UHY

# INTERNATIONAL BUSINESS

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# LET'S GO INTERNATIONAL – BUT WHERE?

**Each year the World Bank pinpoints statistically where in the world it is easiest to do business. The bank's analysis is used sometimes as a starting point to determine where cross-border development of a product or service is most appropriate. Or, it is sometimes used as evidence to support a strong hunch that business success is up for grabs, barring a few barriers.**

The *World Bank Doing Business Guide* 2013 – the 10th edition – benchmarks 185 economies against 10 topic areas (such as starting a business, getting credit, paying taxes and enforcing contracts). Contributors include accountants, lawyers, freight forwarders and government officials. There can be little argument therefore that the report is a near-global, comprehensive measurement of a regulatory quality, and a worthy piece of armoury when deciding where to invest.

The survey is particularly pertinent in today's global economy because tighter budgets make the need to choose the right international opportunity, and get it right first time, even more imperative: it's also pertinent for investors to have the local knowledge and forethought so they can work fast as new opportunities are about to develop – and, in some cases, pull out just as quickly as they are about to evaporate.

The 2013 report, published mid-October 2012, confirms what investors would expect – that doing business remains easiest in high-income, developed economies. But that's where most competition is also found – and, anyway, investors are often more adventurous and creative, looking for places to innovate, to take sensible risks, to meet new challenges and to benefit from markets about to evolve.

## KEY MEASURES IN THE SURVEY

'Ease' of doing business is measured in the World Bank survey by the number of regulations applied to small to medium-sized companies (SMEs) and the ease of compliance across the 10 topic areas. Significantly, given the potential of new markets in the developing world, 'getting electricity' is one of the key measures.

## TOP COUNTRIES FOR EASE OF DOING BUSINESS

In the overall league of the top countries for ease of doing business, the more risk-adverse investor may be drawn to locations that are 'safer bets', such as Singapore at No 1 (Singapore has topped the global ranking for the past seven years) or New Zealand at No 3.

**Top 10 countries 2013 for ease of doing business**

| | |
|---|---|
| 1 | Singapore |
| 2 | Hong Kong SAR, China |
| 3 | New Zealand |
| 4 | US |
| 5 | Denmark |
| 6 | Norway |
| 7 | UK |
| 8 | Republic of Korea |
| 9 | Georgia |
| 10 | Australia |

But places like Georgia (impressively at No 9) – and other economies which have most improved their ease of doing business over the past year – may give an indicator of increasingly favourable regulatory terms for future investment.

## 'MOST IMPROVED' ECONOMIES

**Top 10 'most improved' economies 2013 for ease of doing business**

| | |
|---|---|
| 1 | Poland |
| 2 | Sri Lanka |
| 3 | Ukraine |
| 4 | Uzbekistan |
| 5 | Burundi |
| 6 | Costa Rica |
| 7 | Mongolia |
| 8 | Greece |
| 9 | Serbia |
| 10 | Kazakhstan |

Poland tops the table of 'most improved' economies. "Poland improved the most in ease of doing business through four reforms – easier to register property, pay taxes, enforce contracts, and resolve insolvency by updating documentation requirements for bankruptcy filings," says Wiesław Leśniewski, of UHY's member firm in Poland, Biuro Audytorskie Sadren Sp. z o.o. "Poland also introduced a new civil procedure code that, along with an increase in the number of judges, reduced the time required to enforce commercial contract."

No 2 in the 'most improved' rankings is Sri Lanka – the first time in seven years of the survey that a South-Asian economy has featured among the 'best improvers'. Significantly, too, Greece – somewhere investors may not currently have top of their list – has jumped these rankings significantly to eighth place. Driven by its economic crisis,

Greece has implemented regulatory reforms to ease doing business "at a greater pace in the past year than in any of the previous six", says the World Bank.

"Despite the present negative media publicity we are receiving, Greece has taken radical legislation, regulation and organisational steps to improve and facilitate investors interested in investing in Greece, " says Stavros Nikiforakis, UHY Axon Certified Auditors, based in Athens. "With 'fast track' law, the Bilateral Committee of Strategic Investments (BCSI) has been formed and through it the procedures have been simplified and centralised to 'one shop'. This allows investors to concentrate on operational issues whilst the issues relating to authorisations and approvals are executed by civil servants of the appropriate government department.

"The BCSI is responsible for considering the eligibility of the proposed strategic investments based on the criteria of:

- Feasibility of the project
- The investors' solvency
- Transfer of knowledge and technology
- Forecast increase in employment
- Peripheral or local development of the country
- Subsidies for the enterprise
- Competitiveness in the national economy
- Protection of the environment
- Saving of energy.

Ukraine (at No 3 in these 'most improved' rankings), Uzbekistan (No 4) and Kazakhstan (No 10) show how the Eastern European region is beginning to provide a more favourable environment for investment.

Sarvarkhon Karimov, UHY Tashkent LLC, Uzbekistan, says that his country has made starting a business easier by introducing an online facility for name reservation and eliminating the fee to open a bank account for small businesses.

*significantly, given the potential of new markets in the developing world, 'getting electricity' is one of the key measures.*

Uzbekistan has improved access to credit information by guaranteeing borrowers'rights to inspect their personal data. And it has reduced the time to export by introducing a single window for customs clearance and reduced the number of documents needed for each import transaction.

Uzbekistan has also strengthened its insolvency process by introducing new time limits for insolvency proceedings and new time limits and procedures for a second auction, and by making it possible for businesses to continue operating throughout liquidation proceedings.

Costa Rica is the only economy in Latin America or the Caribbean in the top 10 'improvers'. Costa Rica introduced a risk-based approach for granting approvals for business start-ups and established online approval and tax payment processes. But Colombia, while outside the top 10 'improvers', gets special mention for implementing 25 regulatory reforms over the past eight years.

"Improving business regulation is a challenging task," says the World Bank, "and doing it consistently over time even more so." Yet, it says, some economies have achieved considerable success since 2005 and a few stand out as exceptional within their regions – Georgia, Rwanda, Colombia, China and Poland.

As an example, the survey highlights Georgia's 35 reforms, which have followed "a relatively balanced regulatory reform path", since 2005 – such as its moves to make trading across borders easier by introducing customs clearance zones in cities such as Tbilisi and Poti. "These one-stop-shops for trade clearance processes are open all day, every day, allowing traders to submit customs documents and complete other formalities in a single place," says the survey.

## MOST CHALLENGING LOCATIONS

**'Most challenging' locations 2013 for ease of doing business**

| | |
|---|---|
| 1 | Central African Republic |
| 2 | Chad |
| 3 | Congo |
| 4 | Eritrea |
| 5 | Democratic Republic of Congo |
| 6 | Venezuela |
| 7 | Guinea-Bissau |
| 8 | Guinea |
| 9 | Cote d'Ivoire |
| 10 | Niger |

UHY member firms operate in more than 80 countries globally – across almost all the World Bank listings – and offer support to investors through local knowledge and an in-country presence, whatever local regulations are in force.

But perhaps that level of support is particularly valuable in the more difficult jurisdictions for starting a business, as shown in the World Bank survey – such as in Angola (ranked 172) and Venezuela, which ranks 180 in the ease of doing business stakes out of the 185 jurisdictions surveyed.

*Venezuela is expected to remain one of the least-friendly places to do business over the next few years. In fact, Venezuela is referred to in the World Bank survey in the same context as Zimbabwe.*

"Angola is in a situation of political and economic stability, and is one of the fastest growing economies in the world, essentially due to its natural resources," says Armando Parades, UHY A Paredes e Associados-Angola Auditores e Consultores, based in Luanda. "The Angolan authorities have been trying to improve the country's business environment with significant recent changes to private investment laws and a comprehensive tax reform.

"Although bureaucracy remains high, infrastructures are scarce and the justice system is inefficient, continuing improvements have been happening throughout the economy as a whole and the outlook for the future is very positive. Although obstacles are still high, investing in Angola is considered very rewarding, because economic growth has created opportunities in most economic activities. If the country continues the trend towards the reduction of business barriers its attractiveness as an investments destination will grow even further."

By comparison, the Venezuelan president's victory last October opened the way for further radicalisation of his agenda that economists predict will lead to further tough economic challenges: Venezuela is expected to remain one of the least-friendly places to do business over the next few years. In fact, Venezuela is referred to in the World Bank survey in the same context as Zimbabwe – "a deteriorating business environment where measures add to the complexity and cost of doing business or undermine property rights and investor protection".

All of which makes the work of UHY firm, UHY Servicios Legales & Tributarios, S.C., based in Caracas, still more challenging – and more valuable to investors looking to the probable medium-term opportunities in that country when a new political regime may be in power.

## SUB-SAHARAN AFRICA

UHY member firms are also building a still more extensive presence in Africa, both in the north and in sub-Saharan Africa, which gets a special mention in the World Bank survey for its record number of reforms – a region where less than 10 years ago little attention was being paid to the regulatory environment.

Among the 50 global economies with the biggest improvements since 2005, the largest share – one-third of them – are in sub-Saharan Africa. Burundi is ranked No 5 in the 'best improvers' table (for reforms to starting a business, construction permits, registering property and trading across borders) but top billing in the World Bank survey goes to Rwanda (for a whole raft of entrepreneurship reforms), which has been the top improver in sub-Saharan Africa since 2005.

## BRIC COUNTRIES

Two of the BRIC countries (Brazil, Russia, India, China) rank among the top 50 improvers in the survey: China and India. They were further up the scale in earlier years of the survey, but in the overall global table for ease of doing business they currently have quite low rankings: for example, China is at No 91, Brazil at No 130 and India at No 132 – suggesting perhaps that they have not sustained regulatory reforms that would have placed them consistently among the top-runners.

BRIC countries are not prominently featured in the 2013 World Bank survey, but previous World Bank survey reports have painted a picture of why the BRICs appear not to fare so well in the survey.

Enforcing contracts has been perceived by entrepreneurs as a problem in China – although the mass market opportunities for consumables make investors try and try again. The problem with India is that it has a tendency towards bureaucracy and red tape, and there is lack of political consensus on important issues such as business liberalisation. Reasons to invest, however, are the stable democratic environment, the huge market and the availability of skilled manpower – attractions particularly for investors in 'big-number' sectors such as technology, telecoms and airports.

Russia stands out as an environment with doing business issues over 'rule of law' and excessive government control. "Foreign investors are wary of lack of reform to eliminate risks for their investments," the World Bank has said previously. But reasons to invest in Russia include planned privatisation of government shares in oil, telecoms and transport, and huge undeveloped territory rich in natural resources.

Some parts of Brazil make good investment locations and the country has a thriving consumer market at all socio-economic levels. The oil and gas sector has huge potential. But obtrusive labour laws are a problem for investors, the World Bank has said, and obtaining certain operating licences can take too long.

Diego Moreira, UHY Moreira-Auditores, Brazil, says his firm can help facilitate these bureaucratic processes. "For example, we can help alleviate compliance with obtrusive labour laws by providing consultancy on human resource

(HR) practices as well as providing outsourced HR management," he says.

"On obtaining operating licences, UHY Moreira can reduce the timeframe required to obtain several types of licence (export/import, sanitary, etc) as well as perform the bureaucratic processes for each type of licence.

"For investors interested in the oil and gas sector, UHY Moreira can assist foreign firms register in the all-important Petrobras suppliers registry. (Petrobras is the state-owned oil and gas company.) Such registration is key not only for obtaining contracts with Petrobras but also for being considered as a 'player' in the local oil and gas market.

"Furthermore, through our attest services (audits, due diligence, limited-scope reviews) we can significantly reduce the risk that foreign investors face when acquiring companies in Brazil or when establishing joint-ventures or other types of corporate associations with Brazilian firms. Such risk mitigation factors are of outmost importance due to widespread labour litigation and tax-related legal contingencies."

The other country commonly aligned with the BRIC nations, South Africa, has been credited by the World Bank with encouraging investors; its natural resources are in abundant supply; the economic structure is 'first-world'; the country is already doing strong business compared with other BRIC nations; and the jurisdiction offers a credible connector to one billion consumers on the African continent. Difficulties highlighted are comparatively minor, such as the process for registering for VAT because of significant amounts of fraud (vendors claim and are paid VAT refunds then disappear).

## OTHER INVESTMENT FACTORS

Measuring regulatory 'red tape' in the lifecycle of an SME is all to the good, but the World Bank stops short of measuring economic stability, corruption or other relevant factors affecting markets, such as the consumer's struggle out of poverty. Investors need to look elsewhere.

For corruption indicators, another report, the *Transparency International Corruption Perceptions Index,* is a useful guide. In it, among the BRIC countries, Russia tops the league (perceived to be the most corrupt), with India some way behind in second – both outstripping Brazil and China, with South Africa perceived as the least corrupt location in which to do business. In countries overall where UHY member firms operate, New Zealand comes top as the perceived least corrupt nation, while Venezuela comes bottom.

Another index could also be taken into account when deciding where best to invest: *The Legatum Prosperity Index* measures countries' prosperity, based on both quality of life and material wealth. This measure is pertinent because its research shows that entrepreneurship – encouraging new ideas and opportunity – correlates more closely to a nation's overall prosperity than any other factor. Top of that league is Norway, followed by Denmark, Australia, New Zealand and Sweden. Among the BRICs, China has improved in the prosperity rankings while other countries have changed in their ranking relatively little.

## KEY SURVEY INDICATORS

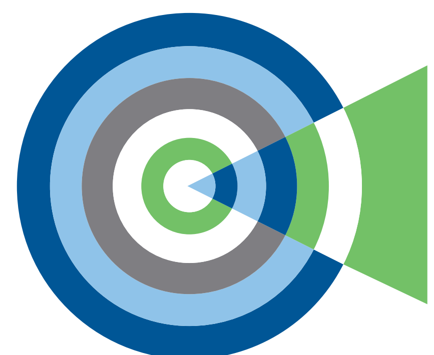
One key finding of the World Bank survey is that European economies in fiscal distress are making efforts to improve their business climate, and this is beginning to be reflected in the indicators being tracked. Part of the solution to high debt, says the World Bank, is the recovery of economic growth, and there is broad recognition that creating a friendlier environment for entrepreneurs is central to this goal.

Policy-makers worldwide have given more attention to one area of business regulation tracked by the World Bank survey over the past year than any other – starting a business. The average time to start a business worldwide has been reduced significantly, from 50 days to 30 days, and the average cost from 89% of income per capita to just 31%.

But perhaps the "most exciting finding", says the World Bank, is the "steady march from 2003 to 2012 towards better business regulation across the wide range of economies included". With a handful of exceptions, every economy covered by the survey has narrowed the gap in business regulatory practice with the top global performance measured by the indicators. "This is a welcome race to the top," says the bank.

But does all this matter? Does regulatory quality affect the mindset of investors? Yes, it does, says the World Bank. In a separate study, the World Bank estimates that, on average throughout all global economies surveyed, a difference of 1% in regulatory quality as measured in the survey is associated with a difference in annual foreign direct investment inflows of USD 250-500 million.

Matched with specialist advice from experts on the ground, and trusted local partners, the World Bank's guide and other indexes may confirm an investor's insight into a potential economic advantage and point to further new opportunities; they may question an investor's ambition (such as to dive into a huge, new-growth market in a jurisdiction that's politically unstable); or, at the very least, they may enable would-be investors to assess more accurately the risks involved when going international.



The average time to start a business worldwide has been reduced significantly, from 50 days to 30 days, and the average cost from 89% to just 31%.

**UHY member firms help mid-size companies to internationalise.**

For example, UHY's member firm in Spain, UHY Fay & Co, has been working with Hidral S.A. The company manufactures passenger and goods lifts and platforms which are sold exclusively to other lift manufacturers, installers and maintenance companies to complement their own product range.

With 165 employees at two manufacturing plants in Seville, Spain, Hidral has a turnover of EURO 18 million (USD 25.8 million). The company also has a subsidiary at Iandaiatuba, São Paulo, Brazil (Hidral Elevadores DO), and in Moscow, Russia (Hidral RU). Its distributors are in France, Lebanon and Russia. Over the last decade the Russian market has been one of Hidral's main export successes, as well as the region producing its biggest growth.

Hidral has an outstanding position in its market sector: its products are represented in more than 45 countries and its export sales represent 40% of total turnover.

UHY Fay & Co worked with UHY's member firm in Brazil, UHY Moreira - Auditores, to establish the company's manufacturing plant in Brazil, Hidral's first such venture internationally, and UHY Fay & Co's legal team worked with UHY Yans-Audit LLC, based in Moscow, to establish the company's subsidiary in Russia. UHY Yans-Audit is now managing accounting, tax compliance and contracting services for the Russian subsidiary.

Hidral previously used the services of a sizeable and well-known Spanish law firm, together with its partner company in Brazil, which was one of Brazil's top law firms. The experience was not satisfactory and Hidral transferred its business to UHY Fay & Co "to work with a firm that allows the development of a closer relationship with communication at the top, as it allows a swift and efficient decision-making process", says Javier Martínez, Hidral's marketing & sales director. "We also needed a firm with a clear focus on developing international business.

"With UHY Fay & Co, we value the transparency in the valuation of its services, the fast and efficient development of the engagements, and its proactive follow-up of the different projects," says Javier Martínez. "We also value very highly the fluent communication between the different UHY offices involved in the engagement."

**Hidral S.A.**
**www.hidral.com**

**Details of all UHY member firms, their locations and their local financial and business advisory services for investors going international are available on the UHY website: www.uhy.com. Doing Business Guides for all UHY locations can be found under the publications section of the UHY website.**

**In the UK, UHY Hacker Young has been supporting Noble Education Network as it expands its network of private primary and secondary schools. Currently, the network has schools in Germany, Austria, Portugal and Vietnam (Ho Chi Minh campus is pictured above).**

The UK-registered company was founded in 2003 by three successful German entrepreneurs who chose to leave their previous industries and dedicate their careers to bettering the lives of children around the world.

Their first social enterprise in education was the creation of Phorms, a German school network of 14 schools that increased access to children of all socio-economic backgrounds to private education. To do this, the team managed a system in which wealthy families directly subsidised tuition for children from disadvantaged families.

The network has since joined forces with the Richard Chandler Corporation, a business building group based in Singapore, which invested several million euros in the venture to create schools globally that offer high-tech private education and new talent discovery methods. The corporation builds and invests in companies that foster the development of prosperous societies.

UHY Hacker Young in London co-ordinates accounting assignments globally for Noble Education Network, provides audit services for UK operations, and provides consultancy for the network's growing international expansion. UHY's group of member firms in Germany, based in Berlin, UHY Deutschland AG, provides services to German subsidiaries, and its member firm in Vietnam, UHY Audit & Advisory Services Limited, and in Austria, UHY-Tax Wirtschaftstreuhand GmbH, have also provided services to the client.

**Noble Education Network**
**www.nobel-education.com**

# THE ANDEAN THREE: AN ECONOMIC POWERHOUSE FOR LATIN AMERICA

Chile, Colombia, and Peru all have market-friendly, fiscally prudent democracies that favour free trade and investment.

**Set among the Andes mountain range, stretching from the Caribbean to Patagonia, in an area of breath-taking vistas, are what have become known as the 'Andean Three'.**

These three dynamic, and often overlooked, economic powerhouses – Chile, Colombia and Peru – already have a combined GDP equalling 65% of that of Mexico – and their economies are forecast to grow faster than both Mexico's and Brazil's over the next five years, largely because of rising foreign direct investment.

But that's not the only reason why the Andean Three should rank high in the strategic planning of companies expanding internationally, says global consultants The Boston Consulting Group.

"Increasingly, Chile, Colombia and Peru are being viewed as an economic bloc serving as a new driver of regional dynamism in Latin America," say the consultants.

They have already forged an alliance binding together their countries' financial and commercial markets. They have free-trade and investment agreements, and last year their stock exchanges merged to form the Integrated Latin American Market. This bourse boasts Latin America's second-largest market capitalisation, after Brazil's Bovespa, and has the largest number of listed companies. The three countries are also planning to connect their electricity grids.

In addition, Chile, Colombia, and Peru all have market-friendly, fiscally prudent democracies that favour free trade and investment. Chile is ranked 11 among all nations in terms of openness to trade on the Heritage Foundation's Index of Economic Freedom, while Colombia and Peru have moved up in ranking to 45 and 41 respectively. By contrast, Brazil ranks only 113 and Argentina 138.

"The sound macroeconomic management of the Andean Three makes them particularly appealing to investors," says The Boston Consulting Group. The Colombian economy has expanded by an average of 4.6% annually over the past five years. Chile has averaged 5.1% annual growth and Peru 5.6%. Yet inflation has been kept in check.

The three nations posted balanced budgets or healthy surpluses from 2005 through to 2008. After running deficits in 2009 as a result of the global recession, Chile returned to a balanced budget in 2010, and Peru ran only a 1% deficit. Brazil and Venezuela, by contrast, have run significant budget deficits since 2006.

The Andean Three are considered to present much lower macroeconomic, political, labour, and foreign-trade risks than most other Latin American nations, according to rankings by the Economist Intelligence Unit. Tax rates and competition policies are also more business-friendly.

Such considerations are fundamental for companies making large, long-term 'bets' in major regional sectors such as mining and energy resources.

Although the Peruvian government is putting greater emphasis on social inclusion, its economic policies have mainly stayed on course. The policies of the Andean Three stand in sharp contrast to the leftist populism of Venezuela, the protectionism of Argentina, and the domestic focus of Brazil.

Investors have rewarded these policies. Foreign direct investment (FDI) as a percentage of GDP has risen since 2005 in all three nations and averages 41% for the bloc. In Brazil and Argentina, by contrast, FDI as a share of GDP has dropped to 17% and 21% respectively. In Venezuela, it plunged from 31% in 2005 to just 12% in 2010.

Capital markets in Peru are also strong, says Carlos Sandoval, UHY Sandoval Aliaga y Asociados S. Civil de R.L., Peru. "The corporate bond market in Peru grew threefold from USD 1,631 million in 2011 to USD 5,149 million in 2012," he says. "The total Latin American region has grown 65%, with Brazil at the top of the list, but it is Peru which has grown the most." These investments are funding infrastructure projects and financing growth companies as they expand their operations in Peru and the region. "There are many companies from the US and Europe coming to Peru to launch their operations and acquire companies in this market," says Carlos. "We advise our clients with mergers and acquisitions, as well as capital-raising."

The private sector is also an important factor, says Ronny Frederick, UHY CE&A Consultores y Auditores de Empresas, Chile. Chile's LAN Airlines has its main South American hub in Lima, Peru, and plans another in Bogotá, Colombia, for example, and Chilean companies such as Abastible, Gasco, and Lipigas control half of Colombia's USD 1 billion liquefied natural gas market.

Cross-border mergers and acquisitions within the bloc rose from 16 per year on average from 2003-2006 to 40 per year from 2007-2010. Peru's Brescia family, whose interests include banking and mining, now owns Chile's largest cement producer, Cementos Melón, as well as a Colombian maker of welding electrodes. CorpBanca, one of Chile's largest commercial banks, is expected to win regulatory approval to buy the Colombian operations of Banco Santander. Meanwhile, the state-run Colombian energy group, Empresa de Energía de Bogotá, acquired 60% of Peruvian gas distributor Calidda in 2011. Mergers and acquisitions are also becoming a trend in industries such as retail, telecommunications and transportation.

Together, the Andean Three are only 35% of the size of Brazil and with less than half that nation's population. "But the bloc is rising on the radar screen of both multinationals and local companies as a driver of Latin American growth," says Samuel Rozo Monsalve, UHY Auditores & Consultores S.A., Colombia. Their consumer markets are at least as thriving as those in the rest of Latin America. More than 30% of Chile's population and 25% of Peru's population climbed out of poverty to the lower middle class between 1990 and 2010, making the Andean Three a growing market for mobile communications, consumer finance and retail.

The bloc's strong trade links with the rapidly growing economies of Asia are another attraction. Total trade with Asia grew by 5% annually from 2005-2009 and accounts for around 10% of the three countries' combined GDP. That is around double the level of South America's other big economies, where trade with Asia has grown more slowly.

By seizing opportunities in the Andean Three, companies can position themselves strongly in Latin America. But, says The Boston Consulting Group, they should keep guidelines in mind:

### Take advantage of the Andean Three's economic integration.

But keep in mind that there are still economic differences among Chile, Colombia and Peru. Chile's economy is the most advanced, for example, and is in a good position to attract well-trained business talent, making it a better option for a regional headquarters. Colombia and Peru are less-developed, but that could create better opportunities for short-term gains.

### Approach the Andean Three differently from other Latin American markets.

The ease of doing business in Chile, Colombia and Peru, compared with much of the rest of the region, means there is less pressure on foreign companies to find local partners, cultivate government connections, and worry about capital expenditure risks.

### Take advantage of the growing links between the Andean Three and Asia.

Because of the Andean Three's geographic position and openness to trade, their economies are positioned to grow as conduits for Asian–Latin American commerce.

**The Andrean Three**

| | |
|---|---|
| GDP, 2011 | **USD 739 billion** |
| Real GDP growth, 2006–2011 | **4.7%** |
| Real GDP growth forecast through 2012 | **4.9%** |
| Economic integration | **• Free-trade and investment agreements**<br>**• Integrated stock exchange** |
| Average ranking, Index of Economic Freedom | **71.7 (Latin America average, 58.5)** |
| Foreign direct investment | **41% of GDP** |
| Stock market capitalisation (MILA) | **USD 550 billion** |

UHY has local firms in the Andean Three countries.

CHILE
UHY Macro Consultores, Santiago
Contact: Juan Marín Hernández
Email: juan.marin@uhymacroconsultores.cl

UHY CE&A Consultores y Auditores de Empresas, Valparaíso
Contact: Ronny Frederick
Email: contactos@ceya.cl

COLOMBIA
UHY Auditores & Consultores S.A., Bogotá
Contact: Samuel Rozo Monsalve
Email: s.rozo@uhy-co.com

PERU
UHY Sandoval Aliaga y Asociados S. Civil de R.L., Lima
Contact: Carlos H. Sandoval
Email: carlos.h.sandoval@uhyenperu.com

**Further details of doing business in Chile, Colombia and Peru are available on the UHY website under the publications section: www.uhy.com**

# CHINA'S DECLARED BACKING FOR SMEs MAY OPEN DOORS TO FOREIGN INVESTORS

Small-medium sized enterprises (SMEs) contribute 60% of China's industrial output and create 80% of China's jobs.

But for the year just past, Chinese SMEs have been experiencing hardships: some have been at risk of collapse. Shortages of electricity, capital and labour have led them to this predicament, and soaring costs have made things worse.

Faced with this indictment of faltering growth, the Chinese government's 12th Five-Year Plan contains a key strategy specifically in support of SMEs. According to the plan, the total number of China's SMEs will grow steadily over the next five years and achieve an average annual growth rate of 8%.

Five primary missions underpin the plan: to improve the capacity of establishing business and creating jobs; to optimise the structure of SMEs; to boost the development of "new, distinctive, specialised and sophisticated" industries and industrial clusters; to upgrade enterprise management; and to refine SME support systems.

So what opportunities could this prospective economic about-turn hold for investors and foreign businesses looking to penetrate the Chinese SME market?

## KEY SECTORS FOR INVESTMENT SUCCESS

Some opportunities relate to China's ongoing need to modernise and upgrade its technology base; others relate to rapidly growing consumer markets in the country; while others relate to the ongoing processes of structural change within the Chinese economy.

The most commonly mentioned sectors of business opportunity for foreign SMEs include:

- **Machine tools** — as Chinese companies continue to upgrade technology, reflecting China's ongoing strength in manufacturing
- **Business services** — as the Chinese economy continues to develop. Examples are public relations, advertising and specialist financial services, such as factoring, private equity and specialist management consultancy
- **Consumer and personal services** — such as healthcare and medical services, and education
- **Optical fibre** manufacturing technology
- **Luxury products** — such as high specification cars for the growing consumer market, but also niche opportunities, such as ultra-light aeroplanes, yachts and ski equipment
- **Low-carbon technologies** — environmental products and services, as the Chinese government increases priorities given to environmental protection.

Energy, particularly renewable energy, has great market potential in China, according to economic analysts. The government is taking aggressive measures to steer the country towards lower-carbon energy use. Yet China's energy use is vast — it is the world's largest consumer of energy — and it relies on coal for two-thirds of its energy needs.

The Economist Intelligence Unit forecasts that China's use of solar power, wind energy and hydropower is destined to grow rapidly — though, not so fast that ascendant Chinese renewables firms can feel secure. It projects that the combined share of renewable energy and nuclear power will rise from 13% in 2010 to over 16% at the end of the decade. As a result of this, and a growing appetite for natural gas, coal will satisfy a lower proportion of China's energy needs. Yet, in 2020 it still expects coal to provide well over half of China's energy needs — which by then will have swollen greatly. As a result, 35% more coal will be burnt in 2020 than in 2010.

Other sectors identified by economic analysts include services and supplies to the plastics industry; lifestyle products; life sciences (medical supplies, pharmaceuticals, healthcare, biotechnology); automotive and aeroplane technologies; high value brand products; and building products and services.

## KEY LOCATIONS FOR INVESTMENT SUCCESS

Investors and exporters study China's Five-Year Plans to identify sectors that will be supported by the Chinese government. But they also study regional differences in the Chinese market: both regional market conditions and differences in how rules and regulations at local and provincial levels are interpreted. Variation is plentiful — China has 23 provinces, five autonomous regions, four municipalities directly under the central government, and two special administrative regions.

As China's growth has shifted into lower gear, the larger eastern provincial economies have been bearing the brunt of the slowdown. Expansion in trade, investment and industrial production has slowed to (by national standards) a crawl. Inland provinces continue to outperform their coastal counterparts, much as they did in the aftermath of the 2008-09 downturn.

Even though many western provinces are seeing a deceleration from their previously heady growth rates, they continue to maintain year-on-year GDP expansion of over 12%. They are also recording faster growth in disposable income and household consumption than the coastal provinces.

Although investors might expect that the poorest would be most adversely affected in periods of economic duress, this has not been the case in China. Beijing, Shanghai, Guangdong and Zhejiang — the country's political, financial and entrepreneurial capitals — are continuing to record the slowest GDP growth rates in the country, at under 8% year on year.

The eastern provinces have been hit hardest because they are much more highly exposed to the property downturn and weakened external environment than the rest of the country. Property investment accounts for roughly one-half of total fixed asset investment in Beijing and Shanghai, for example, compared with less than 20% for poorer provinces, such as Hubei. The eastern seaboard is also more highly exposed to fluctuations in external demand, as many of its manufacturing facilities operate in export-processing.

Falling exports in the eastern provinces have been accompanied by accelerated export growth in central and western provinces, to where a significant amount of manufacturing capacity has since relocated.

Chongqing, Henan and Sichuan, for example, have all recorded a breakneck pace of export expansion, helping to soften the impact of the recent downturn on China's labour market, as migrant labourers forced out of work in the eastern provinces have instead been able to find employment inland.

Sweetened policy incentives and improved infrastructure to support inland trade, such as dredged rivers, expanded river ports and improved highways, have encouraged manufacturers to move inland. In July, Chongqing and Henan saw export growth of 160% and more than 60% respectively.

Among the fastest-growing provinces are Shaanxi and Chongqing, which are at the centre of the national western development policy, and Guizhou, which has the lowest average GDP per head in the country. All three have maintained annual growth rates above 13%.

Foreign SMEs tend to believe, for example, that knowing and understanding the rules and regulations are the key to understanding the local business environment...

Guizhou, for example, is now seeing huge outlays of industrial investment, as well as a massive government drive to develop tourism infrastructure. Property-related investment in July 2012 rose by a massive 90% year on year.

A further notable development is that growth in disposable incomes and consumption expenditure has picked up considerably in many inland provinces. For example, the south-western province of Yunnan has seen expansion in disposable income per head and consumption expenditure of 14.3% and 18.3% respectively, outpacing real GDP growth of 12.6%.

By contrast, the eastern port municipality of Tianjin recorded expansion of just 10.8% in consumption expenditure and 10.1% in disposable incomes. Narrowing the income gap between coastal and inland provinces has long been a priority for the government; the fact that incomes and expenditure in inland provinces are now growing more quickly than on the coast will be welcomed by the government.

Meanwhile, developing the services sector offers a sustainable means of generating long-term growth in China's eastern provinces. Such a transition is under way slowly; for example, Shanghai is piloting tax reforms that should encourage the growth of smaller services enterprises.

## OVERCOMING BARRIERS TO SUCCESS

Some SMEs enter China with a naïve approach *('it's a huge market, I should be there')* without studying whether or not their business proposition is likely to be successful in China. The market is indeed large, but so is the competition in Chinese markets both from local and international suppliers. A second issue is that some SMEs are too optimistic about the extent to which quick gains are possible. Experience shows that businesses need several years to build relations with business partners and government agencies before business will really take off and become profitable.

It is important to invest in the initial years in obtaining an understanding of the business culture in China – and of the specific province in which the SME investor plans to become established. This approach does not only refer to issues such as language, personal attitudes and relations, how business relations are established and developed and how to organise communication with local staff in China, but also to more structural issues.

Foreign SMEs tend to believe, for example, that knowing and understanding the rules and regulations are the key to understanding the local business environment (investment laws, financial and fiscal arrangements, employment laws, etc.), but many tend to overlook that in China power and relationship are much more important than most assume.

Investors need to not just find good local staff and build up relations with local business partners but also to invest in building good relations with local governments and government agencies, such as customs, environmental inspectors and tax offices.

## 'FIRST TO FILE' PRINCIPLE

One specific problem is the so-called 'first to file' principle, which means companies need to register trademarks before entering the Chinese market. One foreign embassy in China reportedly advises companies looking to enter China that they should register their trademarks two years before entering. Another embassy reports that 90% of the intellectual property rights (IPR) cases it deals with are trademark related. Issues also relate to production technologies protected by patents.

Although some economic commentators believe IPR issues are often exaggerated, it is widely agreed that they do add to the cost of doing business in China, particularly in the case of smaller enterprises. IPR problems can present more of a challenge to SMEs than larger enterprises, because typically they do not have in-house lawyers, making it necessary for them to outsource legal services.

> China represents a bigger challenge for SMEs than entering many other markets. But SME investors who seek out expert advice and support from organisations with practical experience of the Chinese market are well placed to overcome the barriers.

## QUALITY INFORMATION

SMEs entering new markets always need information about, for example, market opportunities, potential distributors, laws and regulations, and the availability of business services. However, for SMEs seeking to enter China, *access to good quality information* is reported to represent a higher cost than in other markets.

Similarly, when entering new markets businesses need to understand the regulations governing those markets, in order to identify the implications for their planned activities. However, achieving this in China requires more than just information about the relevant regulations; it also requires knowledge of how these regulations are likely to be applied. This is a particular challenge because of frequently changing laws and uncertainties about how laws and regulations will be interpreted and implemented, not least because some laws can be conflicting.

Non-tariff barriers exist in several industries, as part of the government's attempt to protect Chinese enterprises. One example is the banking sector, which not only makes it difficult for financial service providers, but also for enterprises in other sectors to deal with investment issues in China. Another issue is China's Indigenous Innovation Policy which makes it difficult for non-Chinese owned companies to access public procurement contracts. Chinese companies are favoured because the government believes innovation needs to come from within China.

Recruiting the right local employees can be a major issue. Training is one of the possible solutions to this and several Chambers of Trade and support organisations are involved in cooperating with the Chinese government to set-up advanced technical training.

Fear can also be a key bottleneck (fuelled by reports of bad experiences in China): Chinese partners who keep raising the level of investment required; cases of business partners disappearing; problems with Chinese suppliers, including orders placed but not delivered; and some quality issues.

As a result, one of the messages promoted to SMEs is: 'Don't go to China without a reliable Chinese partner.' China represents a bigger challenge for SMEs than entering many other markets. But SME investors who seek out expert advice and support from organisations with practical experience of the Chinese market are well placed to overcome the barriers. UHY has firms based in key Chinese locations and with local knowledge.

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Investors looking for advice may also wish to contact the UHY China desk in their region. For details, contact the UHY international office at: info@uhy.com

Further details of doing business in China are available on the UHY website under the publications section: www.uhy.com

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