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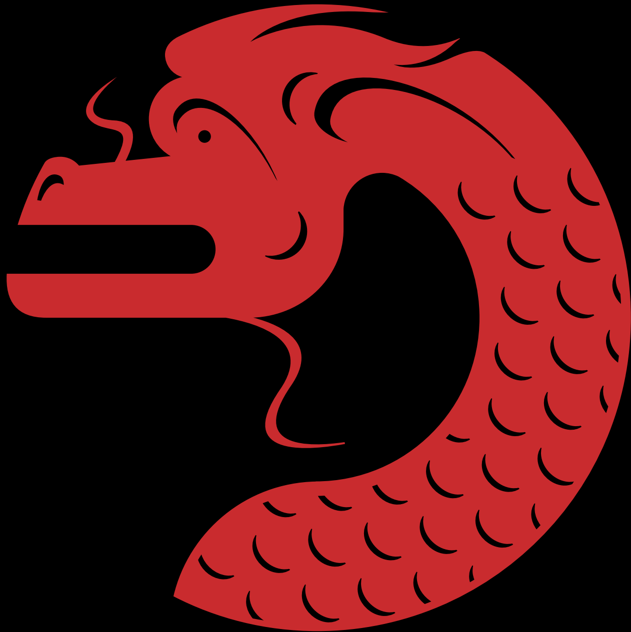

# China Factors

## A guide for investing in China

Global Chinese Services Group
October 2018

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# Preface

Being the second largest economy in the world, China's economy has been transforming from high-speed to high-quality growth. The consumption-driven economy features its immense market with robust demand. As China is celebrating the 40th anniversary of economic reforms, China's opening-up has entered a new era with a master plan for the economy to transform into a top innovative nation and a moderately prosperous society while mitigating rising global protectionism.

China's economy has been resilient. In 2017, the economy grew by 6.9% – for the first time in seven years the pace of growth has picked up. According to the National Bureau of Statistics (NBS), GDP growth in the first quarter of 2018 was 6.8%, and IMF has estimated a 6.5% growth rate for China's economy in 2018. China's consumption upgrading, as well as improved labour force quality, will continue to draw increasing amount of foreign investment.
Innovation and industrial upgrading have become the new growth engines for the Chinese economy. The Government has made abiding commitment to fostering an innovative environment that is conducive to the development of technologies so that manufacturers could move up the value chain. With the major themes of future development focusing on innovation, opening-up, people's livelihood and environmental friendliness, China Government has pledged to open the doors wider by largely lowering the entry barrier to foster a world-class business environment. For example, the market access to general manufacturing, financial services, telecommunications, medical services, auto, and new energy vehicles will be expanded. Overseas investors will be granted tax deferral for the reinvestment of profit made in China. Procedures for setting up foreign-invested enterprises will be simplified.

The 2018 China inbound investment brochure delves deeper into the local market landscape, analysing key proponents and industries that offer lucrative opportunities for foreign investment. With more than 13,000 people in 22 offices across the Chinese Mainland, Hong Kong, Macau and Mongolia, serving more than 800 multinational companies and their affiliated companies on the Chinese mainland, Deloitte is uniquely qualified to support your investment decisions with a full range of audit & assurance, consulting, financial advisory, risk management and tax services. We work closely within Greater China, across Asia-Pacific and around the world to provide clients of every size with local experience and international expertise. We hope this piece of thoughtware serves as a useful guide to make your next bold move in China.

# China – A Resilient and More Open Economy

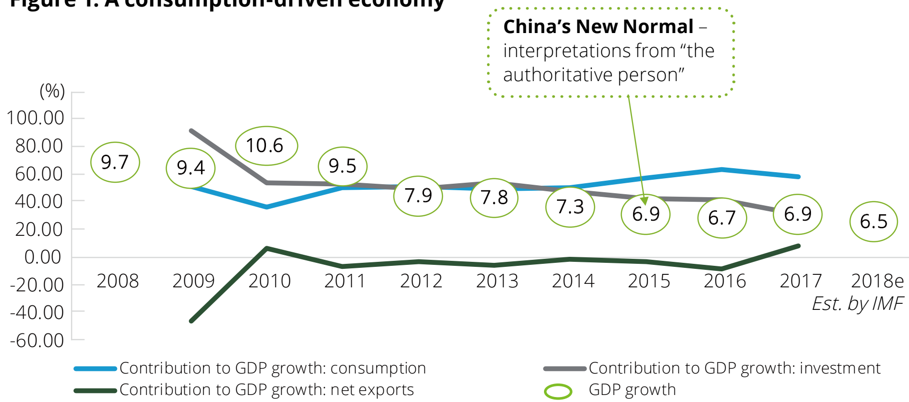
## China making strides in economic transformation

China's economy grew by 6.9% in 2017 – for the first time in seven years the pace of growth has picked up (figure 1). Thanks to a stronger US economy and synchronised global recovery, the outstanding exports grew at 7.9 percent, ending the continuous drop of the previous two years and helping make 2017 better than expected.

The fixed asset investment, used to be the most important driver of China's growth, grew by 7.2 percent in 2017, 0.9 percentage points slower than a year earlier (prior to 2016, fixed asset investment growing at a much more rapid pace), making it a less important driver due to structural adjustments.

China's retail sales of consumer goods grew 10.2 percent year-on-year in 2017, 0.2 percentage points slower than the previous year. Indeed, Chinese retail sales have grown at double-digit rates in the past years. The resilience of the Chinese economy stems from the unfulfilled demand of confident consumers (exactly as President Xi has alluded to in his address at the 19th Party Congress). More importantly, China's consumption upgrade story, a secular trend, is unlikely to be derailed by higher interest rates. Consumption boom is trickling down to 3rd and even 4th tier cities. China's consumption upgrading, as well as improved labour force quality, has drawn increasing amount of foreign investment.

**Figure 1: A consumption-driven economy**




Source: National Bureau of Statistics, Deloitte Research

## Innovation and industrial upgrading as new engines

Meanwhile, innovation and industrial upgrading have become the new growth engines for the Chinese economy. With the world's largest internet user base, China's new wave of technological innovation featuring artificial intelligence and "Internet Plus" lent impetus to emerging sectors such as industrial automation notably robotics, whose sales have been growing at 20% on average for the past five years.

President Xi's speeches at the 19th Party Congress and Two Sessions underscored the Government's abiding commitment to fostering an innovative environment that is conducive to the development of technologies so that manufacturers could move up the value chain. Such policy directives, along with China's strength in IOT and AI, will not only create more business opportunities for leading MNCs, but also enable those who could stay competitive in the Chinese market to become global leaders.

## To deemphasize the growth target

For the current 2018 scenario, however, the economy is likely to slow down for the following reasons. First, the excellent economic performance in 2017 (growth of 6.9%) set a high base, making it difficult to repeat that stellar performance. Second, having prioritised financial risk prevention in 2017, the government is likely to restrain credit growth, which could dampen growth in the short term. In addition, the Trump Administration's pressure on China with regard to bilateral trade deficit reductions will not go away, which could pose challenges to Chinese exporters.

The GDP growth target has been deemphasized in the 19th Party Congress in 2017, which was a favourable measure given that de-leverage and SOE reforms could proceed more easily against a backdrop of slower growth. As China's GDP growth held steady at 6.8% in Q1 2018, economic growth was well on track to reach the government's goal of "around 6.5%". The bottom line is that China still has ample policy leeway thanks to its domestic demand and global cyclical upswings.

## US-China trade frictions–a new normal

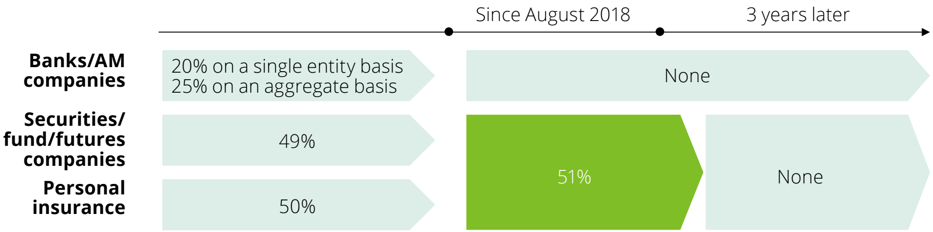
The global rising protectionism is another key factor which cannot be dismissed when it comes to analysing China's economic trend. We have long held the view that the adverse effects on the Chinese economy, because it is so heavily export-dependent and entrenched in global supply chains, lie mainly in three areas: 1) inflation, 2) investor sentiment, and 3) disruption of supply chains. The inflationary impact of tariffs is already visible in China, as 2018 has seen significant increases in rents and furnishings, prices at restaurants, and manual labor in major cities. A further escalation of trade tensions between China and the US is bound to create fresh inflationary pressure on China. This will, in turn, hurt investor sentiment, already shaky amidst economic deceleration and regulatory tightening. Regarding to the impact on supply chains, major decisions on enterprises' strategic investment have to be made with a time horizon of at least 10 years. Therefore, the lack of a clearly foreseeable end to the US-China trade war is deterring private investment and making investors risk-averse.

It is true that President Trump is preoccupied by bilateral trade imbalances, but at the deeper level, market access and reciprocity have become the buzz words in the US and to a certain extent, in several developed countries when it comes to trade relations with China in recent years. Countries like Germany have also demanded for improved market access on grounds of reciprocity rather than filing a claim for trade imbalance (Germany's trade surplus with China in Q1 2018 stood at US$7.77 billion). Therefore, the best policy response would not be tit-for-tat tariffs but rather concrete steps in opening up domestic markets (service sectors in particular) within a clearly defined timetable. At the same time, improved market access will also defuse trade tensions between China and other countries.

## Further opening-up of the economy

Some ground has already been covered in the opening-up. In 2018, as the country is celebrating the 40$^{th}$ anniversary of economic reforms, President Xi's has pledged an "unprecedented opening-up" at the Boao Forum. Specifically, market access mainly concerns manufacturing and service sector, especially financial sector. Last November, the Chinese Government has announced a slew of liberalization policies which covered commercial banks, brokerage firms, VCs, PEs, insurance companies and rating agencies. In President Xi's speech, insurance sector was particularly highlighted, and more importantly, implementation of such liberalization measures within a timetable was being emphasized (Figure 2). President Xi has pointed out that China's manufacturing sector is already quite open, which is true, and suggested that auto sector is strong enough for further opening-up. Specifically, tariffs on imported vehicles will come down and restrictions on joint-ventures will be eased. These actions could ease trade tensions for now, but all eyes will be on policy implementation in the near future. We hope concrete steps will be taken to improve the business environment.

**Figure 2: Roadmap of China's opening on foreign ownership limit**




Source: public information, Deloitte Research

Besides deepening its roots, opening-up has extended its breadth, forged ahead from eastern coastal areas to the hinterland, from pilot cities to metropolitan areas. As China enters a new phase of coordinated regional development, there are increasing opportunities in areas such as Guangdong-Hong Kong-Macao Greater Bay Area, as a junction for China to further opening-up to the global economy.

Last but not least, the Belt and Road Initiative (BRI), which has been a large part of the investment landscape across a swath of the world for nearly five years, will become increasingly important. As directed by the 19th Party Congress, the BRI not only facilitates Chinese outbound investment, but serves as a new platform for international cooperation and gives equal emphasis to "bringing in" and "going global" with regard to capital. Foreign enterprises could also leverage the advantages of the BRI to expand business in key development districts of China.

In conclusion, shifting away from a growth model regardless of resources and environmental constraints, China has been transforming into a consumption-driven economy, whose resilience stems from residents' unfulfilled demand. Moreover, China is pursuing development with its door wide open and will accelerate financial liberalization and improve market access in the long term. It should be noted that foreign capital can also reap the fruits by aligning well with these megatrends, most importantly, the structural upgrading of China's development model and its longstanding commitment to further opening-up.

# China Made a Profound Impression on the FG500 List

112 Chinese companies* made Fortune Global 500 list for 2018. It was the 15th-straight-year that Chinese companies had increased their presence on the list. The rise of Chinese companies was spectacular given that there were less than 10 companies on the list in 2000. The United States leads 2018 FG500 list with 126 companies.

Most China FG500 companies are in the sectors of energy, finance, retail, internet and property. Over 80% of these 112 companies are state-owned. 10 Chinese companies hit the list for the first time, including China Merchants Group, Shougang Group, etc.

Compared to its global peers, China FG500 companies are at the early stage of their globalization journey, but the pace to expand overseas markets is picking up. Deloitte's analysis finds that China FG500 companies accounted for 56% of capital invested overseas from 2013 through 2017.

Bolder reform and opening-up is going to take place in China. China will further expand the scope and raise the quality of its opening-up; China will also advance international cooperation under the Belt & Road Initiative.

The evolving policy and market landscape boasts opportunities and challenges in China for both Chinese companies and foreign MNCs. And we forecast that Chinese companies will continue their outbound investment momentum, especially in markets along the Belt & Road Initiative.

| RANK | COUNTRIES | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| 1 | USA | 128 | 128 | 134 | 132 | 126 |
| 2 | China* | 95 | 99 | 103 | 109 | 112 |
| 3 | Japan | 57 | 54 | 52 | 51 | 52 |
| 4 | Germany | 28 | 29 | 28 | 29 | 32 |
| 5 | France | 31 | 31 | 29 | 29 | 28 |
| 6 | UK | 27 | 28 | 26 | 24 | 21 |
| 7 | Korea | 17 | 17 | 15 | 15 | 16 |
| 8 | the Netherlands | 12 | 12 | 12 | 15 | 15 |
| 9 | Switzerland | 13 | 13 | 15 | 14 | 14 |
| 10 | Canada | 10 | 11 | 11 | 11 | 12 |

Source: Fortune Global 500
*Including companies headquartered in the mainland and Hong Kong only

# China Government Pledges to Improve the Investment Environment

The Chinese government has been constantly working on improving the investment environment for foreign investors. The Standing Committee of the National People's Congress made decision on the amendment of four laws including *the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures, the Law of the People's Republic of China on Sino-foreign Co-operative Enterprises,* and *the Law of the People's Republic of China on the Protection of Investment by Taiwanese Compatriots* on September 3rd, 2016. The Ministry of Commerce published *the Provisional Measures on Filing Administration for the Establishment and Change of Foreign Investment Enterprises* on October 8th, 2016 and made further revision on July 30th, 2017. Under these laws and regulations, it has been explicitly stipulated that the administration of establishment and change of foreign investment enterprises which are not subject to special administrative measures stipulated by the State will be changed from the examination and approval system to a filing system.

In 2017, the State Council issued two important documents relating to the utilization of foreign investment, which are *the Notice of the State Council on Several Measures for Expansion of China's Opening up to the Outside World and Active Use of Foreign Capital* and *the Notice of the State Council on Several Measures for Promoting Foreign Investment Growth*. More than 40 specific policies and measures have been formulated to promote the open and fair competition environment and to enhance the attraction of foreign investments. Furthermore, the *Catalogue of Industries for Guiding Foreign Investment* has been revised for the seventh time in 2017. In the 2017 version, the restricted items on foreign investment has been reduced from 93 to 63 comparing with the 2015 version.

Recently, in the press conference of the first session of the 13th National People's Congress held on March 6th, 2018, Ning Jizhe, the Deputy Director of the National Development and Reform Commission (NDRC), announced that the Chinese government will further improve the policy of attracting foreign investment and improve foreign investment environment by substantially loosening the market access, vigorously promoting the convenience of investment etc. The NDRC will work together with other relevant departments of the State Council to further revise the negative list of foreign investment and gradually extend the foreign investment negative list, which has been put into trial use in the Free Trade Zone to the whole country. The openness of the service industry will be largely enhanced and the general manufacturing industry will be fully liberalized. The restriction on foreign shareholding ratio in certain industries and the restrictions on the business scopes of foreign investment will be loosened or even abolished. The government will also make efforts to create a more fair competition environment for both domestic and foreign enterprises.

Except for the above improvements in foreign investment policies, the government is also working on the simplification of the formalities of foreign invested enterprise establishment. On February 28th, 2018, the Ministry of Commerce and the State Administration for Industry and Commerce jointly issued the *Notice of General Office of the Ministry of Commerce and General Office of the State Administration for Industry and Commerce on Matters Concerning the Acceptance of Applications for Commercial Record-filing and Business Registration of Foreign-invested Enterprises at a Single Window with a Single Form* pursuant to which applications for commercial record-filing and for business registration of foreign-invested enterprises should be accepted at a single window with a single form as of 30 June 2018 to optimize the procedures for foreign-invested enterprises to apply for enterprise establishment, shorten the processing period, and reduce enterprise cost.


Sales Report
Products

# Industry Overview

## Overview

According to the *Global Foreign Direct Investment Review and Outlook 2017-2018* released by the United Nations Conference on Trade and Development, global foreign direct investment (FDI) fell by 16% in 2017, to an estimated US$1.52 trillion, from US$1.81 trillion in 2016. China, with recorded inflows of US$144 billion (US$131 billion according to the Ministry of Commerce), is now the second largest recipient in the world.

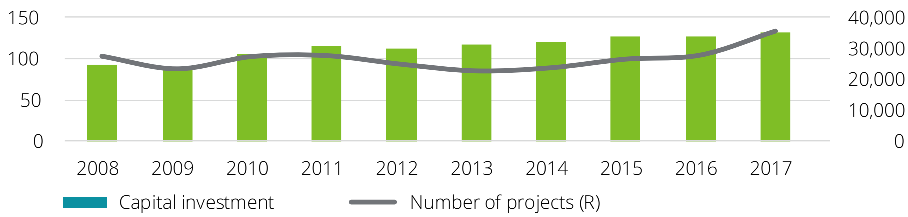
A slump in FDI flows to developed countries (-27% in Europe and -33% in North America) was the principal factor behind the global decline. FDI inflows in the United States and the United Kingdom has returned to prior levels in 2017 after spikes in the previous two years.

Against the backdrop of a decline in worldwide FDI, the share of developing Asia in global inflows rose from 25% in 2016 to 30%. Estimated FDI flows to developing Asia amounted to US$459 billion in 2017, 2% up from 2016, regaining its position as the largest FDI recipient region in the world, followed by the European Union and North America.

According to the report, the United States topped the list of the top 10 host economies for FDI flows with inflows of US$311 billion, followed by China, the third largest FDI recipient in 2016, with US$144 billion and Hong Kong with US$85 billion. Other countries in the list include Netherlands, Ireland, Australia, Brazil, Singapore, France and India (in descending order).

In addition, the report also pointed out that after three consecutive years of growth, global cross-border M&As fell sharply in 2017. In fact, the growth of global cross-border M&As had already slowed in 2016. In 2017, cross-border M&A value went on to contract by 23%, reaching an estimated US$666 billion, but still represented the third-highest level since 2007.

**Figure 3: FDI trends in China (USD Billion)**



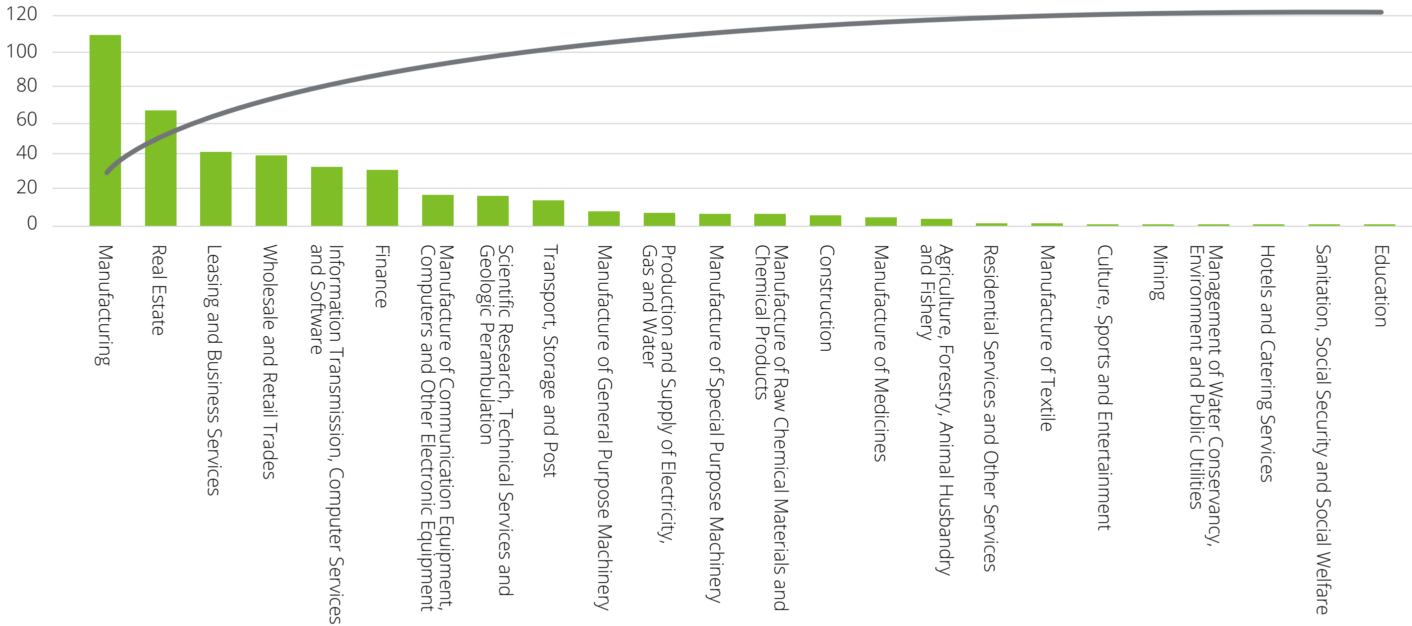

Source: Ministry of Commerce, Wind

## Industry breakdown

According to the 24-group industry classification sorted by the National Bureau of Statistics of China, manufacturing, real estate, leasing and business services, wholesale and retail, information transmission, computer services and software, and finance were most favoured by foreign investors, attracting nearly 80% of the total FDI flows in the past three years.

In 2017, by sector, there were 579 newly established foreign-invested enterprises in agriculture, forestry, animal husbandry and fishery, 29% up from 2016 while the actual use of foreign investment contracted by 52.1%, reaching US$790 million; in the manufacturing sector, 4,986 foreign-invested enterprises were newly established, a year-on-year growth of 24.3%, while the actual use of foreign investment fell 5.6% from 2016, to US$33.51 billion; and in the service sector, 30,061 new foreign-invested enterprises were established, 28.4% up from 2016 while the actual use of foreign investment was US$95.44 billion, representing a year-on-year increase of 7.5%.

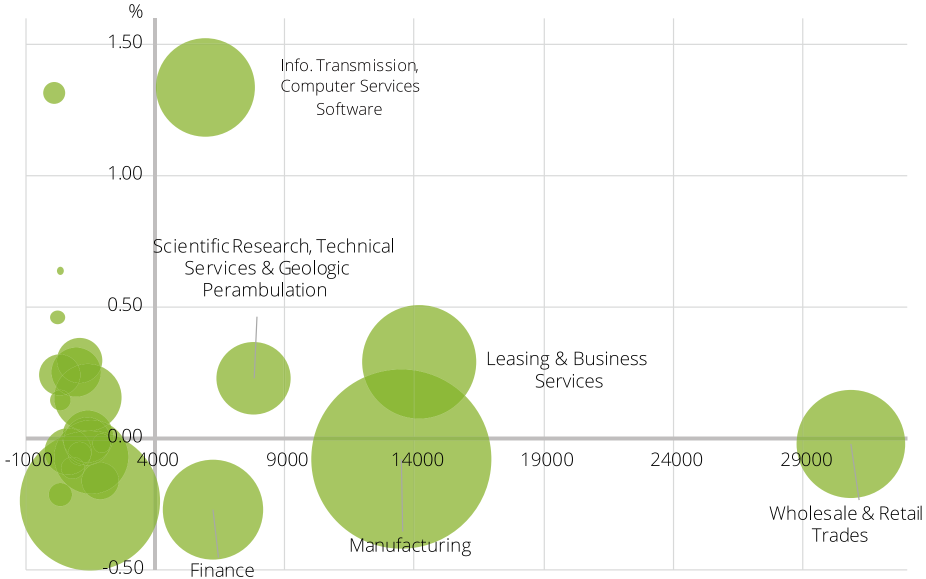
**Figure 4: 2015-17 FDI breakdown by industries (USD Billion)**




Source: National Bureau of Statistics of China, Wind

A further observation on the FDI investment data from 2015 to 2017 is shown in Figure 5 below: the horizontal axis shows the number of foreign direct investment projects in each sector; the vertical axis indicates the compound annual growth rate of foreign direct investment during the three years (for detailed CAGR of each industry, see Table 1); and the bubble size represents the total investment amount over the three years. Three sectors in the first quadrants, including information transmission, computer services and software, leasing and business services, scientific research, technical services, and geological exploration, achieved the best overall performance. The CAGR data from 2015 to 2017 shows that sectors with positive and negative FDI growth can be split into equal halves, with the real estate and financial sectors suffering the worst slump.

**Figure 5: Volume v.s. Value v.s. CAGR of Sector FDI 2015-2017**




Source: National Bureau of Statistics of China, Wind

*Est. by IMF*

**Table 1. Sector rank by CAGR of 2015-2017**

| Sectors | CAGR (%) |
|---|---|
| Information Transmission, Computer Services and Software | 1.34 |
| Mining | 1.32 |
| Education | 0.64 |
| Sanitation, Social Security and Social Welfare | 0.46 |
| Construction | 0.30 |
| Leasing and Business Services | 0.29 |
| Production and Supply of Electricity, Gas and Water | 0.25 |
| Manufacture of Medicines | 0.24 |
| Scientific Research, Technical Services and Geologic Perambulation | 0.23 |
| Transport, Storage and Post | 0.16 |
| Management of Water Conservancy, Environment and Public Utilities | 0.15 |
| Manufacture of General Purpose Machinery | 0.01 |
| Manufacture of Special Purpose Machinery | -0.01 |

| Sectors | CAGR (%) |
|---|---|
| Hotels and Catering Services | -0.02 |
| Wholesale and Retail Trades | -0.02 |
| Manufacture of Raw Chemical Materials and Chemical Products | -0.05 |
| Culture, Sports and Entertainment | -0.06 |
| Manufacture of Communication Equipment, Computers and Other Electronic Equipment | -0.07 |
| Manufacturing | -0.08 |
| Residential Services and Other Services | -0.11 |
| Agriculture, Forestry, Animal Husbandry and Fishery | -0.16 |
| Manufacture of Textile | -0.21 |
| Real Estate | -0.24 |
| Finance | -0.27 |

Source: National Bureau of Statistics of China, Wind

### Table 2. Top 10 M&A Deals by Value (2015-2017)

| Announced Date | Target Company | Target Dominant Sector | Bidder Company | Deal Value (USD Billion) |
|---|---|---|---|---|
| 26/09/2016 | Yum China Holdings, Inc. (95% Stake) | Leisure | Yum! Brands, Inc (Shareholders) | 10.91 |
| 28/04/2017 | Didi Chuxing Technology Co., Ltd. | Internet / ecommerce | SoftBank Group Corp.; Silver Lake Partners; Bank of Communications Co., Ltd.; China Merchants Bank Co., Ltd. | 5.50 |
| 27/11/2015 | China TieTong Telecommunications Corporation (Fixed line telecom and broad band business) | Telecommunications: Carriers | China Mobile Limited | 5.36 |
| 14/03/2016 | CITIC Real Estate Group Co., Ltd. ; CITIC Pacific Limited | Real Estate | China Overseas Land and Investment Limited | 5.25 |
| 02/03/2017 | JD Finance (68.6% Stake) | Financial Services | Undisclosed bidder | 4.98 |
| 21/12/2017 | Didi Chuxing Technology Co., Ltd. | Internet / ecommerce | SoftBank Group Corp. | 4.58 |
| 12/05/2016 | Didi Chuxing Technology Co., Ltd. | Internet / ecommerce | Apple Inc.; China Life Insurance Co., Ltd.; China Merchants Bank Co., Ltd.; Alibaba Group Holding Ltd; ... | 4.50 |
| 19/10/2017 | China Internet Plus Holding Ltd. | Internet / ecommerce | An investor group led by Tencent Holdings Ltd | 4.00 |
| 19/01/2016 | China Internet Plus Holding Ltd. | Internet / ecommerce | An investor group led by Tencent Holdings Ltd | 3.50 |
| 26/10/2015 | Qunar Cayman Islands Limited (45% Stake) | Internet / ecommerce | Ctrip.com International, Ltd. | 3.42 |

Source: Mergermarket.com

**Table 3. Top 10 Greenfield FDIs by Value (2015-2017)**

| Project Date | Investing Company | Parent Company | Source Country | Industry Sector | Capital Investment (USD Billion) |
|---|---|---|---|---|---|
| 2016-12 | Foxconn | Hon Hai Precision Industry | Taiwan | Electronic Components | 8.80 |
| 2017-08 | Samsung Semiconductor | Samsung | South Korea | Semiconductors | 7.00 |
| 2015-05 | Hongkong Land China Holdings | Jardine Matheson Holdings | Hong Kong | Real Estate | 3.04 |
| 2015-12 | Taiwan Semiconductor Manufacturing (TSMC) | Taiwan Semiconductor Manufacturing (TSMC) | Taiwan | Semiconductors | 3.00 |
| 2015-04 | Powerchip Technology (Powerchip Semiconductor) | Powerchip Technology (Powerchip Semiconductor) | Taiwan | Semiconductors | 2.18 |
| 2017-12 | Sateri International | Royal Golden Eagle (RGE Group) | Singapore | Textiles | 1.82 |
| 2017-07 | LG Display | LG | South Korea | Electronic Components | 1.60 |
| 2016-05 | Pacific Oil & Gas | Royal Golden Eagle (RGE Group) | Singapore | Coal, Oil and Natural Gas | 1.52 |
| 2016-05 | Pacific Aerospace Resources & Technologies | ARC Aerospace Industries | United States | Aerospace | 1.50 |
| 2016-07 | Tishman Speyer Properties | Tishman Speyer Properties | United States | Real Estate | 1.34 |

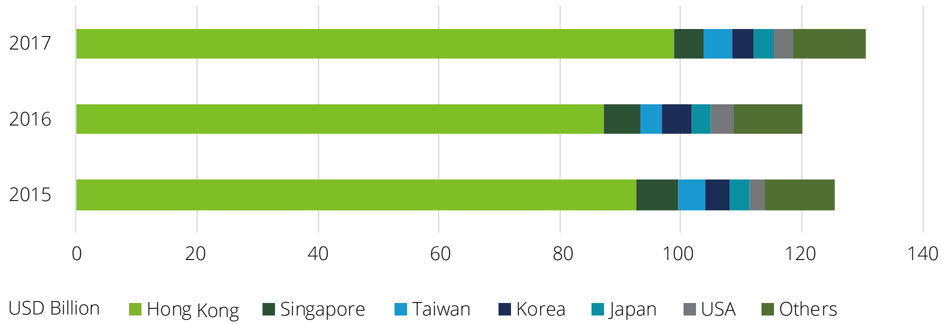
Source: fdimarkets.com

## Source countries

According to official data from the National Bureau of Statistics, 35,652 new foreign-invested companies were established in 2017, a year-on-year increase of 27.8%, while the actual use of foreign investment rose to RMB 877.56 billion, a year-on-year increase of 7.9% (or US$131.04 billion, a year-on-year increase of 4%).

The total actual foreign investment by the top ten FDI source countries was US$12.46 billion, accounting for 95.1% of the total amount of the actual use of foreign investment in the country, 5.2% up from the previous year. The top ten source countries and regions for investment into China were: Hong Kong (US$98.92 billion), Singapore (US$4.83 billion), Taiwan Province (US$4.73 billion), South Korea (US$3.69 billion), Japan (US$3.27 billion), the United States (US$3.13 billion), the Netherlands (US$2.17 billion), Germany (US$1.54 billion), the United Kingdom (US$1.5 billion), and Denmark (US$1.2 billion).

### Figure 5: FDI Breakdown by Major Source Countries



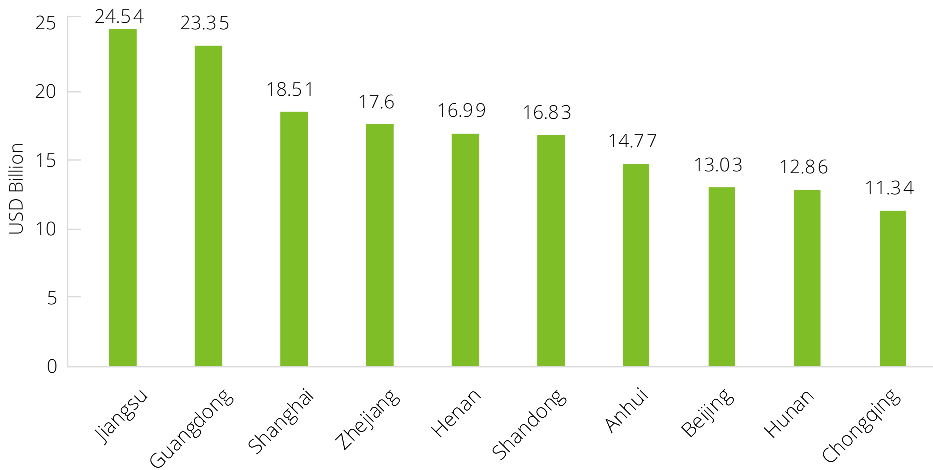

Source: Ministry of Commerce, Wind

In 2017, ASEAN invested in or established 1,287 enterprises in China, a year-on-year increase of 11%, while the actual foreign investment reached US$5.21 billion, a year-on-year decrease of 22.6%; the 28 EU member countries invested in or established 1,873 enterprises in China, a year-on-year increase of 7.6%, while the actual foreign investment reached US$8.79 billion, a year-on-year decrease of 9.1%; countries along the Belt and Road invested in and established 3,857 enterprises in China, a year-on-year increase of 32.8%, while the actual foreign investment amounted to US$5.56 billion, a year-on-year decrease of 20.4%; 11,984 new foreign-invested enterprises were established in the Yangtze River Economic Belt, a year-on-year increase of 2.6%, while the actual use of foreign investment reached US$57.42 billion, a year-on-year decrease of 6%.

## Destination regions

When it comes to the distribution of foreign investment destinations, according to the data from the National Bureau of Statistics, the top ten regions for actual use of FDI in 2016 were Jiangsu, Guangzhou, Shanghai, Zhejiang, Henan, Shandong, Anhui, Beijing, Hunan and Chongqing, and the foreign capital inflows of each province exceeded US$10 billion, with a total foreign investment inflow of US$169.82 billion.

**Figure 6: 2016 Destination Ranking in FDI**




Source: National Bureau of Statistics of China, Wind

# Industry Segmentation

## Snapshot of China's TMT industry—full steam ahead

We live in a time of relentless change yet stubborn continuity. The technology, media and telecom sectors remain as active as ever. Progress will be exponential in some fields, while in other areas the way in which we live and work may shift imperceptibly.

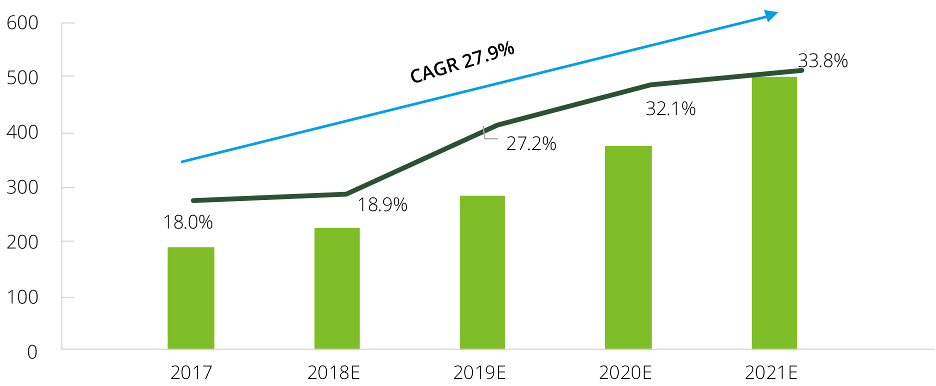
### Technology

The technology sector is expected to sustain high growth, particularly in emerging verticals.

**Robotics on high path:** The Chinese robotics market is set to expand rapidly. China is the largest robotics market in the world. This was the case in 2016 and 2017, and will likely to continue in 2018. "Made in China 2025" initiative aimed at boosting development in high-tech will further push the robotics market growth in the long haul.

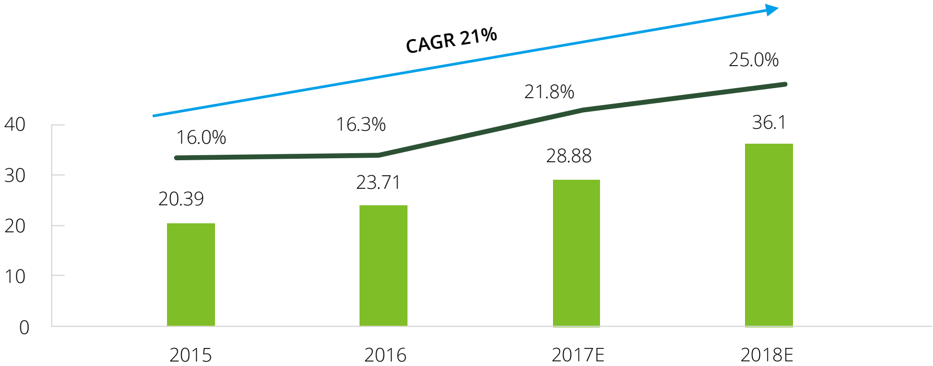
**Figure 7: China's robotics market (2017-2021E)**

**(USD Billion)**



**AI relentlessly march forward:** China's artificial intelligence industry recently received a huge boost of validation from the government, which announced its plans to create a US$150 billion artificial intelligence market by 2030, surpassing the US market.

**Figure 8: China's AI market (2015-2018E) (USD Billion)**




**RPA to transform business dramatically:** Robot-led automation has the potential to transform today's workplace as dramatically as the machines of the Industrial Revolution changed the factory floor. Both Robotic Process Automation (RPA) and Intelligent Automation (IA) have the ability to make business processes smarter and more efficient, though in very different ways. Robotic process automation tools are best suited for processes with repeatable, predictable interactions with IT applications. These processes typically lack the scale or value to warrant automation via IT transformation. RPA tools can improve the efficiency of these processes and the effectiveness of services without fundamental process redesign.

**Intelligent automation:** Intelligent automation has great potential to automate non-routine tasks involving intuition, judgment, creativity, persuasion, or problem solving. The decreasing costs of data storage and processing power are driving rapid developments in the field of Artificial Intelligence, creating a new breed of cognitive technologies with human-like capabilities such as recognizing handwriting, identifying images, and natural language processing. When combined with robotic process automation and powerful analytics, these cognitive technologies can form intelligent automation solutions that either directly assist people in the performance of non-routine tasks or automate those tasks entirely.

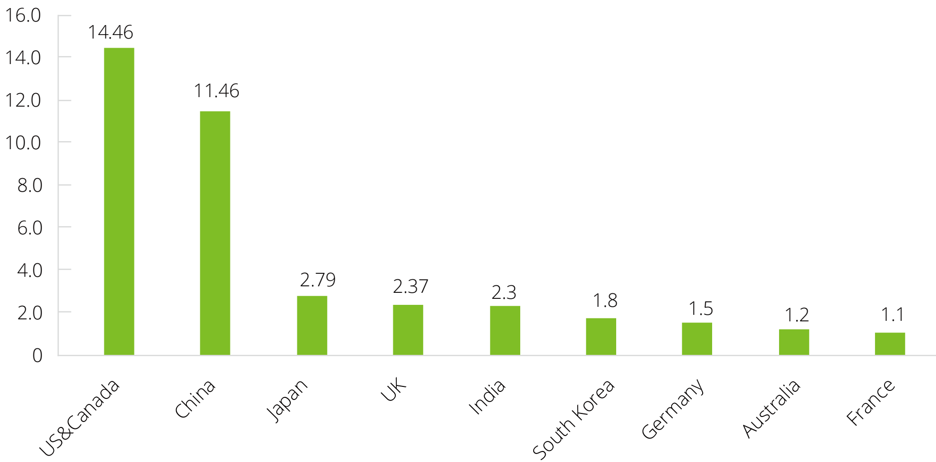
**Machine learning (ML) will take baby steps to mature:** A core element of artificial intelligence will progress at a phenomenal pace. But this will be from a low base. As impressive as it is today, in 50 years' time the ML abilities of 2018 will be considered baby steps in the history of this technology. Over the coming year, ML will become more commonly deployed in enterprises, but will remain far from ubiquitous. Almost every high-end smartphone will have a machine learning chip, but those chips will not yet be fully utilized. Nearly a million ML chips will be installed in data centers, but this quantity will seem small within a decade.

## Media

The media sector is flourishing, particularly in film and live broadcasting.

**Film market bulldozing its way:** After a hiccup in 2016, the Chinese film market rebounded quickly in 2017 and overtook North America in first quarter of 2018. With sustained support from positive policies, capital flow and supply-side development, the industry continues to grow. Revenue generated by China's film industry is expected to surpass that of North America, making it the largest film market in the world. Co-productions will increase, albeit slowly. Co-productions can achieve "win-win" outcomes for both parties, because they are considered to be "Made in China" and enjoy the same treatment as domestic films. Further, tech giants like Baidu, Alibaba, and Tencent as game changers utilize their ability to draw on big data to drive decision optimization and profit growth. The effect of these innovations has already transformed the Chinese film industry chain, from intellectual property to production, marketing and promotion, distribution, ticket sales, and cinema screenings.

**Figure 9: Major global box office compared (USD Billion, 2017)**



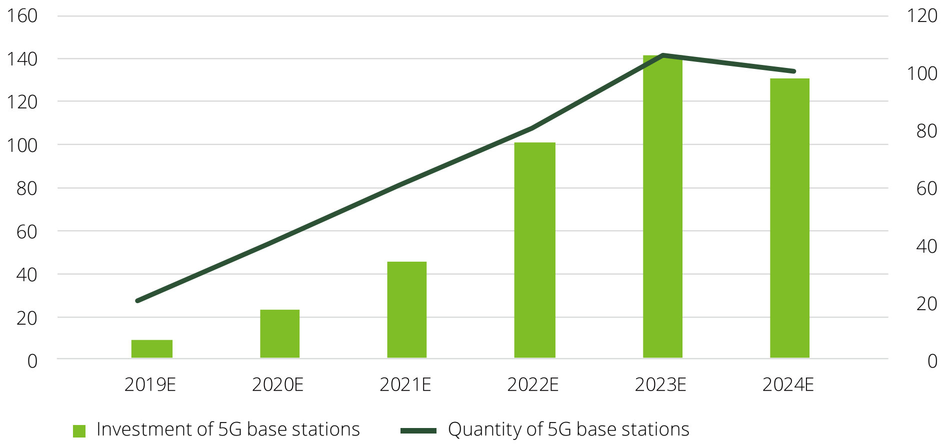

**Live broadcast lively:** The live broadcast market will remain vibrant despite consumers' ever-improving capability to consume content on demand or, in the case of events, to attend remotely. Even in an age in which the mantra for media is often "what you want, when you want it, where you want it" , the way we want to consume is often "now" because of the thrill and convenience of live delivery. And in many regards, digital technology has actually made live content more productive and profitable. China is likely to remain the largest market for live streaming in 2018, with forecast revenue of US$4.4 billion. Viewers are likely to reach 456 million. Live broadcast appears to be still alive in the digital era. Live content will thrive in a digital world – they are as relevant as ever for enterprises and consumers.

## Telecommunication

Mobile and 5G will usher in a new era for the telecom sector.

**5G steaming ahead:** The Chinese State Council will accelerate the development of 5G industry, hoping to start 5G business in 2020 and enhance the competitiveness of China's manufacturing industry by upgrading the communication industry. By 2023, 5G networks should have launched in most developed markets, offering much greater capacity and connectivity speeds. Over a billion 5G users are forecasted for China alone by 2023. Mobile Internet market will further grow in the future, due to the steady growth of mobile shopping and mobile gaming market, the coming of mobile advertising boom, and the increase of e-business activities. And the pace and reach of those networks is likely to get steadily faster. The majority of voice calls have already moved to mobile networks. Now it is the turn of home broadband, thanks to the ever falling cost per gigabyte of data. The scale of fixed assets investment in China's telecom industry has been increasing in recent years. The growth rate of investment will continue in the next few years, under the impetus of the 5G construction.

**Figure 10: China's 5G base station investment**




**Smartphone capability expands:** Explicitly the smartphone is unlikely to change markedly. But implicitly, it is likely going to continue to undergo a massive sequence of upgrades that will steadily widen the device's capability for years to come. Companies that understand best how to harness these invisible innovations are likely to profit most from forthcoming innovations, for example via ever more compelling augmented reality on smartphones. The smartphone is likely to be used by more people, with increasing frequency, and for a wider scope of activities, spanning the practical, informative and entertaining. This trend may well raise the question of whether smartphone usage is excessive: the reality is that the smartphone, like any technology, is a tool whose appropriate usage will be determined by society and individuals.

## Snapshot of China's Retail industry—embracing future retail

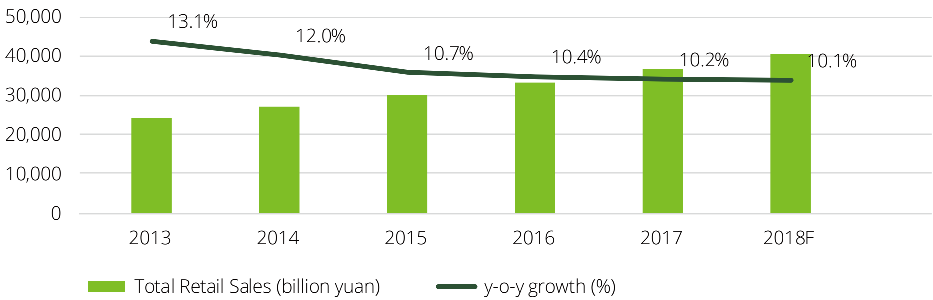
Consumption has become the main driving force behind China's economic growth, and the retail sector, as an important component of consumption, is undergoing a series of transformations and innovations to better meet consumer demands while maintaining steady growth. Market participants have made numerous attempts in channel integration, service model innovation, and traditional value chain optimization. The rapid progress of retail technology and the gradual improvement of data system have become the cornerstone of these changes.

### Industry landscape

According to data from the National Bureau of Statistics, the total retail sales of consumer goods reached 36,626 billion yuan in 2017, representing a year-on-year increase of 10.2% yet a 0.2% drop in its growth rate from 2016, and driven by steady growth in population and resident income, total retail sales of consumer goods remained stable. The trend of growth thus continued.

From the perspective of the categories of goods, the growth rates of most goods have risen from 2016, among which consumption upgrading goods has increased significantly. The sales of household appliances and cosmetics products above the designated standard increased by 9.3% and 13.5% respectively over the previous year, 0.6% and 5.2% up respectively in growth rates; the communication equipment category still maintained an 11.7% growth despite the high growth rate in the previous year.

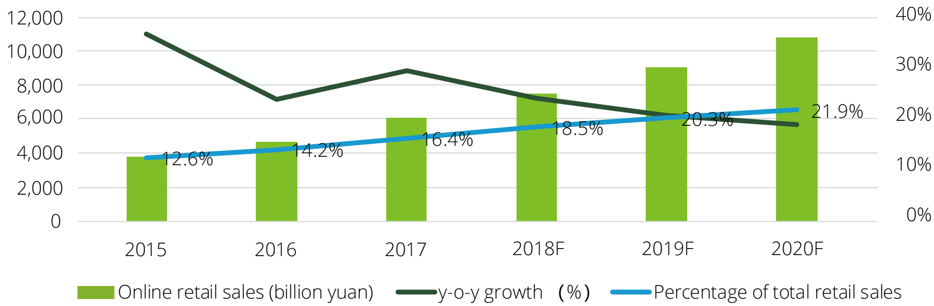
**Figure 11: Total retail sales of consumer goods maintained steady growth**




Source: Wind, Iresearch

In terms of retail channels, online retail sales maintained rapid growth. According to data from the National Bureau of Statistics, online retail sales of physical products nationwide in 2017 reached 5,480.6 billion yuan, an increase of 28.0%, and the growth rate was 17.8% higher than the total retail sales of consumer goods. At a sustained high rate of growth, the penetration rate of online retailing in the overall retail sales has exceeded 15%, and the overall impact on the retail industry has become increasingly significant. The trend of rapid growth and increasing penetration is expected to continue for years to come and the penetration rate is expected to exceed 20% by 2020.

**Figure 12: Increasing online retail penetration**




Source: Wind, Iresearch

## Key drivers

Economic development and continuous income growth have substantially boosted China's consumer market, and the digital transformation driven by technology and data and the industrial integration and innovation facilitate structural improvement in the retail sector. Taking both quality and quantity into account, there are currently three key drivers in China's retail market: consumption upgrade, technology empowerment, and integration and innovation.

The continuous expansion of the consumer market is closely related to the growth of the overall economy and consumer income. With the continuous economic growth, the middle- and high-income population have expanded steadily and have gradually become the core force affecting the consumer market. According to the forecast of *The Economist*, the middle class in China accounted for only 8% of the total population in 2010, but by 2020, this proportion is expected to reach 58.6%, and the number of poor and extremely poor people will decrease drastically. The rapid expansion of middle- and high-income population is driving China's consumption upgrade. Consumer demands for higher quality, better experience, and more customization are bringing new opportunities to the market and in the meanwhile stimulating market participants to optimize and enhance their products and services to better understand and meet consumer demands.

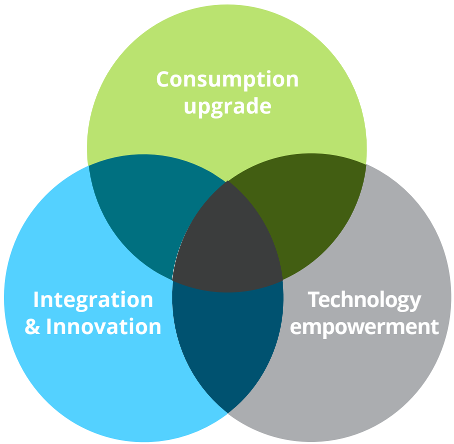
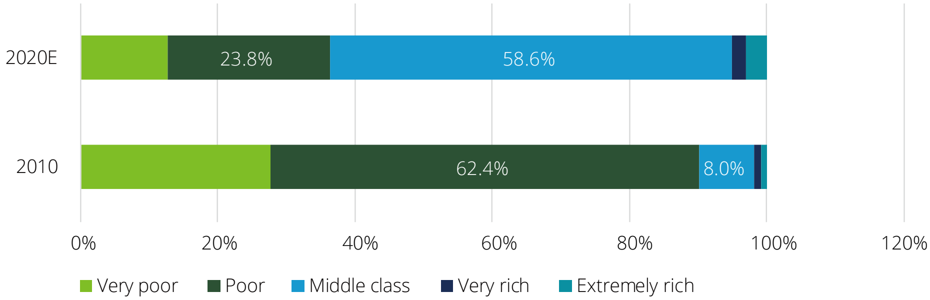
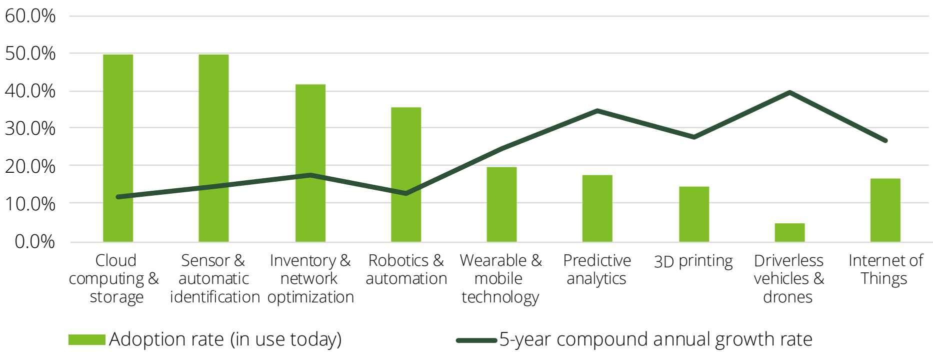


**Figure 13: Growing middle class**




Source: The Economist

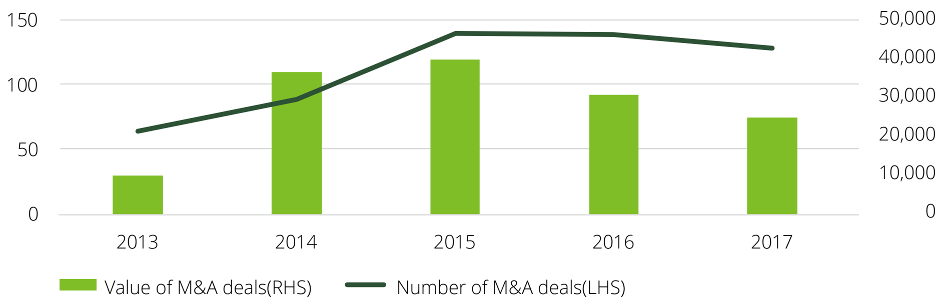
**Figure 14: Technology and analysis become the core driving force behind future retail transformation**




Source: Deloitte & MHI

To better respond to ever changing consumer demands in the unique digital environment in China, market participants are using data and technology as a basis for transformation and using consumer demands as a guide to set up an innovative customer-oriented penetration strategy, trying to identify and meet consumer demands quickly and comprehensively. Through the customer-oriented penetration strategy, companies occupy consumers' life even more, developing consumer loyalty and drawing a more comprehensive and accurate consumer portrait. Current major innovation paths share the same basis-technology and analytics capabilities. According to a global corporate survey conducted by Deloitte and MHI some technologies such as cloud computing & storage, sensors & automatic identification, inventory & network optimization, robotics & automation have been recognized and adopted worldwide and become an important driving force behind enterprise optimization and innovation. Emerging technologies such as wearable & mobile technology, predictive analytics, 3D printing, Internet of Things, and driverless vehicles will also see rapid growth and wider application in the next five years. Advances in science and technology and analytical capabilities are giving businesses and consumers more opportunities and means of interaction and allowing companies more options in reshaping their value chain.

**Figure 15: M&As in the Retail Sector (USD Million)**




Source: Mergermarket

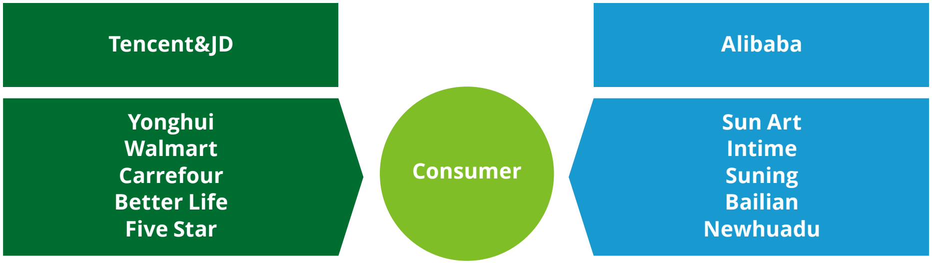
The retail sector has entered a consolidation period since 2013. We can learn from the M&A data that M&A activity has remained at a high level: The M&A transaction volume has remained stable though the transaction value has declined slightly since 2015 when both reached a peak.

## Key trends to watch

### Industrial integration is going deeper

When trying to build a consumer-oriented ecosystem, leading Internet companies have continued to penetrate the offline market. Thanks to these companies, the deepening of industrial integration will continue in 2018, while the traditional retail enterprises will also take a more active and open attitude towards participating in the integration, with focuses on resources and channels.

**Figure 16: Deepening industrial integration**




Source: Deloitte Research

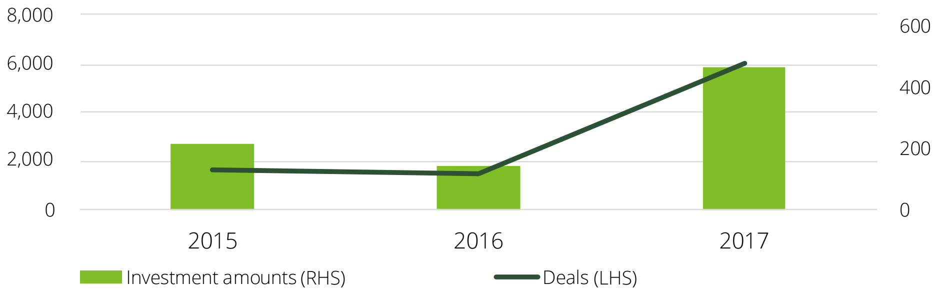
### Capital boosts industry innovation

In 2017, private equity funds and venture capital rushed into the retail sector, and more than half of these investments were concentrated in Series A companies. Investment in start-ups not only drove innovation in the industry but also promoted the application of technology in the retail sector.

### Return of physical retail

Traditional retail companies have already begun to undergo transformation after industrial downturn and achieved recovery and growth in 2017. They rely on the development of science and technology to vigorously push ahead digitization, using new technologies such as cloud computing, Internet of Things, artificial intelligence, and mobile Internet, as well as the constantly improving logistics distribution system to optimize and innovate businesses; meanwhile, the deepening integration of retail enterprises and Internet companies would make the flow and allocation of resources more efficient and boost traditional retail sales.

**Figure 17: PE&VC investments (USD Billion)**

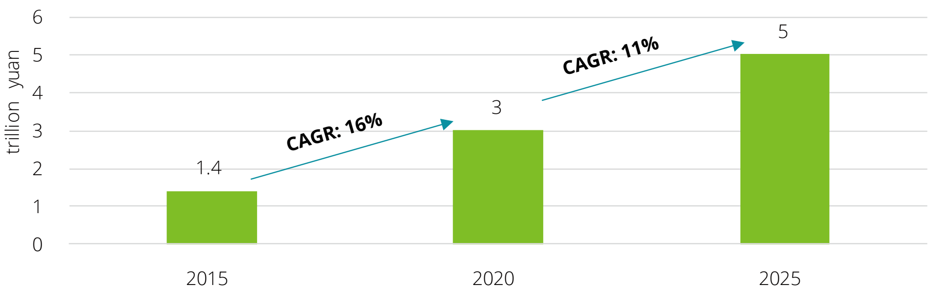



Source: PEdata

**Figure 18: Physical retail sales rebound**


Source: Wind

**Figure 19: China smart manufacturing industry output**




Source: Qianzhan Industry Institute, Deloitte Research

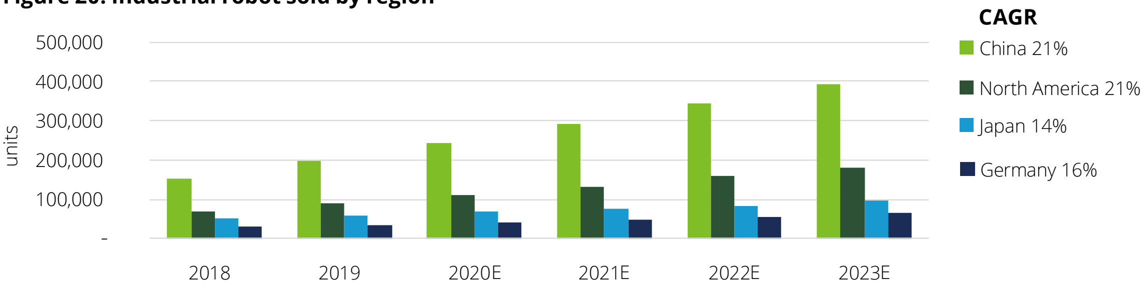
## Snapshot of China's Smart Manufacturing Industry—unfolding the tangible benefits

### Chinese smart manufacturing on fast track

China's smart manufacturing sector will see a compound growth rate of 16 percent in the 2015-2020 period, with the annual output of the sector exceeding RMB 3 trillion by 2020 (about US$473 billion) and RMB 5 trillion by 2025 (about US$796 billion).

In 2018, China will deploy an additional 100 smart manufacturing pilot demonstration projects, according to Ministry of Industry and Information Technology. The selection of the project include both traditional industries and emerging sectors, such as non-ferrous metals, textiles, household appliance, 5G, Internet of Things and connected vehicles.

**Figure 20: Industrial robot sold by region**




Source: IFR, Deloitte Research

## Understanding the policy context

"Made in China 2025" is China's master plan to establish its smart manufacturing ecosystem and realize the industry transformation. It emphasised 10 industries as particularly important priorities. These sectors include robotics, aerospace, new energy systems, electric vehicles and medical products. Chinese Government perceives these industries as the perfect opportunity to leapfrog technologically and boost its global competitiveness. To realize the targets, government has intensified its subsidies and funding mechanisms. It is also targeting the creation of a number of manufacturing and innovation centres and national-level demonstration areas.

Made in China 2025 is a high-level strategy, therefore, we need to see it in the context of other Chinese initiatives, e.g. Internet Plus and BRI, which are running in parallel to push forward the transformation.

Internet Plus strategy aims at traditional industry transformation and innovation to fully capitalize a new set of technologies. With the penetration of digitalization featured by AI, big data and cloud computing, China's manufacturing industry companies grow to be the champion of the world.

"Belt and Road Initiative" represents a chance to export China's technological and engineering standards. Chinese policymakers see it crucial to upgrade the country's industry.

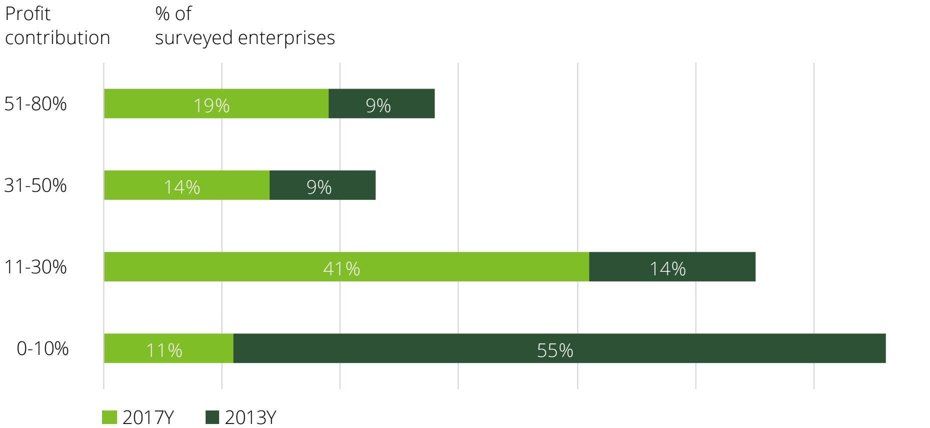
## Key trends to watch

### Tangible benefits start to unfold in scale

2013-2014 were years of education for smart manufacturing, when Chinese enterprises learned what the technology could offer to their organizations and gained a sense of the tangible benefits of deploying smart manufacturing. In 2015, the government launched the pilot project program and manufacturing enterprises started to connect the devices to improve production efficiency. In 2016-2017, as the scales of smart manufacturing projects and industry cooperation evolves, the benefits of digitization began to unfold. Deloitte's survey result shows that smart manufacturing deployment has brought remarkable increase in profit levels in 2017 compared with 2013 (Figure 21).

For the coming years, we expect that the number of connected devices, as well as smart manufacturing projects, will continue to expand with increased impact on revenue, profit and business model. Such increase mainly comes from two sources: the improvement of production efficiency, and the increase in the value of products and services.

**Figure 21: Smart manufacturing deployment bringing significant profit improvement**




Source: Deloitte China smart manufacturing survey 2017

### Volume of data is a distinct advantage but also a challenge

From high levels of state backing to the scale of industry cooperation and a dynamic technology sector, China has many distinct advantages in place to promote long-term growth of smart manufacturing. Of all the drivers, scale of data is China's most distinctive advantage given the key role that data play in smart manufacturing. For example, the advancement of machine learning heavily relies on the volume of data.

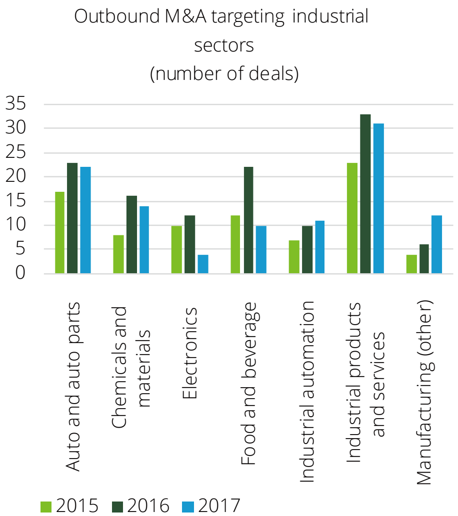
Considering China's population and the scale of its manufacturing industry, Chinese enterprises have natural advantages in obtaining data compared to their European and American peers.

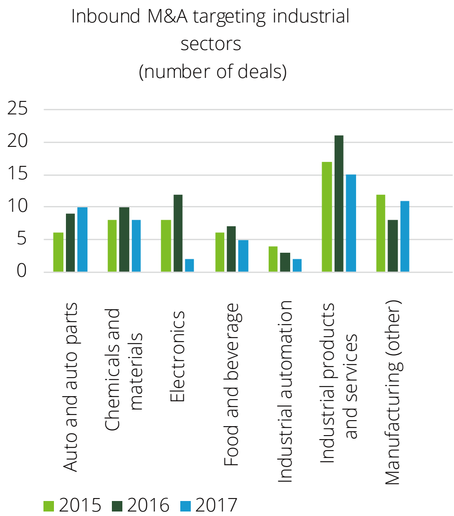
However, capitalizing on the data is another matter. Most enterprises used to collect vast troves of process data but typically use them only for tracking purposes, not as a basis for improving operations. Industrial softwares, IoT and data analytics vendors will need to work closely with their clients to figure out customized solutions.

### Sectors progress at different paces

Nowadays, Chinese enterprises quickly gain technology know-how through two channels: foreign investors and overseas acquisition, whose appetites, however, vary across different sectors. Looking at China's cross-border M&A data, it is clear that auto and chemical industries are still the hot spots. Electronics production and manufacturing will likely continue to get commoditized. Industrial automation, including robotics, sensing equipments, machine vision systems, process control equipments etc., is the only sector increasing in outbound deal activities even at the backdrop of a tighter scrutiny for overseas investment.

**Figure 22: China's cross-border M&A targeting manufacturing sectors**




Source: Mergermarket, Deloitte analysis

## Snapshot of China's LSHC industry—innovation drives growth

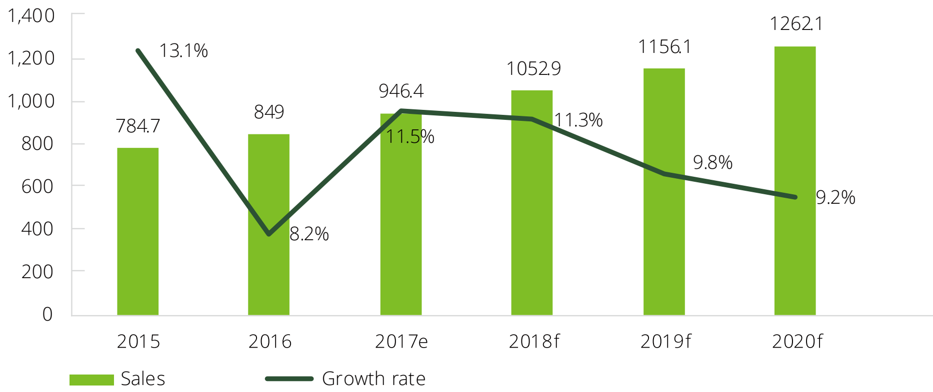
### Industry landscape

According to estimates and forecasts, the life science and health care sector in China maintained double-digit growth in 2017. Sales of pharmaceuticals and medical devices increased by more than 11%, and it is expected to maintain a 9%-11% growth in the coming years. The proportion of total health expenditure to GDP also exceeded 6% and maintained a growth rate of about 9%. It is estimated that by 2020, the proportion of total health expenditure to GDP will reach 6.5%-7%.

There are multiple engines behind such a long period of middle- and high-speed growth for the life science and health care sector in China. First, the most important engine is the changes in the demographic structure. The continuous growth of the aging population and the declining labor force will accelerate the rise of medical demand. In addition, a series of top-level designs and plans from the government, including the "Healthy China 2030" plan, show that the life science and health sector will play an increasingly important role in China's economy. At the same time, the involvement of social capital in the healthcare industry is also deepening. The scale of VC/PE investment has grown rapidly in the past few years with a growth rate of over 40%. The number of IPO companies in the healthcare industry in 2017 also nearly doubled compared with 2016. In addition, factors such as the continuous acceleration of urbanization and the growth of resident income are also attracting attention to the healthcare industry.

In the near future, the focus of life science and health sector in China will remain on innovations of medical reforms, drug development, and digital medical technology, which are important engines for the sector to maintain a stable and effective growth.

**Figure 23: Sales and growth of pharmaceutical industry in China**




Source: BMI, Deloitte Research

## Payment reform and medical partnerships

The rapid growth of medical expenses in China came from both a reasonable increase and an unreasonable one caused by the bubble drug prices and excessive medical treatment. Optimizing payment is an effective method to control the unreasonable growth of medical costs. In the second half of 2017, the General Office of the State Council issued a document saying that it is necessary to speed up the reform on medical insurance payment, whose target is to ensure single-disease payouts covering at least 100 diseases, and to carry out the Diagnosis Related Groups pilot reform.

Furthermore, the establishment of medical partnerships is another important task for medical reform in 2018. As of the end of October 2017, all 3A public hospitals have started the establishment of medical partnerships. In 2018, the task will be focused on the top-down supporting efforts and cooperation led by 3A hospitals. In addition, in 2018, it is expected that more and more private medical institutions will join the medical partnerships, in line with the national principle of encouraging private run medical institutions.

## R&D investment in new biological drug

Amid the trend of "asset-light" pharmaceutical R&D, medical giants and investment institutions in the pharmaceutical sector have acquired R&D pipelines for new drugs, especially bio-based drugs, through investment and M&As. For some time in the future, the new drug R&D investment will focus on small- and medium-sized biotechnology companies in the following four major areas. The first is the field of cellular immunotherapy that has begun to attract wide attention in 2017, and the second is biosimilars, which are expected to enter the Chinese market in 2018. In addition, traditional macromolecular monoclonal antibodies and small molecule targeting drugs will still be hot spots for investment due to huge market demands.

In addition, CFDA has formally joined the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH) in 2017, indicating that China is trying to make its pharmaceutical R&D and registration better in line with international standards. At the same time, CFDA has also issued measures to encourage innovation in the pharmaceutical field, including the trial implementation of the Marketing Authorization Holder (MAH) system, the simplification of the marketing authorization process for high-quality new drugs, and the development of early-stage clinical trial capabilities. China is striving to assert itself as a hub of R&D innovation.

**Figure 24: Four major R&D investment areas for new drugs**


Source: Deloitte Research

### Digital Transformation

Despite the close attention caught in 2016, the investment and financing in related fields such as digital medicine and medical informatization cooled down to some extent in 2017. The underlying reason was that existing market participants have not effectively converted digital technologies into clinical values. The collection of data and technologies did not produce enough changes in the treatment process or in its outcome. Therefore, to drive the industry to enter a profit-making phase, market participants and investors should focus on the transformation of digital technology from "technology-focused" to "value-focused" in the future. Key questions to answer include how to use medical technology in the future, e.g. how to link data to clinical decisions.

## Snapshot of China's Automotive industry—hitting a tipping point

### Gearing up for revolutions

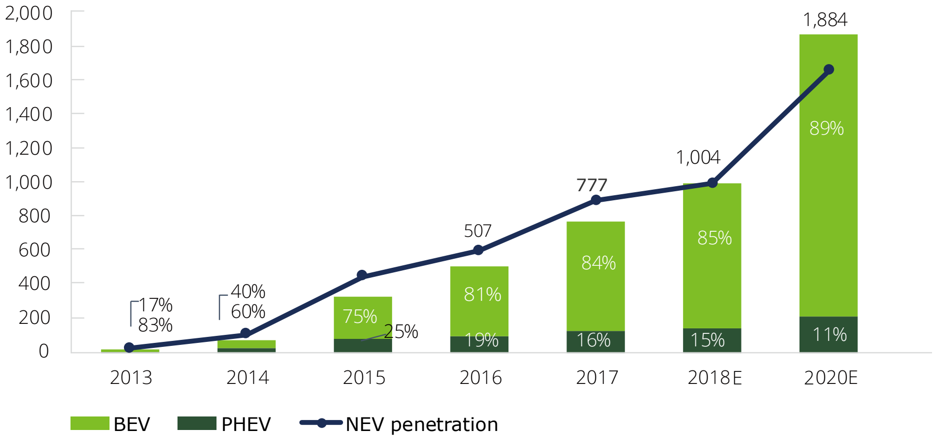
After almost ten years of exponential growth, China's auto market has marched into a mature phase where car sales will keep a steady but slightly lower growth rate. With respect to New Energy Vehicles, China continued to enhance its leading position with annual sales rising by more than 50 percent last year.

China's auto industry has entered an unprecedented era when technology breakthroughs, emerging mobility patterns as well as stringent fuel emission standards will reshape the landscape of the industry. We expect 2018 to be a year in which all players up and down the value chain will have to summon all their resources and to carefully weigh the stakes of every strategy.

### Survival from the policy shift

Underpinned by strong policy push and hefty financial subsidies, China has overtaken the US and become the largest electric vehicle market since 2016. Last year the country unveiled a duel-credit scheme that aimed at gradually phasing out fuel-powered vehicles. Under the new rule, automakers must obtain NEV score of at least 10% in 2019 and 12% in 2020. Those who fail to meet the target will have to either purchase credit from competitors or get fined. China's NEV push has resulted in a new wave of joint ventures by which foreign auto makers who produce a large amount of gasoline vehicles can offset their negative credits.

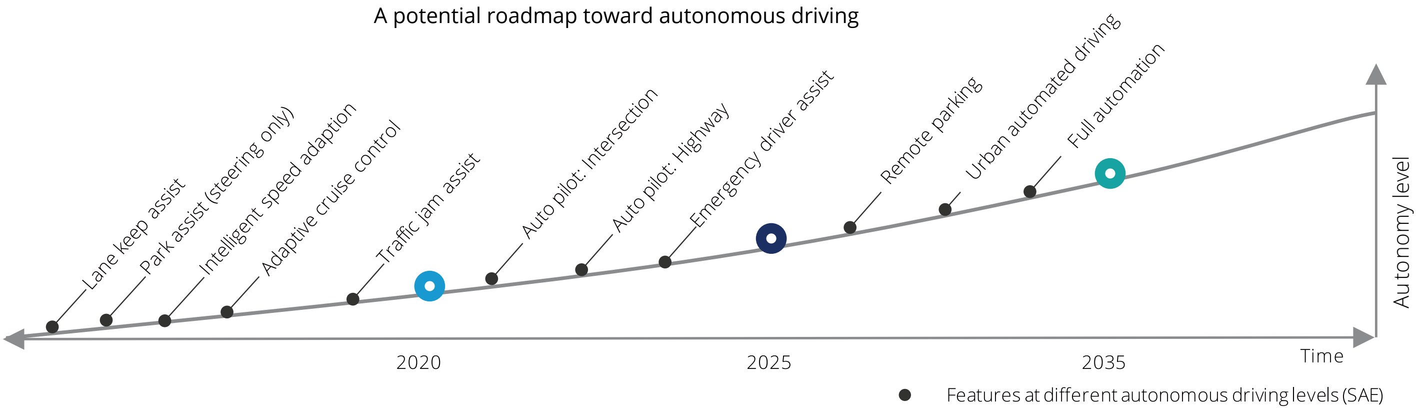
**Figure 25: NEV sales forecast (2013-2020)**




Source: CAAM, Deloitte Research

China's top policy planners have sped up their legislation towards the driverless era. A draft strategy issued in earlier January in 2018 by the NDRC has helped lay out the policy and legal ground for autonomous driving. The document came only one month after Beijing had lifted the ban on the testing of self-driving cars. In March, Shanghai government has passed a rule on self-driving car road test, and become the second city that removed regulatory obstacles to autonomous driving. We expect that a dozen more cities will follow suit in late 2018.

**Figure 26: Roadmap for China's intelligent vehicle industry**




Target:

- **50%** of new cars (~15 million) will be intelligent vehicles by 2020;
- Achieve the commercialization of middle to high level intelligent vehicles **( L3 and above)** .

Target:

- **100%** of new cars will feature intelligent functions by 2025;
- Achieve the scale-up of high level intelligent vehicles **(L4 and above)** .

Target:

- China strives to become global powerhouse for intelligent vehicles and lead international standards on key technologies.

## Key trends to watch

### More open-up for foreign automakers

Talking on the 2018 Boao Forum, President Xi announced that China was on track to reduce the tariff on imported vehicles from the current 25% and a new taxation scheme would be rolled out later this year. In addition, President Xi also declared that China would steer the auto industry towards more openness by lifting the foreign ownership cap on joint venture – a long-lasting policy that was deemed as the implicit guarantee to protect domestic carmakers. The 50:50 ownership cap has arguably enabled local carmakers to gain key technologies and expertise by teaming up with foreign counterparts. The removal of ownership cap will help foreign automakers operate more independently from their local partners and grab a larger slice of the market share in the long run.

### The future competition lies in strategic alliance

After five years of expansion, new mobility service providers have developed into formidable forces and are likely to become the largest procurers of new vehicles in near future. Chinese Original Equipment Manufacturers (OEMs) have been rushing to seal strategic partnerships with mobility platforms such as ride-hailing giant—Didi. Further down the road, carmakers will sell most of their shared and driverless vehicles to ride-sharing and ride-hailing companies, which is seen as the easiest way to capitalize the technologies.

While in the race to self-driving, forming an alliance has even become a prerequisite. OEMs are more anxious than ever to team up with tier-one suppliers as well as tech companies in the hope of sharing investment burdens and risks of market uncertainty. We believe that the future lies in making strategic alliances that will enable companies to decide upon the best technology roadmap as well as the most fruitful path toward commercialization. However, given the many variables, OEMs should weigh their stakes carefully before jumping aboard.

### Chinese automakers' growing appetite for key technologies overseas

Geely's acquisition of 9.7% stake in Daimler marked the most audacious deal for Chinese carmakers by far. China is no stranger in the global M&A market. The intensifying competition in domestic market as well as the fast changes in technologies, consumers and legislation landscapes have prompted automakers to grab cutting-edge technologies and premium assets overseas. Meanwhile, China's push on connected vehicles also requires automakers to make sure they are prepared for the next industry revolution and invest heavily in leading technologies in electric vehicles, intelligent cars and autonomous driving.

## Snapshot of China's Financial Services industry—embracing the opening-up

### Industry landscape

The Chinese financial services industry is characterized by a significant concentration with banks' total assets amounting for over 80% amongst the total financial sectors including banks, insurers, securities, assets under management (AuM) of trusts and public funds. By Q4 2017, the total assets of banking institutions in China have reached RMB245.78 trillion (Figure 27), holding 80.2% of total financial assets.

In the three major areas within the financial sector – banking, securities and insurance – foreign entities are currently dwarfed by their domestic Chinese counterparts. Data disclosed recently by regulators has revealed that the total asset ratio is around 1.7%-6.1% (foreign banks – 1.7% by Q3 2017, joint venture securities – 4.5% by March 2017, and foreign insurance – 6.1% by July 2017).

During the past three years, strong financial regulation and deleveraging have been continuing to slow down the growth of Chinese bank assets or even reduced their assets. Profitability, however, has improved (Figure 28). Furthermore, asset growth of foreign banks has been continuing to increase fast, showing growth momentum (Figure 29).

**Figure 27: Q4 2017 China's financial sectors' total assets (RMB trillion)**

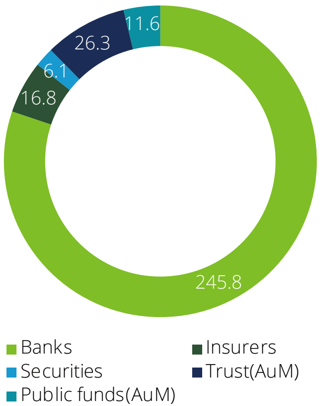



**Figure 28: Banks earnings continue to improve (RMB trillion)**

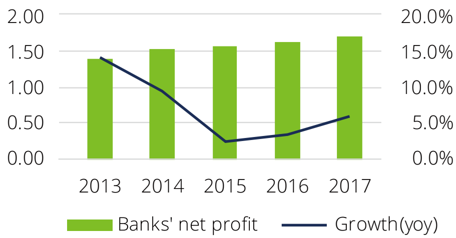
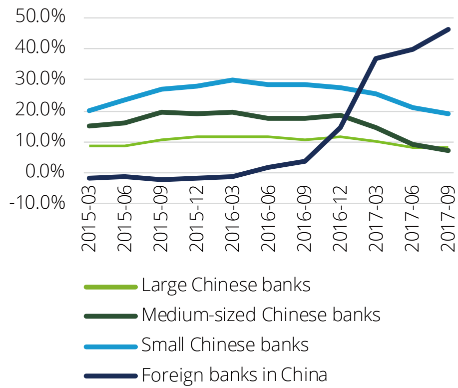



**Figure 29: Higher growth of foreign banks**




Source: CBRC, CIRC, Wind, Deloitte Research

## Foreign investors have not operated well

Currently foreign investors participate in the Chinese market mainly as financial investors due to ownership restrictions of Chinese Government. In fact, most foreign investors have not yet reached the ownership ceiling.

**Table 4. The low ownership of foreign shareholders in China in 2017**

| Sectors | Foreign shareholders | The highest foreign ownership |
|---|---|---|
| Banking | 8 of 25 A share listed banks have foreign institutional shareholders and 5 of them are city commercial banks. | An investment made by Singapore's Overseas - Chinese Banking Corporation in Ningbo Bank is 20%.<br>HSBC holds 18.7% shares in Bank of Communications. |
| Securities | UBS is working to raise its ownership holding from its current 25%. | Only Morgan Stanley's ownership of its JV has reached the ceiling of 49%. |
| Insurance | Most foreign ownership levels stand at between 25 and 50%. | Only AIA has a wholly-owned subsidiary, thanks in large part to historical reasons. |

Source: Wind, CBRC, Deloitte Research

### Tight regulation leads to deleveraging

After a sustained period of growth, 2017 has seen a continuing ramp up in the process of deleveraging—largely aimed at supporting the official policies to address concerns of the risk positioning of the financial sectors, such as the curbed growth of banks' wealth management products (WMPs) which are partly responsible for the ballooning of shadow banking. The supervision has been further tightened in 2018 with stricter controls over financial deleveraging and regulation of conduit business (across institutions) in the asset management (AM) sector whose AUM has already exceeded RMB102 trillion in China in 2017.

### Policies stimulate strategic investment

In April 2018, the Chinese Government announced that they would ease restrictions on foreign ownership in the financial sector (banks, securities and fund, and insurance). The first batch of opening up policies landed in the first half of 2018. The new-round opening-up policy will stimulate the enthusiasm of foreign financial institutions in investing in the Chinese financial sector.

**Figure 30: China will eliminate all foreign ownership limits after 3 years**

| | | Since August 2018 | 3 years later |
|---|---|---|---|
| **Banks/AM companies** | 20% on a single entity basis<br>25% on an aggregate basis | None | |
| **Securities/ fund/futures companies** | 49% | 51% | None |
| **Personal insurance** | 50% | 51% | None |

Source: public information in April 2018, Deloitte Research

**Smaller financial institutions will be the main investees**

Foreign participation will increase the pace of liberalization at the national level and further the internationalization of the RMB. At the industry level this will encourage foreign investors to deepen their long term value investment in the financial sectors. Looking ahead, foreign institutions will likely break through the 50 percent ceiling to become controlling shareholders of many small- and medium-sized Chinese financial companies for the following reasons.

- **Insurance would be the most promising industry**

Thanks to the relatively lower barrier of entry, insurance could become the most promising industry for foreign investors as compared with banking, securities and fund industries. China's insurance premium income in 2017 increased 18.2% on a year-on-year basis to reach RMB3.66 trillion, taking it to the second position in the world in 2017. Given the size of the Chinese population, there is great potential for development for foreign players in the life, health and pension insurance market in China.

- **Banks' profitability will continue to increase**

The net profit of banks is expected to continue to improve in 2018 for three reasons. First, the enhanced regulation will speed up financial deleveraging to lead the tight liquidity, therefore market interest rates will potentially rise, leading to wider interest rate spreads, which will in turn increase profitability. Second, banks will likely deal with their non-performing loans by continuing to reduce credit cost through debt-to-equity swaps and asset securitization. Third, on the demand side, macroeconomic stabilisation and credit demand in various sectors continue.

- **Practical rules of financial opening-up are expected**

The new round of financial opening policy is expected to attract foreign investors to hold stakes in domestic small- and medium-sized institutions, which should provide a positive influence over shareholders and corporate governance behavior and expectations. Nevertheless, the actual opening-up process is expected to be slow, gradual and methodical in nature. We should expect further guidelines with practical rules coming from the Chinese Government in the coming years.

| | |
|---|---|
| **Capital requirement** | The amount of investment required in smaller companies is less than what is needed for large institutions and smaller companies operate in a much more flexible manner and they are always in urgent need of capital. |
| **Advanced technology and management skills** | Foreign strategic investors are well-positioned to help enhance capital adequacy level, drive financial innovation (Fintech applications) and improve risk management. |

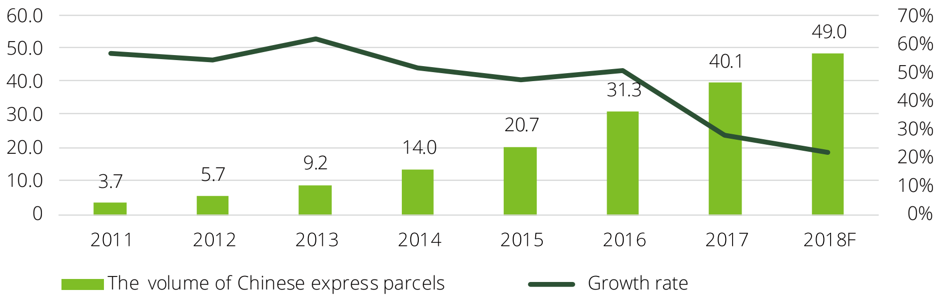
## Snapshot of China's Logistics industry—a more efficient prospect

### Logistics rose to national infrastructure

In 2017, China's 19th Party Congress proposed to strengthen the construction of infrastructure networks such as water conservancy, railways, highways, water transport and aviation, pipelines and logistics. This was the first time that logistics had been mentioned as a part of the infrastructure of the nation's transportation network, elevating the logistics industry to a new and far more prominent position. Logistics has become one of the indispensable infrastructures in the digital economy era.

The rapid growth of the e-commerce market has improved the logistics service capacity. In 2017, the volume of express delivery parcels reached 40.06 billion pieces, a year-on-year increase of 28%. The distribution of domestic express parcels exceeded 100 million pieces per day on average.

**Figure 31: The volume of Chinese express parcels (Billion)**




Source: SPB, Deloitte Research

## The next five years is a crucial period

Many express delivery companies have increased scientific research investment in smart unmanned warehouses, green logistics, Unmanned Aerial Vehicles and other technologies. They hope to transform the express delivery industry through big data and transform them into technology companies.

Alibaba Group announced in September 2017 that it planned to increase its stake in Cainiao (a well-known logistics company which also is an Alibaba subsidiary company) and continue to invest RMB100 billion in the next five years on the heels of tens of billions of yuan already invested to accelerate the construction of a logistics network. The investment will be mainly used for the construction of key technologies such as big data technology, intelligent warehouses, intelligent distribution and a global hub of super logistics. Meanwhile, JD Logistics (another noted logistics company which is owned by JD Group) also planned to build up its Asia No.1 (JD's national logistics centre) in more than 30 core cities over the next five years so that its intelligent warehousing would make an influence on the seven major regions of the country.

## Key trends to watch

Looking ahead, we think that the new trends in the logistics industry in 2018 are as follows:

### Globalization

Economic globalization and the rapid development of multinational corporations, coupled with the constant innovation of internet technologies, has prompted logistics enterprises to work together on a global scale. The global retail industry drives the consolidation of the logistics enterprises to form a global logistics network. In 2018, we expect that logistics enterprises will ride on the coattails of the Belt and Road Initiative to aggressively seize new overseas markets.

### A new ecology of logistics

In 2016, Jack Ma (the founder and executive chairman of Alibaba Group) put forward the concept of new retail and new logistics. The new logistics mode shares information among upstream and downstream enterprises across the entire industry chain. It is an important bridge linking consumers and manufacturers. In 2018, all sectors of the logistics industry will cooperate with one another to reconfigure their own social resources to jointly expand business operations and improve operational efficiency so as to maximize the benefits of joint distribution.

### Artificial intelligence

New logistics technologies that use artificial intelligence have been continuously emerging, driving the application of intelligent techniques such as automatic sorting, electronic waybill and so on. Artificial intelligence is penetrating each and every aspect of the realm of logistics, especially last-mile delivery. In 2018, the overall procurement and utilization of "smart equipment" in the logistics industry will continue to rise.

### Better environmental protection

As a new economic form, sharing economy emphasizes the efficient utilization of idle resources, and its own development provides ideas for green logistics. Shared courier boxes, biodegradable green bags and non-plastic boxes have all promoted the realization of the vision of green logistics. In 2018, more green measures will be introduced, such as green packaging materials and new energy vehicles.


410
360
july
aug.
sep.

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# Implications for Setting up Business in China

## What are the main concerns from tax dimension when dealing with cross - border transactions ?

China has actively participated in the Base Erosion and Profit Shifting (BEPS)Project initiated by OECD since 2013. Foreign investors should keep an eye on the development of the BEPS project and China's response to the project.

Foreign investors need to pay attention to general anti-avoidance rules when making any commercial arrangement. A tax-driven arrangement should be avoided.

Foreign investors must qualify for a beneficial owner criterion in order to apply certain treaty benefits.

Currently large payment overseas is a focus of Chinese tax authorities. Companies may not receive deductions if overseas payments are not justified.

The VAT reform is still on its way in 2015 and is expected to be finished by the end of 2015. Foreign investors should closely watch the latest development of the VAT reform.

## Preferential tax treatments under the Enterprise Income Tax Law (EITL)

Before the unification of the EITL applicable to foreign and domestic enterprises, China offered an array of tax incentives to encourage investors to invest and do business in China.

With the issuance of *Enterprise Income Tax Law Implementing Rules* (EITLIR) on 6 December 2007 and a series of relevant circulars, the following new trends in the tax preferential treatments are clearer.

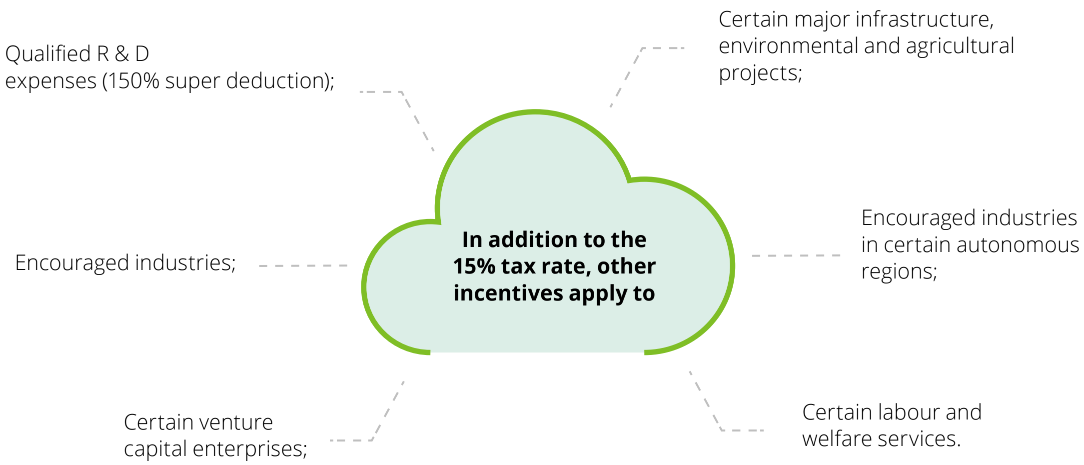
Shift from granting incentives only in special regions to the entire country;

Shift from a regional development orientation to an industry orientation;

Shift from an export-oriented economy to a domestically driven economy.

## Under the EITL, preferential tax treatments are offered to the following encouraged activities and industries:

From tax perspective, the new incentive that has **attracted** the broadest attention is a **15%** tax rate that applies to an enterprise that qualifies as a high and new technology enterprise.



## Specific areas with preferential tax treatments

1. Minority autonomous areas
2. Five special economic zones plus Shanghai Pudong New Area
3. Western region
4. Hengqin New Area, Pingtan Comprehensive Experimental Area
5. Qianhai Shenzhen-Hong Kong Modern Service, Industry Cooperation Zone

Hengqin New Area of Guangdong Province

Pingtan Comprehensive Experimental Area of Fujian Province

Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of Shenzhen City

**The enterprises are entitled to a preferential EIT rate of 15% during the period from 1 January 2014 to 31 December 2020.**

The aforementioned encouraged enterprises refer to the enterprises mainly engaged in the industrial projects specified in the local preferential EIT catalogue and the revenue derived therefrom contributes 70% or more of the total revenue for such enterprises.

For the enterprise with branch offices located outside the special areas, only income sourced from the special areas can be entitled to the preferential tax rate.

While considering the location to set up your business, **the various special zones within China may be a wise choice** as such zones typically offer additional incentives and benefits.

The first group of special economic zones in China were introduced in the 1980s, which provided foreign investors with special preferential treatments, especially tax incentives. **Special economic zones gradually fade out as they offer fewer benefits.**

Other special zones, such as **the free trade zones, emerged over the years as new attractive areas for foreign investments** due to the special customs treatments and other related incentives available to investors.

**The fast growing economy and the need to further open up call for more investor-friendly market environment.** Under this situation, innovative special zones are created recently, among which, Shanghai Pilot Free Trade Zone (SPFTZ) and Qianhai Shenzhen Hong Kong Modern Service Industry Cooperation Zone (Qianhai) stand in the centre of the spotlight.

As the two different zones are with crossed but not overlapping development goals, the incentive policies in both **the SPFTZ and Qianhai** are closely related to and derived from the demand of the investors from home and abroad.

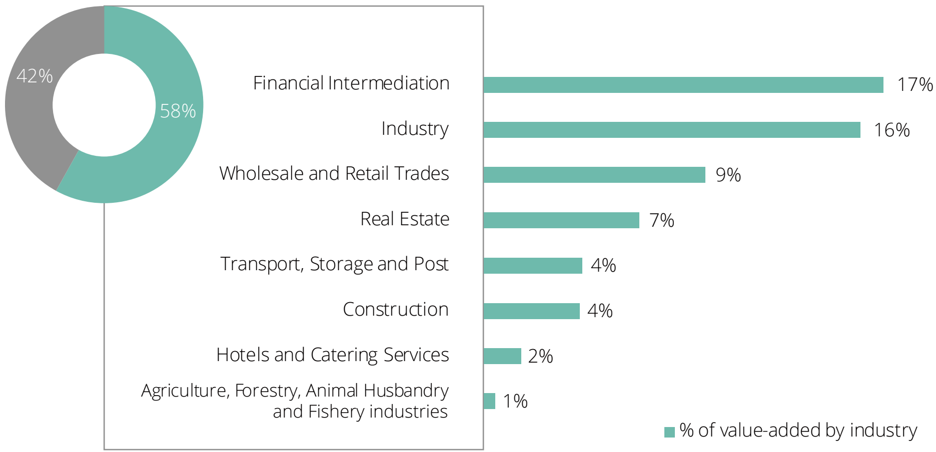
- Free convertibility of RMB capital account;
- Liberalization of interest rates in the financial market;
- RMB cross-border use;
- Further opening up of financial service industry to qualified private capital and foreign financial institutions;
- Reform in foreign exchange administration system.

- Issuance of RMB-denominated bonds in Hong Kong within the approved quota;
- Establishment of Qianhai Equity Investment Mother Fund;
- Pilot of more innovative financial institutions (such as Tecent Qianhai Weizhong Bank);
- Hong Kong-based financial institutions and other overseas financial institutions to set up international or national management headquarters and business operation headquarters;
- Experimentation in the expansion of offshore RMB fund flow-back channels;
- Development of Hong Kong as an offshore RMB settlement centre and establishment of a cross-border RMB innovation zone.

# Regional Snapshots

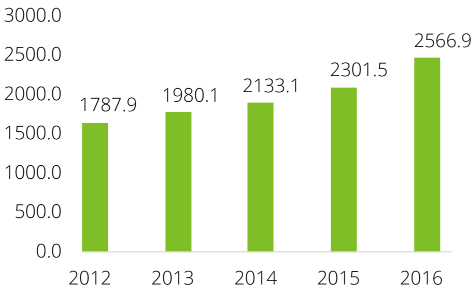

For those who are finding appropriate location to invest in or expand current business scope, we selected several provinces and municipalities and presented as regional snapshots, with regional GDP on a yearly basis and several indicators in foreign investment field, as well as leading industries segmentation.


## Top industries by 2016 industrial value-added



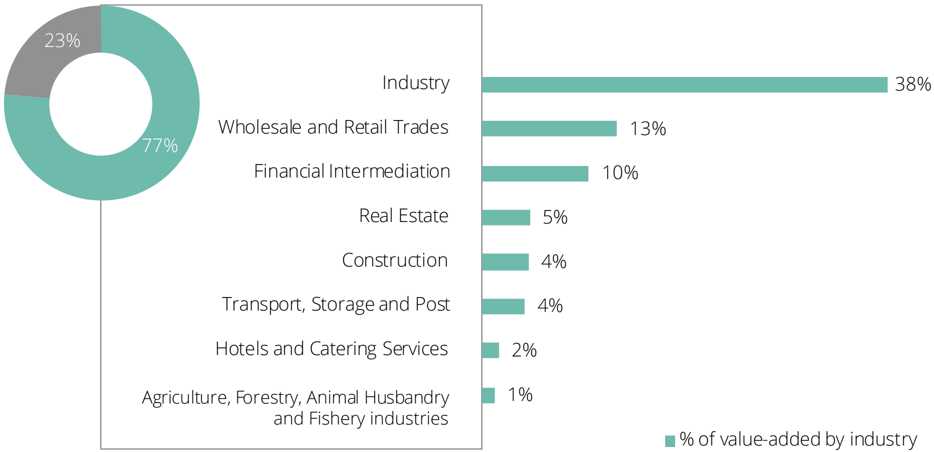

## Regional GDP

RMB Billion



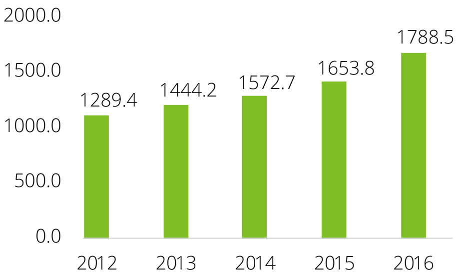

| **Indicator** | **2016** | **2015** | **2014** | **2013** | **2012** |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 30,401 | 29,396 | 28,041 | 27,061 | 26,535 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 427,371 | 380,963 | 201,027 | 177,105 | 149,355 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 275,522 | 245,658 | 119,161 | 105,851 | 90,704 |


## Top industries by 2016 industrial value-added



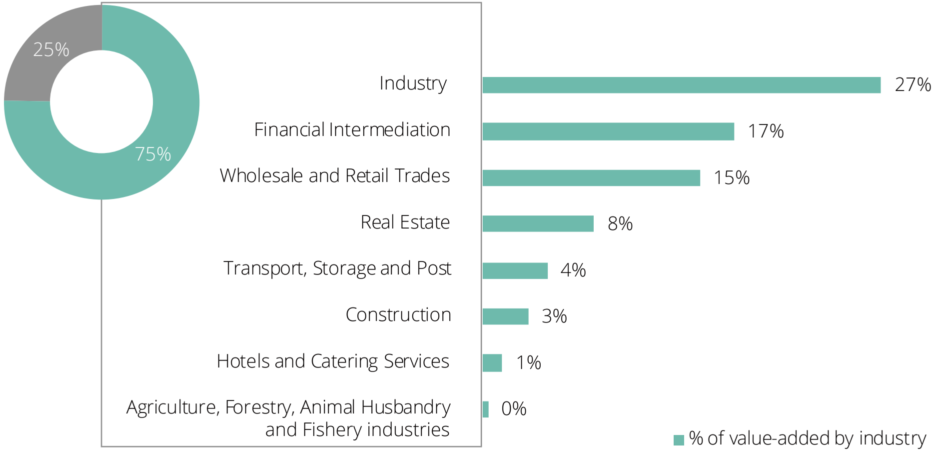

## Regional GDP

RMB Billion



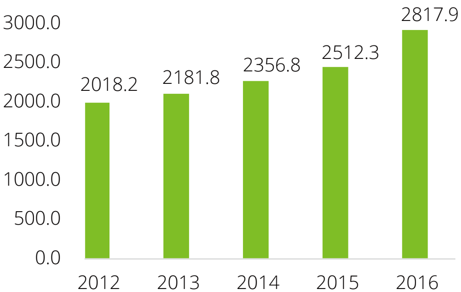

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 13,339 | 12,278 | 11,507 | 11,413 | 11,491 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 222,594 | 181,328 | 144,146 | 127,423 | 118,913 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 148,473 | 112,018 | 82,486 | 72,074 | 64,949 |


## Top industries by 2016 industrial value-added



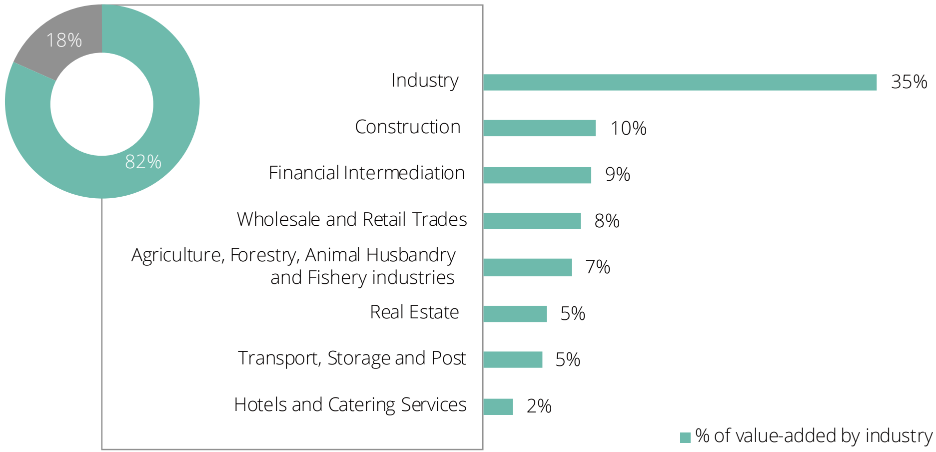

## Regional GDP

RMB Billion



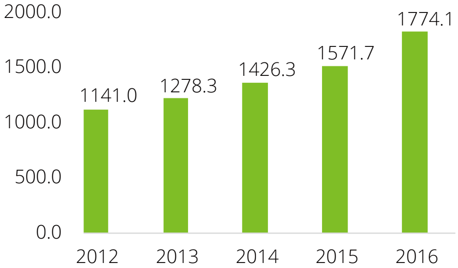

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 79,410 | 74,885 | 68,952 | 64,412 | 61,461 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 734,246 | 661,273 | 530,467 | 457,933 | 413,768 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 508,728 | 449,733 | 335,956 | 282,305 | 251,092 |


## Top industries by 2016 industrial value-added



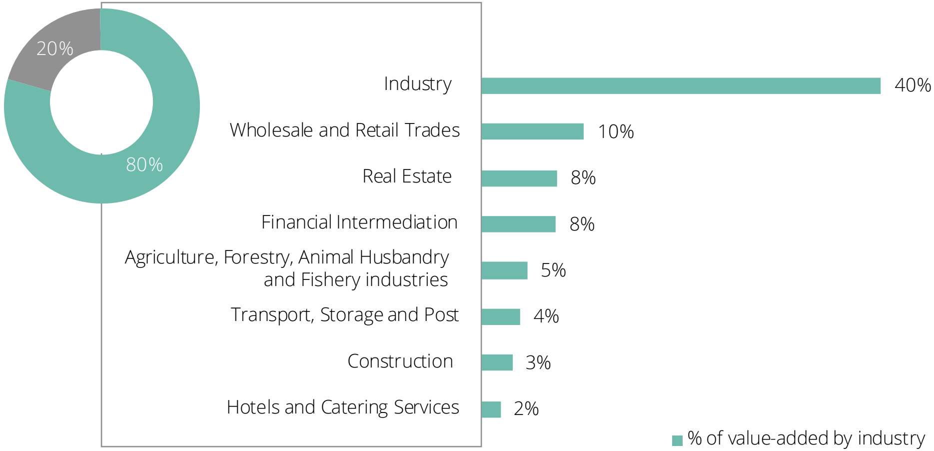

## Regional GDP

RMB Billion



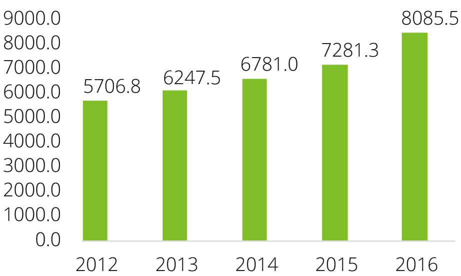

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 5,555 | 5,009 | 5,147 | 5,397 | 4,461 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 88,065 | 78,845 | 67,517 | 58,841 | 53,694 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 54,901 | 49,360 | 42,543 | 36,900 | 31,155 |


## Top industries by 2016 industrial value-added



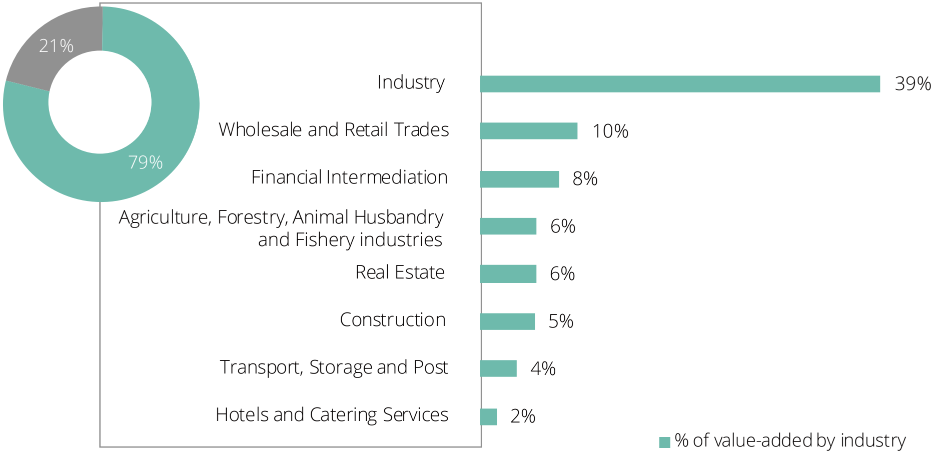

## Regional GDP

RMB Billion



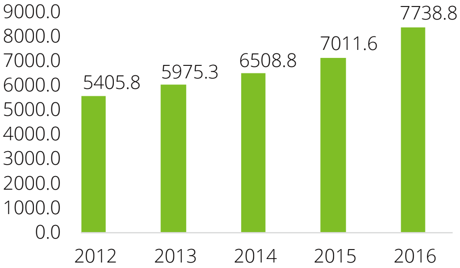

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 119,688 | 111,169 | 104,555 | 100,639 | 98,564 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 781,571 | 644,310 | 562,063 | 512,640 | 478,645 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 508,588 | 390,614 | 337,737 | 303,715 | 283,269 |


## Top industries by 2016 industrial value-added



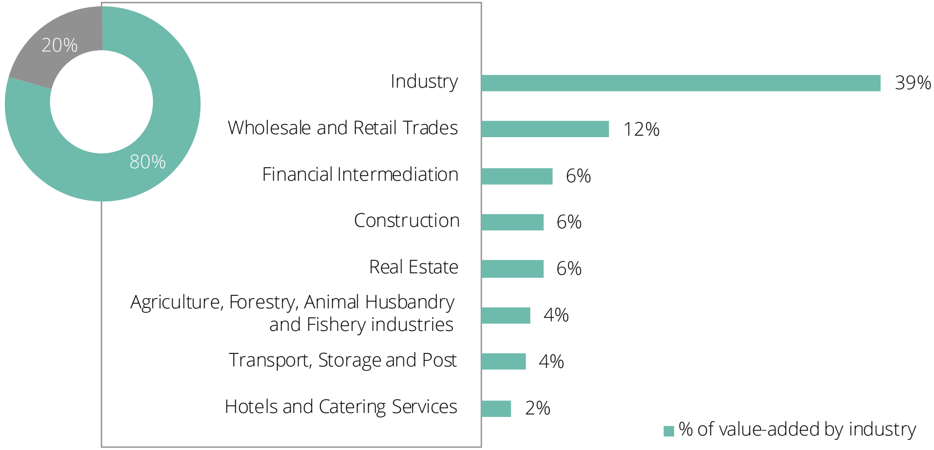

## Regional GDP

RMB Billion



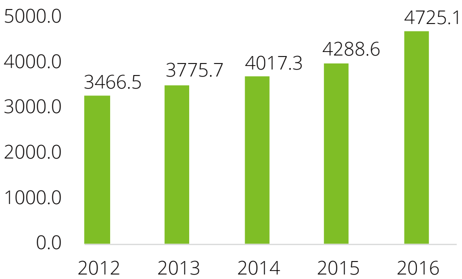

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 55,938 | 53,551 | 51,634 | 50,514 | 50,461 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 879,868 | 782,154 | 718,131 | 666,376 | 625,000 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 471,823 | 422,901 | 383,934 | 354,282 | 330,138 |


## Top industries by 2016 industrial value-added



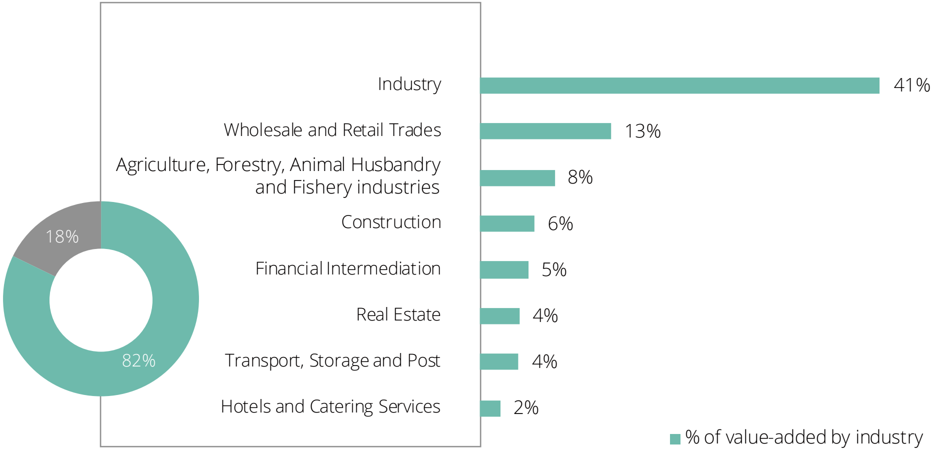

## Regional GDP

RMB Billion



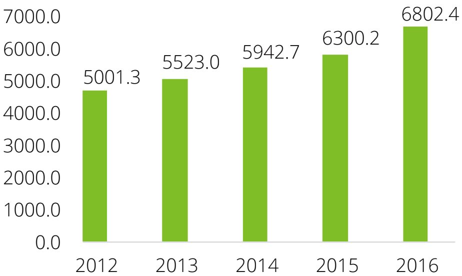

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 34,442 | 32,778 | 31,005 | 30,674 | 29,595 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 319,870 | 291,813 | 262,881 | 240,408 | 217,810 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 192,140 | 171,399 | 152,681 | 140,665 | 127,466 |


## Top industries by 2016 industrial value-added



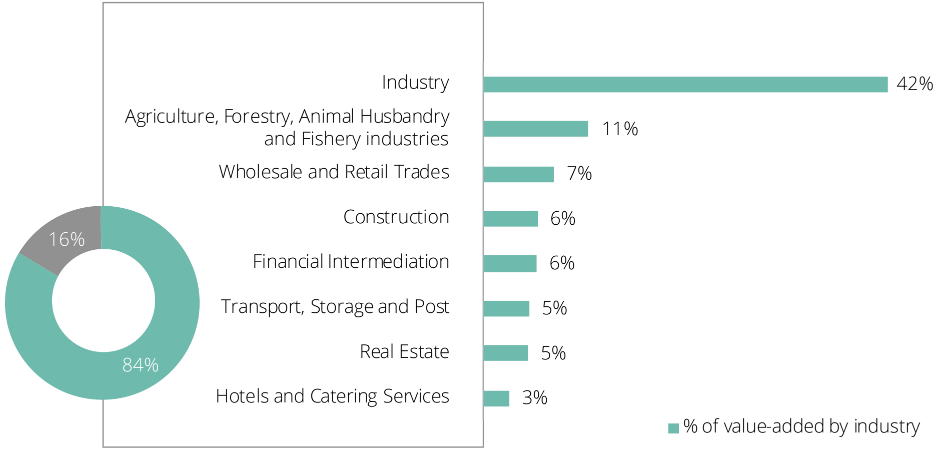

## Regional GDP

RMB Billion



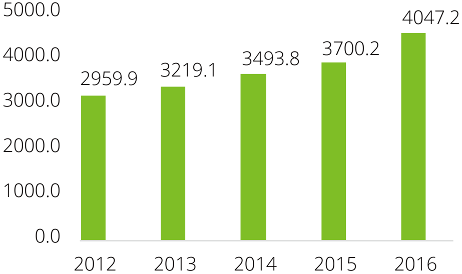

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 28,527 | 27,240 | 26,023 | 25,755 | 25,885 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 251,874 | 219,334 | 199,227 | 176,491 | 158,114 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 147,620 | 127,246 | 113,131 | 99,456 | 89,679 |


## Top industries by 2016 industrial value-added



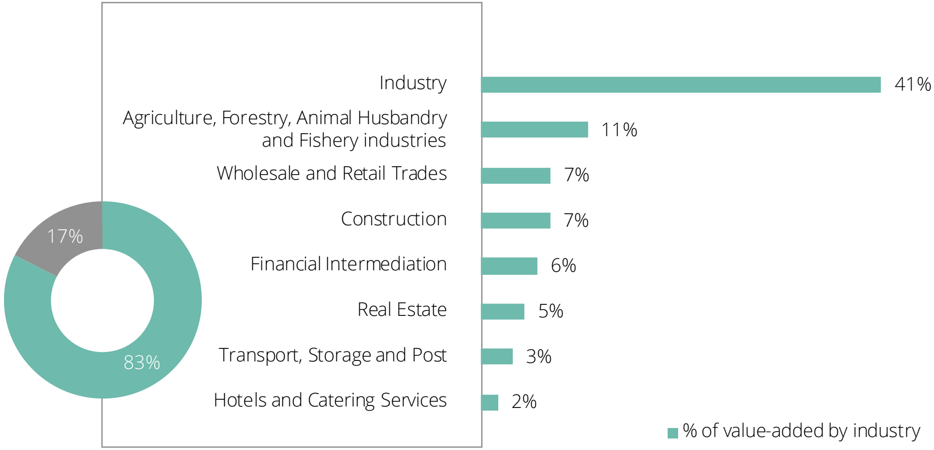

## Regional GDP

RMB Billion



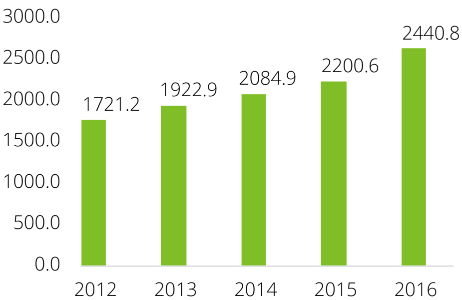

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 8,058 | 8,316 | 10,056 | 9,934 | 10,168 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 82,249 | 68,710 | 58,878 | 47,787 | 46,341 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 44,900 | 34,816 | 29,692 | 24,479 | 23,697 |


## Top industries by 2016 industrial value-added



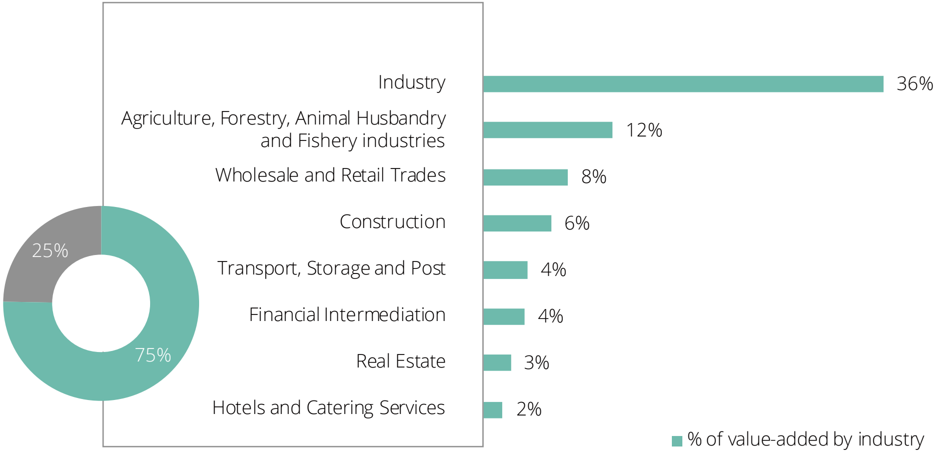

## Regional GDP

RMB Billion



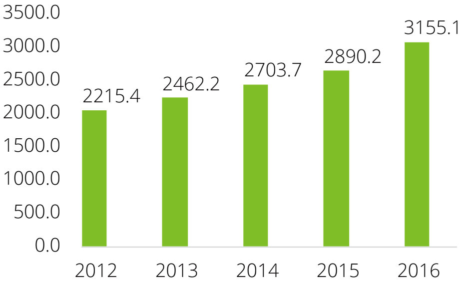

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 5,549 | 5,063 | 4,721 | 4,466 | 4,466 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 67,256 | 106,486 | 48,026 | 41,612 | 39,962 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 34,577 | 30,916 | 26,075 | 22,660 | 20,706 |


## Top industries by 2016 industrial value-added



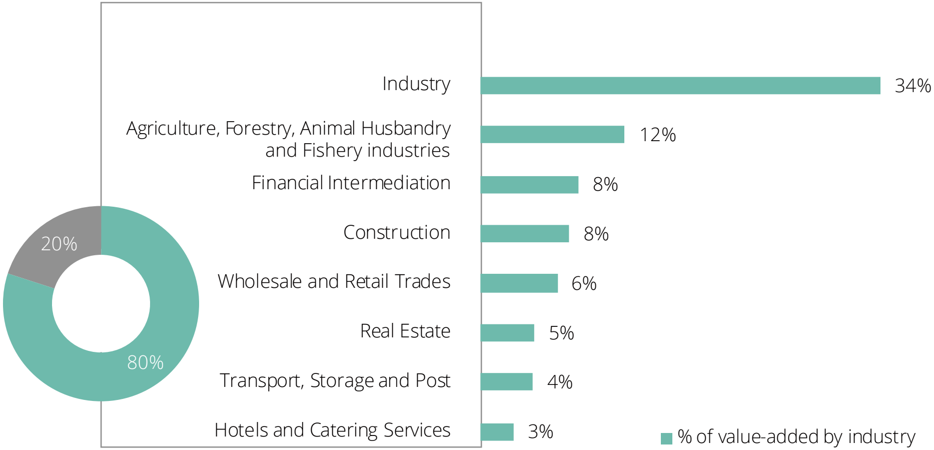

## Regional GDP

RMB Billion



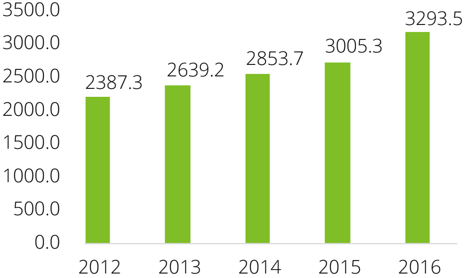

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 6,677 | 5,865 | 5,353 | 5,020 | 4,882 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 58,000 | 52,147 | 46,307 | 40,486 | 38,381 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 30,888 | 28,105 | 24,190 | 20,872 | 19,647 |


## Top industries by 2016 industrial value-added



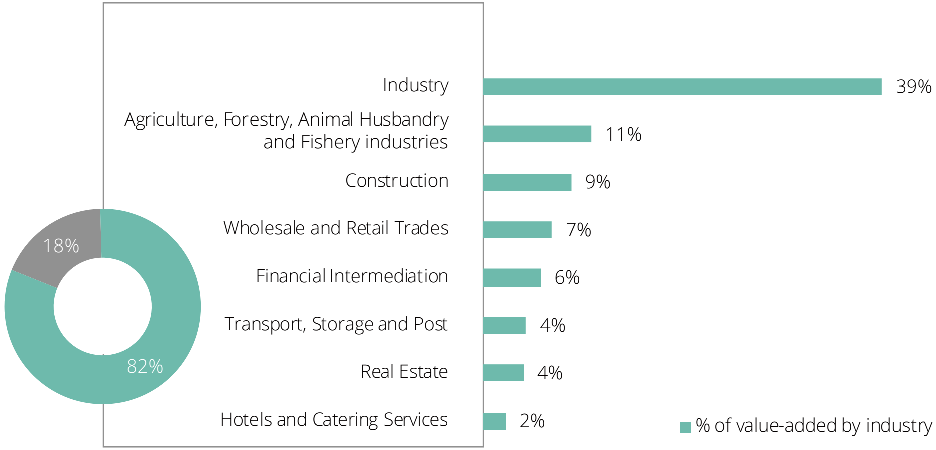

## Regional GDP

RMB Billion



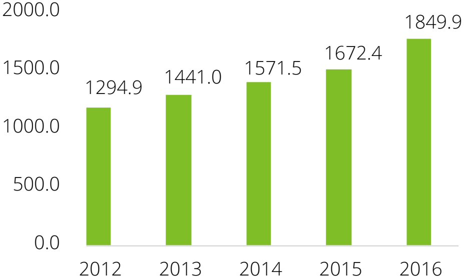

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 10,370 | 10,594 | 10,253 | 9,147 | 9,107 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 94,193 | 88,409 | 82,752 | 72,490 | 64,045 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 55,282 | 50,966 | 46,716 | 41,338 | 37,445 |


## Top industries by 2016 industrial value-added



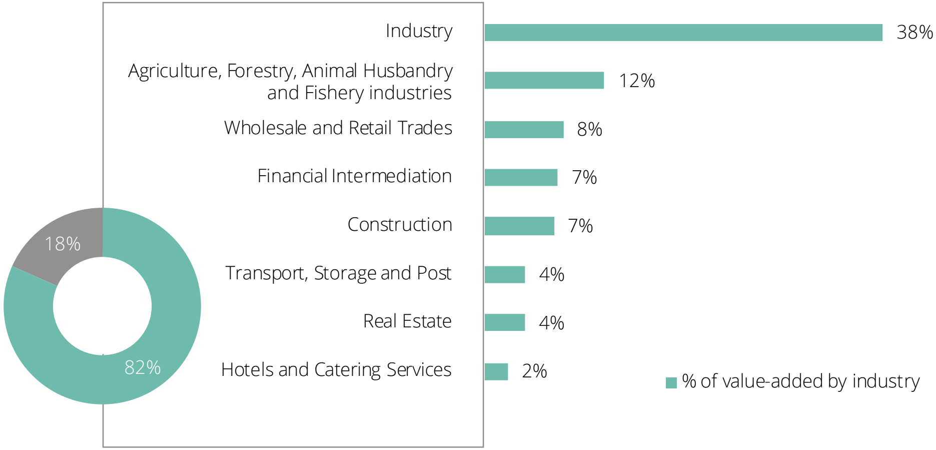

## Regional GDP

RMB Billion



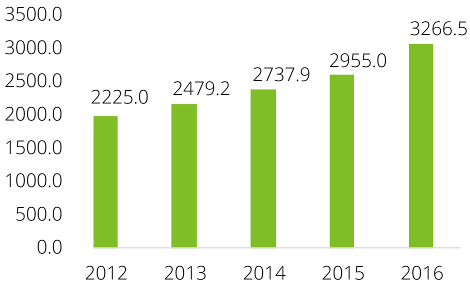

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 6,918 | 7,094 | 7,020 | 6,667 | 7,334 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 77,738 | 72,578 | 67,025 | 58,770 | 53,857 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 55,060 | 48,095 | 43,769 | 38,436 | 34,904 |


## Top industries by 2016 industrial value-added



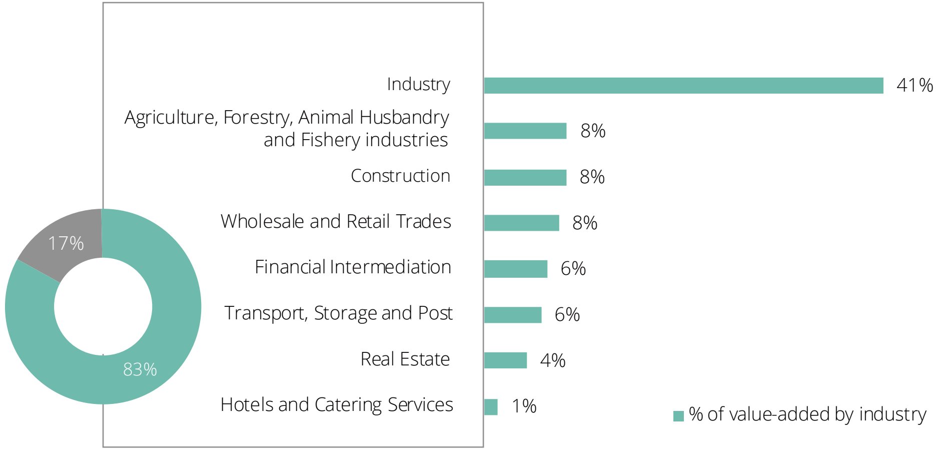

## Regional GDP

RMB Billion



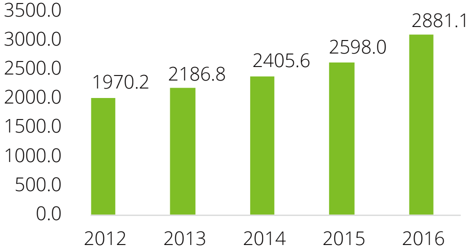

| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 8,976 | 8,646 | 8,160 | 7,693 | 8,023 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 99,316 | 89,231 | 77,671 | 65,357 | 58,274 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 54,407 | 48,166 | 41,016 | 34,923 | 32,150 |


## Top industries by 2016 industrial value-added




## Regional GDP

RMB Billion




| Indicator | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|
| # of Foreign Funded Enterprises (unit) | 28,351 | 25,895 | 24,322 | 23,546 | 23,381 |
| Total Investment of Foreign Funded Enterprisies (USD million) | 226,315 | 196,713 | 173,245 | 156,516 | 145,744 |
| Registered Capital of Foreign Funded Enterprisies (USD million) | 132,127 | 110,901 | 94,485 | 85,375 | 80,443 |

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# Introduction to Global Chinese Services Group

## Going Global with Deloitte

Over the past decade, the "Going Global" strategy has been pivotal in propelling the economic transformation of China. It is also driving the overseas expansion of many Chinese companies, which are able to tap the international markets and acquire new technologies and best practices. Opportunities always come along with pitfalls and it is our mission to provide guidance to Chinese companies through what can be something of a minefield during their globalization journey.

Established in 2003, Deloitte's Global Chinese Services Group (GCSG) aims to advise Chinese companies expanding global presence, and multinational companies operating in China. We have professionals who speak Chinese and/or understand Chinese business culture in 90 countries and regions. This dedicated network is committed to providing professional advice and comprehensive solutions to Chinese companies' globalization.

It is our goal to help our clients expand their global footprint. In the past 5 years, one-third of outbound deals on which we have advised were valued over US$10 billion each. Further, we have participated in the largest overseas M&A transactions, as well as offered one-stop outbound investment services to more than half of the Fortune Global 500® Chinese companies.

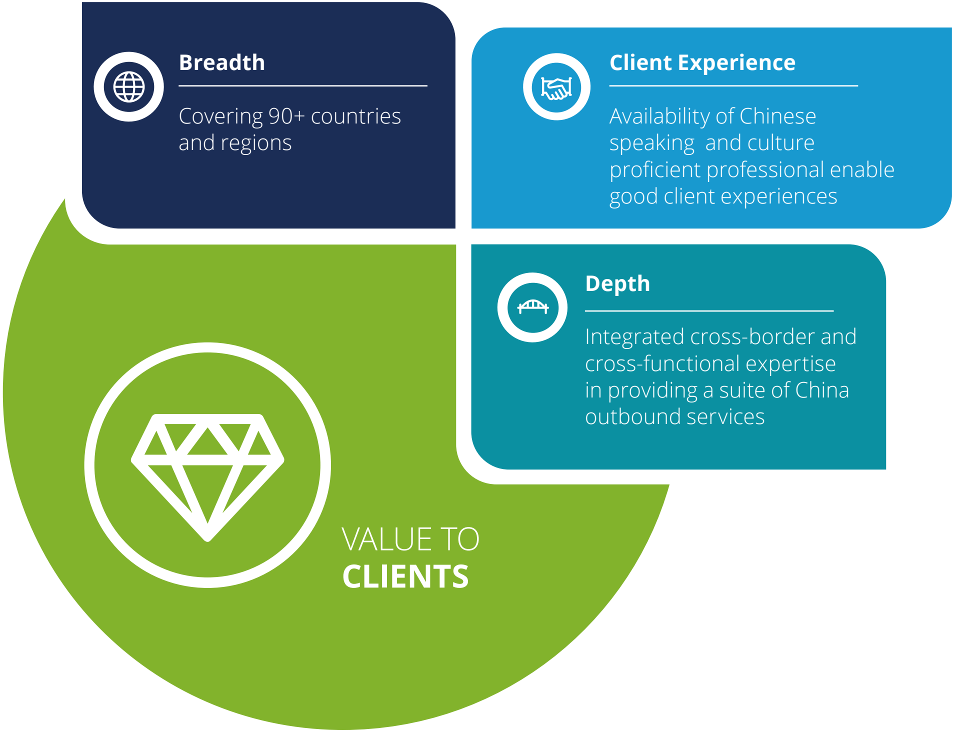
To stay ahead of the curve in putting the needs of clients as our priority, the GCSG continues its efforts in evolving and adapting to the changing dynamics of the marketplaces, and provides advice and solutions to clients to address their complex business challenges.

## Global Coverage

### Covering 90+ countries and regions

## CSG's Value to Clients

**A globally integrated platform aiming to deliver the best client experiences**



## CSG Mission

Operating as a platform to leverage expertise in the Chinese market and bridge the cultural gap, we are devoted to providing our clients with multi-member firm, multi-industry, multi-functional and multi-disciplinary services.

**CONNECT**

- Client focused
- One-stop service
- No cultural barrier
- No time zone limitation
- Experts on China
- Customized solutions
- Time efficiency

# Global Chinese Services Group Core Team

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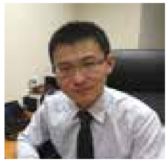

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