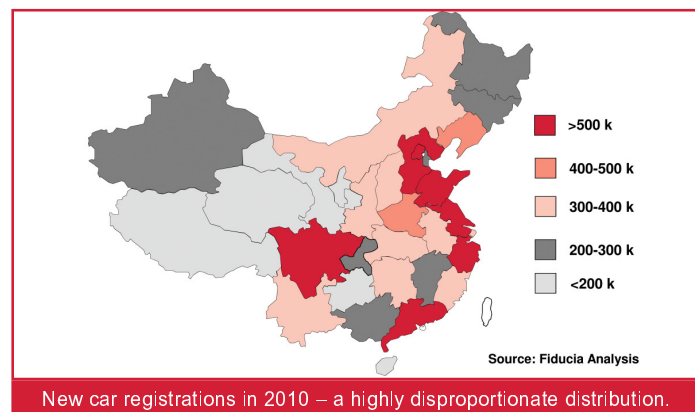


## Which road to take? – The Future of China's Automobile Industry

CAN CHINA'S RECORD CAR SALES IN 2010 BE SUSTAINED? WHAT PROBLEMS ARISE FROM THIS AND WHAT COUNTER-MEASURES ARE BEING TAKEN? CHINA FOCUS REVIEWS AND FORECASTS KEY POINTS FOR THE AUTO INDUSTRY.

China's car market grew by 32% in 2010 with sales of over 18 million vehicles. Passenger vehicles constituted the largest share of the market with sales of 13.8 million, while commercial vehicle sales amounted to 4.2 million. The government's stimulus policies in reaction to the global financial crisis spurred low-end demand from first-car buyers and boosted the sales of domestic vehicles (e.g. tax reduction for cars smaller than 1.6 litres and "Auto Goes Country" program – see China Focus Jul/Aug 2009). From 2008 to 2010 domestic carmakers' sales increased by 70%, notably much faster than the overall growth rate of 40% for overall sales.

As a nation China may sell a lot of cars, but a closer look at what is happening within the country reveals a highly fragmented distribution where the majority of sales concentration is in the coastal areas. The top 8 provinces contributed 50% of the new vehicle registrations in 2010.



### China's car sales: the other side of the coin

Development of public infrastructure cannot keep up with the growth of the car community. Beijing is already infamous for its frequent traffic congestions – in August 2010 the traffic came to a halt for twelve days on a national highway linking Beijing to Tibet. Infrastructure development takes time so the government turns to alternative measures to alleviate the situation. In Beijing we've seen a driving ban on certain weekdays for odd- and even-numbered license plates, a ban for outside license plates during rush hours and a rule where big trucks are only allowed to enter the city at night. The latest measure introduced in January 2011 is a license plate lottery where only 20,000 people picked at random are permitted to buy a car each month.

In Shanghai, road traffic volume has been up 10% each year since 2008. It is likely that the measures in Beijing will be adopted in other trouble-spots, for example, Guangzhou also used the odd- and even-numbered license plate ban during the Asian Games.

### Car rental business profits from restrictions

Although restrictions are increasing and owning costs are surging, the demand to drive is still there. This has triggered the growth of the previously not-so-popular car rental industry. Not only are domestic car rental companies expanding, foreign companies have also begun to invest in this immature market. Goldman Sachs led a EUR 50.7 million investment into Shanghai-based eHi Car Rental in August 2010, which plans to expand its business within one year to about 100 cities across China. US car rental giant Avis, which entered the China market eight years ago, also released a plan to expand its branches from currently 38 to 500 in the next five years.

### Will the latest fashion trend be EVs instead of LVs?

The government continues to promote electric vehicles (EVs) usage despite curbing car sales. The Ministry of Finance initiated an incentive policy in five pilot cities – Shanghai, Shenzhen, Hangzhou, Changchun and Hefei. For example in Hangzhou, each EV buyer can receive subsidies of RMB 6,000 (EUR 660) and additional RMB 3,000 (EUR 330) by exchanging their existing gas-powered vehicle. Whether this will be enough to lead the EV breakthrough in China is questionable.

### New avenues to pursue

After the fading out of the stimulus programmes, and assuming that a large amount of the demand for small cars was satisfied in the last two years, Fiducia expects that personal vehicle growth has reached its peak and will start to slow down to 10-20% over the next 3 years. It is very likely that the domestic producer will shift their focus from volume and put more emphasis on quality, emission and safety instead. Currently Chinese carmakers clearly lack behind their international competitors in these areas. For instance, China is many years behind Europe in terms of achieving emission standards, but they are catching up quite rapidly.

In turn, many international car makers together with their JV partners are working on plans to launch new domestic brands, specifically developed for the Chinese market. With this move they want to tap into the potential at the lower end of the market, which is so far dominated by the domestic producers. It also follows pressure by the central government to increase local innovation and development work by accelerating knowledge transfer. Some industry insiders are skeptical if this move will eventually pay off or rather nurture

## CONTENT

Which road to take? – The Future of China's Automobile Industry

Uncovering Corporate Mysteries: Tax incentives for service providers

Transforming China through Five-Year Plans – Part I: From Paupers to Princes

New EU Cargo Regulations: No Documentation – No Load

China Tax Update

Fiducia New and Events

domestic independence in the end.

This is a shortened version, the full article is available on [www.fiducia-china.com](http://www.fiducia-china.com).

**INFO BOX**

**“The world’s most expensive metal”**

Ask a Shanghainese what the world’s most expensive metal might be: “a Shanghai license plate!” Since the 1990s only a limited amount of license plates in Shanghai have been available, moreover these plates are auctioned off. And every once in a while reports about new record prices at these auctions hit the news. In February 2011 the average price was EUR 4,886 (up a staggering EUR 650 from the previous month), making the licence plate more expensive than the average car in China. Good news for some foreign companies: If the paid-in registered capital of a WFOE exceeds USD 100,000, one licence plate can be obtained for free.

## Uncovering Corporate Mysteries: Tax incentives for service providers

WITH THE SUCCESS OF THE MINI-SERIES, ‘UNCOVERING CORPORATE MYSTERIES’ WILL CONTINUE TO RUN IN CHINA FOCUS AS A SECTION WHERE PRACTICAL INFORMATION ON CORPORATE CHINA IS REVEALED.

China is keen to promote advanced technology. Currently suppliers of high-tech products can enjoy a reduced income tax rate if they qualify for the ‘High and New Technology Enterprises’ status (HNTEs – see China Focus November 2010). Similarly for service companies, preferential treatment is also available if they qualify for the status as Advanced Technology Service Enterprises (ATSE).

A company with ATSE status can enjoy:

- ▶ A reduced Corporate Income Tax rate of 15% as compared to the regular 25%;
- ▶ Corporate Income Tax deduction of actually-incurred staff education charges, up to 8% of the total payroll as compared to the standard 2.5%. Exceeding amounts can be carried forward to the next tax year;
- ▶ Business Tax exemption for income generated offshore.

On November 5th 2010, the qualifying conditions for ATSE status were further relaxed and preferential treatment is now open to a wider range of businesses. The new rules supplement a number of preceding circulars that were introduced in 2009, after a test-run launched at the Suzhou Industrial Park in 2007 had been successfully completed.



Service companies at Suzhou Industrial Park were the first to achieve ATSE status.

Companies eligible to apply for ATSE status must operate out of a first-tier city or any of a total of 21 approved pilot cities. Their business scope has to fall under one of three specified categories:

1. Information Technology Outsourcing (ITO), which refers to software and IT-related services.
2. Business Process Outsourcing (BPO), which refers to a range of service activities from strategic, controlling or supply-chain focused consulting to operational back-office functions.
3. Knowledge Process Outsourcing (KPO), which refers to outsourced R&D and IP-related services.

These categories do not necessarily require the use of ‘advanced technology’ as such, as the character of the services provided may also be essentially knowledge-based. However, practical experience with ATSE status approval cases so far as well as the previous pilot phase in Suzhou suggest that certain activities such as logistics are not covered.

Companies wishing to apply should start with a careful self-assessment and consider any changes in the mode of business operations that might be required to gain ATSE status. Internationally recognised technical qualification certificates such as ISO are not generally required anymore under the new relaxed criteria but could be subject to local specifications or case-by-case requirements.

The ATSE status is not exclusively directed at foreign companies but rather has to be seen in the context of a policy to improve the attractiveness of China as a centre for international outsourcing services. This policy could be beneficial for multinational companies establishing regional shared service centres within China, but also for subsidiaries of foreign companies that are primarily dealing with offshore clients and fulfill the requirements for ATSE status.

For more detailed information on the conditions and application procedure, please feel free to contact us at [contact@fiducia-china.com](mailto:contact@fiducia-china.com).

## Transforming China Through Five-Year Plans – Part I: From Paupers to Princes

THE AMBITIONS OF THE PEOPLE’S REPUBLIC OF CHINA HAVE HISTORICALLY BEEN STEERED BY ITS ‘FIVE-YEAR PLANS’. AFTER A DECADE OF OVER 10% GDP GROWTH, THE COUNTRY EMBRACES A NEW ERA OF MATURITY UNDERSCORED BY PLANS FOR SUSTAINABILITY, BALANCE AND HARMONY. IN THIS TWO-PART WHITE PAPER, CHINA FOCUS LOOKS AT THE SIGNIFICANCE OF THE UPCOMING 12TH FIVE-YEAR PLAN IN RELATION AND CONTEXT TO ITS PREDECESSORS.

On October 1st 1949 a new political system was established. Chairman Mao’s government quickly needed to implement a plan for the country’s future, and so Premier Zhou Enlai led a delegation to the Soviet Union in order to study their governance strategies. What they learnt paved the way for China’s first Five-Year Plan in 1953 with initiatives to manage the distribution of resources, allocate the workforce and map the direction of future development.

## The history of the PRC

### ► 1st Stage – Socialist Development

Influenced by the Soviet economic system of state ownership, the first Plan kicked off with an objective to establish a foundation for socialist industrialisation. Major areas that were nationalised were infrastructure, heavy industry, scientific research and defense.

### ► 2nd Stage – Industrial and Infrastructure Development

Picking up from the disasters of the Great Leap Forward, industrialisation again was the main concern. The Plans in this period addressed very specific milestones of industrial progression. For example:

- Growth of industrial and agricultural output value set at 12.5% (1971-1975);
- Steel and petroleum outputs should reach 60 and 250 million tonnes respectively (1976-1980).

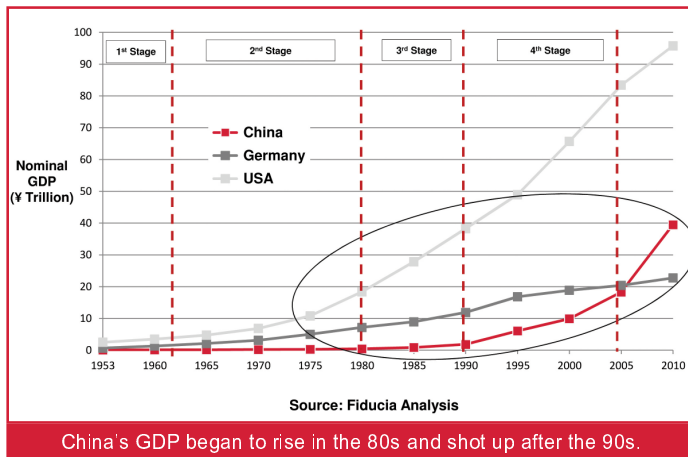
### ► 3rd Stage – Transition from Planned to Market Economy

Under the leadership of Deng Xiaoping, goals became softer and fine-tuned towards a market economy:

- Stagnant economy reformed, with new ideas including opening up to the world (1978);
- Growth of industrial and agricultural output value set at 5% (1981-1985);
- Focus shifted to technology upgrade (1986-1990).

### ► 4th Stage – Accelerated Economic Growth

Equipped with a solid foundation, China entered a high growth period with annual GDP growth averaging 10% (highest in 1992: 14%), mainly driven by export and investment.



## Review of the 11th Five-Year Plan

Prior to 2006, the term “Guideline”, which originated from the studies of the Soviet Union, was used to name Five-Year Plans in Chinese. This term was then renamed to “Programme” for the eleventh Plan, indicating a switch from traditional communism to a more strategic policy. With a new name came a new stage of development. Instead of concentrating on GDP and investment led growth, efforts were made to improve the economy and society in a sustainable way, taking into account the standard of living and environment. Did the 11th Plan achieve these objectives?

### ► Economic Development: Major Success 🟢🟢🟢

Secondary industry grew rapidly during this period and now accounts for 47% of GDP. Transport equipment and infrastructure for air, land and sea were the main drivers.

### ► Social and Living Standard: Success 🟢🟢

Disposable income is low in China; share of wages in GDP is only 8-10%, compared with 20-30% in the Philippines and Mexico and 58% in the US. If disposable income is not pegged to national economic growth it could create social

unrest, therefore raising the de facto wealth of each Chinese citizen was one of the Plan’s priorities, which targeted 5% annual increase in disposable income for urban residents and 5% annual rise in net income for rural residents. Through measures, such as raising minimum wage (first introduced in 2004), China achieved the above targets with handsome results, thereby trickling macroeconomic growth success down to the people. Yet the widening gap between rural and urban growth, together with the looming inequalities and healthcare gap between the rich and poor raise an imminent concern for the government to deal with.

### ► Environmental Improvement: Failure 🟡

Apart from implementing environmental regulation, one measurable indicator China set to achieve was 20% energy consumption reduction per GDP. However, it could only achieve 15% reduction. One hindrance was because the massive financial crisis stimulus package boosted investment sectors that were mostly high energy-consuming manufacturing industries. Nevertheless, China managed to reduce energy consumption for major energy-intensive industries (e.g. oil processing, nuclear fuel processing), which decreased by over 20% due to growing investment in energy savings and renewable energy sectors. Wind energy is a good illustration. China became the largest wind turbine market globally, surpassing the US in 2009 and currently has about 40% of global share in terms of installed capacity.

Overall, the 11th Plan was successfully implemented. Still, there is follow up work to address in the next Plan. The content of 12th Plan is expected to continue with the emphasis on structural and sustainability development. With “inclusive growth” and “balanced economy” as the headline, China is expected to highlight domestic consumption, especially in the midst of international pressure to reduce its trade deficit coupled with domestic inflationary worries.

Part 2 will discuss the announcements of the 12th Plan and what lies on the cards for foreign companies, so stay tuned.

This is a shortened version, the full article is available on [www.fiducia-china.com](http://www.fiducia-china.com).

## New EU Cargo Regulations: No Documentation – No Load

FROM JANUARY 1ST 2011, NEW DOCUMENTATION RULES CONCERNING GOODS COMING INTO EUROPE HAVE COME INTO FORCE. CHINA FOCUS HIGHLIGHTS THE NEW CHANGES AND HOW THEY AFFECT THE SHIPPING BUSINESS.

European Customs recently stepped up security on incoming shipments, resulting in additional costs, paperwork and penalties for businesses that bring goods into Europe. Chinese traders are especially affected given that the EU recently became China’s biggest trade partner, surpassing the US in 2010. Concurrently China is the biggest source of imports for the EU.

The new Import Control System requires that the ocean carrier submit an Entry Summary Declaration (ENS) to the relevant national Customs authority for all cargo containers on a vessel that will call on one or more ports in the EU. The ENS must be submitted at least 24 hours before loading at the port of departure (other forms of cargo transportation, such as by air or road, have different cut-off times). Customs will use this 24 hour window to risk assess the

shipment. This is akin to the rules already established in other jurisdictions, such as the US and Canada. The information required for an ENS includes:

- ▶ Full name and address of the Consignor and Consignee (EORI Number where available);
- ▶ Notify party / 3rd party name and address where applicable (EORI Number where available);
- ▶ Description of the goods – HS Code (universal classification system);
- ▶ Number & type of cargo, shipping marks, gross weight, container and seal numbers, UN dangerous goods code where applicable, transport charges payment method code.

Most of the information required has always been provided by the consignor to either the ocean carrier directly or to the freight forwarder during the container booking process. New pieces of data that consignors have to submit are the 'Economic Operator Registration & Identification (EORI) Number' and 'HS Code' which previously weren't required.

If the carrier or freight forwarder submits an insufficient or late ENS, this will incur delays, nominal penalties and at worst the container will not be loaded, hence 'No Documentation – No Load'. Carriers and freight forwarders have in turn adopted this rule to consignors and they generally give a cut-off time of 72 hours prior to vessel berth for consignors to submit all ENS required data. Given that ENS filing requires technology upgrades, consignors will be charged a handling fee per submission.

From experience, this new system has been running smoothly so far. Fiducia has been offering client trade support for over 28 years, for more information on our trade services please contact us at [contact@fiducia-china.com](mailto:contact@fiducia-china.com).

#### FIDUCIA NEWS

Fiducia has been awarded the status of being a 'Caring Company' by the Hong Kong Council of Social Service. This was achieved through recognition of numerous CSR activities and ventures in line with our Fidu-Share campaign, which focuses on caring for the community, employees and the environment. We'd like to thank our staff for their support and we will strive to further enhance Fidu-Share. Look out for new projects in future China Focus issues.



In other news, congratulations to Associate Alvis Kong on successfully completing the Hong Kong 2011 Standard Chartered Marathon! Alvis negotiated the 21km course in an impressive time of just over two hours. His admirable achievement, which includes raising sponsorship funds to donate to Médecins Sans Frontières, inspires us to incorporate our activities with charitable causes.

#### CHINA TAX UPDATE

##### Further Requirements for Education Surtax (ES)

In December 2010 we announced that foreign enterprises and nationals would have to start paying ES at a standard rate of 3%. As a further measure to unify the tax environment, the Ministry of Finance announced that in addition to ES, which is imposed at the state level, there will also be a Local Education Surcharge (LES) that is imposed by local governments. Previously LES was not collected by all provinces and furthermore the rate of LES differed from province to province. With the new rule in place, LES will be collected at a standard rate of 2% by all local governments, although implementation date was not specified.

Shanghai has already begun to administer LES collection. As with ES, LES will be levied on Value Added Tax, Business Tax and Consumption Tax, and funds collected will support educational development.

#### UPCOMING EVENTS

##### 10th March *Hannover, Germany* "Compliance, Controlling and Financing in China"

Hosted by IHK Hannover (The German Chamber of Industry and Commerce) and together with legal and banking experts, Managing Director Juergen Kracht will provide insights on Corporate China. His presentation will focus on 'Controlling in China' and afterwards there will be an open discussion board.

##### 29th March *Hong Kong* "Establishing a China Presence"

Business Development Manager Thaddaeus Mueller will host a discussion with members from the Hong Kong Startup Association on operating a business in China, its associated challenges and how companies can successfully govern their businesses.

##### 31st March *Hong Kong* "Sourcing Trends and Strategies in China"

Managing Director Juergen Kracht is a main speaker at the first-ever event dedicated to foreign businesses that is given by the Hong Kong Trade Development Council. He will give advice on how to buy from China and why it is still the preferred country to source from.

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Editor & contact for press and article reprints: [contact@fiducia-china.com](mailto:contact@fiducia-china.com)

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