

FDI In China's Middle Enterprise Sector

TEXT / LIM LEE MENG

China's rapid economic growth over the past three decades has attracted a tremendous amount of foreign direct investment (FDI). During the early years following the PRC's 1978 opening, many of the world's leading multinational corporations established manufacturing platforms in China. Now a rising number of mid-sized companies are undertaking direct investments in China.

sector. Mid-sized companies entering China often enjoy flexible marketing and nimble operations, and are eager to leverage those assets for profitable growth. But these companies typically lack a deep knowledge of China's foreign investment environment, and must stay abreast of ongoing shifts in the country's FDI regulations to achieve their growth objectives.

Key Developments In Chinese FDI

In addition to reducing tariffs on most imported goods, China's accession to the World Trade Organisation (WTO) in 2001 lowered entry barriers to foreign investors. However, not all Chinese industries are fully open to foreign investment.

China's Foreign Investment Guide specifies four FDI categories: Encouraged, Permitted, Restricted, and Prohibited. Agricultural technology, export manufacturing, environmental management, industrial safety, and other high-priority industries are included in the "encouraged" category. Defense and related industries deemed critical to national security are placed in the "prohibited" category. Per China's WTO agreement, the Beijing government is broadening foreign investors' access to banking, insurance, franchising, architecture, and other formerly restricted industries.

China's Corporate Income Tax (CIT) reform of January 2008 is also transforming the country's FDI environment. That reform harmonises tax rates for domestic and foreign companies, prescribing a step-wise increase in the CIT leading to a uniform rate of 25% in 2012. The result of this measure is to reduce tax incentives for foreign-owned enterprises, which previously paid a preferential rate of 15 percent.

Despite the less favorable tax environment, inbound FDI reaching China has actually increased since the enactment of the CIT reform. Data released by the PRC government show the following

FDI totals from China's top ten investing countries for 2009:

China's Top 10 Investing Countries for 2009

Country	USD Billion
Hong Kong	53.993
Taiwan	6.563
Japan	4.117
Singapore	3.886
USA	3.576
Korea	2.703
Britain	1.469
Germany	1.227
Macao	1.000
Canada	0.959

China's continued success in attracting foreign direct investment despite the elimination of tax incentives demonstrates the country's competitive advantages as an FDI destination: High GDP growth rate, huge domestic market, low labour costs, large installed multinational base, and proximity to the dynamic Asia-Pacific region.

Moreover, other recent changes in Chinese business law (including reforms of the country's Anti-Monopoly, Labour Contract, and Merger & Acquisition Laws) have heightened China's allure to foreign companies. Mid-sized companies lacking experience in China would be well advised to engage consultants to help navigate the country's evolving legal environment.

Foreign Investment Modes

Prior to WTO accession, foreign investors surveying China were ordinarily limited to joint ventures. But foreign companies now enjoy a wide range of entry modes: Mergers and acquisitions (M&A), Representative Offices (RO), Wholly Owned Foreign Enterprises (WOFE), and Foreign Invested Commercial Enterprises (FICE).

Middle enterprises entering the Chinese market must carefully align these investment modes with their strategic objectives. Many mid-sized companies are undertaking WOFEs, while others are converting their Chinese ROs into WOFEs to advance their market expansion plans.

More aggressive players are launching cross-border M&As, illustrating the impact of WTO-mandated changes in China's foreign investment laws and deregulation of the country's capital market. Mergers and acquisitions offer important advantages over greenfield investments, especially opportunities for rapid capture of local market share. The Beijing government's acceleration of privatisation/restructuring of State Owned Enterprises (SOEs) is widening the domain of suitable M&A targets for mid-sized companies seeking to expand their Chinese operations.

Outbound FDI

Under the "Zouchuqu" (to venture out of China) policy, the Chinese government encourages local enterprises to venture into overseas markets either through M&As or greenfield investments.

Heretofore outbound investments by Chinese companies have focused on hydrocarbons and raw materials. Chinese authorities anticipate an expansion of outbound FDI in key manufacturing industries (notably automobiles and capital equipment), Information Technology, and financial services. South East Asia, South Asia, Africa, and the Middle East have received the bulk of Chinese foreign investment. However, Chinese companies are increasingly looking to the developed Western markets for M&A opportunities to access advanced technologies and acquire international brands.

With rapidly expanding foreign reserves and increasing purchasing power resulting from RMB appreciation, Chinese outbound investment is likely to post strong growth rates in the coming years. China's large SOEs, which enjoy financial and political support from the Beijing government, will continue to play the lead role in foreign investment.

But Chinese middle enterprises, often supported by provincial or local governments, are now launching overseas investments. Mid-sized companies are building manufacturing bases in lowcost countries like Vietnam and Cambodia along with trading hubs in entrepots like Hong Kong, Singapore, and Dubai. Foreign real estate is also attracting growing attention by Chinese middle enterprises as well as wealthy individuals. SA

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Middle enterprise FDI in China covers a wide range of service industries as well as the country's core manufacturing