



New Entry Points

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When thinking about entering or expanding business in China, many companies assume that major cities like Beijing or Shanghai are their best bets. While many Canadian firms do base their operations in these cities, increasingly we advise companies to look outside these established strongholds. The Chinese government certainly is encouraging this. One of CCBC's themes in 2008 has been *New Entry Points* — helping our members to understand where they might want to go next (or first). In this article, we look at three key areas of opportunity: Southwestern China, Liaoning Province, and Hong Kong.

There is no question that a world of opportunity exists, and the Chinese government sees the opportunity to develop nontraditional areas as key to ensuring balanced geographic development. Traditional southern and coastal markets are not so much saturated as they are not encouraged at the moment. Many Canadian firms are surprised to find that governments in cities like Shanghai will plainly tell them **not** to invest in their city, but rather to go inland. The central government has a powerful interest in developing these areas, and this is reflected in changes to taxation and incentive policies, which make it cheaper and easier to do business outside the established coastal areas.

Chongqing and Chengdu

In April 2008, CCBC led a mission of member firms to Chongqing and Chengdu to explore opportunities in these two beachheads of China's *Western Development Strategy*, which was announced in September 1999 to address the widening income disparity between the east and west. Paramount in this strategy's agenda are industries including transportation, telecommunications, energy, urban infrastructure, forestry, mining, minerals, agriculture, environmental protection, water conservation, professional services (legal, financial) and education (including professional training).

Canada has expertise in all these high-priority industries and therefore should be able to benefit from these growing opportunities. The CCBC mission joined with 100 Canadians in seven different delegations that went through Chongqing in one week. Some were focused on science and technology, others on education, and the CCBC group was particularly focused on exploring investment from this region into Canada.

Our goals were similar in Chengdu, and, while the cities are radically different, the energy and pace of change projected in both cities were equally impressive. Perhaps the most notable tour we took in Chengdu was of an industrial park that was attracting

business investment at the same time it was assisting rural residents in urbanizing by moving them into residential areas within the park.

By promoting industrial development concurrently with the urbanization efforts, they were able to ensure that these relocated peasants received the social security, training, and jobs they would need to make the transition smooth.

At the same time we saw this urbanization and the overall creation of a stronger labor and consumer market locally, we observed a strong trend of wealthy Chinese from coastal areas purchasing luxury property in Chengdu, indicating just where local Chinese see the future opportunity.

Chengdu's aggressive agenda was demonstrated by its mayor, GE Honglin, who brought a delegation of Chengdu businesses to CCBC's policy program in Beijing in January 2008. In meetings with CCBC members firms in areas like air transportation and automobile manufacturing, GE, who is a graduate of the University of Windsor, demonstrated the desire and wherewithal to bring business to Chengdu and to build the infrastructure to support it.

Go West

Since the *Go West* policy began, China has been actively developing its Western Provinces. Although many aspects of business in the region have improved, the one that represents the biggest contrast to the past is infrastructure. High transport costs used to make it feasible only to focus on regional operations – exporting was too expensive. Now, many who choose not to export their products do so for another reason – a blooming local consumer market that demands that these products stay in the region. Chengdu, for example, is China's third-largest market for car sales.

It made quite an impression on us when participants in one of CCBC's afternoon session during our visit were because a large outdoor trade show focused on the recreational activities consumers can undertake with their cars was holding up traffic.

Members on our mission had very positive things to say about the region. One told us, "It was an education as a private sector Canadian businessperson to see the rapid business development activity in China and their movement to market mechanisms. The visit created specific opportunities for our company and I believe the mandate of Canada/China Business Council should be enhanced to provide further resources to facilitate for Canadian business."

Another stressed that practical business opportunities must accompany the government policies. "I have traveled to that part of the world for a long time and have seen the development in the west and also the limitations. The selection of location should be driven by the need of companies and the markets. The policy alone would not be the draw, and it has to be the bottom line issues and profitability." This delegate went on to stress that firms should look for their market niche and area of focus in China's second- and third-tier cities as they explore.

Of course, the May 2008 earthquake that devastated Sichuan province alters the opportunities somewhat. The growth and development are still there, and the major cities in the region have quickly returned to business as usual. However, the priority for investment has changed, with strongly-encouraged sectors such as infrastructure and building materials joining high-tech, cultural tourism, equipment, manufacturing, modern agriculture. Total investment related to post-earthquake reconstruction is expected to top one trillion RMB (\$142 billion CAD), according to the MOFCOM Chengdu office.

While the government focused on Western China and coastal regions developed nicely by themselves, other regions of China have found themselves in need of additional support. The Central Provinces (HuNan, HuBei, HeNan for example) are areas of recent attention that CCBC will address in its November AGM program in Beijing.

Five Points One Line

Meanwhile, in the “rust belt” of the Northeast, Liaoning province embarked upon an ambitious effort in 2005 to develop its coastline through a project called *Five Points One Line*. The five points, (highlighted on the map) represent five key development areas in Dalian, Yingkou, Jinzhou, Dandong and Huludao, and the “line” represents a new motorway along the coast.

According to LI Hong, Chairwoman of the Liaoning Chamber of Commerce in Shanghai, the transportation links being built up along this line will make intra-provincial travel extremely efficient. LI commented, “This strategy will completely push open the progress for those coastal economic development areas, improve the port industry and coastal economics, and foster new economic growth points and dense industrial zones.”

Provincial officials often stress the very low real estate price incentives that are being offered as part of this program (music to the ears of those reeling from the property value increases in other major cities!).

As the only coastal province in China’s Northeast, Liaoning intends to build on its coastal capabilities, such as in shipbuilding and aquaculture. Liaoning is one of China's most important industrial bases, covering a wide range of industries, such as energy, petroleum, coal, aerospace, mining, steel, metal refining, shipbuilding, automobile, chemical industries, industrial robots, medical equipment, biological pharmaceutical, and IT.

Some have questioned whether this strong focus on growth will come at the expense of the environment. Liaoning is well aware of the environmental risks of this new growth and has pledged to “build a new industrial base in a scientific way, ensuring efficient use of natural resources and environmental protection,” according to China’s Executive Vice Premier and former Liaoning party secretary, LI Keqiang.

To that end, the province will spend its additional revenues from investment on environmental protection projects.

Map of 'Five Points & One Line'



(1) Dalian Changxing Island Harbour Industrial Zone
Area: 129.7 square kilometers

(2) Liaoning (Yingkou) Coastal Industry Base
Area: 120 square kilometers

(3) Jinzhou Xihai Industrial Zone and Huludao North Port Industrial Zone
Area of Jinzhou Xihai Industrial Zone: 22.79 square kilometers
Area of Huludao North Port Industrial Zone: 21.87 square kilometers

(4) Liaoning Dandong Industrial Zone
Area: 30 square kilometers

(5) Dalian Huayuankou Industrial Zone
Area: 50 square kilometers

Hong Kong

Finally, one of the old points is one of the new points – the *Hong Kong Special Administrative Region* (HK). Even for larger firms which start elsewhere in China or have moved their China headquarters from HK to the China Mainland, many find that

HK still plays a vital role. But for SME's, which make up the bulk of the Canadian economy, HK offers advantages of 1) ease of setting up business, 2) a strong banking and legal system and 3) tax advantages and transparency. HK is part of China and can be the easiest way for SME's to get started.

Elizabeth Thomson, President of CCBC member firm ICS Trust, has worked in Hong Kong for more than two decades and helps many Canadian firms to run their business in China through HK. She says that HK buys firms a quick and simple process, where within two to four weeks ICS can set up a whole corporate structure, allowing a firm with pending deals to put them through.

Thomson doesn't diminish the role of a China base, but she finds HK often offers the most straightforward path. "We see people who have been dithering about a decision because they are totally confused by the different viewpoints and advice they're getting. In China you can't find the kind of simplicity, with a straight end-to-end process, that HK offers. In HK, you are dealing with a very lengthy history of legal and banking systems and a common law platform familiar to most Canadians. We can easily tell clients how long it will take, how much it will cost, and what you will get, something that is hard to achieve in China."

Another factor that ICS often sees in SME's is a just-in-time urgency. Many are just now pursuing a strategy they should have been looking at five years ago. They ask "how can we do this now without a team of lawyers and accountants already added on to our meager group of senior-level people?" SME's just don't have the wherewithal, deep pockets, and financial resiliency to jump right into China that multinational corporations (MNCs) do.

MNCs have many people running around, but an SME is lucky if it has a person or two handling all of Asia.

To cover everything they have to do in Asia and China becomes impossible with an overly-full calendar back home at headquarters. A lack of people resources, lack of time, and lack of deep pockets means that setting up in Hong Kong, and even using a firm like ICS Trust to establish their corporate structure and be their back office for China is the path of least resistance.

Ultimately, there is no single answer about the best entry point. Much depends on your sector, your end customer, and your existing relationships within China. But as our three examples of Southwestern China, Liaoning and Hong Kong SAR show, it is important to consider your options and to look beyond the established ports of call when making a decision on where to invest next.

HK advantages

In addition to the straightforward procedures and comfortable familiarity with HK's business environment, ICS President Elizabeth Thomson says there are two key reasons

that all firms should include HK in their China structures, even if their operations are very mainland focused -- ease of exit and a low-cost tax system.

- 1- As success in a China venture is never guaranteed, a firm needs to have an exit strategy. Using a HK holding company, a firm looking to exit can sell the assets or shares, just as they could in any Canadian province. In China it would take six months to a year to accomplish that same end.*
- 2- HK has an old colonial system of taxation with corporate profits taxed at 0-16.5%, while China has chosen to have a fairly expensive tax system that compares to Canada or the US. “At the end of the day, Hong Kong is the only sensible corporate legal tax gateway...It’s not necessarily easy to achieve and takes lot of work to learn, but in these economic times, all good business people need to look at how to add to the bottom line – profitability!” claims Thomson.*