

SEB & Swedish Trade Council China Survey 2007

SEB MERCHANT BANKING SHANGHAI – China Establishment Analysis

2007-09-13

- The flow of Swedish companies into China continues to be very strong, with one new company entering the country every 4th day. The high level of activity witnessed during the last survey remains. Ninety-two companies entered between July 2006 and June 2007 compared to 88 companies during the same period 2005/2006.
- China has become a market for small Swedish companies. More than 50% of the companies that entered under this period have less than 100 employees globally.¹
- 66% established in East China. Of these, the majority set up in Shanghai.
- Industrial products is still the most important product category. However, there is a clear trend that more companies are entering within four areas:
 - Services
 - Consumer Goods
 - Environmental protection
 - Health Care

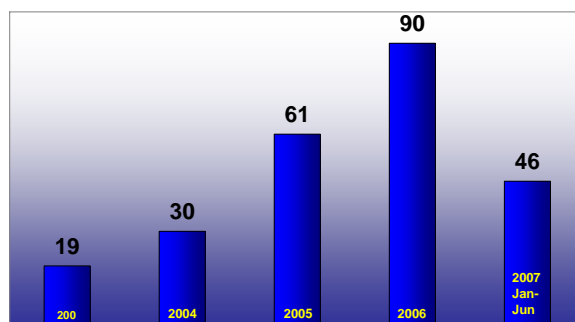
The SEB / Swedish Trade Council China Survey was conducted in July 2007 and is based on both primary sources such as interviews with company representatives, establishment consultants and the Swedish Chamber of Commerce, as well as secondary sources such as press releases, homepages and media. The report is a follow up of the survey of Swedish business establishments in China that was undertaken in 2006 and that covered entries between January 2003 and June 2006. As in the last survey, Hong Kong has been excluded.

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Continued high and stable inflow

China's booming economy continues to attract foreign investments on a large scale and foreign direct investment in the country cumulatively surpassed 750 billion USD at the end of June this year. Since China embarked on its opening-up policy in 1978, China has approved the creation of 610,000 foreign-funded enterprises. The strongest focus continues to be on Shanghai and East China, a trend that seems to have grown stronger in the past year. According to statistics from China's Ministry of Commerce, 6,748 foreign businesses registered in Shanghai in 2006, compared to 1,801 in Beijing. For the first 3 months of 2007, a record 600 new foreign business registrations per month, or 20 per day, took place in Shanghai, compared to 161 per month in Beijing. Between July 2006 and June 2007, a total of 92 Swedish companies, with no previous establishment in China, set up operations with their own personnel, or were in the final stages of doing so. Compared to the same period last year, which was an "all time high" for Sweden, the speed at which Swedish companies are setting up in China has continued during the last 12 months, and even increased slightly.

Diagram 1 Number of new Swedish entries into China, 2003- June 2007



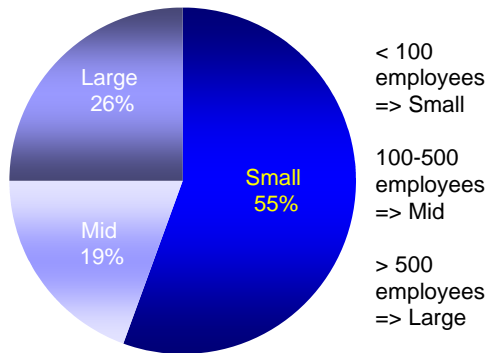
The speed at which new Swedish companies set up in China continues to be equal to one new Swedish company every 4th day.

At the same time, companies with previous establishments in China continue to expand rapidly with new offices in different parts of the country. Thus, the actual number of establishments of subsidiaries by Swedish companies is considerably higher than the number of establishment by new-comers to China.

Mainly small-sized companies are entering

In this year’s survey, it is evident that a majority of the companies are small-sized; 55% of the companies entering China today are small companies with less than 100 employees globally. Just 20% of the new entrants are medium-sized with 100-500 employees globally, and less than 26% are large companies with more than 500 employees world-wide.²

Diagram 2 Size of the entering companies



The trend identified in last years survey continues, strengthening the picture that many of the large sized Swedish companies are already present in China.

² The companies in this survey have been categorized differently from the SEB China Survey 2006, in which sizes were divided as follows: small: 0-50 employees, medium: 51-499 employees, large above 500 employees

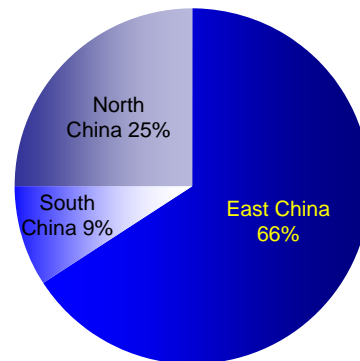
For many of the small newcomers China is one of the first foreign markets in which they establish. Several of the companies are niche players in narrow segments, others are sub suppliers to one or a few single global customers in China, and yet others are seeing opportunities to build up business with Chinese companies or consumers. The typical way for them to set up is to start with a small office or in an incubator with only one or a few employees. About 20% of the new companies in this survey have established through the Swedish Trade Council’s incubator service (Business Support Office, BSO).

One important reason why more small companies are entering China than before is because the process of setting up a company in China has become easier. The new company form, “Foreign Invested Commercial Enterprise” (FICE), which allows local sourcing, import and export as well as distribution in China, has become a very popular vehicle for Swedish companies entering the market.

Shanghai and east China – still the most popular point of entry

Every second company establishing business in China last year set up their first office in Shanghai. Along with companies setting up in nearby provinces, 66 % of the companies entering China chose to establish business in East China, 25 % chose North China and 12% South China (excluding Hong Kong).

Diagram 3 Localization of entering companies



This can be compared to last year's survey when 61% set up in East China, 15% in South and 24% in North China. Hence, Shanghai and its surrounding provinces are increasing in popularity among Swedish companies.

East China and Shanghai

As mentioned above, this is very much in line with the trend among foreign companies in general in China. Shanghai and the Yangtze River Delta (YRD), covering the provinces of Jiangsu, Zhejiang and Anhui, contribute to almost 25% of China's GDP and one third of its trade today (over 60% of Swedish exports to China end up in this region). It is also the largest recipient of foreign investment in China.

North China and Beijing

As in the last survey, Beijing is the second most popular point of entry. Many international headquarters within telecom and automotive, as well as headquarters for Chinese companies, attract Swedish companies. And some industries and products, like medical technology, require an approval from the authorities in Beijing which is easier to obtain with an office in Beijing. The upcoming 2008 Summer Olympics is also driving a great deal of investment in infrastructure. As a result, Swedish products and services have been sold within the areas of construction, airports, trains and water. An increased interest to establish in Qingdao and Tianjin, in the province of Shandong in north eastern China, has been noticed and might affect future surveys.

South China and Guangzhou

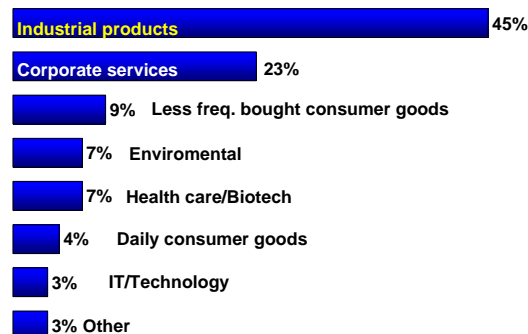
South China continues to mainly attract Swedish sourcing companies that set up purchasing offices in South China. Hong Kong is not covered in the report but has seen a revival due to its fast growing and open economy. Of the new entrants in China, about 10% established business through a Hong Kong company. When China's tax reform is implemented in 2008, which increases the tax rate to 25% for foreign production companies, Hong Kong's lower tax rate of 17.5% will make it an attractive location for holding companies to absorb as much as possible of the profit for many foreign companies in China. Hong Kong is also a popular test market, along with Shanghai or Beijing, for retail companies opening shops in

China, of which the most well-known is H&M, which recently set up their first Chinese stores, two in Hong Kong and two in Shanghai.

Less focus on industrial goods

Below is an overview of the different industrial focus of Swedish companies entering China during the research period of this year's survey. The five largest categories were industrial products, corporate services, consumer goods, environmental technology and health care.

Diagram 4 Percentage of Companies – divided by industry – that entered China between July 2006 and June 2007



Industrial Products

The percentage of Swedish companies within the category **Industrial products** has fallen from 51% to 45% as compared to the period covered in last year's survey. The companies included in this category include everything from producers of pulp and paper to welding equipment, lifts, mechanical components, heat exchangers and telecom products. Several of these companies set up production in China, or have ambitions to do so over time, but many also set up trading companies to source or sell in China.

The category industrial products has fallen because there is a much wider range of Swedish companies entering the market today than previously. Even if the flow of Swedish sub suppliers to the telecom, automotive, electronics sectors and others continues, the inflow does not seem to be as large as before and other kinds of companies are finding opportunities in China instead. In terms of revenue and number of

employees, the Industrial product category is still very dominant.

Corporate Services

The second largest category of newly arrived Swedish companies in this year's survey was **Corporate Services**. Twenty three percent of the companies that established business in the last 12 months were within the service industry, as compared to 12% in last year's survey. This includes companies in businesses like financial consulting, translation services, security consulting, IT-consulting, logistics, management consulting, law firms, recruitment services, technical consulting and others. The need among foreign companies in China to get first class services is growing rapidly. But also Chinese companies entering international markets or listing abroad have completely new needs. It's worth to note that Chinese exports to Sweden are booming, and more than doubled in the last 5 years. The service industry overall in China has grown in importance, which is further confirmed by the Swedish Trade Council's statistics of incoming inquiries, where the number of inquiries related to the service sector has doubled over the past 12 months. One example is that today one third of the total of all Swedish establishments in North China are in the service sector. The increase of service related establishments is likely to continue in the coming years.

Consumer Goods

The third largest category was **Consumer goods**, all together accounting for 13% of the entrants in the last 12 months. The Swedish companies within this category cover everything from an alcoholic beverage company and a coffee chain to luxury products such as fashion clothes. There are several possible reasons for this development. Firstly, China opened up the market for distribution at the end of 2004, allowing foreign companies to import and sell products directly to end consumers, as well as to set up retail stores in the country. Secondly, the fast growth of China's middle class opens huge opportunities for Swedish companies with the right consumption product. Disposable incomes in large cities like Beijing, Shanghai and Guangzhou are approaching 25,000 RMB per year or around

23,000 SEK per year (compared to around 150,000 SEK in Sweden) and are increasing by around 10% per annum as compared to only 2-3% in Sweden.

Several Swedish consumer goods companies have previously (before this survey) established sales in China including companies like IKEA, H&M, Oriflame, Electrolux, New Wave (Orrefors/KostaBoda), Hästens Sängar, Duxiana and Gant. This trend is also visible in the Swedish Trade Council's statistics of incoming inquiries, of which currently about 25% consist of companies aiming to sell products and services in China. The number has doubled in 12 months.

Environmental technology Sector

Another category worth mentioning is the environmental technology and energy sector. Seven Swedish companies supplying products like wind and sun power related products, consulting, emission trading and water purification set up business in China during the last 12 months. In last year's survey, there were no environmental technology companies.

With China's economy continuing to grow rapidly, the country's environmental problems are getting worse. China is today the world's largest emitter of carbon dioxide and sulphur dioxide, 70% of its lakes are severely polluted and only 50% of urban sewage is treated. According to the World Bank, 750,000 people per year die premature deaths due to pollution in China. The government is acutely aware of the problem and there will continue to be a strong need for knowledge and technology in the years to come. The country's investment in pollution treatment has risen from 1% to 1.3% of China's GDP and is likely to increase further. In China, Sweden is seen as a good example in the environmental area and is renowned for its environmental knowledge and technology. According to UNESCO and UNCTAD's reports, Sweden is considered as one of the most innovative nations in the world in areas such as environment technology and protection. This will continue to create opportunities for Swedish environmental technology companies and related industries.

Health Care

The percentage of companies within health care increased slightly from 6% to 7% in this year's survey. It covers for example companies selling medical equipment, dental products and biotech research instruments.

In the last few years, China is reforming its health care service sector with the goal to attract foreign investments to develop non-government-owned medical institutions and to provide better training to China's some 30,000 hospitals. Even if this sector is still fairly regulated, often requiring licenses that are not easy to obtain, and banning full foreign ownership of hospitals, the need for high quality health care treatment will increase exponentially with the ageing of China's increasingly affluent population.

Conclusions and outlook

The SEB/Swedish Trade Council China Survey 2007 shows a continued large inflow of Swedish companies to the Middle Kingdom. The number of new companies the first six months is even higher than last year, 46 companies have entered between January and June 2007 compared to 44 companies during the same period last year.

Sweden's interest for China is not new, but as the Chinese market changes and develops, no company with international ambitions can neglect it. As three of the world's ten largest markets are in Asia, it should be expected that Swedish companies allocate even more of their resources to developing Asian markets. Swedish companies have to develop an Asia/China strategy regardless of whether they have business in the area yet or not. Not only because the Asian and the Chinese markets are increasingly important markets for sales of Swedish products and services, but also since the competition from Chinese and other Asian companies or other foreign companies with an Asian operation will increase over time, influencing prices on the world market.

As this survey has shown, The Swedish companies entering the Chinese market now are different from earlier years in the sense that they

are smaller and less industry focused than before. China is not only a market for large companies and for manufacturing anymore, it is a much more diversified market offering opportunities to anyone who has the right business idea and the resources to build a sustainable business in the world's soon-to-be third largest economy.

As China's economy continues to grow at double digit rates, a totally new market is emerging with new business opportunities for Swedish industry. China's middle class consumers are getting richer and more diverse. They are also getting older, requiring more and more health care related products and services.

The huge foreign manufacturing industry in China (constituting around 60% of Chinese exports) expects the same quality of service from service providers as in their home markets. Chinese companies are going abroad and need help to build brand names and distribution channels, develop managing skills and understand western markets. This demand is likely to continue to make China an attractive market for Swedish companies offering corporate services. The Chinese environmental challenges are daunting, and the need for help with knowledge and technologies will be huge for many years to come. This will open up opportunities for Swedish environmental companies.

At the same time, China continues to be a low cost country with a vast pool of inexpensive labor – offering large opportunities for Swedish companies producing or sourcing in the country. However, an efficient supply chain has to be developed and implemented in order to be profitable.

All in all, this will continue to create a great deal of opportunities and China will continue to be one of the markets with most potential in the world for Swedish companies for many years to come.

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