PRAGMA

The China Newsletter

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Jesa

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Welcome to the June 2009 edition of Pragma's China Newsletter, prepared by Jesa

News from Jesa

by Saro Capozzoli
Founder and GM of
Jesa Investment &
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The end of June is at our doorstep and it is time to start summing up the results of the first semester of this year. As far as our company can report, two different behaviours and perspectives can be underlined: the point of view of foreign companies and the one of their subsidiaries in China.

If one observes China from abroad, as a new investor, one can note a slow down in decision-making process.

As a matter of fact, several projects have been postponed or slowed down. Despite the efforts of the Central Government to ease procedures - delegating some powers to provincial authorities for the approval, the setting up and the management of foreign invested companies -, the Ministry of Commerce announced that foreign investments in China plunged of 21% year on year in the first four months of 2009.

On the other hand, for an observer from China, these decisions are lost chances to enjoy internal favourable conditions.

Indeed, besides the governmental efforts to ease the investment approval, there are several data that are worth considering. For instance, the cost of the land has decreased of 30% as well as the rent fees of productive buildings and offices. Generally speaking, this is the best time to find more reasonable prices and make the most of these advantages to get started on the right foot in China.

For companies having outsourcing activities in China, this is the right time to negotiate with suppliers to get better conditions or to start renewing the pool of suppliers.

Moreover, companies with good financial situation and risk sustainability can consider Chinese companies as potential targets for acquisition. The best targets are companies belonging to interesting industrial sectors able to speed up the path of market penetration. A stable presence in the market is one of the key factors of success for foreign companies.

With the current global slowdown in the countries where mother companies are located, the Chinese domestic demand could represent a breath of fresh air… despite Chinese pollution, of course.

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What is Jesa?

Pragma's and Jesa's logos in Shanghai

Jesa is a service company headquartered in Shanghai specialising in facilitating start-up of new industrial productions while providing reliable management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia).

Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 save technicians following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on every single commercial and technical issue.

Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients financial resources and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shooting analysis) to verify performances in support to companies already established in China, and we provide tax and accounting consultancy.

Chinese overseas direct investments

While business around the world may suffer the ongoing financial crisis, Chinese biggest companies are looking abroad for investments. The Ministry of Commerce has released a guideline for overseas investment to help Chinese companies seek overseas opportunities.

This guideline comes as a consequence of the eager commitment of Chinese companies to invest overseas. It includes investment laws, regulations and statistics of more than 20 countries but it is expected to cover 160 countries by the end of June.

China's overseas investment has been increasing rapidly in recent years. In 2008, the country outbound investments in non-financial sector soared by 63.5% to USD 40.65 billion. The contract value of projects in foreign countries went up by 39.4% to USD 56.6 billion.

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The fast-growing domestic market is not stopping the Companies in their "going-global" path. The most obvious reason behind this is to acquire technology and know-how. Chinese companies aim to reach the quality level and R&D capability to compete with more mature US and European companies.

Another reason to make overseas acquisition is the market diversification and the acquisition of global consumers, to gain distribution overseas and penetrate new markets.

Moreover Chinese are pulled by developed economies that are facing increasing needs of funds to boost the recovery of a host of their companies.

Three are the main kinds of investment that are driving China abroad.

The first types of deals involve Chinese State Owned Enterprises that are taking stakes in overseas commodities firms. Since 2005 many cases have been concluded successfully, allowing China to enter and participate in foreign companies capitals. In 2005, China National Petroleum Corp acquired Canadian-owned Petro Kazakhstan for US $ 4.2bn. Three years later, in 2008, China Petrochemical Corp (Sinopec), the second-largest Chinese oil producer, acquired Canada's Tanganyika Oil, operating in Syria, for US $ 1.9 bn. The state-owned Aluminum Corp of China (Chinalco) offered US$19.5bn for an 18% participation in Rio Tinto, an Anglo- Australian mining company but the whole deal is delayed by an infinite series of regulatory checks.

A second type of overseas direct investment is the state-to-state, loans-for-oil deal. Last February, to ensure energy supplies from different countries, the Chinese government provided billion in loans-for-oil deals to Russian, Brazil and Venezuela oil companies in return for interest and the right to buy hundreds thousands barrels per day of oil for 20 years. Funding for these loans has come from the China Investment Corp (CIC), a sovereign wealth fund created in 2007.

A third type is the investments that both state-owned and private companies do in non-resource sectors such as computers, automobiles and engines. Among these the most important cases are the US$1.7bn purchase by Lenovo, a leading Chinese computer manufacturer, of US-based IBM's personal computer business in 2005 and a US$2.4m acquisition in February 2009 by diesel engine giant Weichai Power of Moteurs Baudouin, a French marine diesel-engine maker.

This picture doesn't exclude that the internationalisation process is without risks and limits for Chinese investors. First of all, a foreign currency restriction is in force and this makes hard the approval process for the convertibility of the Renminbi. For the record, it is worth to say that this is now changing as the Government encourages the overseas investments.

The limits and risks are also represents by the political consequences of some of previous bids that have made many potential acquirers more cautious. When in 2005 China National Offshore Oil Company Ltd (CNOOC) offers to purchase an American Company, Unocal Oil Company, a political storm was triggered and CNOOC withdrawn the offer. The Global economic crisis is impacting as well on this process causing the decreasing of attractiveness of overseas markets, due to the state of flux entire industries are suffering.

Lastly it cannot be forgotten the host of management issue brought by an overseas acquisition and Chinese companies are ill-equipped to address differences in management style, legal systems and cultural gaps. The overseas thirsty is however newly confirmed by the Chinese Prime Minister Wen Jiabao that announced that a new purchasing delegation will be sent to Europe very soon to increase imports from the area and reinforce the positive results of the previous one.

China recovery

At the end of May, the Government announced that the Chinese economy will reach in 2009 8% of growth. In the Chinese culture, eight is a lucky number because the pronunciation sounds like the word prosperity. Reminding to the ancient traditions and combining a massive financial stimulus the Government's target might be feasible. At the beginning of this year, such a growth was considered to be impossible due to the deep global recession that causes astonishing plunge in the export, the fall of the growth rate to 6.1% and 20 million of unemployed around the Country.

The same economists that doubted so much about the Government's target feasibility are now revising their forecast. There are evidences that China is turning the corner and is leading out itself – and the rest of the world? – of the global economic crisis.

For the record, economists often doubted the credibility of Chinese data regarding the growth of its GDP and even if they still think that the Government might be up to this kind of tricks, it is reasonable believe that data are correct.

Paul Cavey, an economist at Macquarie Securities, explains that this year the GDP growth is 6.1% higher than last year, even if the electricity production (two variables that historically are used to grow together) was 4% lower than it had been a year earlier. This discrepancy is due to the fact that energy-guzzling heavy industries (steel and aluminum) bore the brunt of the slowdown last year. Steel output fell by more then 10% to the fourth quarter, so it is hardly surprising that energy use dropped.

In April, the PMI (Purchasing Manager Index) reported the largest month on month increase in the PMI's five-year history, breaking into expansion territory for the first time since July 2008. This demonstrated that the manufacturing sector has begun a sustainable recovery.

Moreover for the first time in nine months, Chinese Manufacturers are raising their staffing level. This situation may also improve customer sentiments toward the consumption boosting home and retail sales growth.

According to analysis on the car sales during April, unit sales for top 25 car assemblers were up 23.6% year on year, compared to the 2% rate of growth registered in the first quarter.

China is strengthening the intellectual property protection

China has launched a national plan for intellectual property rights and it is strengthening the protection of intellectual investments, increasing the compensation for infringements.

PRC officials are increasingly aware of the importance of the intellectual property protection for an innovative economy and, as demonstrated by revisions to the IPR law, seek to improve legal frameworks and channels through which companies can protect their intellectual property investments.

For this reason the Supreme Court has stressed in several occasions that shall be adopted a flexible and practical method to calculate the damages in case of infringement in order to adequately compensate the right owner.

It is moreover foreseeable that in 2009, the Court will place stronger evidence on the balance between the interest of the rights owners and the interest of the public, and prevent the rights owners from abusing their power. This means that the standards applicable to patent infringement determination may be tightened.

China is both trying to protect foreign companies' rights from increasingly sophisticated Chinese counterfeiters (and enforce the international treaties signed) and Chinese companies that are enforcing even more patents against foreign firms.

Chinese companies are in fact just as eager as Western firms to protect their investments aiming to be the brain of the world as they already are the factories. The applications for patents in the country's patent office have reached the biggest volume in the world with more than 800.000 applications filled in 2008. Most of them are technologies that undergo minimal review and receive only a 10-year term.

In the other hand Chinese companies are increasingly filing for "invention" patents that receive 20 years of protection. Chinese companies in 2009 will surpass foreign ones in receiving "invention" patents in the country.

Chinese firms are also increasingly protecting their patent abroad, a sign that they want to protect them when exporting products to rich countries.

Revision of the patent law that is taking into effect in October strengthens the requirements for the patent's novelty, bringing it up to global standards.

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