



TALKING POINTS

FDI in China's Middle Enterprise
Sector

Lim Lee Meng
RSM Chio Lim

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TALKING Points

FDI in China's Middle Enterprise Sector

- Inbound foreign direct investment in China, a sphere long dominated by large multinationals, now includes a rising number of mid-sized companies.
- The PRC government actively promotes foreign investment in high technology and related industries placed in China's "encouraged" category.
- WTO-mandated liberalisation of China's foreign investment laws is widening foreign investors' access to financial services and other sectors previously designated as "restricted".
- China's January 2008 corporate income tax reform harmonises rates for domestic and foreign companies. But the elimination of preferential taxes for foreign-owned enterprises has not slowed the pace of inbound investment reaching China, demonstrating the country's locational advantages as an FDI destination.
- Recent changes in China's Anti-Monopoly, Labour, and Merger and Acquisition Laws illustrate the dynamic evolution of the PRC's foreign investment environment, underscoring the need for professional guidance of middle enterprises lacking experience in the country.
- While joint ventures have historically dominated foreign investment in China, WTO-related legal changes have broadened the array of entry modes available to foreign investors, including wholly owned foreign enterprises.
- A growing number of middle enterprises are undertaking mergers and acquisitions in China, illustrating the strategic advantages of M & As over other investment modes.
- Parallel with the rise in inbound foreign investment by mid-sized companies, outbound FDI by Chinese middle enterprises is growing in response to China's expanding foreign reserves, appreciating currency, and support by local/provincial governments.
- While the bulk of China's overseas investment is destined for other emerging/developing countries, an increasing number of Chinese middle enterprises are pursuing investment opportunities in the developed Western markets.

FDI in China's Middle Enterprise Sector

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.

Middle enterprise FDI in China covers a wide range of service industries as well as the country's core manufacturing 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 Organization 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 between January and April 2008:

Country	USD Billion
Hong Kong	15.105
Virgin Islands	6.336
Singapore	1.694
Japan	1.526
Korea	1.245
USA	1.202
Cayman Islands	1.061
West Samoa	0.952
Mauritius	0.681
Taiwan	0.649

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 theater.

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 privatization/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 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 low-cost countries like Vietnam and Cambodia along with trading hubs in entrepôts like Hong Kong, Singapore, and Dubai. Foreign real estate is also attracting growing attention by Chinese middle enterprises as well as wealthy individuals.

The author is Lim Lee Meng, Senior Partner, RSM Chio Lim, the Singapore member firm of RSM International.

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Biography

Lim Lee Meng



Mr Lim is the Senior Partner of RSM Chio Lim, and the director of the China Practice Group of RSM International. He also coordinates the inbound and outbound Chinese business of RSM International.

In addition to his audit and tax portfolio, he also provides advice to companies on cross-border investments and initial public offering.

Outside his profession, Mr Lim is the independent director of 6 listed companies in Singapore, and is a familiar face on national television, where he has been invited to comment on the Singapore Budget for many years.

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