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HELPING YOUR BUSINESS GROW INTERNATIONALLY

OPPORTUNITIES FOR UK BUSINESSES IN CHINA'S REGIONAL CITIES

Fast track to the world UK

Acknowledgements

This report is the outcome of research collaboration between the China-Britain Business Council (CBBC) and the Centre for International Business University of Leeds (CIBUL). Quantitative analysis of secondary data was conducted by the University of Leeds, while the CBBC teams in the UK and China carried out surveys, interviews and fieldwork.

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Important Notice

This research report is prepared by the China-Britain Business Council (CBBC) and the Centre for International Business University of Leeds (CIBUL) on behalf of UK Trade & Investment (UKTI). While UK Trade & Investment commissioned this work, the views presented are those of CBBC, CIBUL and the individuals and companies interviewed, and are independent of Government and do not constitute Government policy. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omission, however caused. The information contained in this publication should not be relied on, or be regarded as a substitute for detailed advice in individual cases. No responsibility for any loss or damages caused to any person acting or

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EXECUTIVE SUMMARY

The original 'Opportunities for UK Businesses in China's Regional Cities' report, published in September 2008, received positive feedback from both British and Chinese businesses and it was warmly welcomed by the Chinese Government. UK Trade & Investment (UKTI) and the China-Britain Business Council (CBBC) have organised more than 200 regional activities in China since April 2009, and since 2008 a number of senior figures have led numerous Regional Business Missions to China's regional cities, including the British Ambassador and the Chairman of the CBBC, Sir David Brewer. These business missions have enjoyed high levels of engagement from the Chinese Government, and the British companies involved have gained much from this access as well as from the introductions to local businesses they have received. There have been numerous events, both in the UK and China, that have sought to promote the opportunities in Chinese regional cities identified in the 2008 study.

This report presents the findings of research conducted in 2011 by the CBBC and the Centre for International Business at the University of Leeds (CIBUL) for and on behalf of UKTI.

The focus for many British companies in China continues to be in a small number of large and familiar cities such as Beijing, Guangzhou, Shanghai and Shenzhen.

However, business conditions in these cities are evolving quickly. In particular, numerous British companies are experiencing mature and increasingly saturated markets in these locations, with only niche opportunities for development, and growing competitive pressures from other foreign firms and increasingly sophisticated Chinese companies.

Moreover, factor input costs in China are at their highest in these cities. As a consequence, many British companies with a presence in these cities are actively seeking fresh business opportunities in a variety of China's regional cities.

Of the 274 cities in China with a population in excess of one million, 35 were shortlisted in our study on the basis of their economic size, economic growth rate, population and level of inward foreign direct investment. These cities were then ranked and grouped on the basis of a number of indices calculated using data published by China's National Statistics Bureau, the World Bank and other sources. These rankings and groupings capture the relative attractiveness of the shortlisted cities as business locations for UK companies in terms of the general business environment they offer, and their attractiveness for three different types of business activity, namely local sales, production to supply domestic markets, and research and development. Indices were also calculated to group cities in terms of their attractiveness under each priority theme.

Finally, an overall index was calculated to rank the 35 cities in terms of their general attractiveness as business locations for British companies.

To augment the quantitative analysis, the research team also collected primary data on the challenges and opportunities presented by China's regional cities using a questionnaire survey of British companies that was completed by 120 respondents.

The phenomenon of "City Clusters" was identified by the 2008 report. To develop this observation, a set of criteria has been developed to identify 12 "City Clusters" and an analysis conducted to list and compare these clusters particularly in relation to levels of foreign direct investment. Though not a criterion of "City Clusters", it became evident through the research that one commonality is the geographical limitation to within a Province.

The opportunities within themes for the 35 Regional Cities have been taken from a review of the individual cities' 12th Five Year Plans and these city plans are integrated within provincial Five Year Plans. Therefore, an introduction to a further seven provincial capitals in relation to their development and thematic potential opportunities is also included in this report in order to present a wider view of the opportunities available to British companies across China.

The key findings of this research are as follows:

- The rate of urbanisation and economic growth together with the government supported development initiatives in each of China's cities offers considerable opportunities across all business themes for British companies. The more economically advanced the city it follows that the demand and solutions become more niche. The business opportunity tends to be higher up the value chain in those more economically advanced cities matching the skill set offered by UK industry and commerce, especially for SMEs.

- The 35 regional cities identified in this study account for 17 per cent of China's population, 39 per cent of China's Gross Domestic Product (GDP) and 47 per cent of Foreign Direct Investment (FDI). The concentration of opportunity in these cities is already known to competitors bidding for the same engagement. Competition is not only coming from high profile international firms but also increasingly from nationally developed and regionally developing Chinese firms.

- Although the eastern regions still attract the highest level of FDI to China, the regions which are gaining share of FDI are all northern, western or central provinces including Hebei, Heilongjiang, Henan, Hubei, Hunan, Inner Mongolia, Jilin, Liaoning and Sichuan. Compared to the findings of the 2008 report these provinces now also have a higher number of cities which are more attractive by business activity. These two factors add to the ability to define areas of China as "City Clusters". This report identifies 12 "City Clusters" which offer equivalent types of thematic opportunity and can also be defined by similar attractiveness levels across a range of business activity, ease of business due to road infrastructure and have equal levels of government structure in order to identify engagement. As such, recognition of these "City Clusters" will help firms adopt a progressive strategy to market entry and market development.

- The greatest challenges and barriers to trade and investment relate to government regulation, policies and bureaucracy. UK companies are not formulating clear strategies in response to this. As in 2008, we have found that UK firms value the support they receive from UK Government and trade promotion organisations (TPOs) in a number of areas including lobbying and representation (especially to raise the profile of UK businesses in regional cities), access to city-level business networks (including local government and businesses, TPOs and other UK companies), and access to general city-level market intelligence and business information (especially about sector-specific business opportunities). It now appears that in addition to this work UK Government and TPOs need to be more active in disseminating information which aids understanding of Chinese government regulation at both a national and local level.

INTRODUCTION

In 2008, the report "Opportunities for UK Businesses in China's Regional Cities" focused attention on the market expansion and development of China's Regional Cities and the relevance of this to British businesses. However, in the last three years there have been several major economic and political developments which have impacted British business and their internationalisation prospects. The global financial crisis and recession which began in 2008 has changed the international economic landscape. China was not immune to this and the country launched its own financial stimulus package of US$400bn in late 2008. As a consequence of the global economic challenges, annual inward foreign direct investment shrunk by a third in 2008 but has recovered since. The positive development is reflected by the Chinese economy being valued at US$5.8 trillion in 2010, overtaking Japan to become the second-largest economy behind the USA. In 2010, China was the second-largest exporter nation and fourth-largest importing nation. Moreover, the 12th Five Year Plan was launched in March 2011 giving clear indication of the government supported priorities nationally both by province and city. In addition to economic and social targets, this plan sets out clear environmental objectives. It is now necessary to reassess the opportunities in China and, in particular, its regional cities for British industry in light of these developments.

China's economy continues to grow in double digits per annum. In recent years, the less populated, less developed western and central regions have outperformed the historic economic growth engines of the Eastern Coast. A number of factors have brought this about, including a policy shift from prioritising export driven growth to one driven more by domestic consumption and a stronger integration of the provincial economies. One of the most important factors is the national government's stimulus package which has, among other things, directed funds towards major transportation infrastructure projects in Western and Central China and which has promoted the development and opening of new domestic markets. To illustrate, the municipality of Chongqing, home to some 32 million people, recorded a gross domestic product growth of 17.1 per cent from 2009 to 2010, driven largely by infrastructure construction investments but with significant increases in the manufacturing and service industries. This is mirrored by similar levels of economic growth in other regional cities. Thirty-three of the 35 cities covered by the current study and included in the 2008 study saw their population rise from 195 to 205 million between 2005 and 2009 and their combined GDP grew by US$828 billion, or 16.5 per cent per annum, within the same period. The predicted surge in urbanisation presents challenges for the Chinese authorities which are recognised in the 12th Five Year Plan: greater emphasis is placed on education, sustainable housing and infrastructure, universal healthcare, environmental protection and the expansion of financial services. These internal challenges of urbanisation in all China's cities match many of the UK's manufacturing and service skills which therefore opens opportunities to UK businesses.

The focus of China's Five Year Plan will require greater domestic technological development and upgrading along the value chain. British firms can benefit from this by being better integrated into the supply chain of multinational enterprises operating in China or into those of national Chinese firms. Likewise, British firms can exploit their expertise and explore new business models in joint research and development projects with Chinese organisations. In the aerospace industry, for example, Airbus and Rolls-Royce have supply chain and training centres in Tianjin, 40 minutes south-east of Beijing by high-speed rail, and Rolls-Royce is jointly developing products with two major domestic suppliers from Xi'an and Chengdu, the gateways to West China.

At the same time, Chinese middle to high-end consumers are becoming increasingly sophisticated and demanding. China has recently surpassed the USA as the largest national market for cars with sales of 18 million units in 2010, of which two-thirds are foreign marques manufactured by five Sino-foreign joint ventures. Baotou, the Inner Mongolian cashmere and mining city, has the highest number of luxury cars (including Rolls-Royce and Bentley) per capita in China.

In the past, British businesses have focused their investments and operations in Beijing, Guangzhou, Shanghai, and Shenzhen for good reasons. As the national capital, Beijing will always attract the public relations operations of foreign firms. Shanghai is the largest commercial centre in China and is home to the world's leading financial and professional service companies. The manufacturing centre for exports remains firmly situated in and around Guangzhou and Shenzhen with their good links to international transportation hubs. However, the situation is evolving. For many British companies that have spotted business opportunities outside of the major conurbations of China, it will be more appropriate for them to build public relations activities with local governments than in Beijing.

Increasingly, professional services companies are following their international manufacturing clients into regional cities in China and financial services are establishing new offices in those cities that are opening specialised exchanges. Similarly, manufacturers are benefitting from lower operational costs and improving infrastructure in the Chinese hinterland.

In addition to the four major cities of Beijing, Shanghai, Guangzhou and Shenzhen there are another 270 cities in China with a population in excess of one million. Across these highly populated cities there are other factors evident to different degrees. These include the level of economic and social development, industry structure and business environment. The heterogeneity in economic growth, operational costs, competitiveness in local B2B and B2C markets, local government support and policy momentum in respect of regional development and the business projects provide both opportunities and challenges for firms to identify and select the optimum location in China. The choice of city will be influenced by the strategic objectives of the company and the types of activity it wishes to undertake. The purpose of this report, therefore, is to help UK companies identify where the best opportunities can be found among China's regional cities, while taking activity type and industrial sector into account.

1.1 Research Aims and Objectives

The aim of this report is to identify where, and how best, UK business should take advantage of the opportunities presented by the ongoing growth of China's regional cities. Specifically, the objectives of the research are to:

- Identify those regional cities in China that offer the most promise as locations for UK companies, taking account of the different types of business activity that might be conducted locally.

- Map these opportunities against the specific capabilities of UK companies, focusing on eight key business themes that match the expertise of the British economy (namely aerospace, automotive, built environment, education, energy, healthcare, rail, and retail). Each of the themes has been reported to encapsulate, where relevant, opportunities in ICT, F&PS and low carbon solutions, as well as cross over opportunities within themes.

- Update how UK companies could capitalise on the business opportunities presented by regional cities in China.

- Identify the current and future challenges and barriers to trade and investment and review the successful strategies which British firms adopt to address those.

- The research, which was carried out by the China-Britain Business Council (CBBC) and the Centre for International Business at the University of Leeds (CIBUL), comprised both quantitative and qualitative data collection and analysis.

1.1.1 Quantitative Data Collection and Analysis

In order to focus attention on those regional cities most likely to be of interest to UK companies, a quantitative-based city-screening process was implemented using secondary data obtained from China's National Statistics Bureau (in particular, China City Statistical Yearbooks 2006-09) as well as the World Bank and other sources. Specific information on the process followed is available on request from the CBBC.

In the first stage, a preliminary screening was conducted in order to shortlist a number of cities for more detailed analysis. Annual data were collected on gross domestic product (GDP), GDP growth rate, population, GDP per capita and foreign direct investment for each of the 274 cities in China with a population in excess of one million (in 2009). This data provided an indication of market size and potential. Beijing, Chongqing, Guangzhou and Shenzhen were omitted at this stage either because of their familiarity to UK businesses or the presence of UK Trade & Investment offices. Data for Shanghai was retained against which to benchmark the shortlisted cities. These data were then converted into a score which was weighted and summed to produce an attractiveness indicator for each city. Thirty-five cities progressed to the second stage of our analysis. With respect to the 2008 report, Daqing and Zhuhai were replaced by the better performing cities of Changzhou and Quanzhou.

In the second stage, a number of location-attractiveness indicators were calculated for each of the 35 shortlisted cities. Separate indices were computed for overall business attractiveness and general business environment, as well as for three different types of business activity which UK companies are likely to conduct in China, namely local sales, domestic market-oriented production, and R&D. A broad range of secondary data was collected, standardised and benchmarked against Shanghai. Shanghai was chosen as the benchmark city because of its familiarity to business, helping comparisons to be drawn. We then categorised each of the shortlisted cities into one of three groups, from Group A to Group C (with Group A being the most attractive), for each of the indices calculated.

In the third stage, a further set of indices was calculated to capture the attractiveness of each city for eight business themes that UK companies demonstrate international competitive strength. These themes are aerospace, automotive, the built environment, education, energy, healthcare, rail, and retail. Again, the shortlisted cities were categorised from Group A to Group C (Group A being the most developed and policy supported), for each priority sector on the basis of the calculated indices.

1.1.2 Qualitative Data Collection and Analysis

To complement our quantitative analysis, corporate members of the British Chamber of Commerce in Beijing and CBBC were invited to provide information about their experiences of the China market by completing a survey. Responses were received from more than 120 companies. The findings of this survey, which are presented in Section 5, together with comparisons to the responses we received in 2008, informed our analysis.

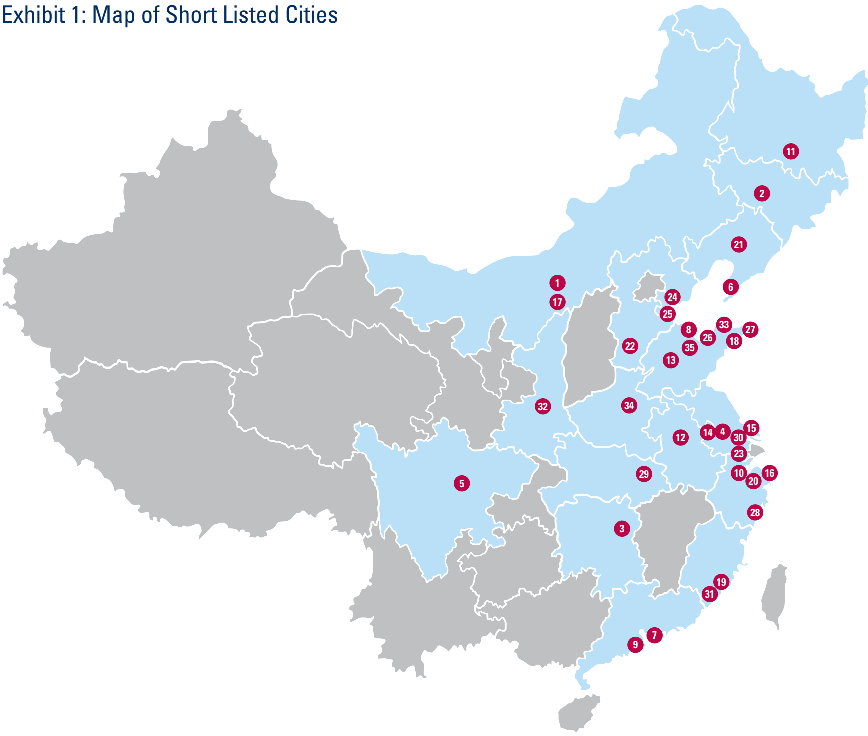
2. SHORTLISTED REGIONAL CITIES IN CHINA

2.1 Geographic Distribution

The Chinese cities exhibiting the largest market size and potential are still to be found predominantly in the Eastern provinces. This follows expectations given the selection criteria and historical foreign trade and transportation linkages which have forged the growth in these provinces.

Since 2008 the ongoing investment in, and improvements to, transportation infrastructure across China has made the notion of regional "City Clusters" a reality. Arguably, these regional "City Clusters" question the received notion of the three economic powerhouses in China being the Bohai Rim, Yangtze River Delta, and Pearl River Delta. Whereas in 2008 we identified four distinct clusters, using the same criteria we can now discern 12 "City Clusters" each of which have their own supporting infrastructure, markets, and development plans. To give just one example, Ningbo, a city of 1.3 million people located 90 miles south of Shanghai, has benefitted from the building of the Hangzhou Bay Bridge, and this has reduced the travel time by car to Shanghai to less than two hours, enabling Shanghai-based firms to relocate activities to a less costly location. Similarly, Nantong, a city 70 miles to the north of Shanghai and previously isolated by the Yangtze River, is now attracting Shanghai-based firms due to two new bridges – one connecting it with Pudong in Shanghai and the other with Kunshan in Suzhou. Beyond the traditional clusters, Wuhan and Zhengzhou, for example, are not merely North-South and East-West railway transportation hubs, but are now vibrant commercial centres with excellent road connectivity offering a diverse range of business opportunities and with ambitious political plans to further diversify their industrial base.
The increasing heterogeneity requires greater strategic analysis and clarity by individual companies.

Exhibit 1: Map of Short Listed Cities



No.	PROVINCE	CITY
1	In. Mong.	Baotou
2	Jilin	Changchun
3	Hunan	Changsha
4	Jiangsu	Changzhou
5	Sichuan	Chengdu
6	Liaoning	Dalian
7	Guangdong	Dongguan
8	Shandong	Dongying
9	Guangdong	Foshan
10	Zhejiang	Hangzhou
11	Heilongjiang	Harbin
12	Anhui	Hefei
13	Shandong	Jinan
14	Jiangsu	Nanjing
15	Jiangsu	Nantong
16	Zhejiang	Ningbo
17	In. Mong.	Ordos
18	Shandong	Qingdao

No.	PROVINCE	CITY
19	Fujian	Quanzhou
20	Zhejiang	Shaoxing
21	Liaoning	Shenyang
22	Hebei	Shijiazhuang
23	Jiangsu	Suzhou
24	Hebei	Tangshan
25	Tianjin	Tianjin
26	Shandong	Weifang
27	Shandong	Weihai
28	Zhejiang	Wenzhou
29	Hubei	Wuhan
30	Jiangsu	Wuxi
31	Fujian	Xiamen
32	Sha'anxi	Xi'an
33	Shandong	Yantai
34	Henan	Zhengzhou
35	Shandong	Zibo

Exhibit 2: Regional Distribution of Short listed Cities

REGION	PROVINCE	CITES	NO. OF CITIES
Northeast	Heilongjiang	Harbin	4
	Jilin	Changchun	
	Liaoning	Dalian, Shenyang	
Bohai	Hebei	Shijiazhuang, Tangshan	10
	Tianjin	Tianjin	
	Shandong	Dongying, Jinan, Qingdao, Weifang, Weihai, Yantai, Zibo	
Southeast	Jiangsu	Changzhou, Nanjing, Nantong, Suzhou, Wuxi	13
	Zhejiang	Hangzhou, Ningbo, Shaoxing, Wenzhou	
	Fujian	Quanzhou, Xiamen	
	Guangdong	Dongguan, Foshan	
Central	Anhui	Hefei	4
	Henan	Zhengzhou	
	Hubei	Wuhan	
	Hunan	Changsha	
Soutwest	Sichuan	Chengdu	1
Northwest	Shaanxi	Xi'an	3
	Inner Mongolia	Baotou, Ordos	

Exhibit 3: General Business Environment

CITY	RATING	CITY	RATING	CITY	RATING
Changzhou	**1**	**Changchun**	**2**	**Baotou**	**3**
Chengdu	1	Changsha	2	Harbin	3
Dalian	1	Dongying	2	Ordos	3
Dongguan	1	Hefei	2	Tangshan	3
Foshan	1	Jinan	2	Wenzhou	3
Hangzhou	1	Nanjing	2	Xi'an	3
Nantong	1	Shaoxing	2		
Ningbo	1	Shijiazhuang	2		
Qingdao	1	Weifang	2		
Quanzhou	1	Wuhan	2		
Shenyang	1	Yantai	2		
Suzhou	1				
Tianjin	1				
Weihai	1				
Wuxi	1				
Xiamen	1				
Zhengzhou	1				
Zibo	1				

2.2 City Attractiveness Groupings

In this section, we present and discuss four groupings of cities devised using a number of attractiveness indices calculated using official secondary data. Our discussions are informed by primary data obtained through the questionnaire survey.

2.2.1 General Business Environment

Sixteen variables were used to calculate a general business-environment index for each of the 35 shortlisted regional cities. In calculating this index, emphasis was placed on the role of economic size, foreign trade levels and inward foreign direct investment (FDI) volumes as indicators of market size, liberalisation and openness to international businesses. Compared to the 2008 study, the cities of Chengdu, Foshan, Nantong, Shenyang, Zhengzhou and Zibo now rank higher among the previous top listed cities. This emphasises the point made earlier that the business environment has improved across all regions of China. Between the regions there exists significant differences in opportunity, and this is addressed by our analysis of particular opportunity by business activity.

2.2.2 Attractiveness by Business Activity

China's position in the international strategy of businesses is evolving. Historically, companies have tended to use China as a low-cost manufacturing base from which to supply export markets. Since the 2008 report, production for the domestic market has become the driver for market entry, and foreign invested firms generally receive no special treatment from the Chinese authorities, with the exception of high-technology, added value operations which benefit the Chinese economy and support the upgrade of the value chain. Companies who can show this can often benefit from tax breaks and operational subsidies. These developments are reflected in the attractiveness of cities for sales, domestic-oriented production and R&D.

It is important that firms looking to target Chinese consumers recognise the advances of certain cities. Among the higher ranked cities now appear Chengdu and Foshan. These cities have a large retail and wholesale market and a large middle class consumer base but with variable scope in the luxury market.

The production environment for the domestic market has particularly improved in the cities of Changsha, Chengdu, Dongguan, Hangzhou, Nanjing, Ningbo, Suzhou, Tianjin,

Exhibit 4: City Attractiveness by Business Activity

BUSINESS ACTIVITY	CITY PROFILE	CITIES HIGHLIGHTED
Sales (Local Sales)	Higher than average disposable income Strong retail sales Good retail intrastructure Lower cost access to seaports	Chengdu, Dalian, Dongguan, Foshan, Hangzhou, Qingdao, Suzhou, Tianjin
Overall Domestic (Local Production for Domestic Markets)	Good logistics network Low labour costs Good labour availability Comparatively low energy costs Preferential government policies	Changsha, Chengdu, Dongguan, Hangzhou, Nanjing, Ningbo, Shenyang, Suzhou, Tianjin, Wuhan, Xiamen, Zhengzhou
Overall Export (Local Production for Export Markets)	Easy access to seaports Strong concentration of multinatinal manufacturers Large pool of educated workers Good manufacturing infrastructure and facilities Reliable energy and transportation infrastructure	Dalian, Dongguan, Foshan, Hangzhou, Ningbo, Qingdao, Quanzhou, Suzhou, Tianjin, Wuxi, Xiamen
Research and Development (R&D)	Large pool of university educated workers Reputable universities and science and technology facilities High government spending on science and education Concentration of high technology development zones	Changsha, Chengdu, Hangzhou, Jinan, Nanjing, Suzhou, Tianjin, Wuhan, Xi'an

Wuhan, Xiamen and Zhengzhou. But it needs to be recognised that the traditional and emerging pillar industries vary massively between them. Amongst key industries referred to in the city pages of this report Changsha is renowned for engineering and food production, Chengdu for ICT and aerospace, and Xiamen for electronics and consumer goods.

For local R&D the cities of Nanjing and Jinan are more prominent. All the major cities for this business activity reflect their status as university cities with specialised research departments. Exhibit 4 summarises the findings.

2.2.3 Overall Attractiveness Grouping

In addition to our general business environment and business-activities groupings, we also present in Exhibit 5 a grouping based on the overall attractiveness of the shortlisted cities. This is a composite index which incorporates each of the aforementioned business activity indices. Our analysis reveals that the overall business attractiveness score has improved particularly for Changchun, Nantong, and Wuxi. There are great differences between these cities. Nantong and Wuxi are both part of the Yangtze River Delta but exhibit great variety in their key industries, natural resource endowments and supply chain configurations for both local and national distribution. Changchun is nearer to either Vladivostok or Pyongyang than it is to Beijing. This brings us to the point that companies have to consider a matrix of important criteria and a selection of the regional cities to populate it in order to inform their Chinese business strategy. Additionally, their strategy will need to address the challenges businesses face and foresee as reported in the next section.

Exhibit 5: Overall Attractiveness Ranking

CITY	RATING	CITY	RATING	CITY	RATING
Chengdu	1	Changchun	2	Baotou	3
Dalian	1	Changsha	2	Dongying	3
Dongguan	1	Changzhou	2	Harbin	3
Hangzhou	1	Foshan	2	Ordos	3
Nanjing	1	Hefei	2	Shaoxing	3
Ningbo	1	Jinan	2	Tangshan	3
Qingdao	1	Nantong	2	Wenzhou	3
Suzhou	1	Quanzhou	2	Zibo	3
Tianjin	1	Shenyang	2		
		Shijiazhuang	2		
		Weifang	2		
		Weihai	2		
		Wuhan	2		
		Wuxi	2		
		Xiamen	2		
		Xi'an	2		
		Yantai	2		
		Zhengzhou	2		

CASE STUDY

COLIN BUCHANNAN

"CHINA IS SO MUCH MORE AND SO MORE VARIED THAN JUST THE MAJOR CITIES ALONE. THE OPPORTUNITIES EXIST EVERYWHERE BUT YOU NEED TO MAKE THE EFFORT TO SEEK THEM OUT."

Colin Buchanan (CB) is a leading transport planning, planning, urban design and economics consultancy founded by Sir Colin Buchanan in 1964. The company offers impartial and objective advice and excellent design solutions to a wide variety of clients. The company prides itself on the integrity and professionalism of its staff, who are key to the business, and the ability to provide a bespoke service to a broad spectrum of clients.

Major projects which CB has completed in China include detailed transport planning for Shanghai Hongqiao Airport, detailed station planning for Beijing Metro and may other metro operators around China, design review for Changzhou City Rail and design review for nine pavilions, including the China National Pavilion, for Expo 2010.

CB first approached the Chinese market following an introduction by UKTI to the Shanghai Development and Reform Commission who requested assistance with development of a strategic transport plan. This first project and recognition that there were many other projects around metro system development, a key skill set of CB, led them to establish a WOFE office in Shanghai in 2006.

As Chris Morley – CB General Manager China – explains: "At last count there were 23 cities in China developing metro systems which is an important source of work for a company like ours."

However, the company has been quick to develop opportunities matching their other skill sets. Working closely with local partners is key to the market development strategy of CB China. For example, the work with Shanghai Expo came about through introductions from relationships which had already been developed with partners at Tongji University. Chris Morley recognises that initial introductions at the correct level are vital to start new business and open opportunities and that UKTI and the CBBC have been of great help to do this in different cities such as Chongqing, Chengdu and Wuhan. The company now has a range of clients in China, including municipal governments for design-led studies, local design institutes, local operators of transport systems and Chinese and localised international architectural firms.

"By having a local office we are able to pitch as being local with international experience but there is a premium for international work and work that includes colleagues in the UK". Chris Morley explains that to overcome any price issue they carefully select work in those Chinese cities which have greater international awareness and familiarisation through trade or those which have a stature or ambition which adopts international thinking. "A local presence with local staff, even a representative office, or even regular visits from the UK makes you visible and shows that you are committed to working with people. Face time with clients is important. Never underestimate that relationships are key to business, repeat business and the building of a sustainable relationship with clients."

Though business can be developed remotely, the scale of business which CB has created in the past four years could not have been achieved without an office in China. "Localisation has allowed us to compete on cost and to have good communication with clients and stakeholders. Without a local office our level of development would have been extremely difficult."

In approaching the market Chris Morley has two areas of advice. "There is no difference to how work is commissioned or how we interact with clients and stake- holders in different areas of China. China is so much more and so more varied than just the major cities alone. The opportunities exist everywhere but you need to make the effort to seek them out."

"It is important to approach the market with a level of humility, recognising that the people you are working with are skilled, intelligent, and knowledgeable of their own market. CB brings professionalism, honesty, integrity, and a demonstration that we understand the issues and are able to deliver. This is how relationships are built."

3. "CITY CLUSTERS"

"City Clusters" is a term used to describe a group of cities in close proximity to each other. At the same time, they are also distant from the next nearest cluster creating an obvious identity of their own. As well as this geographic identity the "City Clusters" are also areas determined by their demographic characteristics of high population and high population density. We have identified 12 such "City Clusters" across China, namely:

Fujian – the cities of Fujian Province

Hei-Ji – the cities of Heilongjiang Province (abbreviated to a single character 黑 "hei") and Jilin Province (abbreviated to a single character 吉 "ji")

Henan – the cities of Henan Province, north and western Jiangsu Province and Anhui Province

Hubei – the cities of Hubei Province

Hunan – the cities of Hunan Province and western Jiangxi Province

Inner Mongolia – the cities of Inner Mongolia and northern Shanxi

Jing-Jin-Ji – the municipalities of Beijing and Tianjin and the cities of Hebei Province (abbreviated to a single character 冀 "ji")

Liaoning – the cities in central and southern Liaoning Province

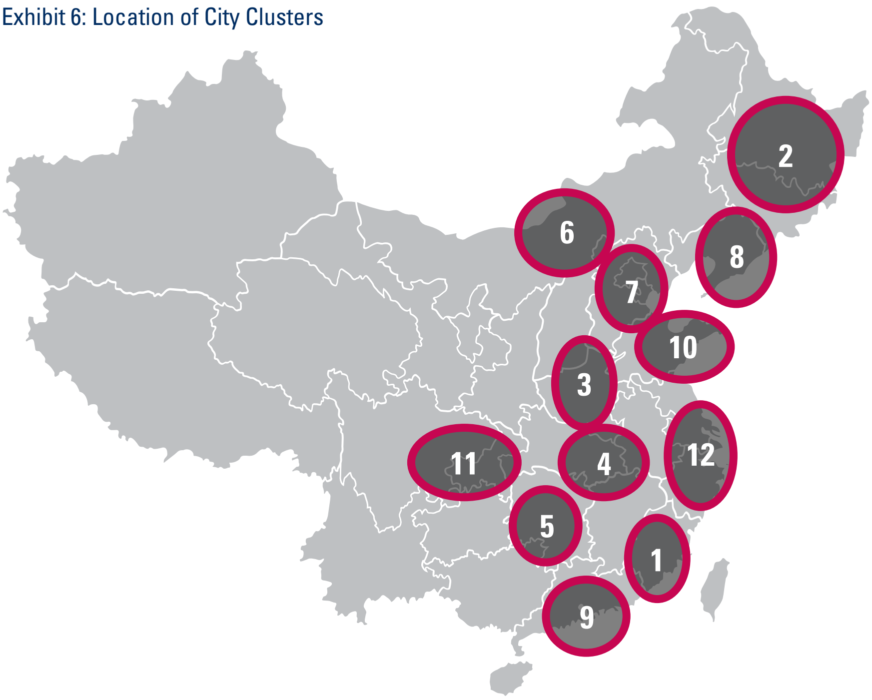
Pearl River Delta (PRD) – the cities around the Pearl River in Guangdong Province

Shandong – the cities of Shandong Province

Sichuan – Chongqing Municipality and cities in Sichuan Province

Yangtze River Delta (YRD) – Shanghai municipality and cities in Zhejiang and Jiangsu Province

Exhibit 6: Location of City Clusters



1. Fujian
2. Hei-Ji
3. Henan
4. Hubei
5. Hunan
6. Inner Mongolia
7. Jing-Jin-Ji
8. Liaoning
9. PRD
10. Shandong
11. Sichuan
12. YRD

In total these 12 "City Clusters" encompass 157 of the 287 cities which are referred to by Chinese state statistical reporting bureaux. More accurately, these cities are Prefecture Level Cities which link smaller outlying cities, towns and districts to one major city. For example the Prefecture Level City of Suzhou in Jiangsu Province comprises the seven districts of Suzhou City and the five County Level Cities of Changshu, Taicang, Kunshan, Wujiang and Zhangjiagang.

Prefecture Level cities also contain regions of agricultural production and are not purely metropolitan areas. They also have common political status and economic reporting processes. This means that the market access and market data for these cities is standardised and form a more suitable basis for comparison rather than equating a County Level City with a Prefecture Level City.

Exhibit 7: Population Chart (2009)

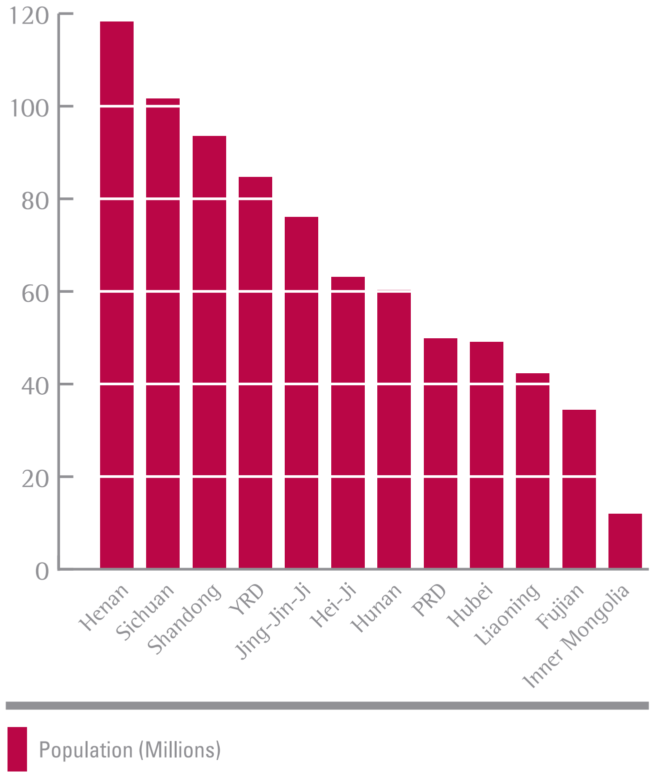
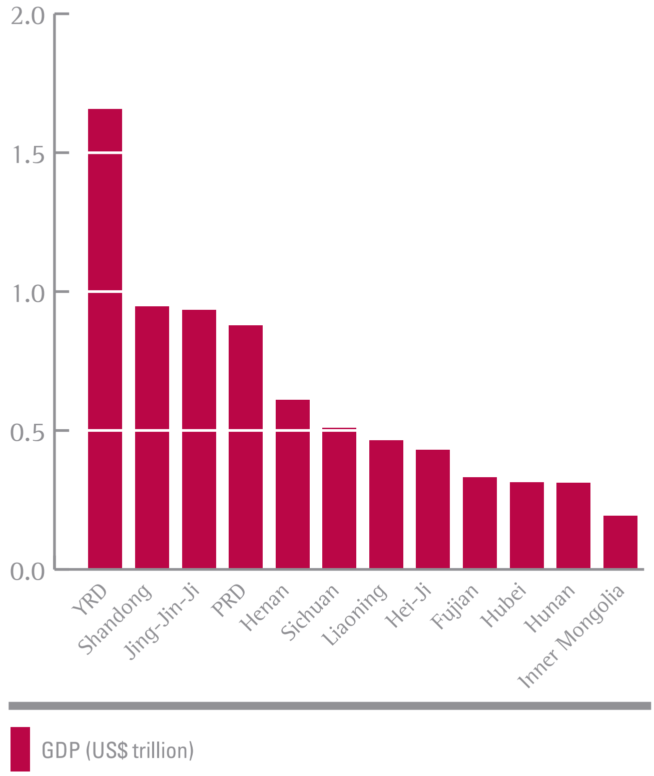


Exhibit 8: GDP Chart (2009)



In total these 12 "City Clusters" account for 63 per cent of the national population with an average of 65.4 million people per cluster. They range in population from the Henan cluster (118.2 million) to the Inner Mongolia cluster (12 million). In population they are equivalent to 12 areas the size of the UK.

With a combined GDP of US$7.6 trillion these 12 "City Clusters" are collectively three times the economic size of the UK. However, there is a significant difference in GDP levels across these 12 clusters. For example, the GDP of the YRD (US$1.7 trillion) is 8.5 times that of the Inner Mongolia cluster (US$0.2 trillion).

Exhibits 7 and 8 reveal that the Inner Mongolia cluster is smallest in terms of both population size and GDP. However, when ranked by GDP per capita, the significance of the Inner Mongolia cluster becomes more obvious. The city of Ordos in the Inner Mongolia cluster has the highest GDP per capita in the whole of China and, together with other cities with high GDP per capita, this skews the results for this cluster. The high level of GDP per capita is mainly due to the presence of highly productive mineral exploitation in the region. There are other cities across China such as Dongying in the Shandong cluster and Daqing in the Hei-Ji cluster which, due to the dominance of mineral, oil and gas exploitation in the local economy, have very high levels of GDP per capita. In itself, this demonstrates that using one indicator of economic performance is not a good standard to judge the relevance of the economy to a broad offering from a UK exporter or investor. The exception in the case of Ordos, Dongying and Daqing, besides mineral and oil and gas equipment and services, is the sale and provision of luxury goods and services.

Exhibit 9: GDP/Capita (2009)

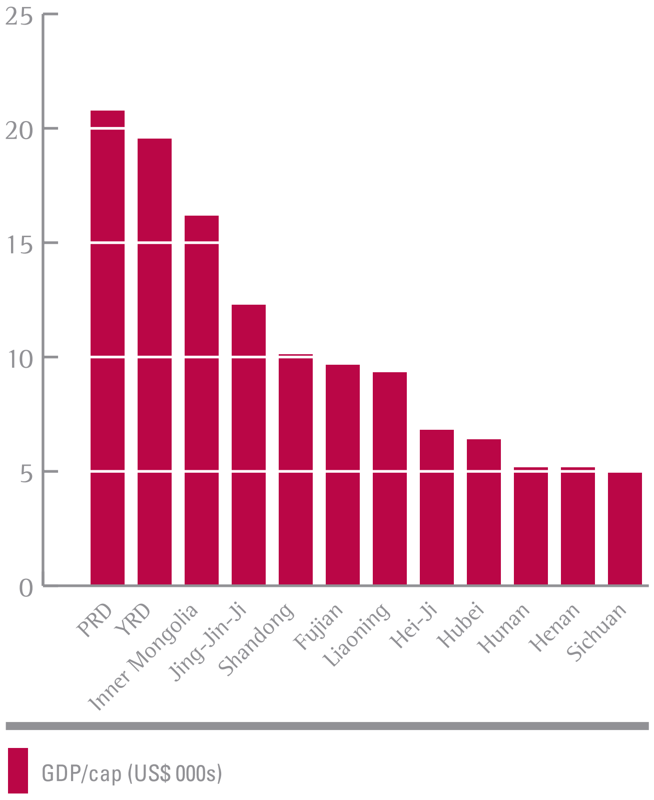
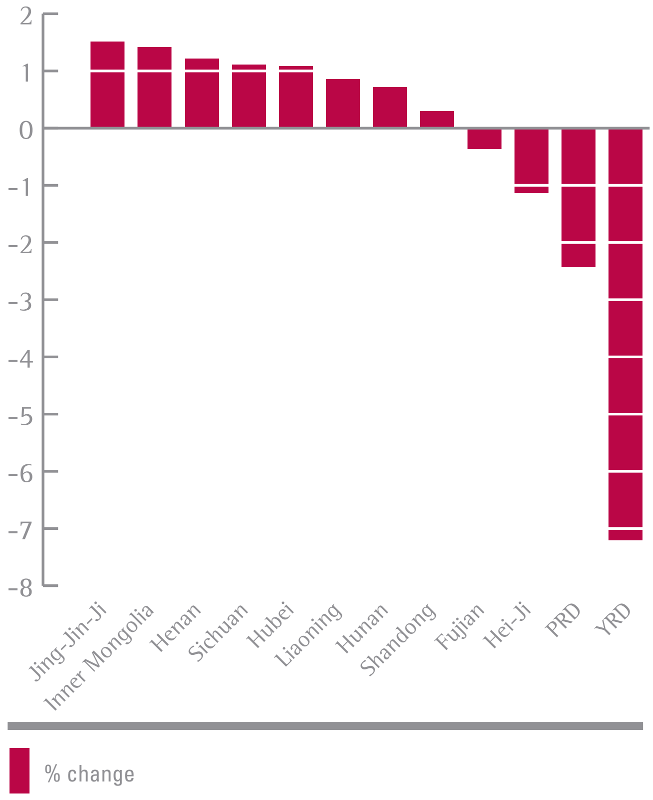


Exhibit 10: Percentage Change in National Total of FDI (2007-2009)



Foreign Direct Investment (FDI) is an obvious factor for UK companies to consider as they evaluate business opportunities in China in that it shows the path of investment from other international sources. The period of data examined for this report covers the years 2006-2009 and as such it captures a major period of international economic downturn. As such FDI data are extremely volatile with few clearly discernable trends. Therefore, rather than considering FDI in real terms we have compared the change in FDI as a percentage of the total for China between 2007 and 2009; that is, around the year of 2008 when global FDI flows declined most sharply in recent times.

In 2007 the 12 clusters combined attracted 88 per cent of all annual FDI flows to China. By 2009 this figure had fallen slightly to 85 per cent. The individual clusters attracting the greatest level of FDI were the YRD (35 per cent), the PRD (13 per cent), Jing-Jin-Ji (10 per cent) and Liaoning (9 per cent). Exhibit 10 shows that the areas away from the eastern coast have grown in importance for international investment. Even within the Jing-Jin-Ji cluster the two major cities of Beijing and Tianjin actually saw a decrease in FDI, both in real terms and as a percentage of the national total. The percentage increase in this cluster is due to the increase of FDI in the cities of Shijiazhuang, Tangshan and Baoding.

The level of FDI inflows to China declined by 32 per cent between 2007 and 2009. However, this does not show the whole picture. Not only did the clusters of Hubei and Henan see a percentage increase, but also they are the only two regions to have seen a real term increase in FDI during this period. From this we can deduce that the focus of FDI is widening away from the eastern coast to include the central regions of China.

For sales, a key attractiveness of “City Clusters” is the ease of access to a large population within a defined area generating sales efficiency. The connectivity of different cities in a cluster has been developed with huge investment in road and highway construction in recent years and is now one of the defining characteristics of a cluster.

Exhibit 11: High Speed Rail development map

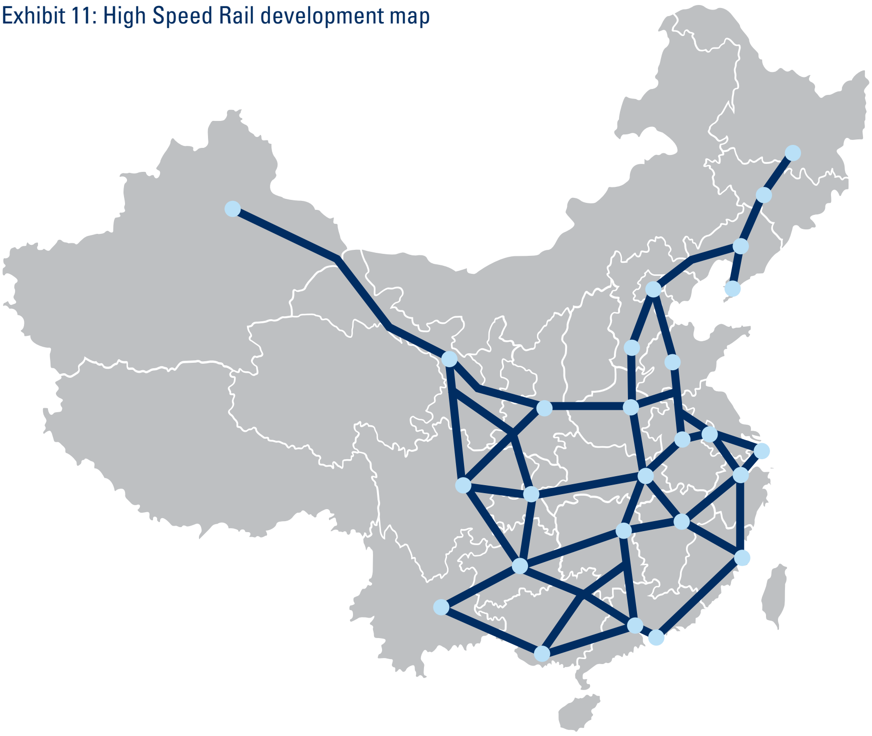
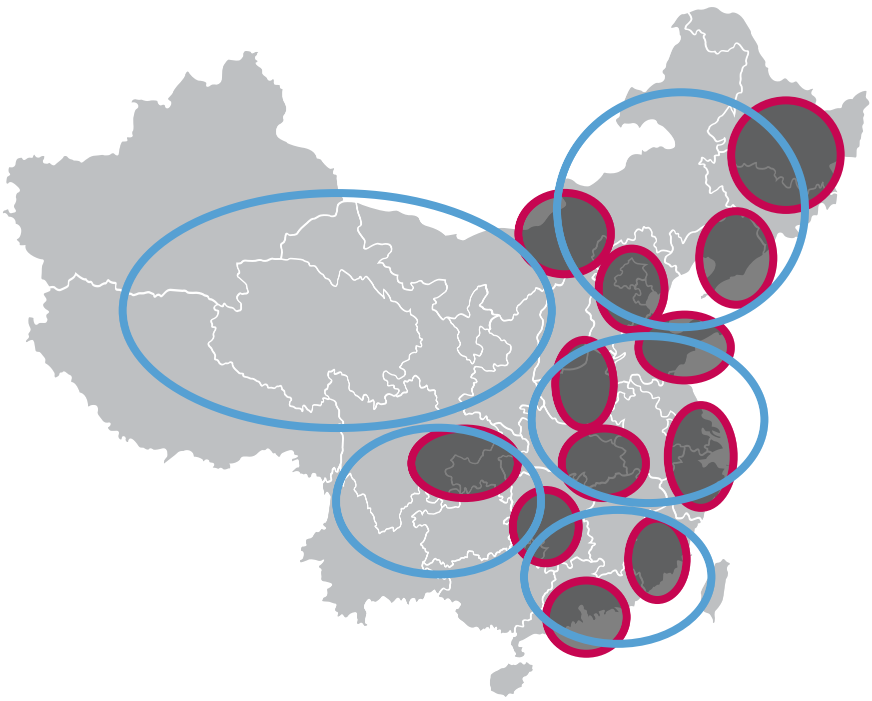


Exhibit 12: National Air Hubs map



Different cities within an easily accessible range can each be exploited for their potential in terms of public relations with government bodies, land and labour costs, R&D centres or sales. It is not likely that one location could be paramount in each of these factors and so road connections make choice of multiple locations based on attractiveness a reality. In this respect, the clusters can be approached in the same way as any nationally operating firm would approach the choice of different locations based on optimum attractiveness criteria for the location of a national HQ, back office, manufacturing and distribution.

The development of high speed rail is connecting these "City Clusters". Just as road has been a major factor in the development of "City Clusters" it is likely that the expansion of high speed rail to areas such as Nanning, Kunming, Xi'an and Urumqi will aid the formation of new clusters in these regions.

The third level of transportation is air. The newly announced plan for five national hubs clearly overlaps both the location of existing "City Clusters" and the high speed rail expansion programme. Although there are, and will continue to be, differences within these hubs, be they "City Clusters" or wider regions in the South, East, South West, North West and North, as defined by population, industry and wealth, the differences may transpire to be only in scale of opportunity. With increased competition from known internationals, developed domestic companies and emerging domestic companies, long-term success, though constrained in market size, may be more attainable through first mover advantage in regions and clusters beyond the coastal areas of the PRD, the YRD and Jing-Jin-Ji.

Though it is often said that China is a land of regions differentiated by local languages, foods and customs, this is an oversimplification of the country and does not relate to the needs of companies. Issues relating to law, taxation, product quality and government procurement are national. What is more relevant is the identification of sources of raw materials, supply chain and clients that can be most efficiently joined through a company's manufacturing and sales bases and networks.

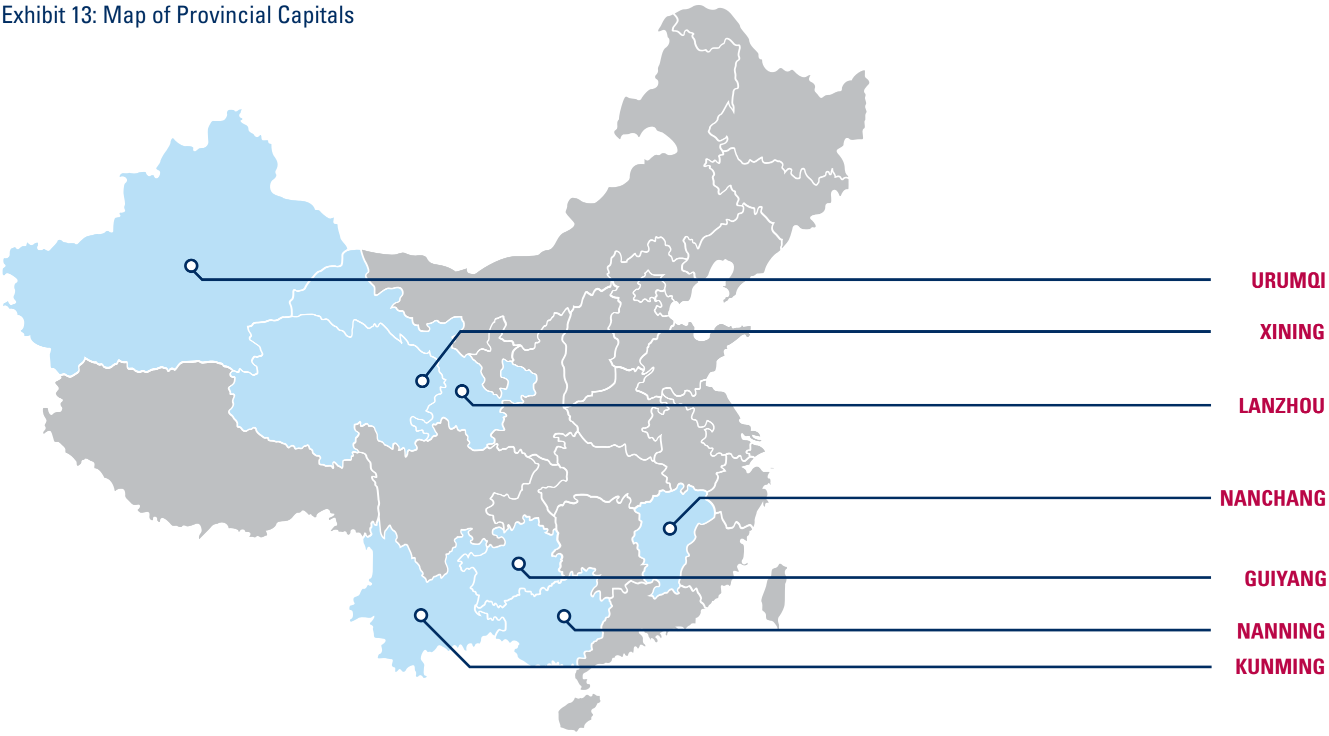
For companies who are able to define a client base, either consumer or corporate, within a "City Cluster" it is important to note that marketing activity to raise client awareness may be localised. It is the case and should not be expected otherwise that successful brand recognition in one "City Cluster" does not automatically lead to recognition outside that cluster. As each of these clusters is similar in size both by population and land mass to the UK, this leads to the potential of a more manageable market entry strategy, particularly for SMEs.

Thirty-three of the 35 regional cities shortlisted in this study are within areas defined as "City Clusters". The two exceptions are Xi'an, the capital of Shaanxi Province, and Hefei, the capital of Anhui Province. Anhui is being encouraged by Beijing to become more integrated with the YRD. It is likely that once this occurs the YRD cluster may be better viewed as three clusters in the north centred around Nanjing (provincial capital of Jiangsu), in the middle around Shanghai, and in the south around Hangzhou (provincial capital of Zhejiang). With the development of both rail and air hubs in the north-west the cities of Xi'an, with Lanzhou (Gansu Province) and Urumqi (Xinjiang Province), should become an elongated and vast new "cluster". Though this north-west "cluster" may not have the same characteristics of dense road infrastructure and population, it is a region of common national and regional political, economic and social strategy. The same can also be said of a potential cluster in the south-west of China which may link the Provincial Capital cities of Guiyang, Kunming and Nanning in Guizhou, Guangxi and Yunnan Provinces respectively. Whereas today we can highlight 12 "City Clusters", by the end of the next Five Year Plan we may be in a position to evaluate 16.

"City Clusters" offer a defined geographical perspective of what can otherwise be a vast and intimidating market. Most of the clusters are within the constraints of a single province and so the politically driven economic direction for the cluster can be more easily determined. As areas of large population, the size of the client base for either consumer or corporate markets supports a sustainable business model. Infrastructure, physical and business services, are well established. These individual clusters are areas where the marketing of a product or service can be launched and maintained. For all these reasons, for companies making a market entry and even for companies who have a presence in another region of China, adopting a "City Cluster" perspective offers structure to the modelling of their development strategy.

4. PROVINCIAL CAPITALS

Exhibit 13: Map of Provincial Capitals



As "City Clusters" can also be viewed as regions around or within a province, the provincial capital of that cluster is very important as the centre of transport infrastructure and the political centre from which economic and social planning for the region disseminates. We now introduce seven other provincial capitals which cannot yet be described as centres of clusters because of their relatively under-developed transport infrastructure and their dispersed population. With efforts of urbanisation and infrastructure development these cities and provinces may soon form additional "City Clusters".

Exhibit 14: Table of provincial capitals

PROVINCIAL CAPITAL	POPULATION	GDP	FDI
	million	RMBb	US$b
Guiyang	3.67	97.2	0.11
Kunming	5.34	180.9	0.73
Lanzhou	3.24	92.6	0.04
Nanchang	4.97	183.8	1.58
Nanning	6.98	152.5	0.28
Urumqi	2.41	109.5	0.13
Xining	1.94	50.1	0.03

Over the past decade, Beijing has launched a series of high-profile campaigns designed to stimulate growth within China's less-developed interior and help it "catch up" with the wealthier east. The most prominent of these has been the Western Development Strategy (WDS), which since its launch in 2000 has pumped an estimated RMB2.2 trillion into developing transport and energy infrastructure, enhancing environmental conservation, and improving educational and living standards across China's western provinces and autonomous regions. The WDS has not been the only project of this type. Beijing's promotion of the Greater Tumen Initiative, Beibu Gulf Economic Zone and Greater Mekong Sub-Region have reflected a similar desire to bring growth to provinces and regions marginalised by the economic boom of the past 30 years, principally by encouraging their closer integration with neighbouring countries and wider regional networks.

This centrally-mandated drive has made an impact. Although the provinces and regions that constitute China's west – namely Chongqing, Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang, Yunnan – continue to play a secondary role in economic terms to the east, over the past five years the western region has recorded an average GDP growth rate of 13.7 per cent – the highest of any part of China (although from a relatively modest base). The area is rich in natural resources, boasting around 65 per cent of China's proven coal and gas reserves and 40 per cent of its crude oil, and it has become critical in efforts to develop the country's renewable energy sector. Extensive construction of air, road and rail infrastructure has done much to better connect the region, both with the eastern seaboard of China and with other countries. The government is committed to releasing more investment into the region and it has signalled that, over the coming decade, it will introduce further tax breaks for key industries, implement a series of major infrastructure projects, and look to raise levels of domestic consumption across the west.

Focusing on Beijing's role in promoting these initiatives, however, masks the crucial role played by key provincial capitals in determining the allocation of government funds, the shaping of major capital projects, and the capturing of FDI. Economic decision-making has been rapidly decentralised in post-reform China and local governments are now invested with authority across a range of issues, including land sales, infrastructure projects, residential property construction, public offerings, and mergers and acquisitions involving local state-owned enterprises. Provincial capitals act as focal points for deal-making because of the presence of key regional administrative organs, such as the provincial party committee, provincial government and the local people's congress. Although these institutions clearly remain amenable to central government directives, they exercise a much greater degree of autonomy in their day-to-day activities than was the case even a decade ago.

Foreign businesses looking to develop their presence in China often presume they have to go through the central government if they are to achieve their aims. But in today's China, working with provincial power structures can often be a quicker and more efficient way of furthering corporate interests. Engaged in competition with other provinces and regions to produce high growth rates, they tend to be receptive to external business proposals and typically have a number of local incentive schemes to attract FDI. It is by being engaged from the "bottom up" in China that outside investors can best source up-to-date information about business opportunities, gain access to local markets, and develop helpful long-term relationships. China is too large a country for foreign firms to focus their business strategies on the big cities along the eastern coast.

What follows is an introduction to some key provincial capitals in western China that serve as potential gateways to their respective provinces and regions. These cities are important staging posts for any business interested in engaging with the fast-developing central and western provinces of China.

Guiyang – Guizhou

Guiyang is the capital and economic hub of Guizhou, an ethnically diverse and environmentally rich province in south-west China. Guizhou is one of the poorest provinces in China, with a GDP per capita of only RMB10,258 in 2009 and a population of whom only 29 per cent live in urban areas. As such, there exists great potential for development and the local government is committed to increasing provincial GDP from RMB430 billion to RMB800 – 1,000 billion over the next five years. The province is particularly strong in coal power-generating capacity (supplying Guangdong province with about 12 per cent of its electricity), and has considerable potential for developing a hydroelectric sector that already generates 70 per cent of Guiyang's electricity needs. There is a significant mining sector in Guiyang, particular in bauxite, and the city has a large chemicals and pharmaceuticals industry.

Around 1200km of new expressway are currently being rolled out across Guizhou and Guiyang Longdongbao International Airport is being rebuilt to meet growing demand. There are various plans to improve public services in the provincial capital, including the building of new health facilities and increasing the household waste water treatment rate to 95 per cent by 2015. To fit into the province's ambitions to bolster its tourist industry, Guiyang will introduce over 400,000 square metres of green area by 2015, thereby increasing green coverage to 45 per cent.

Opportunities:

- Aviation
- Built environment
- Energy
- Healthcare
- Rail

Kunming – Yunnan

The capital of the picturesque province of Yunnan, Kunming serves as an important transportation hub in south-west China, linked by air, rail and road to countries to the south. Although one of the poorer Chinese provinces in GDP terms, there exist ambitious plans to develop the province and use its location as a bridging point to markets in South-East Asia. Kunming plays an important role in the Greater Mekong Sub-Region, an Asian Development Bank-led project designed to enhance economic cooperation between south-west China, Cambodia, Laos, Myanmar, Thailand and Vietnam. Kunming and Yunnan will reap enormous benefits in terms of greater cross-border trade resulting from the China-ASEAN Free Trade Agreement that came into force in early 2010.

To capitalise on these opportunities, Kunming has been identified as the focal point of efforts to overhaul Yunnan's transport network. RMB190 billion has been earmarked for extending expressways over the next five years so that Kunming is better connected with each of Yunnan's counties. More than RMB10 billion will be invested in improving the province's rail connections by 2020. Kunming will continue to market itself as a major tourist destination, famed for its horticulture, adding a further 600,000 square metres of green space to its urban area over coming years. There is a RMB2.5 million budget to buy new healthcare equipment and plans to build ten new hospitals.

Opportunities:

- Built environment
- Healthcare
- Rail

Lanzhou – Gansu

Historically an important stop on the Silk Road, Lanzhou is the capital of the western province of Gansu,. The city remains a key regional transport hub, connecting Xinjiang and Central Asia with eastern China through its rail connections. Its Zhongchuan Airport is currently being expanded to increase domestic services and international flights to Greater China, Japan and South Korea. Lanzhou is a significant energy producer, with a large oil refinery, nuclear fuel complex, and a thermal generating plant. There are major plans to harness the wind and solar energy potential of the province. FDI is mainly concentrated in the Lanzhou Economic and Technological Development Zone and Lanzhou High-Tech Industrial Development Zone.

Opportunities:

- Aviation
- Built environment
- Energy

Nanchang – Jiangxi

The capital of Jiangxi province in south-eastern China, Nanchang is an important transport hub, marking the point where the Beijing-Jiulong and Shanghai- Kunming railways meet. It is the trading hub for Jiangxi's agricultural sector, which ranks highly within China in the production of rice, freshwater products, timber and bamboo. The region also possesses considerable mineral resources, including copper, gold, silver and rare earth metals. With average wage levels lower than in neighbouring provinces, Jiangxi is the second-fastest growing provincial destination for FDI. Ford Motors have had a manufacturing plant in Nanchang since 1997 and there is also an Export Processing Zone and High-Tech Industrial Development Zone in the city. Over the next five years, Nanchang plans to construct three new waterworks, eight new hospitals and a series of solar and other renewable energy plants.

Opportunities:

- Automotive
- Aviation
- Built environment
- Healthcare

Nanning – Guangxi

Nanning is the capital of Guangxi Autonomous Region in southern China and an increasingly important city in China-ASEAN trade relations. As part of the Beibu Gulf Economic Zone, Nanning has been identified by Beijing as a key city in expanding China's land and sea links with South-East Asia. The proposed Nanning-Singapore Economic Corridor is a 3800km-long infrastructure project designed to facilitate the movement of goods between China, Vietnam, Laos, Cambodia, Thailand, Malaysia and Singapore. Nanning also hosts the annual China-ASEAN Expo and China-ASEAN Business and Development Summit. In 2010 the city's GDP, industrial output and exports were almost double 2005 figures.

With investment flows set to continue, Nanning will be the centre of massive railway and expressway construction across Guangxi. The city will build a number of power stations and hospitals, while its Wuxu International Airport will be expanded over the coming years. Also, Nanning has ambitions to enhance its status as a major domestic tourist destination and to develop its reputation as a "green city" through various sustainable environmental and renewable energy projects.

Opportunities:

- Aviation
- Built environment
- Energy
- Healthcare

Urumqi – Xinjiang

The capital of Xinjiang Uyghur Autonomous Region, Urumqi is the major industrial centre in China's largest province. Urumqi acts as the transport node for the province and it is the main route for inward investment into China's north-western region. Its development has been a priority under the WDS and the city has received even more attention since the ethnic unrest in July 2009 . The local government aims to increase Urumqi's GDP to RMB420 billion by 2020.

Urumqi is positioning itself to benefit from Xinjiang's position as one of China's most important sources of natural gas, oil and coal reserves, with plans to construct a range of new facilities – including wind power – to increase overall energy production. A fourth terminal and second runway are planned to be added to Urumqi's Diwobao International Airport by 2015 and work on a second airport may also begin. International designers have been invited to design two new urban districts and there are plans to construct a new urban railway for public transportation.

Opportunities:

- Aviation
- Built environment
- Energy

Xining – Qinghai

Xining is the capital of Qinghai province in north-west China, which ranks lowly on most economic indicators compared to other provinces. Although Xining is the departure point for the Qingzang railway into Tibet that was completed in 2006, the province faces significant infrastructure bottlenecks if it is to realise the potential of its natural resources. Qinghai's numerous salt lakes contain 90 per cent of China's lithium, potassium and magnesium reserves. The Yangtze, Yellow and Lancang (Mekong) rivers flow through the province and 12 dam projects are currently planned to take advantage of this hydroelectric potential. Xining plans to burnish its green credentials through investing in solar, wind and other low-carbon technology. The Xining Economic and Technological Development Zone is home to companies working in the chemical, non-ferrous metals, food and biochemical industries.

Opportunities:

- Built environment
- Energy

CASE STUDY

THE PEEL GROUP

“OUR MESSAGE IS BETTER ACCEPTED BY ENTHUSIASTIC COMPANIES OUTSIDE THE TRADITIONAL MAJOR CITIES. THESE COMPANIES ARE GENERALLY OWNED BY WEALTHY INDIVIDUALS AND HAVE SUPPORT AND ENCOURAGEMENT FROM THEIR LOCAL GOVERNMENTS.”

It is 40 years since John Whittaker established the foundations that form the company as it is now, through a philosophy of recycling capital and long-term investment, predominantly in Northwest England. These principles have been integrated with the foundations laid down by those companies which have been brought together into the Peel Group of today.

In March 2011, the UK Government established four “Enterprise Zones”. One of these was given the name of “Mersey Waters” which includes Peel’s flagship projects, Wirral Waters and Liverpool Waters, and more importantly the land proposed for the Peel International Trade Centre. This will be the first of its kind in the United Kingdom and the largest and most sustainable Trade Centre in Europe.

The company first started going to China in 2006 to source construction materials such as marble for their property developments in the UK. In 2007, Liverpool City Council started to make more of the sister-city relationship with Shanghai and so Peel joined business delegations visiting Shanghai. During a visit in 2007 Peel promised to name the proposed sixty-storey tower in the Liverpool Water development Shanghai Tower.

In 2010 Peel was a major sponsor of Liverpool City pavilion at Expo 2010 in Shanghai, the only UK city to have a purpose-built pavilion. As well as raising the profile of Peel in China the company also encouraged and promoted other companies from Northwest England to visit and participate in the six-month event.

Naomi Peck – Marketing and Project Manager – explains that prior to the Expo Peel had some thoughts about what opportunities the China market may have presented but went out with no fixed plans. “We went with a general idea of what we wanted to achieve. We realised that in the first place you have to introduce yourself and then understand the messages you get back from the people you talk to. The Chinese style is of relations first then business.” As such the proposition for the Peel International Trade Centre only came about after listening to what Chinese companies wanted to do in the UK and then creating a solution based around Peel strengths.

The Peel International Trade Centre is being promoted to countries with large numbers of manufacturers including China, India and South Korea. The opportunity is for these companies to have permanent show rooms with access to warehousing, distribution and assembly which can become European trade hubs. Although Peel has a sales director in Shanghai the main focus of sales is in the surrounding provinces of Jiangsu and Zhejiang. Later this year promotion will begin in Guangdong. Naomi Peck explains “To date, we have had the most success in promoting ourselves to companies in second and third tier cities than the major centres of Beijing or Shanghai. Our message is better accepted by enthusiastic companies outside the traditional major cities. These companies are generally owned by wealthy individuals who have the support and encouragement from their local governments. They want to expand overseas but may be unfamiliar with what that entails. We offer a partnership with these companies. This extends to market research and business introductions. It does not cost us much more to go that extra step to offer advice and information tailored to individual companies. We have found it important to become a ‘useful partner’ to our clients.”

5. CHALLENGES OF DOING BUSINESS IN REGIONAL CITIES

Our 2008 survey found that restrictive regulations and sector limitations and language and cultural difficulties were the most significant challenges confronting British firms as they looked to expand their business interests in China. This was followed closely by human resources-related concerns, stifling bureaucracy, cost increases and rising competition. The results of our 2011 survey, which was completed by 120 British companies with activities in China, point towards a more nuanced picture today. The enduring nature of some of these challenges is revealed, but new challenges have appeared as British companies are strengthening their engagement with China.

5.1 Barriers and Difficulties

Regulations and bureaucracy continue to be highlighted as the predominant challenge experienced by British companies in China today. Although the issues raised are highly sector-specific, numerous British companies draw attention to difficulties arising from the clarity and transparency of the regulatory environment in which they have to operate, the restrictiveness and excessiveness of rules and "red-tape" with which they have to comply, the frequency at which these rules and regulations change, and the lack of predictability that all this causes. Of course, many of these issues apply across the country, but because the implementation of regulations takes place at a local level, this finding highlights the importance of understanding of how rules and regulations are administered at a provincial and municipal level in China's regional cities.

Unlike the 2008 survey, the challenges associated with building relationships and trust with local business partners, clients and customers, and government officials was found to be the second most challenging aspect of doing business in China. In many ways, this reflects a deeper involvement in China among respondent firms. It seems that while establishing a business presence in China has become more straightforward in recent years the problems associated with identifying key contacts in partner, client and government organisations, establishing mutually beneficial and trustful working relationships with them, and developing meaningful channels of communication have now become much more pronounced. Also related to the deepening engagement of British firms in China is the issue of the transfer and localisation of the business model, which was revealed to be the fourth most important category of challenge faced by respondents. Once a business presence has been achieved, companies report numerous obstacles to successfully implementing the business plan, including factors such as protracted lead times from suppliers, supply chain management and quality control issues, administrative delays which result in longer lead times for client organisations, the management of risk, problems with obtaining finance, banking system inefficiencies, and infrastructure deficiencies. All of this makes it difficult for some firms, especially smaller ones, to build their business in China. Again, an awareness of the particular conditions offered by individual regional cities will be needed if companies are to successfully build the relationships and contacts required to effectively transfer their business model there.

The third most frequently reported challenge concerns the ongoing difficulties associated with language and cultural differences. Despite clear efforts made by respondent firms to localise the business model and to use Chinese staff in key managerial positions wherever practicable, language and cultural barriers remain a significant operational issue for many. These issues may become magnified in those regional cities away from the coastal regions of China, where the history of foreign business engagement is much shorter, and where familiarity and understanding with foreign business practices and needs are likely to be less well developed.

Although less frequently mentioned than in our 2008 survey, human resources-related factors continue to be an issue for a number of respondent firms. The difficulties highlighted relate primarily to the quality of labour, the work ethic, education, and skills shortages of the workforce, staff recruitment and retention, and, perhaps most significantly, wage inflation. In many ways, these challenges provide an impetus for relocation of certain labour-intensive activities away from the coastal cities to cities where skills and talent are available at lower cost. However, companies will need to take care to ensure that these cities can provide a workforce that satisfactorily meets HR needs.

The next two factors highlighted by respondents as key concerns for them in China are related, at least in part, to the capabilities and skills of the firms themselves. Many companies reported that it is their own lack of local knowledge and, in particular, the shortage of detailed market-related data and information to feed into the decision-making process, that has now become a significant obstacle to doing business in China. Other factors highlighted concern the difficulties some firms face in raising the image, profile and understanding of their business in China. A similar number of responses also point towards the issue of problematic business practices in China. These include problems in evaluating client creditworthiness and untimely settlement of invoices as well as scams, fraud and corruption which some respondent firms have experienced in China from time to time.

The next set of factors identified as challenges to doing business in China received the same number of mentions by respondent firms. Among the issues categorised as problematic within the legal environment are shortcomings in contract law and lack of transparency regarding laws and regulations. The problems of protecting and enforcing intellectual property rights were also highlighted as a distinct legal issue by respondent firms. Included in formal and informal protectionism are factors relating to the discretionary powers of government agencies and the favouritism extended to domestic compared to foreign firms that is perceived by respondent firms.

The remaining issues identified in our 2011 survey were each mentioned fewer than ten times by respondent firms. Of these, the greatest departure from the results of the 2008 survey relate to the increasing costs in China and the intensification of competition from both domestic and foreign companies. Each of these issues was scored much lower than previously, suggesting that they have become less of a concern to British companies over the last three years, or that respondent companies have developed strategies to deal with them. At the same time, foreign exchange-related factors (such as exchange rate risk and concerns about the future appreciation of the Renminbi), taxation-related matters (in particular, changes to VAT and corporation tax conditions), and trading regulations and requirements (most notably in relation to import and export controls and restrictions, the duties levelled, border controls, and, in one case, export controls in the home country) have all been mentioned by a few firms in the most recent survey, but by few, if any, in the 2008 survey.

5.2 Strategies

New to our 2011 survey was a question on the strategies and approaches that British companies have employed to successfully confront the challenges faced when developing their business in China. Our findings reveal both congruency and divergence between the strategies employed and the nature of the challenges experienced by respondents.

It is perhaps not surprising, given the fact that regulations and bureaucracy and building relationships and trust with partners and customers collectively were viewed as the principle barrier to business development in China, that building relationships was by some distance reported by respondent firms to be the best way to overcome many of the obstacles to doing business there. Understanding and being responsive to the demands, requirements and perspectives of clients and government agencies were perceived by many respondents to be fundamental to business success in China. This goes hand in hand with the need to be patient, committed and flexible when dedicating managerial time and resources to China (with various respondents using terms such as persistence, resilience, realism, and attention to detail to describe the managerial traits required). This was the second most frequently reported category of response to this question.

Localisation is also seen as pivotal, with many respondents pointing to the importance of employing competent and educated Chinese managers in key positions (especially if individuals have studied or worked previously in the West). Associated with this is the need to find and work effectively with local business partners, and to tap the specialist knowledge and expertise of financial and professional services providers. This becomes an imperative when contemplating a move away from the coastal regions, where many of these support structures are already well established, to China's regional cities, where they may be much less well developed.

Also regularly reported was the importance of undertaking market research and due diligence prior to entering into any formal dealings with Chinese companies. Of course, this may be much harder to do in China's regional cities, where market and firm-related information is likely to be less readily available than in China's more advanced cities, and about which knowledge and experience in the foreign firm will need to be accrued over time.

The final three success factors most clearly highlighted by respondent firms relate again to management processes and aptitudes. Several companies indicated the importance of establishing a strong management team to build the business in China, including the importance of securing clear and committed support from all levels of the parent company, and assigning good quality professional staff to plan and manage the China-based operations. Associated with this is the importance highlighted by some firms of transferring established business standards, codes of practice, operating procedures and internal control mechanisms to China in a way that operations there are managed and run no differently to those in other foreign markets. At the same time, a few respondents also mentioned the importance of learning "the rules of the game" in China, and using this knowledge to deal with local companies and compete with rivals on equal terms.

5.3 Future Challenges

Also new to the 2011 survey was a question on what the future challenges to British businesses in China might be. Although fewer in number, the responses received to this question in many ways mirror those given to the question on present challenges, which suggests that at least some managers are not optimistic that the major barriers to trade and investment with China will ameliorate in the medium to long term, especially with regards to the levels of regulation and restrictions imposed by central and local government. However, the issue of policy direction was emphasised much more in response to this question. This suggests that some respondent firms are pessimistic that future policies will facilitate development of their business opportunities in China. Similarly, human resources-related problems are highlighted as an ongoing concern for many British businesses. In some respects, this finding focuses attention on the need for British companies to at least explore the opportunities presented by China's regional cities as one way to address wage inflation and talent shortages in the coastal regions, among other things. Although it was not highlighted by many firms as a present concern, the difficulties associated with protecting and enforcing intellectual property rights in China are seen by many respondents as a future challenge to developing market opportunities in China. Related to this is the competitive threat of domestic as well as foreign firms in China that some respondents see as likely to strengthen over time. Clearly, the need to register intellectual property rights, to seek legal advice when infringements have been detected, to actively pursue the enforcement of these rights, and to introduce systems and procedures within the firm to reduce the likelihood of technology leakage to rival companies should be at least part of the strategic response to the rising competitive threat that many respondents perceive will be presented by Chinese and foreign rivals. Among the remaining issues that respondents collectively regard to be potentially significant constraints to the expansion of their China operations include concerns about rising production costs, the sustainability of national economic growth, a lack of improvement to, and even deterioration of, the legal environment, the threat of protectionist trade restrictions (both from China and the industrialised countries) and, related to this, a rise in discriminatory practices against foreign firms in China, and finally, some foreign exchange-related concerns, especially in relation to the future appreciation of the Renminbi. Clearly, one implication of our findings is that it would be sensible for managers to take account of these types of risks when designing a business plan for expanding operations in China. At the same time, a strategy for exploiting the opportunities presented by China's regional cities should be an integral component of this plan as one way to address cost and market-related concerns which are becoming more pronounced in the country's more economically advanced eastern provinces.

Exhibit 15: Challenges of Doing Business (Total number of survey responses)

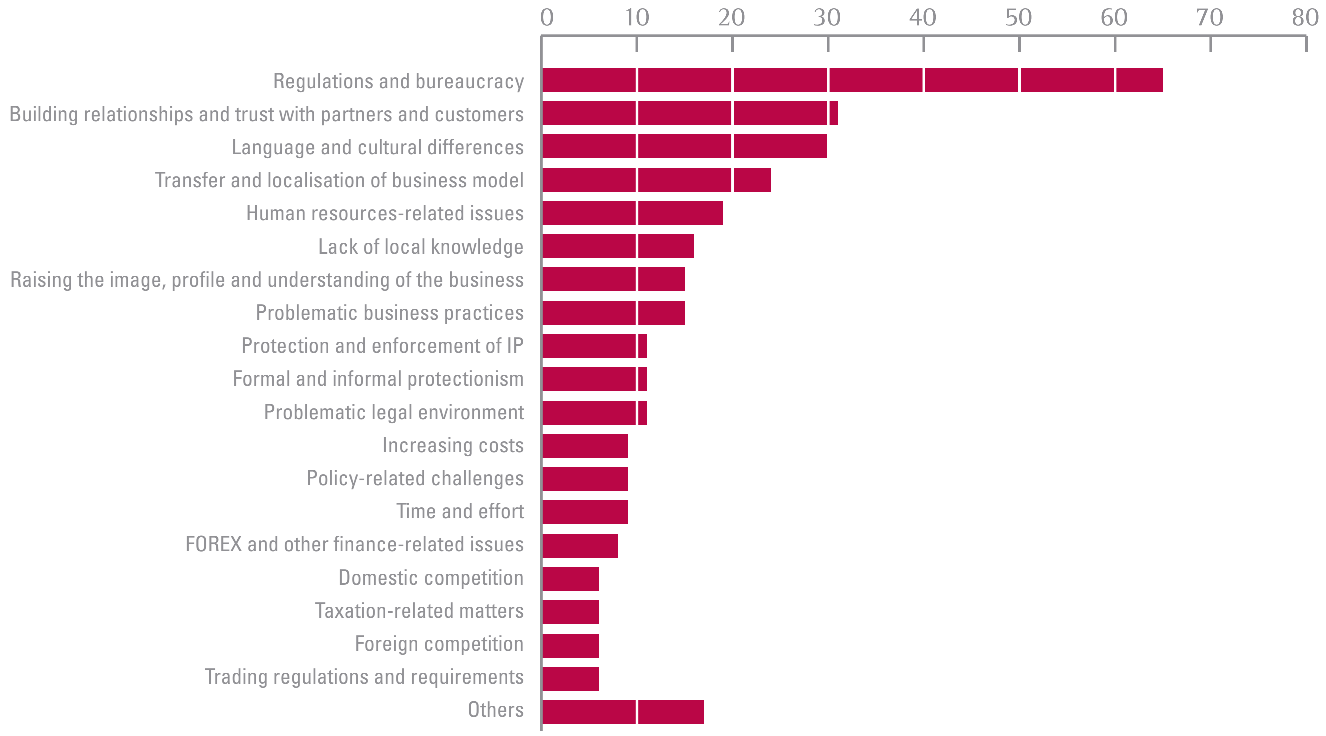
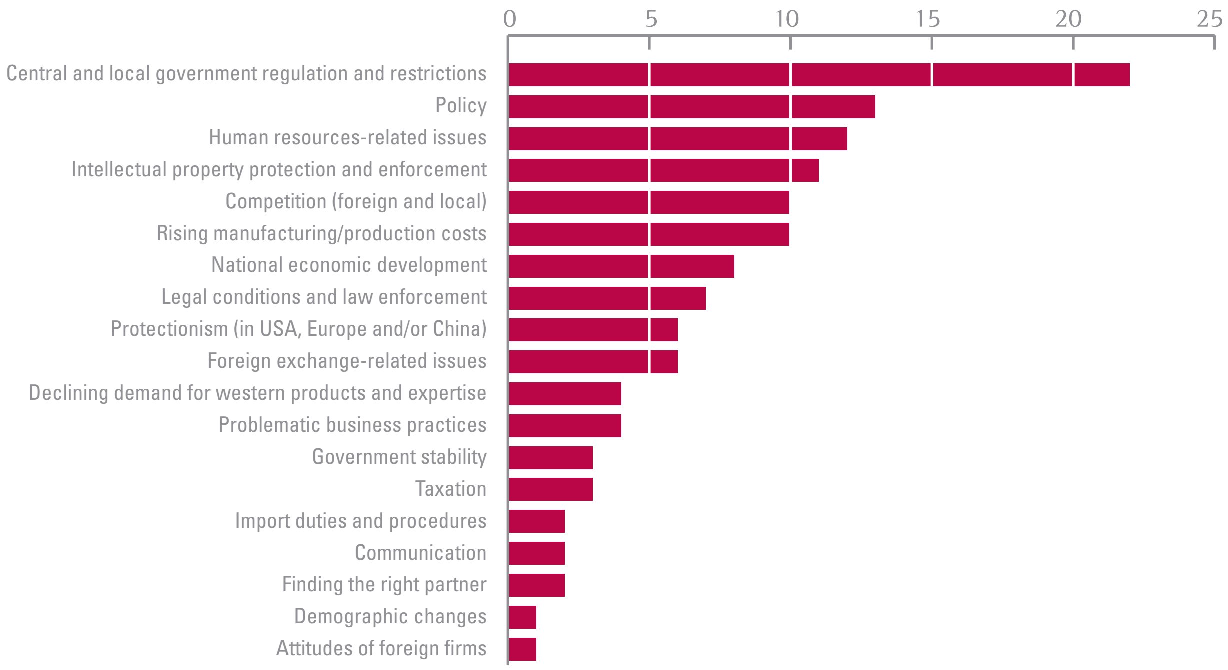


Exhibit 16: Strategies to Overcome Barriers and Obstacles (Total number of survey responses)

Exhibit 17: Future challenges (Total number of survey responses)



6. GOVERNMENT SUPPORT

During the research, companies already active in China's regional cities were invited to comment on how UK Government might improve the services it offers to new entrants and existing firms. It was found that they would like to see continued and further support from Government and TPOs in one or more of the following areas:

Lobbying, representation and access to market: This is seen by companies as a key benefit of working closely with the UK Government and its agencies in China. It is recognised by companies who have existing and developing business in China that UK Government and its agencies engagement with Chinese government create an understanding that the UK is a valuable partner. Firms report that they would like more support, to help raise the profile of UK businesses in China's regional cities and to help them to access existing support networks within individual cities, including key contacts with local government and businesses, TPOs and other UK firms.

Access to city information: Companies would like to have better access to general city-level market intelligence in China. This is difficulty with assessment of the non-comparable data on different cities and regions which exists from a variety of sources. UK Trade & Investment and its partners could create a structured and accessible portal that is centralised and contains up-to-date and comprehensive information as an extension to the city pages contained in this report.

Access to business information: Companies have expressed difficulty accessing information relevant to commercial and trading conditions in different cities and to conduct background checks on potential business partners. UK Trade & Investment and its partners could work closer with both Chinese policy makers and the financial and professional services (many of whom are UK owned) to better understand and disseminate this information to UK firms.

Awareness of commercial opportunities: Companies would like to have better access to information on specific business opportunities. This means better support for introductions to decision makers and information on the decision making process and regulation to comply. UK Trade & Investment and its partners could extend the services which are already in place to high-light opportunities to include the further information and support UK firms require.

UK Trade & Investment and its partners in China already provide much of this assistance, information and support requested by companies. However, it appears UK companies are requesting extension to and greater cohesion between these services.

7. CONCLUSIONS

It is apparent from this updated research that the regional cities in China continue to offer a wide range of opportunities across a broad number of sectors to UK companies. Clearly, those companies seeking to serve local consumer markets in China will be attracted by the economic expansion, rising purchasing power and growing populations that the rapid urbanisation of China's regional cities has engendered. Whereas in 2008 the regional cities in the more advanced coastal regions offered the most attractive business opportunities, this has now expanded to embrace the majority of mid to large Chinese cities across a much wider geographic space.

The location opportunities for those companies looking to manufacture only are found in those the cities near to the coast, from the far Northeast to the South of China. Recognition of local resources, client clustering, adequate logistics and governmental support within this wide area then becomes important. Although many contributing factors were used to calculate the R&D score, there is a strong match between the best R&D location and the density of leading Chinese universities. Hangzhou, Suzhou and Tianjin should be priority regional cities for any firm looking to locate production and R&D in China.

As with the 2008 report, the heterogeneity and fast rate of development of China's regional cities, and the relative locational advantages of individual cities, still need to be carefully assessed against the current and future strategic objectives of companies. This report provides a framework for understanding the current state of development of China's regional cities and the opportunities this presents to UK firms.

8. UK TRADE & INVESTMENT SERVICES

How we can help you

UK Trade & Investment (UKTI) is the lead government organisation that supports companies in the UK trading internationally. The China-Britain Business Council (CBBC) is UKTI's partner for delivering trade services in mainland China. Our extensive partner network available through the British Embassy in Beijing, the British Consulate-Generals in Shanghai, Chongqing Guangzhou, and Hong Kong, and through the eleven CBBC offices across mainland China, can assist UK companies by providing advice and information on primary and regional cities. Trade development services provided and delivered by UKTI and CBBC are structured around providing advice, support, information, opportunities and making it happen.

Overseas Market Introduction Service (OMIS) is a tailored service to access market and industry information, identify potential contacts or assist in planning an event. Please note: The Overseas Market Introduction Service (OMIS) is a chargeable service based on a series of clear price bands which depend on the market, level and type of activity required. A bespoke work plan will be developed and agreed with a UKTI adviser. Typically, a small, short report identifying distributors can vary from as little as £555 (plus VAT) to a more comprehensive piece of work or a number of activities for several thousand pounds.

Passport to Export provides new and inexperienced exporters with the training, planning advice and ongoing support they need to succeed overseas. Gateway to Global Growth is a service for experienced exporters. It offers a strategic review, planning advice and support to help companies to build on their previous success and develop new overseas markets.

Events and seminars are held across the UK and the world. They include specific sector and market-based activities.

Trade missions are organised to help UK companies visit the marketplace they're interested in and talk face-to-face with prospective business partners. UKTI also organises missions into the UK to allow overseas delegates to meet with potential partners or investors.

Business opportunities can be emailed directly into your in-box, highlighting hot leads in your chosen overseas market. Companies can sign up for this free service by visiting www.ukti.gov.uk

High value opportunities programme proactively identifies global supply chain opportunities, coupled with an online service giving access to several hundred sales leads around the world each month.

More information on how to access these services through our network of International Trade Advisors is available at http://www.ukti.gov.uk/export/howwehelp/internationaltradeadvisors.html

UKTI publications on exporting to China are available at http://www.ukti.gov.uk/export/countries/asiapacific/fareast/china.html

9. USEFUL CONTACTS

UK Trade & Investment
www.ukti.gov.uk

British Diplomatic Posts in China
www.ukinchina.fco.gov.uk/en/

China-Britain Business Council
www.cbbc.org

British Chamber of Commerce in China
www.britcham.org

HELPING YOUR BUSINESS GROW INTERNATIONALLY

Solutions for Business

Funded by UK Government

A range of UK Government support is available from a portfolio of initiatives called Solutions for Business (SfB). The "solutions" are available to qualifying businesses, and cover everything from investment and grants through to specialist advice, collaborations and partnerships.

UK Trade & Investment is the Government Department that helps UK-based companies succeed in the global economy, and is responsible for the delivery of the SfB product "Helping Your Business Grow Internationally".

We also help overseas companies bring their high-quality investment to the UK's dynamic economy – acknowledged as Europe's best place from which to succeed in global business.

UK Trade & Investment offers expertise and contacts through its extensive network of specialists in the UK, and in British embassies and other diplomatic offices around the world. We provide companies with the tools they require to be competitive on the world stage.

For further information please visit www.www.ukti.gov.uk or telephone +44 (0)20 7215 8000.

Or contact the China Britain Business Council www.cbbc.org or telephone +44 (0)20 7802 2000

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