpose must be authorized by JESA.

SPECIAL MENTION:

This is last newsletter prepared by **Elena Veneziani** since she will start soon another fresh and challenging experience for her career. We would like to thank her so much for the detailed work to analyse and preparing articles about interesting news for all of us, but also to "catch" and force me to prepare and discuss the "Saro's Thoughts", the article that opens the newsletter.

From next month **Francesca Sardini** will take care of our newsletter and she will update all of us about what it is happening in China and the new trends.



Please consider the environment before printing this document