Foreign investment in China for Post-Pandemic Growth

--A Guide to Strategic Considerations, Site Selection and Economic Zones

February 2023

Disclaimer

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Executive Summary

With the removal of the "zero-case" policy, China has regained the momentum for its economic recovery. China welcomed 2023 by ending this drag on its economy growth and reconnecting to the world. The international community also sees this move as a positive sign, with the International Monetary Fund (IMF) predicting that China's GDP growth will rise to 5.2% in 2023.

Domestically, the central government has undertaken massive stimulus measures to stabilize the fundamentals of China's economy. However, an ageing population, weak consumption and supply chain disruptions, coupled with pressure to transform and decarbonize industries, have increased macroeconomic uncertainty. Efforts to decarbonize economy, promote innovation, stimulate consumption and boost exports and imports are now more strongly encouraged than ever. The Government is working to steer the economy onto a more sustainable and balanced path.

China continuously widens the market access to foreign businesses. Notably, the recently released Foreign Investment Law, along with a decreasing negative list and a growing list of industries that encourage foreign investors, is sending a clear signal. China is trying to attract and retain more foreign investment by cutting back on the numbers of restrictive industries and deregulating foreign investment. China is also keen to expand its global trade network and create more scenarios for foreign direct investment.

China's economic zones continue to be the main area that accommodate foreign investment, especially for manufacturing industry. Since 1978, China has established more than 700 national-level economic zones and up to 15 types of economic zones across the country to stimulate and promote foreign direct investment. This model has proven to be a success for both Chinese and foreign investors. Economic zones have become a major source of economic growth, with investors benefiting most from preferential policies, advanced infrastructure and a sound business environment. The main types include Economic and Technological Development Zones (ETDZs), High-tech Industrial Development Zones (HIDZs) and Special Customs Supervision Zones (SCSZs), each with a unique set of characteristics, objectives and incentives that create a strong investment potential. However, current economic dynamics require a deeper understanding of the characteristics of these development zones, which often confuse investors but are crucial to site selection. Beyond the basics, the internal operation procedure and regulatory system of a development zone are key parameters for investors in developing their business strategy and navigating the uncertainty of the future.

Site selection requires more resilient decision-making and adaptive strategies. Location is a key determinant of the long-term development and thriving for business, going beyond short-term financial metrics. In addition to simple cost-oriented considerations, a more flexible and holistic model that includes cost saving to expand benefits, flexible supply chain networks, assessing national and regional policy incentives, bridging cultural gaps and identifying the potential benefits of industry clusters should be more applicable to today's business environment.

High-tech manufacturing has been identified as a priority for China's economic development. Automobiles, green energy, semiconductors and biomedicine have attracted and will continue to attract more attention from the government and investors. Multiple pressures have prompted local governments to provide more aggressive fiscal policies and improve the business environment. Companies are also working towards self-reliance and alternative solutions to improve supply chain resilience. Investors should keep follow up and take advantage of industry policies, combined with local resources, to create more value and ensure business growth for the foreseeable future.

1. The Macro Landscape of China

Over the past four decades, China's GDP had grown 30 times since the implementation of reform and opening-up policy, with a striking average annual growth of 9.5% [01]. China becomes the largest exporter and the second largest economy and consumption market in the world.

With the unremitting epidemic outbreaks in the past three years, the global economy has been through a series of unwarranted and impactful disruptions. For China, Zero-covid policy with lockdowns, supply chain disruption, aging population, weakened domestic demand, combined with subdued expectation, are posing a downward pressure on the economy. As negative factors piled up, the tumultuous 2022 saw the growth rate shrank abruptly to 3% from 8.1% in 2021. The 14th Five Year Plan (FYP), for the first time in its history, did not set any explicit GDP target. For FDI, it targets to better utilize foreign capitals for "high-quality" development, setting a signal on the future role of foreign investors.

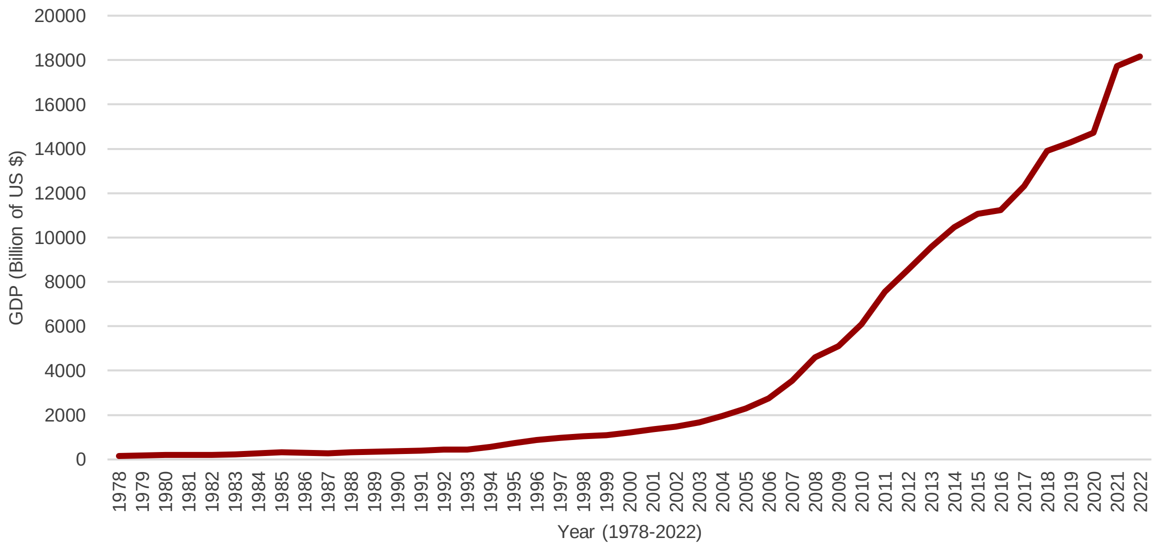

Figure 1: China's GDP, 1978-2021

The beginning of 2023 saw a dramatic change from abandoning China's zero-covid policy. As of 8 January 2023, restrictions on international travel were removed. Mass PCR tests and health tracking apps were also neatly phased out within a few days.

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01 http://www.npc.gov.cn/zgrdw/npc/zgrdzz/site1/20190403/00016cd0abbd1e0e6af60a.pdf (accessed 26 April 2022)

Looking forward, China's full reopening is redirecting its economic outlook. IMF projected growth in China to rise to 5.2% in 2023. Positive signals like consumption rebooting, and travel appeared. Flights in China are expected to recover to pre-Covid levels by the end of February [02]. However, weaker overall demand, supply chain disruptions and subdued investor expectations will take time to recover. Stability, reliability and flexibility are paramount to the recovery of supply chains. Official lending figures for January showed a sharp decline. Despite the rocky start, China has put in place a series of policies to support the domestic economic recovery.

1.1 City Clusters as Prioritized Areas of Development

China's central government points to 19 mega city clusters as central to the next stage of industrialization and urbanization. Together they constitute over 80% of the country's GDP and 75% of the population with merely 29% of the national area [03]. Among them 10 clusters are prioritized and will receive more policy-based support in coming years.

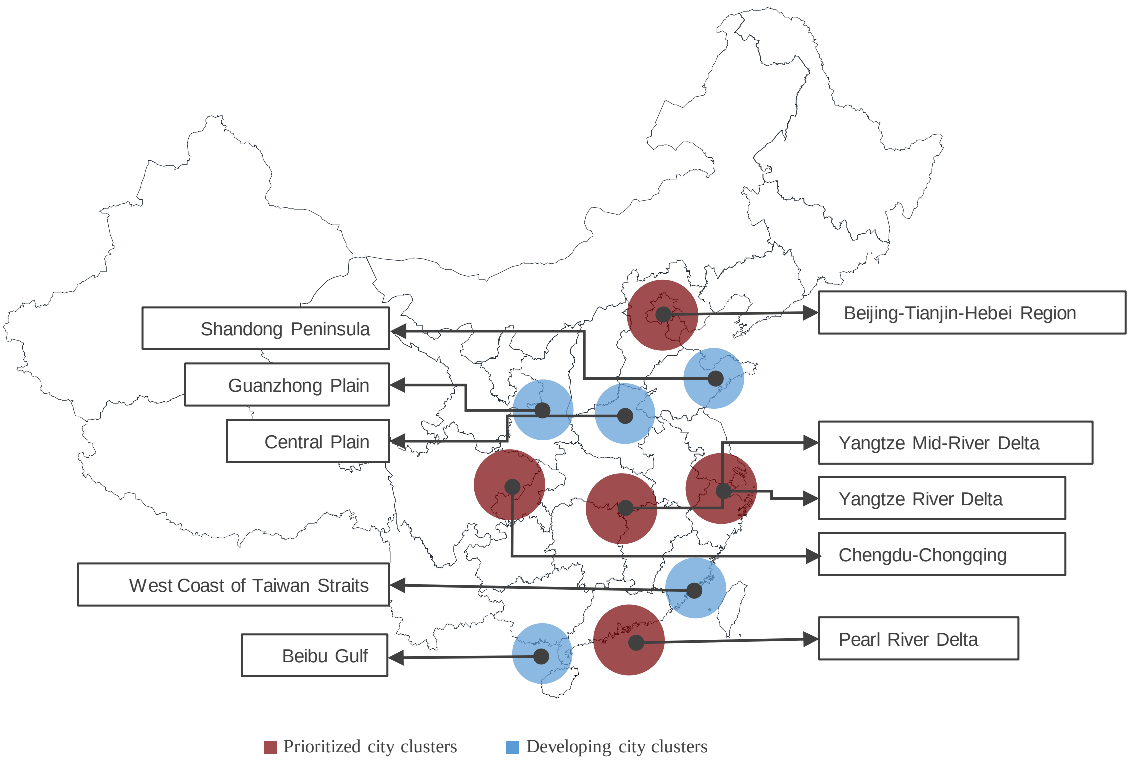

Figure 2: Prioritized and Developing Mega City Clusters in China

The 14th FYP clarifies these clusters as major sources of consumption and key drivers of innovation and more synergies within each cluster are planned, including:

[02] https://m.gmw.cn/baijia/2023-02/17/1303286815.html (accessed 19 February 2023)
[03] https://www.thepaper.cn/newsDetail_forward_4603344 (accessed 26 April 2022)

Table 1: Planned Synergies within Mega City Clusters 04

Sector	Major Actions Planned
Transportation	connect intercity infrastructures, lower transportation costs, facilitate combined transport
Public Service	household registration system reform, connect service systems, sharing education, healthcare and social insurance resources
Innovation	sharing higher education and R&D resources, encourage modern service industry and smart manufacturing
Manufacturing	industrial resources relocation, supply chain coordination
Tourism	sharing customers and tourism resources, encourage intercity tourism projects

1.2 Aging Population and Increasing Labor Cost

China is on the course of losing its demographic dividends as the old-age dependency ratio (OADR) reached 19.4% in 2022, making an obvious turn up in the late 2010s. Removal of restrictions on having a second child in a family in 2016 05 failed to reverse this trend. Fertility intension dropped to a new low of 1.8 in 2022 06. Consequently, 2022 saw China's population declined for the first time in 60 years, by 850 thousand 07. Experts predict that this aging trend of population will persist for coming decades, exerting much pressure on future labor force. The demographic crisis is gradually weighing on China economy.

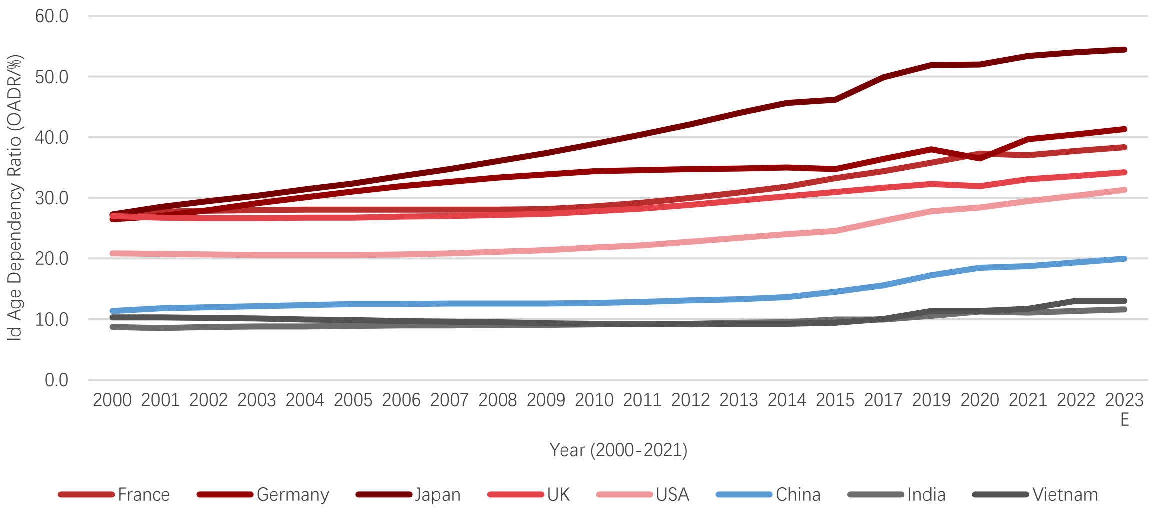

Figure 3: China's OADR Compared with Other Countries 08

04 http://www.gov.cn/xinwen/2016-03/04/content_5048862.htm (accessed 27 May 2022)
05 http://www.stats.gov.cn/xxgk/jd/sjjd2020/202105/t20210513_1817410.html (accessed 27 May 2022)
06 http://www.stats.gov.cn/xxgk/jd/sjjd2020/202301/t20230118_1892285.html (accessed 27 May 2022)
07 Data were mainly retrieved from the OECD, see: https://data.oecd.org/pop/old-age-dependency-ratio.htm, and also World Bank, see: https://data.worldbank.org/indicator/sp.pop.dpnd (accessed 27 May 2022)
08 https://blogs.worldbank.org/opendata/new-world-bank-country-classifications-income-level-2022-2023 (accessed 19 February 2023)

While facing a dwindling workforce, the country's per capita GDP came in at 12,741 dollars last year, approaching the World Bank's threshold for a high-income country [09]. As a direct result, China's advantage in labor force and labor cost is shifting to south and east Asian countries.

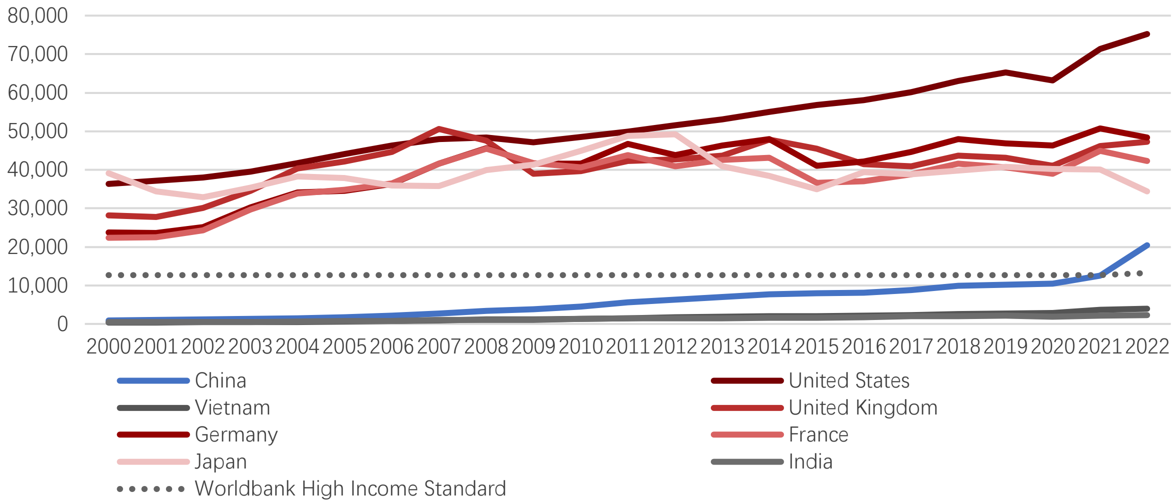

Figure 4: China's GDP per capita Compared with Other Countries [10]

1.3 The Dual-Carbon Goals

China announced its dual-carbon goals in 2020 — carbon peak by 2030 and carbon neutrality by 2060. Currently, the country contributes over 30% of global total annual CO_2 emission as the largest emitter by 2022. China is also the largest coal producer and consumer in the world. Over 85% of China's energy consumption comes from fossil fuel.

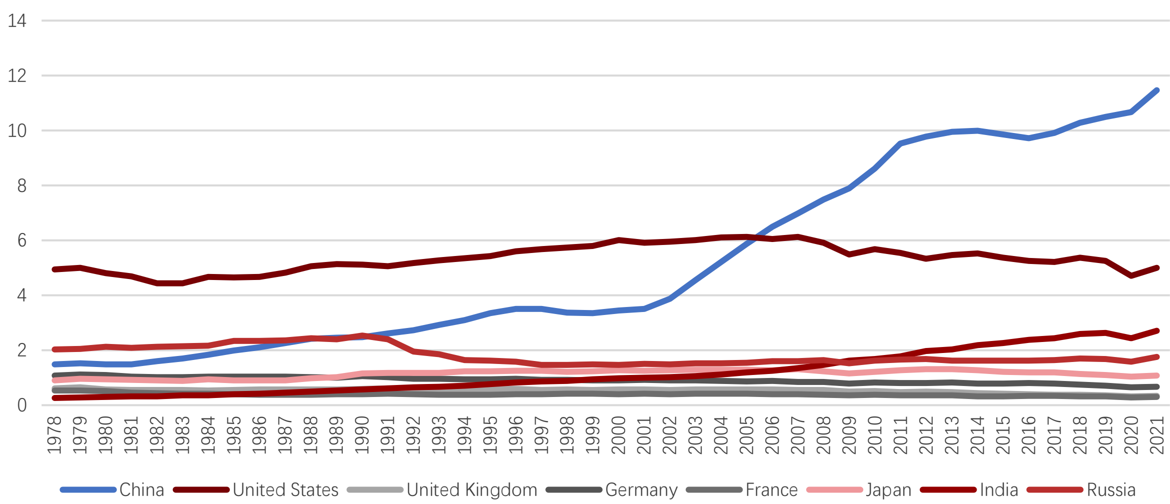

Figure 5: Annual CO_2 Emission of China Compared with Other Countries [11]

[09] https://blogs.worldbank.org/opendata/new-world-bank-country-classifications-income-level-2022-2023 (accessed 19 February 2023)

[10] Data source: World Bank, see: https://data.worldbank.org/country/china?view=chart (accessed 20 February 2023)

[11] Data sources: Oxford Martin School, see: https://ourworldindata.org/co2/country/china?country=; and World Bank, see: https://data.worldbank.org/indicator/EN.ATM.CO2E.PC (accessed 20 February 2023)

Unavoidably, this pledge demands a radical shift from fossil fuel to clean energy as soon as possible. Two primary strategies were developed to diversify the energy mix: reduce fossil fuel consumption and increase renewable energy's share. Precise phased targets were also set up to guide implementations.

Table 2: China's Duel-Carbon Goals with Phased Targets and Preferred Industries [12]

Aspects	Present	2025	2030	2060
Annual CO_2 emission per capita (tons)	7.41	6.10	1.55	-
Ratio of Renewable Energy	15.17%	20%	25%	80%
Forest Coverage Rate	24.02%	24.1%	25%	-
Encouraged Industries	ICT, biotechnology, new energy, new materials, high-end equipment, new energy vehicles, environmental protection, aerospace, marine equipment and other strategic emerging industries			
Restricted Industries	steel, cement, flat glass, electrolytic aluminum, coal power, petrochemical and coal chemical industry			

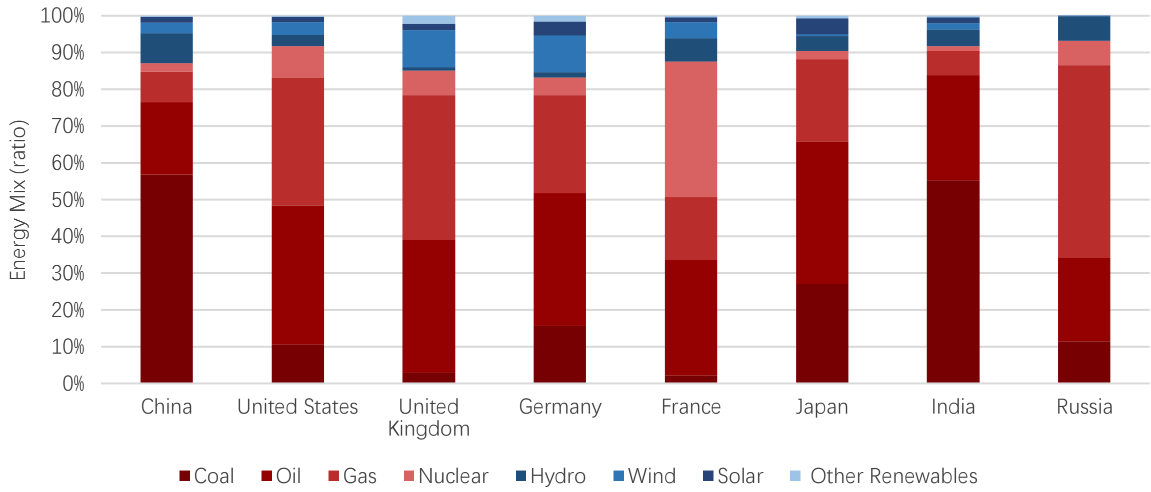

Figure 6: China's Energy Consumption by Source Compared with Other Countries [13]

So far, the rationalization and structural reform in coal industry have directly caused power shortage in industrial production. From 2016 to 2021, China closed over 5600 coal mines [14] and implemented rigid CO_2 emission controls on coal-fired power generation. During the energy crisis in 2021, many factories were forced to shut down temporarily [15], disrupting supply chains nationwide.

[12] http://www.gov.cn/zhengce/2021-10/24/content_5644613.htm (accessed 20 February 2023)
[13] Data source: https://ourworldindata.org/energy-mix (accessed 20 February 2023)
[14] Data Sources: 1) http://www.gov.cn/xinwen/2021-03/04/content_5590094.htm;
2) https://view.inews.qq.com/a/20211231A0BJOH00 (accessed 28 May 2022)
[15] http://www.gov.cn/zhengce/2021-10/09/content_5641609.htm (accessed 28 May 2022)

On the other hand, these goals have unlocked new opportunities for foreign investors. China is pushing green industry fast into a market-oriented status. For example, government subsidies provided solely for domestic companies producing new energy vehicles are phasing out quickly, giving way to a fairer market for foreign investors.

1.4 Actions in Intellectual Property

Intellectual property protection in China has improved substantially after years of efforts. China has considerably reformed its intellectual property system recently. In 2018, China's National Intellectual Property Administration (CNIPA) was put under the governance of State Administration for Market Regulation to improve administrative efficiency. From that time on, China rapidly instituted a number of significant reforms to the majority of most controversial technology transfer policies and IP court infrastructure that should help mitigate the effects of discriminatory treatment of foreign IP in local courts.

In 2020, China signed the EU-China Geographical Indications Agreement [16] to offer better protections for European products, such as FETA cheese and French champagne; China has also set up over 97 regional IP Protection Centers [17] from 2017 to 2022 to simplify bureaucratic process of patent application and IP protection. Selected administrative powers are distributed to such centers to serve local companies in the following aspects:

- Patent pre-assessment, invalidation and evaluation;
- IP protection, consultancy and legal assistance;
- Data-based services, such as patent searching and navigation.

Notably, in 2021, China issued a grand blueprint to become an intellectual property "powerhouse" by 2035 [18]. The document puts much emphasis on building "an IP protection system supporting the world-class business environment" and "an IP market operation mechanism encouraging innovation and development".

Earlier in 2022, China joined the Marrakesh Treaty [19] and the Hague Convention [20], connecting its system more closely with international rules. IP protection has become an essential component of the state policy toolkit to improve business environment, promote import/export, and attract foreign investments.

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[16] https://www.europarl.europa.eu/RegData/etudes/ATAG/2020/659320/EPRS_ATA(2020)659320_EN.pdf (accessed 28 June 2022)
[17] http://www.gov.cn/xinwen/2023-01/16/content_5737371.htm (accessed 20 February 2023)
[18] http://www.gov.cn/gongbao/content/2021/content_5643253.htm (accessed 26 April 2022)
[19] http://english.cnipa.gov.cn/art/2022/2/23/art_2829_173355.html (accessed 29 May 2022)
[20] https://www.wipo.int/hague/en/news/2022/news_0005.html (accessed 29 May 2022)

1.5 SMEs as Priorities of Economic Development

By the end of 2022, more than 48 million Small and Medium Enterprises (SMEs) [21] in China are active, making up over 99% of all enterprises in the country, more than 60% of the GDP, 50% of the international tax revenue, 80% of the employment, and 70% of all technological innovations [22]. They play a vital role in improving personal income, encouraging innovations and stimulating consumption

Therefore, China has privileged SMEs' development and taken constructive measures in favor of SMEs. For foreign companies, evaluating qualifications and applying for such recognitions and programs would help to secure favorable policies and tax benefits from governments.

Table 3: National-level Constructive Measures to Support SMEs [23]

Aspects	Measures
Innovation	R&D expenses deduction before tax; intangible assets (patents) amortization before tax for Technological SMEs; direct rewards for talents, etc.
Incentive Programs	Technological SMEs; Specialized and Sophisticated Enterprises that Produce New and Unique Products
Direct Tax incentives	Preferential tax rates, for example, 20% CIT rate for micro-SMEs; VAT exemption, and lower VAT rate for small taxpayers, etc.
Funding	Beijing Stock Exchange with lower threshold for SMEs; guaranteed loans with discounted interest rates
Others	National innovation and entrepreneurship competitions to support start-ups; tax deduction for SMEs employing people with disabilities, etc.

[21] China's classification of SMEs is substantially different from European SMEs which can be found here: http://www.gov.cn/gongbao/content/2012/content_2041870.htm (accessed 31 May 2022)
[22] http://www.scgqt.org.cn/touzi/2021/1201/122021_57444.html (accessed 31 May 2022)
[23] Sources: Ministry of Science and Technology, Ministry of Industry and Information Technology (accessed 31 May 2022)

2. Positive Signals Sent to Foreign Companies

Widening the market access for foreign investment has been a key policy for opening up and one of China's primary driving forces for industrialization and urbanization. The foreign direct investment (FDI) has risen from 2.26 billion dollars in 1983 to nearly 189.13 billion dollars in 2022.

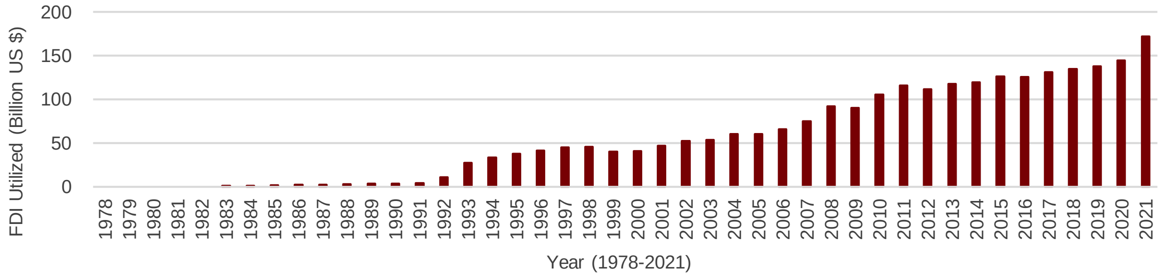

Figure 7: FDI Utilized by China [24]

By 2021, There are over 66 million foreign-funded enterprises, accounting for about 1.3% of the total number of enterprises in China, 40% of foreign trade, and 1/6 of the tax revenue, creating over 40 million jobs. They have become a significant contributor to China's economic growth.[25]

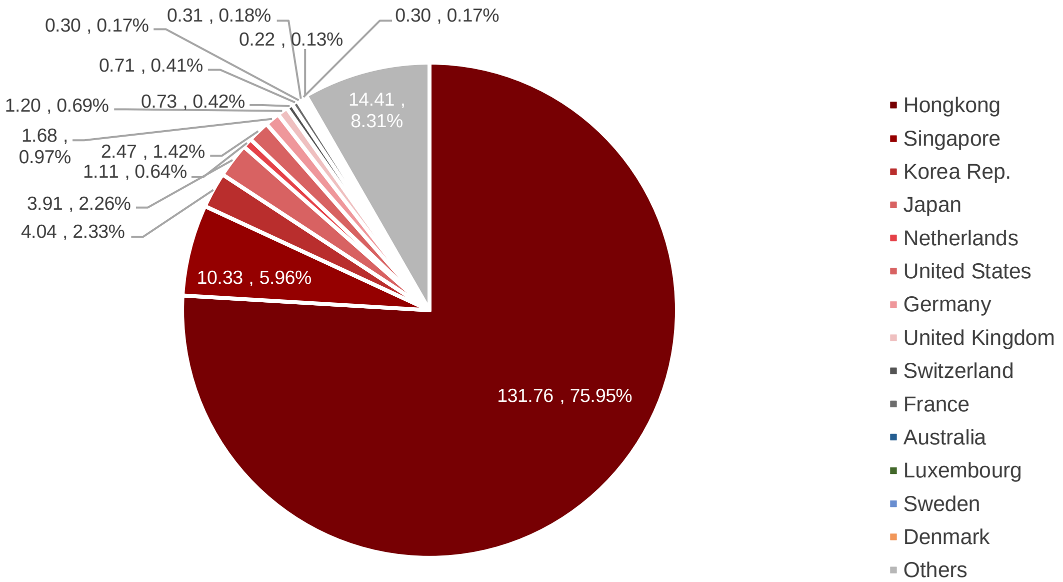

Figure 8: Major Sources of FDI in China in 2021 [26]

[24] Data source: NBS, see: https://data.stats.gov.cn/easyquery.htm?cn=C01 (accessed 20 February 2023)
[25] Data source: NBS, see: http://www.stats.gov.cn/tjsj/ndsj/2021/indexch.htm (accessed 20 February 2023)
[26] Data source: NBS, see: https://data.stats.gov.cn/english/ (accessed 20 February 2023)

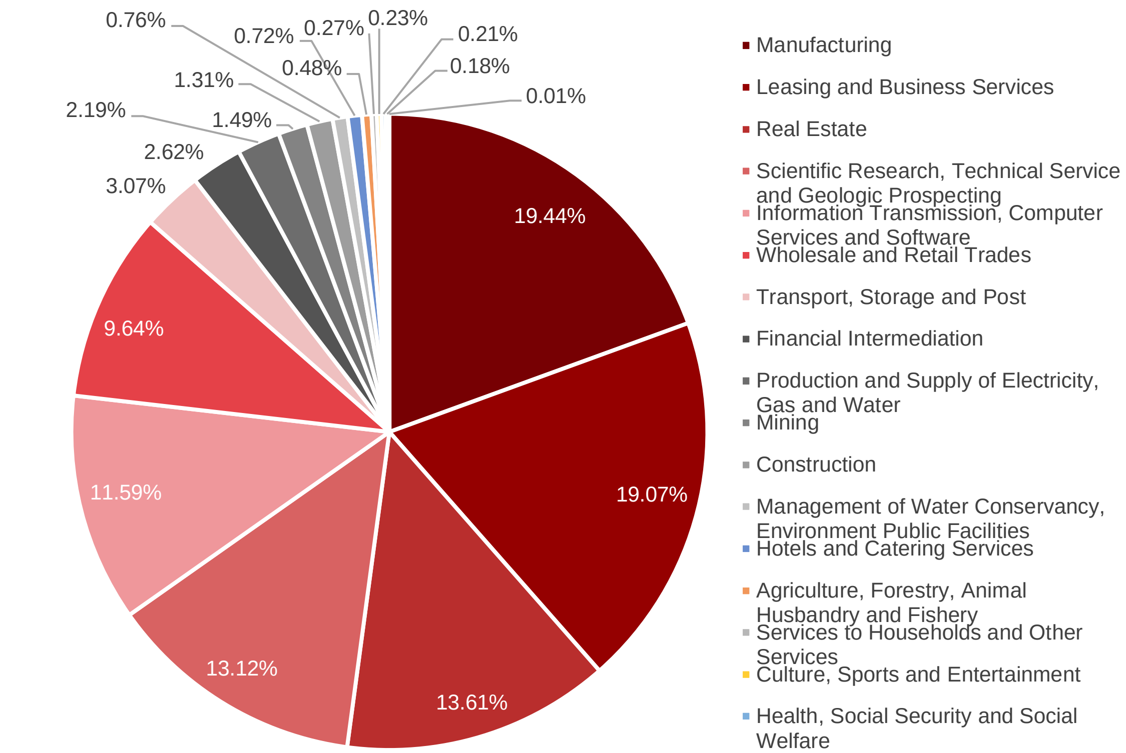

Figure 9: Sectoral Distribution of FDI in China in 2021 [27]

Manufacturing, Technology and Business Services are the top recipient sectors of FDI in China, followed by Real Estate, and Wholesale and Retail Trades.

The 14th FYP has set up a new target to attract a total 700 billion dollars FDI from 2021 to 2025, an annual average of 140 billion dollars.

2.1 The Foreign Investment Law and the Decreasing Negative Lists

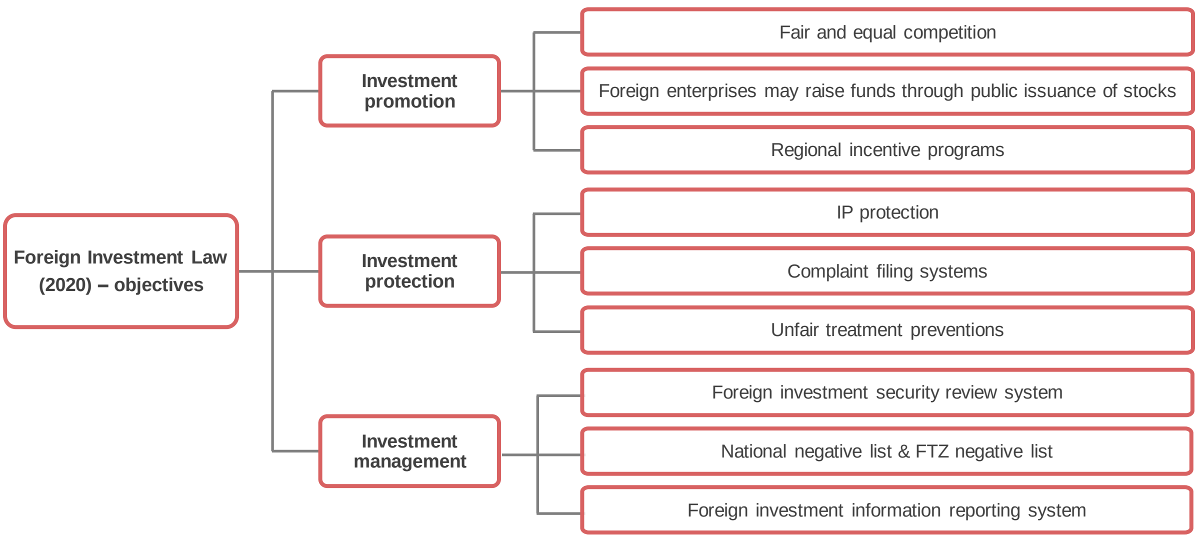

Figure 10: Major Objectives of Foreign Investment Law

27 Data source: NBS, see: https://data.stats.gov.cn/english/ (accessed 20 February 2023)

The Foreign Investment Law (FIL)[28] was approved in 2019 and came into effect in 2020. Replacing former regulations, the new FIL tries to create a more transparent and welcoming business environment for foreign businesses through leveling the playing field in their competition with domestic ones. It sets clearer rules to regulate foreign investment activities and local administrations at the same time.

A positive signal was also sent by the "Negative Lists".[29] Sectoral restrictions on foreign investments have been significantly removed from 2017.

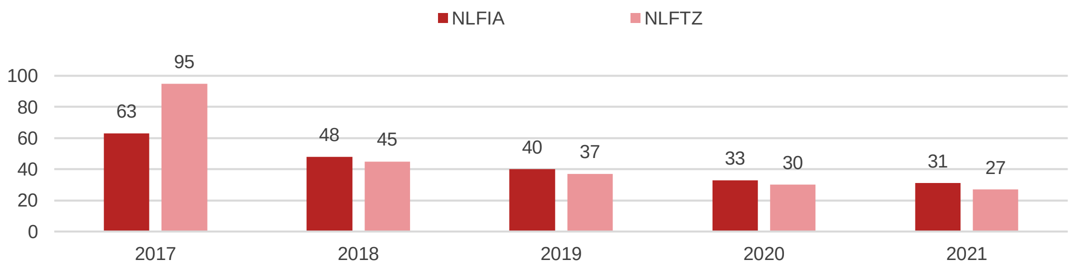

Figure 11: Changes in China's Negative Lists (2017-2021) [30]

Table 4: Changes of NLFIA and NLFTZ from 2020 to 2021

Negative List	Sector	Changes
NLFIA	Manufacturing	Removing completely the restriction on the shareholding percentage of foreign investors in the manufacturing of passenger cars and the restriction that one foreign investor may establish two or fewer joint ventures in China to manufacture the same type of vehicles
		Lifting the restrictions on foreign investment in satellite television broadcasting ground receiving facilities and the production of key components
NLFTZ	Manufacturing	Same to the NLFIA
	Leasing and Business Services	Removing all other restrictions in market research services, except that controlling stake in radio and television rating survey shall be held by the Chinese party.
		Allowing foreign investments in social survey services, except that Chinese party in social survey services shall hold no less than 67% of the shares and the legal representative shall hold China nationality.

[28] Source: Asia Perspective, MOFCOM (accessed 2 June)

[29] The negative list is a document that delineates industries that are prohibited or restricted to private investment by companies in China. Any industry not included on the list is presumed to be open to investment without requiring additional administrative approvals. Three negative lists in China are the Negative List for Market Access (NLMA), the Special Administrative Measures (Negative List) for Foreign Investment Access (NLFIA), and the Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (NLFTZ).

[30] Source: Asia Perspective, MOFCOM (accessed 2 June 2022)

2.2 Encouraged Industries for Foreign Investment

According to the Plan "Utilization of Foreign Investment for China's 14th FYP (2021-25) Period" issued by the Ministry of Commerce of PRC (MOFCOM) three areas of foreign investments are encouraged, namely, high-tech industries[31], strategic emerging industries[32] and modern service industries[33].

In May 2022, the NDRC released the new version of Catalogue of Industries for Encouraging Foreign Investment (2022 Version)[34] which consists of a national catalogue, and a central-western regional catalogue.

Table 5: Major Incentives for Foreign Companies Active in the Specified Sectors [35]

Catalogue	Incentives
National Catalogue	Exemption from customs duties (below the total amount of investment) for imported equipment used in production
Central-western Regional Catalogue	All incentives for investments fall inside the National Catalogue applies equally to the Regional Catalogue
	15% CIT rate for companies set up in western regions
	Priorities in allocation of industrial land for companies in the manufacturing sector; at most 30% discount for the transfer of land fees.

2.3 Growing Trade Networks by Agreements

China's growing presence in the global economy can be attributed mainly to its growing global trade networks. In 2021, the trade with free trade partners accounts for about 35% of its total foreign trade with a value of over 166 billion dollars in China. [36]

FTA is valued by China as an effective approach to integrate into the global economy and boost the competitiveness of its exports, as well as particularly an essential supplement to the multilateral trading system[37] and China has been keen to stipulate trade agreements with other countries.

In making investment decisions, practical examinations of such agreements should not be neglected. For example, examine whether the products are included in a specific FTA, tax reductions, custom registration processes to invoke treaty status, and other potential benefits were applicable.

31 https://www.dlhitech.gov.cn/resources/news/newsConstantImages/20210126183848590.pdf (accessed 6 May 2022)
32 http://www.gov.cn/zhengce/content/2016-12/19/content_5150090.htm (accessed 6 May 2022)
33 http://www.gov.cn/gzdt/2012-03/22/content_2097018.htm (accessed 6 May 2022)
34 The Catalogue includes two sub-catalogues: The Catalogue of Encouraged Industries in China for Foreign Investments, and the Catalogue of Encouraged Industries in Central and Western China for Foreign Investments, see: http://www.mofcom.gov.cn/zfxxgk/article/gkml/202205/20220503311130.shtml (accessed 6 May 2022)
35 http://www.gov.cn/zhengce/2020-12/28/content_5574304.htm (accessed 6 May 2022)
36 http://fta.mofcom.gov.cn/article/fzdongtai/202205/48557_1.html (accessed 21 February 2023)
37 http://www.scio.gov.cn/xwfbh/xwbfbh/wqfbh/44687/47307/wz47309/Document/1715458/1715458.htm (accessed 6 May 2022)

Table 6: China's Major Global Trade Networks by 2022 [38]

Agreement	Time of Signature	Members	Status
World Trade Organization (WTO)	2001	164 members, 24 observers	effective
Free Trade Agreement (FTA)	Vary with countries	16 FTAs signed and 8FTAs in progress, with 26 countries/regions	16 FTAs implemented and effective
Regional Comprehensive Economic Partnership (RCEP)	November 2020	15 members, including China, Japan, South Korea, Australia, New Zealand, and 10 ASEAN member countries	Currently effective for 13 members including China, but not yet fully implemented between members
Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)	Formal application submitted in September 2021	Currently 11 member which are all trans-pacific countries, including Japan, Canada, Australia, Chile, New Zealand, Singapore, Brunei, Malaysia, Vietnam, Mexico and Peru	Effective from 2018
Digital Economy Partnership Agreement (DEPA)	Formal application submitted in November 2021	Currently 3 members, including Singapore, Chile and New Zealand	Effective from 2021

[38] Data Source: MOFCOM (accessed 2 June 2022)

3. "Economic Zones" in China – Opportunities to Leverage on

"Economic zones" (or "development zones" / "special economic zones"(SEZs) / "economic development zones") [39] have virtually been ultimate destinations of foreign investment in China, though investors may not be fully aware of this fact. By the end of 2022, there are over 700 of over 15 types of national-level economic zones in China. [40]

For these zones, each type's features, preferential policies, and incentives are mostly different from others due to national regulations. Zones within a specific type are uniform in general goals, while they may also differ in terms of focused industries and actual benefits due to provincial regulations.

The actual benefits are fundamentally shaped by zones' distinctive features, goals and incentives. Features like location, infrastructure, labor force, local industrial resources, technology availability have basically decided what industries a zone can cultivate, while types of focused industries would further determine its specific development goals. Their autonomy, combined with local government support, determines how powerful local incentives a zone can hand out unilaterally for foreign investors, especially when some national-level incentives have become universal and non-discriminated. In selecting a destination of investment, foreign companies should evaluate the zones carefully for the most relevant and applicable type.

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39 This article uses "economic zones" as the general term. Special Economic Zones (SEZs) is used as a reserved term for China, though it is commonly used to address all sorts of economic zones in the rest of the world. The definition of "economic zones" used here comes from UNCTAD, see: https://unctad.org/system/files/official-document/WIR2019_CH4.pdf (accessed 6 May 2022)

40 The total number was calculated based on the latest version of Directory of Development Zones in China (2018 Version), see: http://www.gov.cn/zhengce/zhengceku/2018-12/31/content_5434045.htm (accessed 6 May 2022)

Table 7: Different Types of National-level Economic Zones in China

Type		Number	Example	Major Goals&Features
Special Economic Zones		7	Shenzhen SEZ	1) Original zones for policy experiments 2) Attract foreign investment
Economic and Technological Development Zones (ETDZs)		230	Guangzhou Economic and Technological Development Zones	1) Business regulatory reforms 2) Attract foreign investments 3) Develop advanced manufacturing industry 4) Increase exports
High-tech Industrial Development Zones (HIDZs)		168	Hefei High-tech Industrial Development Zones	1) Commercializing high-tech research findings 2) Develop knowledge and technology intensive industries
Special Customs Supervision Zones (SCSZs) (168 in total)	**Bonded Zones (BZs)**	9	Shanghai Waigaoqiao Bonded Zone	Promote international trade, warehousing and exports
	Export Processing Zones (EPZs)	1	Guangzhou Export Processing Zone	1) Attract foreign investment 2) Promote exports, especially fabricating and assembly industry 3) Improve manufacturing quality 4) Learn management experiences
	Cross-Border Industrial Zones (CBIZs)	1	Zhuhai-Macao Cross-Border Industrial Zone	Ensure employment and upgrade local industries
	Bonded Logistics Parks (BLPs)	0	Tianjin Bonded Logistics Park	1) Promote exports, International warehousing and logistics services 2) Allow no advanced manufacturing
	Bonded Ports (BPs)	2	Zhangjiagang Bonded Port	1) Integrate the policies of BZs, EPZs and BLPs in tax and foreign exchange management 2) Promote exports, international trade and logistics services
	Comprehensive Bonded Zones (CBZs)	155	Shenzhen Yantian Comprehensive Bonded Zone	Integrate all functions of other types of SCSZs
Cross-border Economic Cooperation Zones (CECZs)		19	Dandong Cross-border Economic Cooperation Zone	1) Build cross-border business relationships; 2) Increase bilateral trade and exports 3) Encourage local industrial development
Other Types of Development Zones (OTDZs)	**Including China National Tourist Resorts (CNTRs), Finance and Trade Zones, Taiwan Investment Zones, etc.**	23	Shanghai Finance and Trade Zone	Attract domestic and foreign investment for a certain purpose or industry, such as finance, tourism, regional trade.
Pilot Free Trade Zones (PFTZs)		21	Shanghai Pilot Free Trade Zone	1) Attract FDI 2) Promote international trade 3) Integrate all functions of SCSZs 4) Test new opening policies 5) Promote internationalization of RMB
National New Areas (NEAs)		19	Xiong'an National New Area	1) Replace former SEZs in functions 2) Optimize industrial structure 3) Explore new models of urbanization and industrialization
Comprehensive Reform Pilot Zones (CRPZs)		12	Shanxi Comprehensive Reform Pilot Zone	1) Test new models of overall regional development beyond economic focuses 2) Similar to NEAs but with specific missions and tasks
National Innovation Demonstration Zones (NIDZs)		22	Zhangjiang National Innovation Demonstration	Test ground for independent innovation in high-tech research and industrialization

3.1 Economic Zones with Distinctive Features, Goals and Incentives

3.1.1 Special Economic Zones (SEZs)

SEZs are the earliest zones in China designed to incentivize foreign investment and bolster local economy with an experimental purpose. By now, there are 7 SEZs in China.

Groundbreaking measures were taken solely in SEZs, such as allowing private business operation, reducing Corporate Income Tax (CIT), easing entrance restrictions and duty exemption for specific manufacturing equipment and raw materials.

These measures, though less relevant for foreign investors today[41], have boosted unprecedented local development. As a result, most SEZs are highly developed in infrastructure, transportation, logistics and commercial facilities, and are often regional hubs of innovation, labor force and business opportunities, making them still superlatively vital targets for foreign investments.

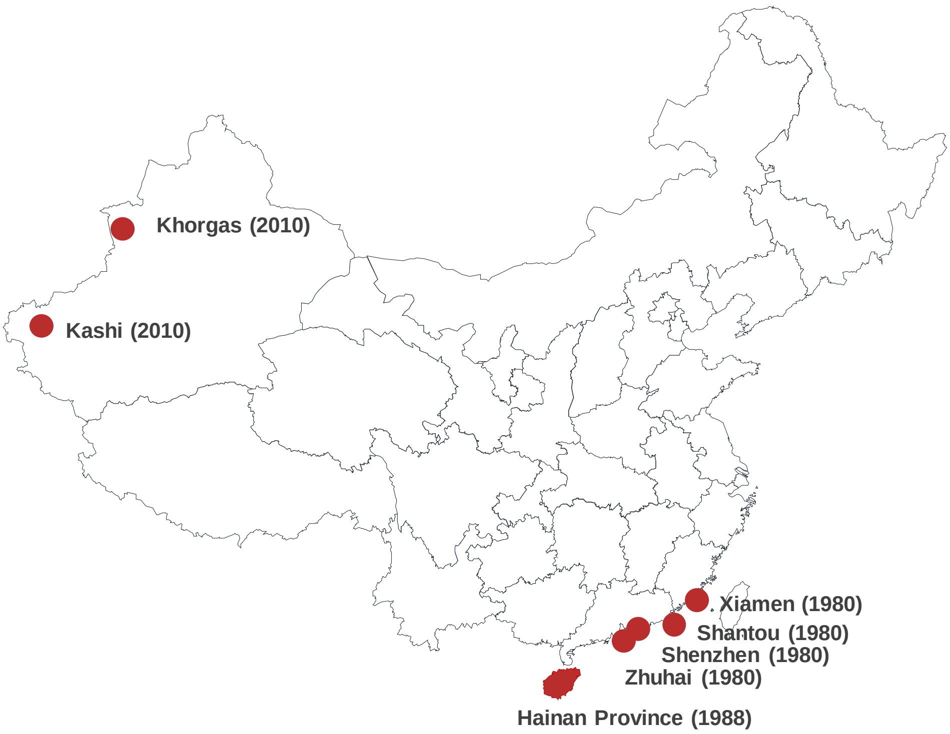

Figure 12: Seven SEZs in China

[41] Many of the key tax incentives offered previously in SEZs were reversed in the Corporate Income Tax (CIT) Reform in 2008, especially the 15% CIT rate. See: http://www.npc.gov.cn/zgrdw/huiyi/dbdh/11/2008-03/09/content_1410206.htm (accessed 6 May 2022)

3.1.2 Economic and Technological Development Zones (ETDZs)

ETDZs are portions of a city designed to grow technology-intensive industries through business regulatory reforms, improving infrastructure and attracting foreign investment and technologies. Government funding and subsidies to investments are typically directed towards advanced manufacturing industries and export businesses. Today there are in total 230 national ETDZs across China.

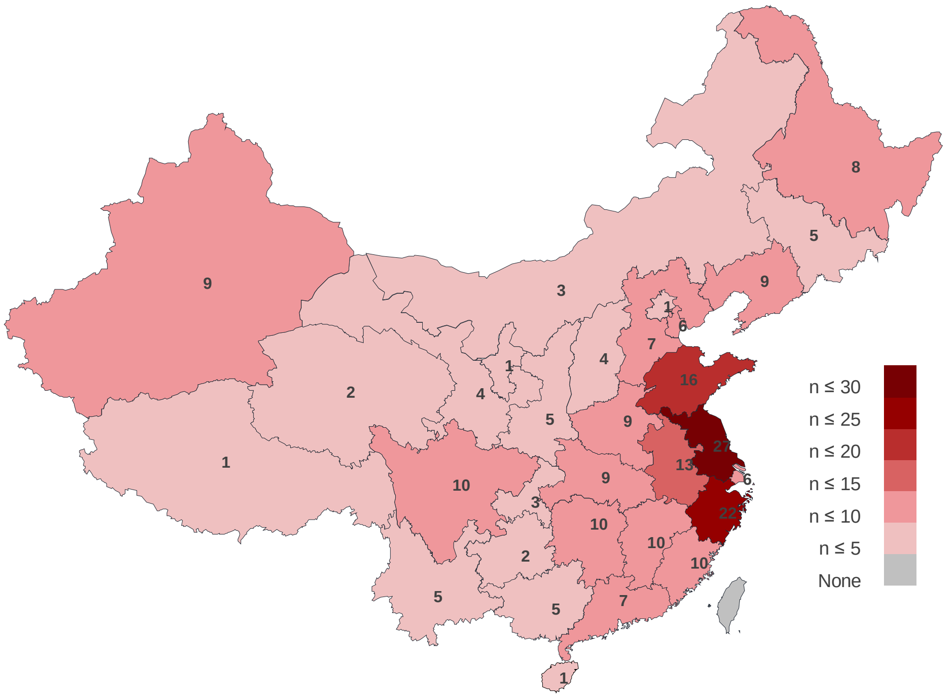

Figure 13: Distribution of 230 ETDZs in China

Economic Prospects [42]

ETDZs are major recipients of FDI and sources of exports. In 2021, FDI utilized by ETDZs reached 68.4 billion dollars, accounting for 23.1% of the country's total FDI, with an annual increase of 17.5%; the total export value was 651 billion dollars, accounting for 20.8% of the country's total exports. This figure of FDI dropped significantly to 37.3 billion dollars in 2022, but still accounting for 21.1% of the country's total FDI.

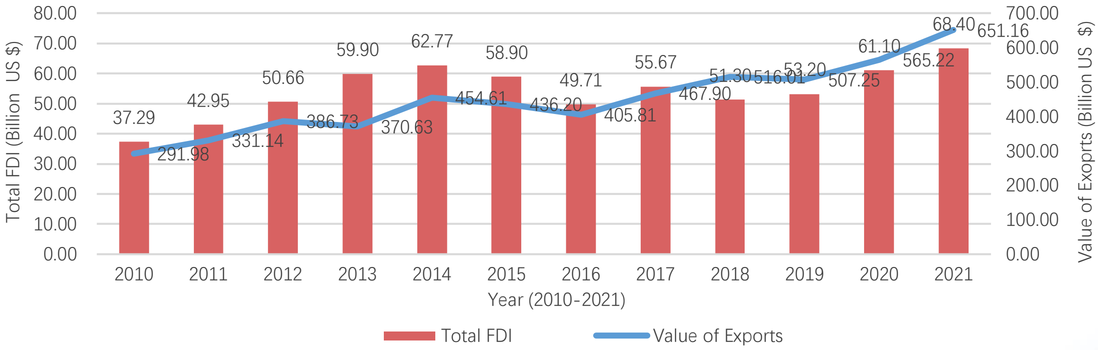

Figure 14: FDI and Exports Value of ETDZs

[42] Data source: MOFCOM (accessed 22 February 2023)

Limitations

ETDZs have inherent limitations in some respects. For example, State-Owned Enterprises (SOE) in ETDZs are the indispensable counterparts that foreign investors must deal with in obtaining office, land and factory building, but they are virtually controlled by the administrative committee. Significant decisions can only be made with the approval of the committee, a detrimental factor which undermines investors' negotiation leverage and decreases communication efficiency.

Another limitation is the land shortage in popular ETDZs located in eastern China. Inadequate industrial land supply has forced some to opt to stricter standards in land acquisition. For example, companies in Beijing ETDZ must lease the land first and achieve a certain production capacity within 5 years before being eligible to lease for a maximum of 15 years [43].

Typical Features and Incentives

See attachment 1

3.1.3 High-tech Industrial Development Zones (HIDZs)

HIDZs are areas designed with the unique objective of commercializing high-tech research findings and developing IP-intensive industries. Today there are altogether 168 HIDZs in China [44]. A Torch High-tech Industries Development Center (THIDC) [45] was set up early in 1980s to oversee and guide all HIDZs in China.

To define high technologies, the Catalogue of Strongly Supported High Technologies [46] listed 8 general sectors and for each, it specifies those qualified as high techs. The 8 sectors are:

- Information and Communication Technologies (ICT)
- Biotechnology and New Medicine
- Aviation and Aerospace
- New Materials
- High-tech Services
- New Energy and Energy Saving, Resources and Environment
- Advanced Manufacturing and Automation.

[43] http://kfqgw.beijing.gov.cn/zwgkkfq/zcfg/zcwj/bqzc/202204/t20220415_2677796.html (accessed 3 June 2022)
[44] Suzhou Industrial Park is in some statistics not included as a HIDZ but an ETDZ, but it retains all governmental support provided for HIDZs.
[45] http://www.chinatorch.gov.cn/ (accessed 4 June 2022)
[46] https://www.dlhitech.gov.cn/resources/news/newsConstantImages/20210126183848590.pdf (accessed 4 June 2022)

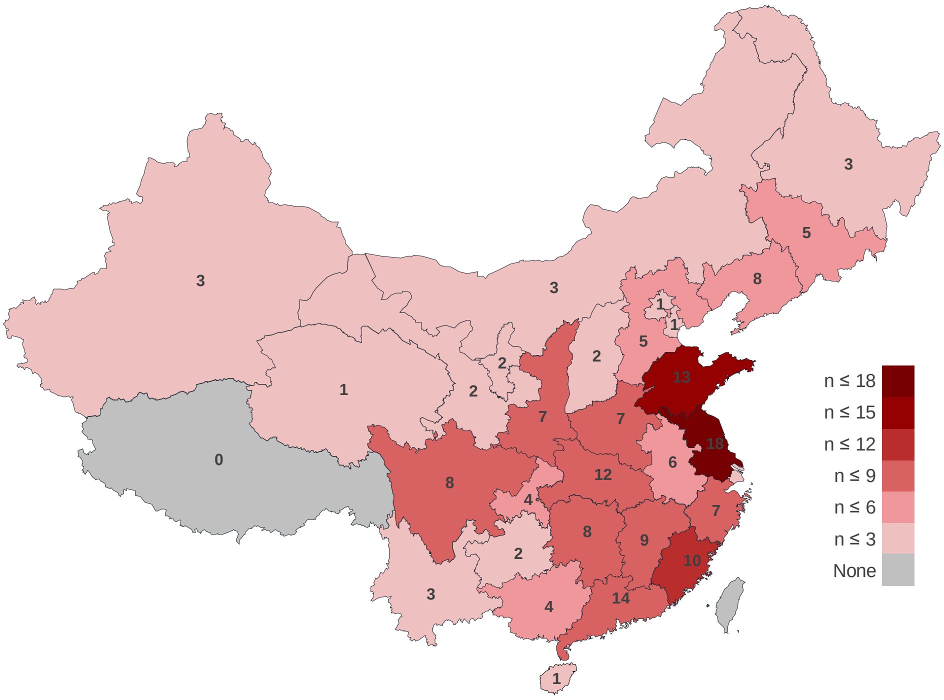

Figure 15: Distribution of 168 HIDZs in China

Characterized by ambition in high-tech commercialization, HIDZs own 36.4% of all High-tech Enterprises, and 30% of all Technological SMEs in China. 47 In addition, 67% of all companies listed in Sci-Tech Innovation board (STAR Market) 48 originate from HIDZs. 49

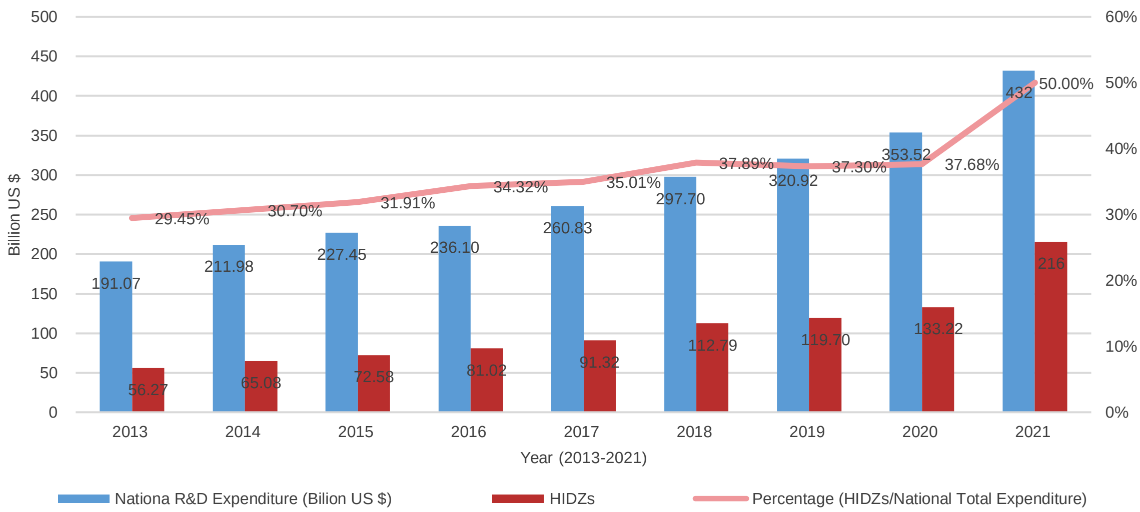

Figure 16: Increasing R&D Expenditure of HIDZs

47 See: Typical Features for High-tech Enterprises and Technological SMEs

48 Companies listed in the STAR Market are all innovation-driven enterprises. STAR Market has strict regulations on the R&D expenditure, patents and profit margin, see: http://kcb.sse.com.cn/ (accessed 4 June 2022)

49 https://tech.gmw.cn/2022-02/25/content_35545174.htm (accessed 4 June 2022)

Many technologies specified in the 8 sectors are bottleneck industries highlighted in public reports. Preferential policies and government subsidies are expected to be directed towards these industries in the coming years, where foreign companies may find more favorable opportunities. [50]

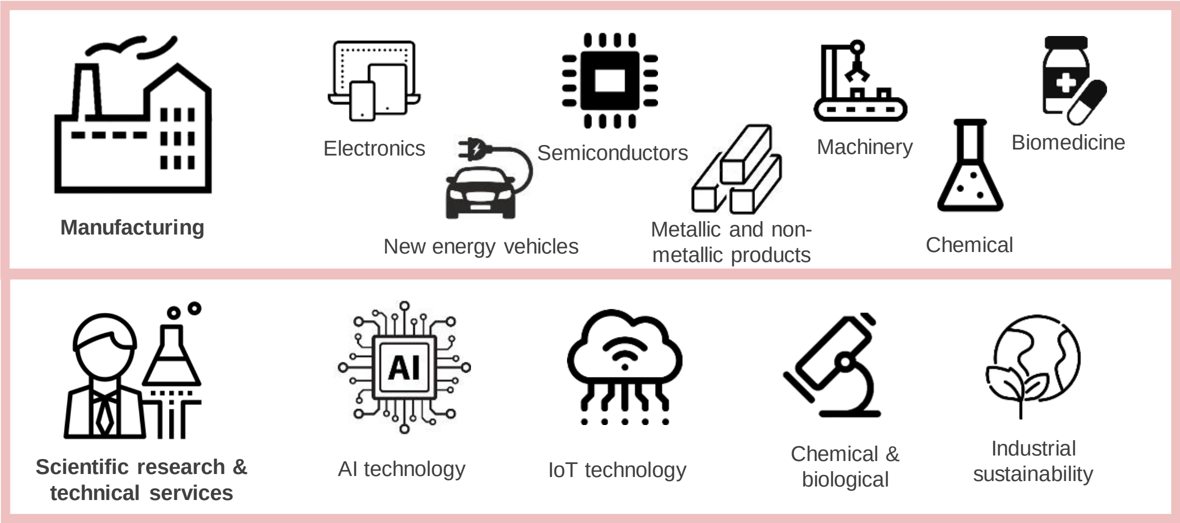

Figure 17: Chinese Government Priorities for Industries Development in Coming Years

Typical Features and Incentives

See attachment 2

Limitations

HIDZs are ideal locations for companies in innovation and high-tech businesses from where the most favorable incentives are accessible through various types of programs. Within HIDZs, high-tech companies could enjoy richer innovation resources, industrial opportunities, and social benefits that no other types of zones could provide.

But there are intangible problems for foreign companies in practical application given the sophisticated procedures and preconditions. For example, to apply for HTE, the company's intellectual properties must be registered in China and owned by the Chinese branch, which is not the case for many foreign companies; additionally, at least 60% of the company's R&D expenditure must be used in China. Therefore, foreign investors should examine all the procedures and preconditions very carefully before application and making investment decisions in HIDZs.

[50] Source: Asia Perspective, MOFCOM (accessed 4 June 2022)

3.1.4 Special Customs Supervision Zones (SCSZs) and Pilot Free Trade Zones (PFTZs)

Special Customs Supervision Zones (SCSZs) were segregated areas set up under the supervision of customs authorities with the basic function of bonded processing trade to lure foreign investments and promote international trade. While located in the territory of China, SCSZs are treated as "overseas" in commercial aspects.

6 sub-types of SCSZs were introduced in due course.[51] Though named differently, they partially overlap in functions. By the end of 2022, there are in total 168 SCSZs in China, with more awaiting approval from the General Administration of Customs.[52]

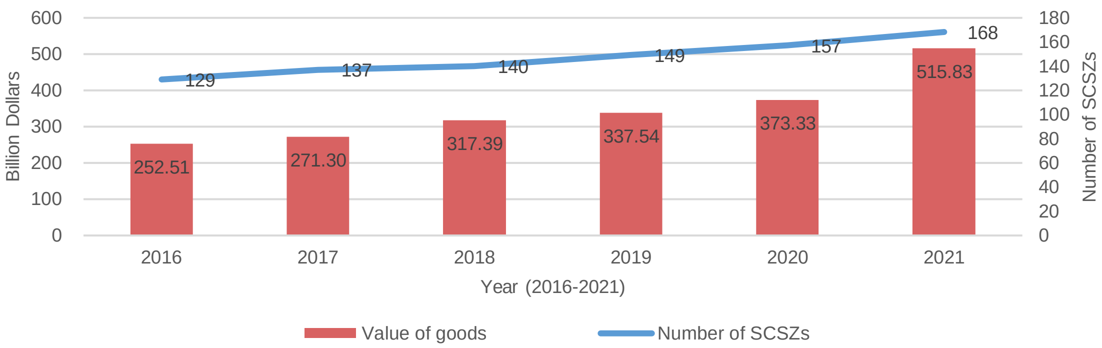

Figure 18: Number of SCSZs and Value of Goods Passing through SCSZs [53]

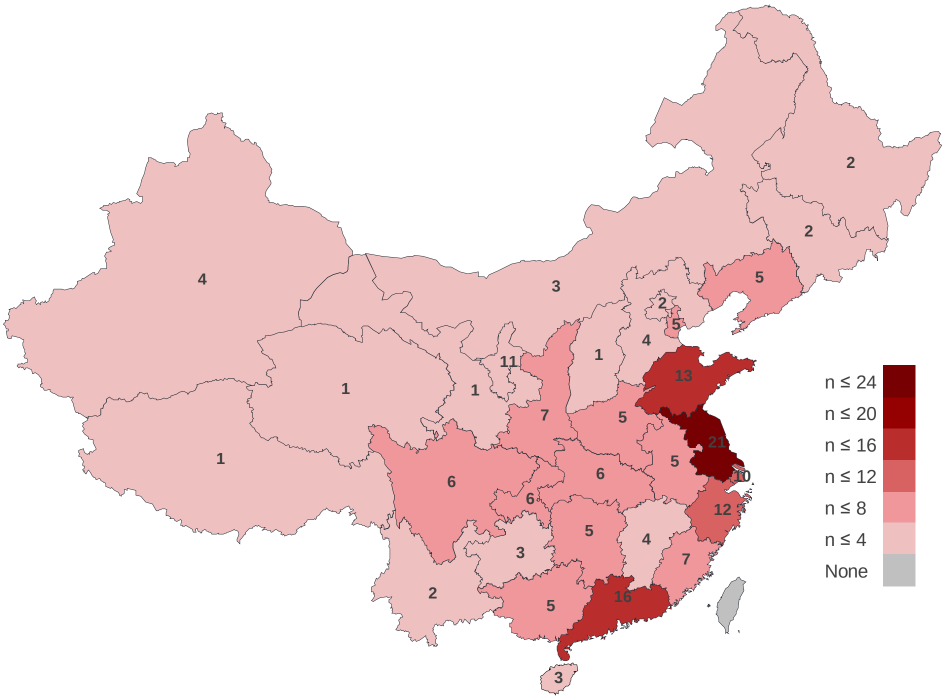

Figure 19: Distribution of 168 SCSZs in China

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51 See: "Different Types of National-level Economic Zones in China"

52 http://www.customs.gov.cn/zms/hgtsjgqy0/hgtsjgqyndqk/4803303/index.html (accessed 21 February 2023)

53 http://cceeccic.org/407775227.html (accessed 21 February 2023)

However, the Plan to Speed Up the Integration and Optimization of SCSZs issued in 2015[54] proposed that all existing SCSZs will be gradually upgraded into CBZs as they incorporate all functions of the rest types; and all newly-established SCSZs will be uniformly names as CBZs.

On par with its functions, SCSZs are strictly export-driven zones. Figures from custom authorities revealed that the total FDI of SCSZs have already passed 100 billion dollars early by 2019. In 2021, the total value of bonded goods passing through SCSZs reached 515.83 billion dollars and the total import and export value amounted to 1,210 billion dollars, roughly 20% of that of national total. CBZs presented itself as the dominant type of SCSZs, contributing to 3/4 of the import and export value combined of SCSZs, a tendency expected to continue due to the endorsement of national policies.

Typical Features and Incentives

See attachment 3

Pilot Free Trade Zones (PFTZs)

Pilot Free trade zones (PFTZs) are areas delimited by the central government within the country's border as multi-functional economic zones to liberalize trade and foreign investment by means of preferential tax and special custom supervision policies.

In principle, PFTZs would allow goods to be imported, manufactured and re-exported without "intervention" from customs authorities. However, current PFTZs in China are undergoing a test run and business activities inside remain largely supervised by custom authorities. During this period, they usually start by incorporating several SCSZs geographically, with their functions upgraded and expanded. Successful experiences and models are shared with others on a regular basis.[55] Till now, there are 21 PFTZs in China.

Just as SCSZs, PFTZs currently also rely heavily on export and international trade. In 2020, The FDI utilized by 21 PFTZs reached 32.37 billion dollars, making up of 18.1% of that of the national total; its value of import and export rose to 1,091.14 billion dollars, approaching 18% of that of the national total, with an increase of 14.5% than last year. [56]

Limitations

SCSZs are typical outward-oriented zones that are good options for companies in processing and assembly operations, international trade, e-commerce and logistics, etc. PFTZs are supposed to further liberalize business environment with policy tools, and free businesses from

54 http://www.gov.cn/zhengce/content/2015-09/06/content_10141.htm (accessed 4 June 2022)
55 http://www.customs.gov.cn/zms/zmsyq/zmsyqzdcxyfztg/index.html (accessed 5 June 2022)
56 https://m.gmw.cn/baijia/2023-02/02/36340960.html (accessed 21 February 2023)

burdensome regulations of custom supervision, but the result of such reforms remain inconsistent and unclear. Dissimilarities between PFTZs in terms of incentives require investor to examine each PFTZ individually, which exerts much pressure on the preparation works before entry.

3.1.5 Zones with Broader Goals

NEAs and CRPZs are zones designed with broader goals beyond economic aspects In fact, most NEAs and CRPZs incorporate ETDZs or HIDZs within their scope geographically; industrial development remain one of their core objectives for which they enjoy more freedom and autonomy in providing incentives. Investors may consider combining extra incentives from NEAs and CPRZs when selecting a zone.

National New Areas (NEAs)

NEAs are zones designed to restructure regional industries with policy tools to solve the socio-economic problems appeared in the process of development, such as structural imbalance of industries, overcapacity, housing shortage, traffic congestion, resources shortage and environmental pollution, etc. To this end, the decisive task of a NEA is to pinpoint the balance between urbanization and industrialization.

Today there are 19 NEAs in China, of which most were authorized after 2010. NEAs typically cover the entire district of a city along with rural regions. The administrative committee of a NEA is also made government of the district to ensure policy implementation.

Decided by their goals, incentives of NEAs tend to take social aspects into account and vary substantially from one another. The lack of an industrial focus undermines its appeal to investors. In addition, most NEAs include ETDZs or HIDZs within its scope. But still, it could provide stronger incentives in certain innovative and green industries[57], a positive factor to examine in selection of local economic zones.

Comprehensive Reform Pilot Zones (CRPZs)

CRPZs are created to explore new ideas and methods to assist local development in a specific direction. Today there are in 12 CPRZs in China. Similar to NIDZs, most CRPZs are located in major city clusters where the socio-economic status is ready for experimental changes. For example, Chengdu-Chongqing CRPZ works on the balancing rural and urban development, Shanxi CRPZ tries to shift its growth model from selling resources to a more innovation-driven path.

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[57] Most NEAs have formulated supporting incentives for innovation and green industries, for example: http://www.xihaian.gov.cn/zwgk/gknr/zfwj/zcxwj/bgswj/202201/t20220125_4279217.shtml (accessed 5 June 2022)

In practice, the central government merely grants more autonomy to local administrations. Common incentives like tax relief, financial support and national projects are not handed out directly to the scheme of CRPZs, pushing local administrations to invent other types of incentives. As a result, some CRPZs have rather strong incentives. For example, Shanxi CRPZ's reward for setting up local headquarters.[58]

3.2 Opportunities and Challenges Emerging for Foreign Companies

As per the shifting goals of each type of economic zones, incentives provided are evolving to be more precise, institutionalized and diversified after years of trials. To form incentives, the central government would first issue general polices with a certain purpose, of which suitable items would be selected by provincial/municipal government to form an overall guideline for local zones. Zone administration would then breakdown the goals into tasks independently and formulate matching incentives. This mechanism enables zone administration to interpret national policies with a certain freedom except for strict "redlines"[59] and customize actual incentives to attract investment efficiently.

Apart from tax relief, one-stop corporate services, tax rebate, fund-raising support, investment incentives, low-interest loans, talent pool, land use, IP protection and government purchase orders are increasingly offered by zone administrations as negotiable options to leverage their strengths, an opportunity for investors to earn more favorable incentives.

But some come with more meticulous requirements. For instance, corporate income tax refund is now a common tool for many zones, but comes more industry-oriented and program-based. Such incentives often require certain criteria and a series of procedures to apply for.[60] This process has also given rise to terminology issues regarding certain interpretations of policy. For example, "regional/corporate economic contribution", a common criterion in evaluating corporate qualifications for direct reward, is often interpret differently. Some zones may take investment in fixed assets into consideration, while others simply focus on tax. [61]

Autonomy of a zone is also a mixed factor for foreign investors. A zone with more autonomous

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58 https://zgq.shanxi.gov.cn/zcwj/zgqzc/202112/t20211210_3845471.shtml (accessed 5 June 2022)

59 For example, negative lists aforementioned in 2.2.

60 As illustrated by a policy document issued by Hefei High-tech Industrial Development Zones, a company has to pay over 3 million RMB taxes and increase by over 30% in terms of its tax contribution to the Zone to get a 50% tax refund of the increased part. See: http://gxq.hefei.gov.cn/public/13781/107521471.html (accessed 5 June 2022)

61 For example, Beijing ETDZ considers only tax contribution, see: http://kfqgw.beijing.gov.cn/zwgkkfq/yzxwkfq/202202/t20220222_2614349.html (accessed 5 June 2022) While Shanxi CRPZ also evaluate other factors, see: https://zgq.shanxi.gov.cn/zcwj/zgqzc/202112/t20211210_3845470.shtml (accessed 5 June 2022)

power may indicate easier administrative procedures, quick responses, more financial support from central government and more comfortable business environments, such as the case in Guangzhou ETDZ.[62] However, greater degree of autonomy could also be tricky in negotiations for terms of investment. The administrative team often hold a stronger position and prefer large companies, as their top priority as a government body is to maximize the taxable value of each acre of land.

Foreign investors could rely more on local policy experts to clarify ambiguous criteria, evaluate qualifications, and negotiate more skillfully.

[62] Guangzhou ETDZ's administrative team oversees the ETDZ and the city district at the same time, as the Administrative Committee of the Guangzhou ETDZ and Government of Huangpu District.

Attachment 1

Typical Features and Incentives of ETDZs

Aspects	Description	Example
Industrial Focuses	Generally prefer technology-intensive and manufacturing industries.	At least one type of manufacturing industry for each ETDZ, see: *Catalogue of China's Development Zones the Approval of Which is Announced*
	Each ETDZ concentrates efforts on a few specific sectors, the so-called "theme" of development.	Beijing ETDZ listed Information and Communication Technologies (ICT), Robotics and Smart Manufacturing, High-end and Intelligent Connected Vehicles, Biotechnology and Healthcare as four pillar industries.
Location	Prefer more developed areas, as lots manufacturing industries have strict requirements for infrastructure, transportation and labor force quality.	Most ETDZs located in the eastern and middle regions of China, see: "Distribution of 230 ETDZs in China".
	Mostly located in peripheral regions of a city to acquire adequate industrial land.	Chengdu ETDZ located in the southeast corner of the entire city, Chengdu HIDZ is much closer to the city center by contrast.
Land Area	Usually cover a much larger area compared with the rest types of zone: the Average land area is roughly 13 square kilometers.	Guangzhou ETDZ covers the whole District of Huangpu, while Guangzhou HIDZ includes only a few industrial parks, which is the same case for many other cities.
Infrastructure & Facilities	Usually with well-developed infrastructure, such as well-connected intercity railways, close to airport and logistic centers, mature supply facilities for industrial resources.	Applicable for most ETDZs
	Build standard factory buildings and offices beforehand to attract investors.	Applicable for most ETDZs
	Many ETDZs incorporate one or several types of SCSZs to facilitate exports.	Wuhan ETDZ incorporates Wuhan CBZ within its scope geographically.
Operations & Management	An administrative committee appointed by local government.	Applicable for most ETDZs
	There are also one or several state-owned companies (SOEs) in charge of investments and business operations.	Applicable for most ETDZs
	In rare cases, local government itself act as the administrative committee, which actually gives more autonomy to the zone.	Qingdao ETDZ integrated with Government of Huangdao District in Qingdao
Typical Incentives	Tax relief.	The 15% CIT rate which applies to foreign invested manufacturing companies; foreign companies can also apply for two years exemption of CIT and an extra three years of 50% CIT reduction; local governments could also decide to further reduce local CIT.
	Export incentives.	Products manufactured for export were exempted from commercial and industrial taxes in its production process.
	Preferential policies for manufacturing industry.	Tariff and import tax are removed for manufacturing equipment, raw materials, construction materials, vehicles and office consumables utilized for the sole purpose of operation/production (not for sale). Some ETDZs may offer free standard factory buildings and zero-interest loans used for purchasing manufacturing equipment for promising startups.
	Prioritized Land supply	ETDZs usually provide industrial land at a low price/low rent for manufacturing companies. A common practice is to allow companies to delay payment for a few years until they are able to pay with profits.

Attachment 2

Typical Features and Incentives of HIDZs

<table>
<tr><th>Aspects</th><th colspan="2">Description</th><th>Example</th></tr>
<tr><td rowspan="2">Industrial Focuses</td><td colspan="2">Generally welcome high-tech industries specified in the Catalogue, prefer innovation-driven, IP-intensive and green industries.</td><td>Companies recognized as High-tech Enterprises enjoy more incentives than non-recongzined ones.</td></tr>
<tr><td colspan="2">Each HIDZ also concentrates efforts on a few specific sectors as the “theme” of development.</td><td>Hefei HIDZ lists artificial intelligence, integrated circit, quatumn technology, biomedicine and new energy as major directions of development.</td></tr>
<tr><td rowspan="2">Location</td><td colspan="2">Close to city centers, at regional hubs of creativity and innovation</td><td rowspan="2">Beijing Zhongguancun HIDZ is much cloer to the city center compared with Beijing ETDZ. Also, Zhongguancun is the most renowed national hub and higher education center in China.</td></tr>
<tr><td colspan="2">Easier reach to R&D institutes, universities and commercial facilities</td></tr>
<tr><td>Land Area</td><td colspan="2">Usually cover a smaller area than ETDZs, but bigger than SCSZs: the average land area is roughly 10.7 square kilometers.</td><td>Many HIDZs are included geographically in ETDZs, such as Guangzhou HIDZ.</td></tr>
<tr><td rowspan="3">Infrastructure & Facilities</td><td colspan="2">Usually with well-connected transportation network and sophisticated commercial facilities to serve researchers and employees.</td><td rowspan="3">Applicable for most HIDZs, but prototypical cases can be best found in better-developed HIDZs, such as Shanghai Zhangjiang HIDZ, Beijing Zhongguancun HIDZ, and Shenzhen HIDZ.</td></tr>
<tr><td colspan="2">An HIDZ typically own clusters of research centers and universities doing high-tech R&D for local industries.</td></tr>
<tr><td colspan="2">Incubators, investor and technolgical service companies often gather in HIDZs to provide cheap facilities and services for start-ups.</td></tr>
<tr><td rowspan="3">Operations & Management</td><td colspan="2">An administrative committee appointed by local government.</td><td rowspan="2">Applicable for most HIDZs.</td></tr>
<tr><td colspan="2">There are also one or several state-owned companies (SOEs) in charge of investments and business operations.</td></tr>
<tr><td colspan="2">In rare cases, local government itself act as the administrative committee, which actually gives more autonomy to the zone.</td><td>Changzhou HIDZ integrated with Government of Xinbei District in Changzhou</td></tr>
<tr><td rowspan="5">Typical Incentives</td><td rowspan="3">Universal Incentives</td><td>Tax relief.</td><td>Mostly program-based, for example, 15% CIT rate for High-tech Enterprises and Technological Advanced Service Companies.</td></tr>
<tr><td rowspan="2">Less restrictions and facilitations for foreign professionals</td><td>Multiple-entry visas valid for multiple years for professionals; for those working in HIDZs, validity of a residence permit can be extended to at most five years.</td></tr>
<tr><td>Less restriction on age (up to 65 years old)in application of residence permit</td></tr>
<tr><td rowspan="2">Locally customized Incentives</td><td>Fixed assets investment subsidies</td><td>Applicable for most HIDZs, but vary significantly. The subsidies are usually given directly to enterprises with a fixed ratio of the amount of investment made.</td></tr>
<tr><td>Subsidized housing and government rental assistance</td><td>Incentives may include office, manufacturing building and operation subsidies, which is also applicable for most HIDZs, but vary significantly.</td></tr>
</table>

Attachment 3

Typical Features and Incentives of SCSZs

Aspects	Description	Example
Industrial Focuses	Generally welcome manufacturing and international trade-related industries, such as processing and assembling, e-commerce, logistics, maintenance and repair services	Applicable for most SCSZs.
	Each SCSZ also concentrates efforts on a few specific directions of a sector.	Shanghai Waigaoqiao CBZ focuses on industrial resoruces procurement , import and exports of non-ferrous metals and IT parts.
Location	located near regional transportations centers, such as ports, logistic parks, airports and train stations.	Applicaboe for most SCSZs.
	Sometimes several SCSZs are incorporated into a ETDZ to reduce transporation cost.	Guangzhou EPZ is located in Guangzhou ETDZ.
Land Area	The smallest zone of all types of zones on average: the average land area is roughly 2.5 square kilometers.	Applicable for most SCSZs.
Infrastructure & Facilities	Usually with well-connected transportation network, warehouse, factories and logistics facilities.	Applicable for most SCSZs.
	No residencial and commercial ares are planed or allowed in SCSZs, only facilities necessary for production, trade and business operations are allowed.	Applicable for most SCSZs.
Operations & Management	An administrative committee formed by local custom authorities.	Applicable for most HIDZs.
	There are also one or several state-owned companies (SOEs) in charge of investments and business operations.	
Typical Incentives	A series of preferential tax policies	Bonded policy, tax exemptiona and reduction, tariff rebates,etc. For example, goods entering SCSZs from abroad are not categorized as imports and enjoy preferential bonded policies
	Trade facilitation and promotion policies	For example,t he processing and manufacturing companies in the zone can use the surplus production capacity to undertake the entrusted processing from outside the zone.
	Relaxed foreign exchange policies	Goods entering and leaving the area (outside the domestic area) can be settled in foreign currency or RMB.

4. Site-selection Evaluation Criteria

In the evaluation of site, companies should find the equilibrium of different factors for instance cost, risk and potential benefits. In the context of the complicated political and economic context, Strategic risk, rather than simple cost-orientated, management awareness is extremely important for foreign companies nowadays to mitigate the risks in going concern. Meanwhile, potential opportunities and benefits can be attained through industry clusters.

4.1 Cost Reduction to Expand Profit

It is the most basic goal for companies that to expand the margin size. The attraction of different sites from cost saving dimension to the enterprise should be measured by two indicators: first, the extent of overall cost deduction, to be specific the cost of labour, land, energy, delivery, material and financing; second, the fluctuation of price of the sensitive factor for the company.

Companies should carefully analyse both the characteristics of their industry and the operation performance to identify their accurate qualitative and quantitative demand in each production factor. Textile and other upstream factories, which are highly dependent on labour force and sensitive to the human cost, often prefer location that is close to the low-cost labour force to reduce the cost of production. Land is the most crucial factor of production in agriculture because of the high requirements on quantity and quality. Therefore, agricultural companies tend to be distributed dispersedly in vast rural area. However, industry and service industry tend to be in urban areas with dense population, sufficient raw materials and superior location conditions due to the characteristics of raw material orientation, transportation hub orientation and population aggregation orientation.

4.2 Contribution to Risk Management

Flexible Supply Chain Network

The pandemic has exposed the fragility and inherent inefficiencies of traditional supply chain and the limitation of the just-in-time methodology that many companies relied on today. In the context of globalization, foreign companies today have complex supply chains and face significant pressure to build a flexible supply chain to resist the risk in chains disruption.

Logistics capability of a city should be taken into consideration when evaluating site. Developed logistics network can help improve the level of product circulation. Once the supply chain disrupts, the ability of logistics to timely schedule can help alleviate the impact of disruption.

Company can spread the risks of disruption if the site is located close to other alternative upstream supplier. While China is shifting away from low-cost production, more and more foreign companies are seeking to diversify their market and supplier portfolio and considering moving toward other Southeast Asian countries. China's neighbouring country Vietnam, for instance, has cheaper prices over land purchasing, labour wages, and operational expenses for factories and warehouses. Removing part of the supply chain there cannot only integrate supply chain, but also diversify the market.

Country and Regional Policies Incentive

The impact of risk arouses in changing of policies is often intense for foreign companies because of the high potency, short response time and complexity of causes. Therefore, company need to pay attention to and comprehend the policy at not only national but also regional levels.

The government's policy program is one of the most primary drivers for China's regional and industrial prosperity. Notable cities such as Guangzhou, Shenzhen, and the newest megacities such as Chongqing are a direct effort of the country's government to promote trade activities and economic growths within those cities. Apart from national-level policies, provincial governments also have objectives and policies in-place to support the growth of certain municipal counties. Regional incentive programs for foreign companies within specific industries can drastically differ. When selecting sites, the company should consider both regional incentive programs targeting one specific industry and incentive programs targeting its downstream and upstream sectors, leaving more possibilities to supplier and buyer portfolio and ensure that the shortlisted sites do fall within the national or regional government's area development plan. The conformance with policies may in future years help companies realize economic benefits.

Narrowing Cultural Gap

The level of regional internationalization is vital in evaluating the acceptance and entry difficulty, as it provides a straightforward indicator of how friendly a market to foreign companies is. In regions that have low level of internationalization, problems such as inadequate support for administrative activities, lack of IP protection, obstacle in doing business with other local businesses and lack of talent may arise, thus damaging operation longevity for foreign companies.

While selecting the site, international education system is another essential factor. There is a huge demand in international education to accommodate the children of foreign executives and workers. The amount of international schools can indicate Western educations need which is always on par with the number of foreign talent and the advanced level of education. International school shortage can become a big hinder in site-selection.

4.3 Potential Benefits in Industrial Clusters

Industrial clusters consist of companies, suppliers, service providers, educational, research and specialized training institutions that support one another. The development of industrial clusters can attract more related enterprises, deepening cooperation of production in this region and improving regional production efficiency, then in long-term greatly reduce the transportation costs caused by frequent transactions among enterprises. Because of the corresponding R&D service institutions and professional talents, professional knowledge, production skills, market information and regional innovation are easy to produce and promote in clusters. The clusters can also expand their influence by attaining local government support for their contribution in jobs creation, urbanization advancement and the development of regional economy and society.

5. Overview and Examples in Selected Industries

Over the past few years, the rapid growth in the manufactory industries, such as Automotive, Green Energy, Semiconductor and Biomedicine have drawn the most attention of the investors.

5.1 Automotive

In 2022, China's auto production and sales completed 27.021 million units and 26.864 million units respectively, up 3.4 percent and 2.1 percent year-on-year, with production and sales ranking first in the world for 14 consecutive years. Benefiting from favourable policies to stabilize growth and promote consumption, such as the halving of purchase tax, China's auto market achieved growth against the economy downturn, showing strong development resilience.

The rise of New Energy-Powered vehicles, particularly electric vehicles, is a key driver for the growth of automotive industry. The annual production and sales of new energy vehicles reached 7.058 million units and 6.887 million units respectively, up 96.9% and 93.4% year-on-year, with a market share of 25.6%.

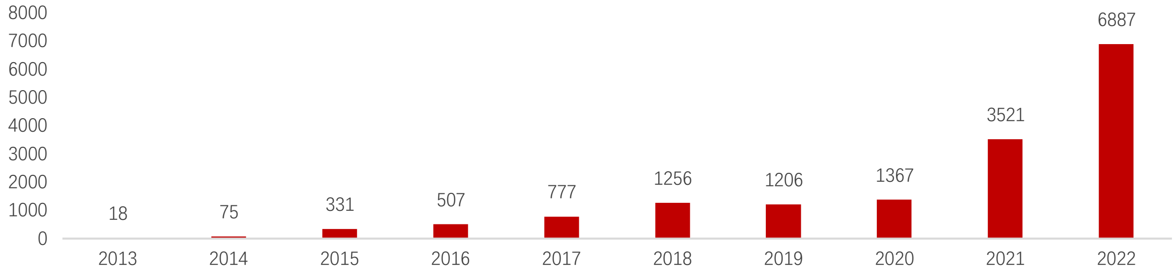

Figure 20: China's EV Sales Volume in Thousand Unit [63]

On policy side, China had undergone a path to gradually open its automobile market to the foreign investors.

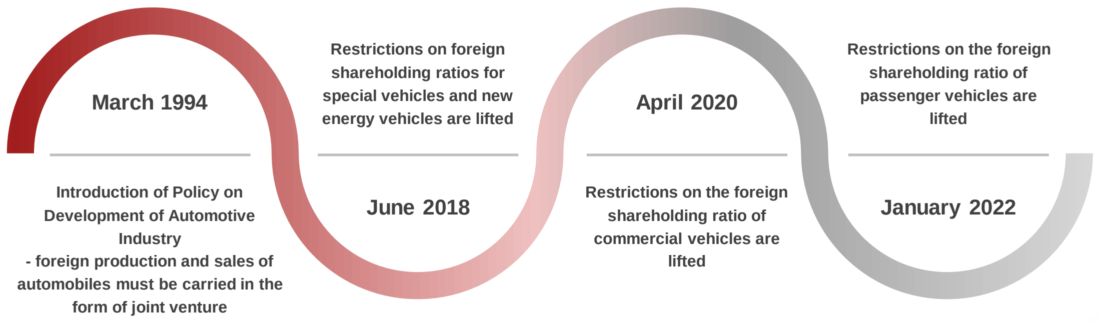

Figure 21: Change of Policies for Automotives

[63] https://www.hangyan.co/charts/3032795900985476307/ (accessed 11 February 2023)

On the other hand, the growth of China's automobile export is also exhibiting its increased share in overseas markets. In 2021 alone, the total export units have exceeded 2019 and 2020's combined figures. 64Statistics from China Association of Automobile Manufacturers (CAAM) show that in year 2022, China car export reached a total of 3.111 million vehicles (67.9 thousand EVs, account for 21.8% of the total) , up 54.4% year-on-year. China has overtaken Germany, United States and South Korea to become the world's second largest auto exporter after Japan.

During the period of 2021-2022, automakers and companies in the industrial supply chain have increased their investment in China. By establishing R&D centers in the world's largest automotive market, these companies will have a better understanding of market trends and better access to local resources for R&D in product design, service upgrades and technological innovation.

Newly Established R&D Center

Auto Maker	Location	Auto Supply Chain Company	Location
Mercedes-Benz	Beijing	EASTMAN V-KOOL HÜPER OPTIK LLumar SunTek WINDOW FILMS	Shanghai
HYUNDAI	Yantai, Guizhou	vitesco TECHNOLOGIES	Tianjin
PORSCHE	Shanghai	Continental	Chongqing
Ford	Shanghai	SCHAEFFLER	Shanghai
Volkswagen	Suzhou	FORVIA Faurecia	Shanghai

5.2 Green Energy/Energy transition

To follow up with central government's call on peaking and neutrality of carbon emissions, local governments have introduced a series of policies to renewable energy development and created a favourable business environment for investors. In addition, foreign investment in renewable energy industry is encouraged under the Special Administrative Measures for the Admission of Foreign Investment (2020). Foreign investors entitled to enjoy “equal treatment" as Chinese companies, and many restrictions for market access have been removed or revised. However, state-owned enterprises are the main players in China's renewable energy sector and dominate along the industry chain. Many foreign investors have chosen to establish joint ventures to gain access to the Chinese market.

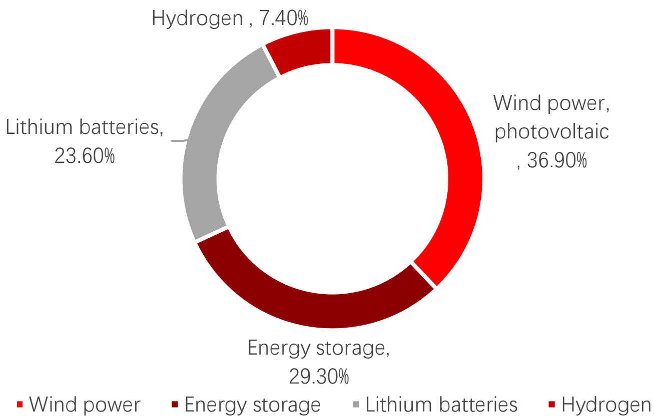

Figure 22: Investment Distribution of Renewable Energy Sector in 2022 [64]

According to CINNO Research, an institute focusing on China’s emerging market, in 2022, the investment in Renewable Energy Projects in China (including Taiwan) amounted to US$ 1.31 trillion. Among the investments, nearly US$ 480 billion went for wind power and photovoltaic projects, accounting for 36.9%; Energy Storage investment totals US$384 billion, accounting for 29.3%. The total amount of investment in lithium battery energy storage is roughly US$309 billion, accounting for 23.6%, while the total amount of investment in hydrogen energy is over US$97 billion, accounting for 7.4% of the total.

In 2022, wind power and photovoltaic, energy storage as well as lithium batteries was called “triumvirate” of the renewable energy industry, which can be seen as key investment area in China’s renewable energy sector. Investment for photovoltaic mainly focused on silicon wafer and silicon rod projects, while investment in wind power mainly go to power station set up and operation projects. Geographically, Hubei, Zhejiang and Hunan provinces occupying 25.6% of the Energy storage investment. In contrast, 38.5% of the investment in lithium batteries is distributed at Hubei, Sichuan and Jiangxi provinces.

[64] https://new.qq.com/omn/20220424/20220424A03Z1M00.html (accessed 8 May 2022)

5.3 Semiconductor

For semiconductor industry, China remains the largest single market in the world, accounting for nearly one-third of total semiconductor sales worldwide, according to a report of the Semiconductor Industry Association (SIA). In China, the expanding consumer electronics sector is primarily driving the demand for semiconductors in manufacturing smartphones, laptops, digital cameras, washing machines, televisions, etc. Additionally, a significant growth in the automotive industry is also propelling the production demand. Moreover, the emergence of numerous advanced technologies, such as GPS, IoT, AI, remote sensing, etc., will continue to drive the demand for semiconductor-based components in China over the forecast period.

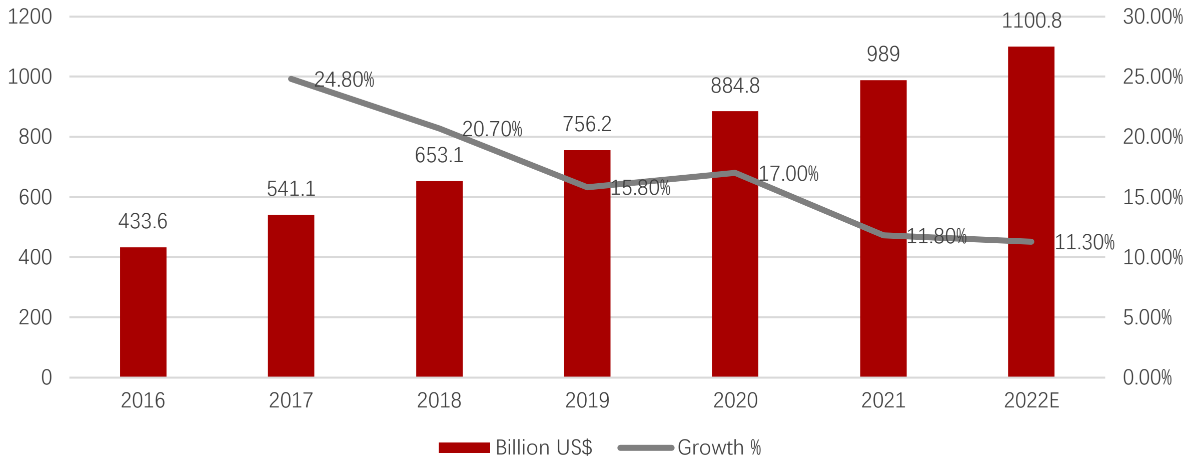

Figure 23: China's Semiconductor Manufacturing Market Size [65]

As China undergone a trade war with US and economy downturn caused by epidemic outbreak, government has carried out a series of reforms to better the business environment and bolster the semiconductor industries:

- 2016 June: Incentivizing core technologies breakthroughs for industrial development, and production.
- 2018 March: Reduced or exempted income tax for some integrated circuit manufacturers and implemented new incentive programs for newly established integrated circuit enterprises.
- 2020 August: Integrated circuit design, equipment, materials, packaging, testing, and software companies to be exempted from corporate tax and halved income tax.
- 2021 March: Exemption from import tariffs on some integrated circuit products.
- 2022 December: China will invest $143bn in its chip industry over a five-year period with a focus on advanced manufacturing. Much of the funding will be available for purchases of domestic semiconductor equipment for chip-producing companies will be entitled to a subsidy of up to 20% on the cost of equipment, companies will also receive tax breaks for investing in the assembly, packaging, and R&D of chips.

[65] https://www.askci.com/news/chanye/20220120/1743051730361.shtml (accessed 15 February 2023)

5.4 Pharmaceutical

While the Chinese pharmaceutical market continues to face uncertainty on the back of challenges around drug pricing and the low levels of IP protection, China still presents one of the most attractive investment destinations in the APAC region. Underpinning this notion, China boasts several inherent advantages that makes it well positioned for continued FDI flows into the pharmaceutical sector. These include a rapidly aging population, well-established manufacturing industry for pharmaceuticals, and notable government commitment to the sector's development.

Currently, the major pharmaceutical investment in China is dominated by domestic investors. Notably, investments related to antiviral production are the most active investment in the biopharmaceutical sector. In addition, internet giants such as Tencent, Baidu, Ali and Byte dance have engaged in the life healthcare sector as strategic investor.

There are various regulations and restrictions for setting up a pharmaceutical factory in China. Biomedicine producers are in areas with local policy support and rich resources, such as Liaoning, Jiangsu and Guangzhou.

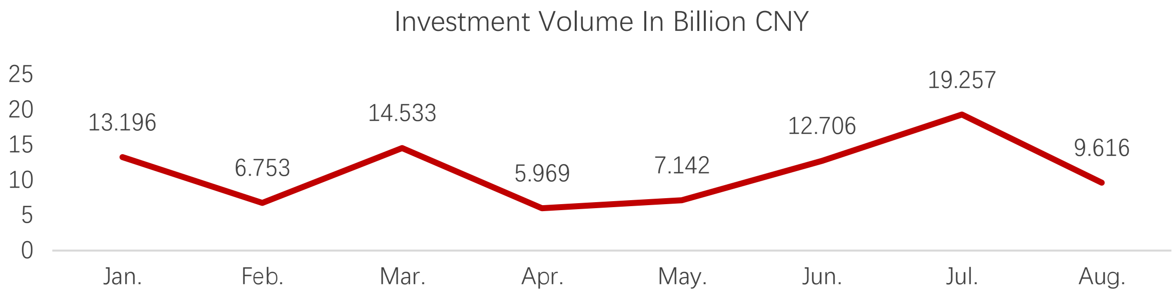

Figure 24: Investment of Pharmaceutical Industry in 2022[66]

[67] From January to August 2022, a total of 1,026 financing events occurred in pharmaceutical industry, with a total investment of RMB 89.174 billion.
The major cities in Shanghai, Guangdong, Beijing, Jiangsu and Zhejiang, together accounted for 83% of the financing events and 87.67% of the financing volume of the year.

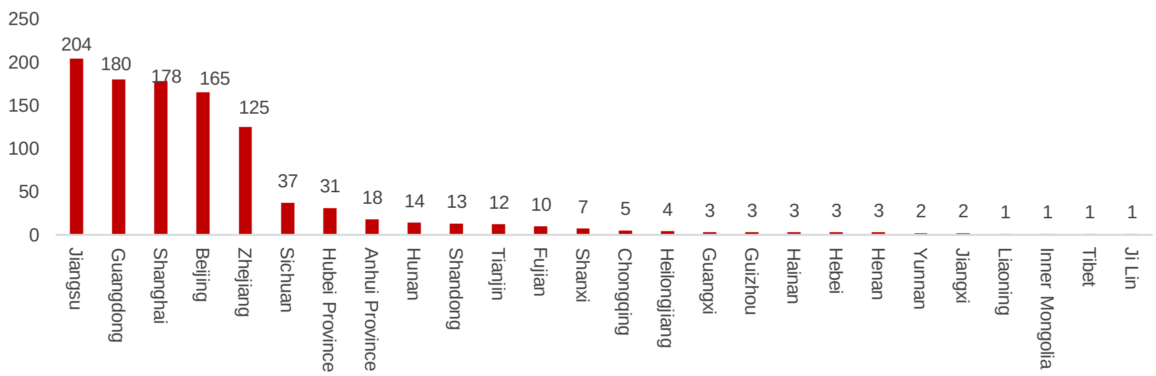

Figure 25: Numbers of Investment Cases by Location

[66] https://cj.sina.com.cn/articles/view/6762123370/1930dd06a001013srk (accessed 8 May 2022)
[67] https://www.cn-healthcare.com/articlewm/20221008/content-1446488.html (accessed 12 February 2023)

6. Recommendations

6.1 Choose Suitable Forms of Entry

Greenfield investment model

Greenfield investment model refers to practices where a company enters a new market and builds all operations/facilities from scratch, where items to be developed could range from construction of a new factory to establishing company's own supply chain without any external acquisition. This model is usually applied to companies who wanted to assume high levels of control over its internal management and business operations, corporate image retainment, and a high degree of control over its staff and workplace culture.

Despite lucrative results from a successfully established greenfield company, this model is particularly risky due to the high levels of uncertainty. Greenfield requires the company to develop all business operations from the ground-up, where without adequate support from local partners and from the government, the company would be facing very costly expenses. Additionally, without solid knowledge on a new market, particularly if the management does not thoroughly understand the workplace culture, ease of doing business, and policy & regulations, minor market shift related to currency fluctuations, changes in trade barriers, and supply chain disruptions could all be fatal to the company.

The COVID-19 pandemic severely impacted greenfield FDI projects in China in recent years. Due to uncertainty in supply chains, fluctuations in commodity prices, as well as various lockdown restrictions, greenfield models of entry were not the most popular among market entry cases to China.

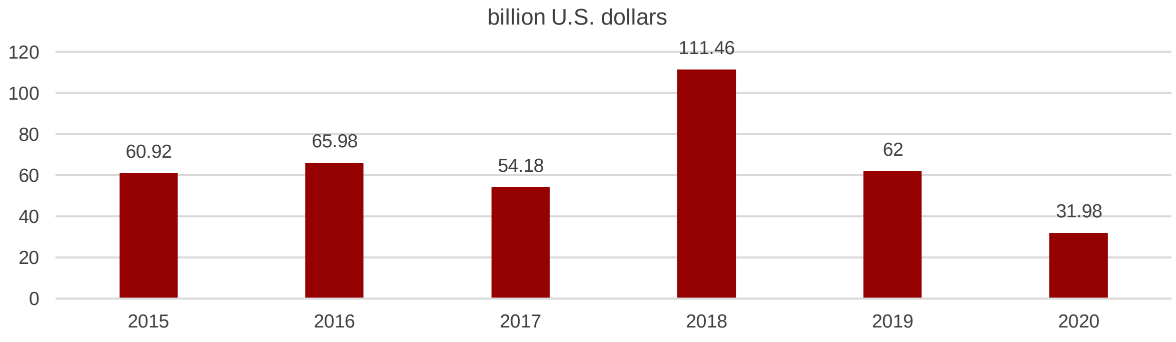

Figure 26: Value of Inward Greenfield FDI Projects in China [68]

[68] https://www-statista-com.eu1.proxy.openathens.net/statistics/1286909/china-value-inward-greenfield-fdi-projects/ (accessed 8 May 2022)

Brownfield investment model

The brownfield model is when a company entering a new market by acquiring existing local operations, where the acquisition could range from production lines to entire factory campuses. Common ways of conducting a brownfield model is either through a M&A activity or leasing out existing operations within the new market. The brownfield model is attractive for many companies due to the lowered risk factors compared to Greenfield, and that Brownfield would enable a swifter and cheaper market access for the company.

Quality and quantity of production output, scalability and ability to customize production lines, locational constraints, and difference in culture are key factors to be considered prior adopting a brownfield model to enter China. Companies should ensure thorough due diligence is conducted on shortlisted potential acquirees, and that the acquiree is capable of meeting the quality control from the company. Additionally, implementing a constant flow of communication with local supervisor upon a finalized acquisition and necessary supervision on production sites are all essential to ensure business longevity.

Joint venture model

Unlike the Greenfield and Brownfield model, joint venture allows companies to enter the market by collaborating with a local partner within similar markets or is capable of meeting support demands from the company. The company would require creating a JV company with its local partner and that the newly established JV company would include shared ownership from the two parties. This model of entry has been popular among industries such as the automotive industry prior 2022, where China's central government prohibited full foreign ownership of car companies to promote domestic growth. Companies should also closely follow China's national Negative List, as for certain industries, the only model of entry for foreign companies is through a joint-venture model with another domestic company.

6.2 Conclusion & Suggestions

According to the "2022 Special Report on Economic Situation in South China" released by the American Chamber of Commerce in South China on March 1, 2022, more than 90% of the surveyed companies chose China as one of their investment destinations, and more than half of professional service companies listed China as their first choice for investment. land. The report shows that foreign companies have a strong willingness to reinvest in China. In 2022, 72% of the surveyed companies said they would continue to reinvest in China; the total amount of the investment could reach US$100 million in the next three to five years. China will continue its significance as a key link for global supply chain.

Which city is right one for our business? Over the past three decades, the economic growth of China has seen the rise and expansion of cities across the country. Some cities grew faster than others in terms of economic development, transportation systems, population, as well as their historical and cultural significance. Cities like Beijing, Shanghai, Guangzhou and Shenzhen are known as First-Tier Cities and continue to attract the majority share of domestic and foreign investment. In the recent years, Second-Tier or Third -Tier Cities like Suzhou, Chengdu, Hangzhou, Qingdao, Tianjin, Dongguan, Wenzhou, Wuxi etc. has been rising as hot invest cities for foreign companies, especially for manufacturing industry investors.

On many occasions, the process of site selection begins when a company decides that an existing office or manufacturing location should be moved, or a new location should be added to the portfolio. Selecting a location for a manufacturing plant is a complex and lengthy process, often taking many months or even years. For that reason, many companies choose to engage outside consultants to advise them in selecting manufacturing sites. AP was regularly serves as site selection consultant to our clients and here are some takeaways as the key factors for site selection.

Talent supplying and retaining. The proximity to academy facility such as vocational schools or universities is important to the supply of qualified employee. The city dynamism and living standards could be the factors for retaining talents in a long run.

Cost Structure. Lowering costs allows greater profit margins and higher cash reserves to compensate for the financial risk of every investment. Fixed costs such as facility, labour and operational cost as well as variable costs like raw material and logistic cost will vary between regions.

Optimized supply chain. With an optimized supply chain, the facility can maximize production efficiency and scale down the need to carry unnecessary inventory. In fact, many companies in similar fields tend to cluster in one city or province to leverage this.

City Infrastructure. A stable power supply and the access to road, railway, airport or coast can facilitate travel and the transport for import and export.

Policy Incentives: As we mentioned in our report, special economic zones and industrial parks offer different policies to attract domestic and foreign enterprises to invest locally. In fact, in addition to the policies announced by the central government, local SEZ or industrial park administrations can offer additional incentives for the setup of legal entities. Depending on investment scale and the employment opportunities offered, free or cheap land use, public services and VAT, corporate income tax, personal income tax rebates, and even import/export tax exemptions for goods and equipment can be negotiated. Another suggestion is to sign an investment agreement. This agreement not only establishes the investor's commitment, but also ensures policy consistency from the local government.

About EUCJIC

The EU-China Joint Innovation Center (EUCJIC) was established at Brussels in 2017 as a non-governmental organization. Our founders include former civil servants, entrepreneurs, innovators and investors who share the same value of helping European SMEs to scale up by embracing international cooperation and innovation, exploring great potentials of Chinese market. We have set up two offices in Brussels and Beijing, with also independent close partners in Germany, France, Netherland, Spain, Finland and the UK.

We have provided innovation-based services and international networking opportunities for companies from both Europe and China, such as start new businesses, develop projects, build connections, create partnership, explore new markets, organize events and find financial support. Particularly, we are specialized in helping European SMEs with site selection, business localization, government relations and market development in China's industrial parks. We assist SMEs to realize their business goals by securing the most favorable local policies and incentives which actually cover various aspects of operation of a business, from company registration, tax rebate, office rental, human resources, government subsidies, public utilities, land use, equipment sourcing, government purchase orders and others.

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Asia Perspective is the most trusted and well recognized partner and service provider for European companies in China and South East Asia.

We are clearly specialized in bridging the business ecosystems of Europe and East Asia. Our services cover market entry and growth, operational setup and reorganization, production and sourcing, as well as cross-border M&A and financing.

Our approach has always been to offer realizable advice and hands-on support – actually getting our hands dirty on the ground implementing the strategies and plans that we develop for our clients. We offer both project based advisory to help develop your business, and ongoing business services to unburden you from setting up and managing your own sales, operations, sourcing or production in Asia.

With decades of experience in the region, and we have supported European market leaders in reaching their business goals and visions. We now count many of them amongst our recurring clients.

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--A Guide to Strategic Considerations, Site Selection and Economic Zones

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