

China's 12th Five Year Plan: what does it mean for the UK?

China's Five Year Plan has been the country's main tool of economic development since 1953. The most recent Plan focuses on controlled growth, social and environmental issues, giving rise to many opportunities for UK business.

In particular, technology companies are likely to benefit from the considerable incentives on offer, as well as China's move up the value-chain generally. We also see specific opportunities for companies in the infrastructure, green-tech, automotive and aerospace sectors, as well as growth in business services and consumer goods companies.

UK companies should also consider focusing on tier 2 and 3 cities, away from the traditional heartlands of Shanghai and the Pearl River Delta, while looking at joint ventures with Chinese companies.

During March 2011 the National People's Congress (NPC) session, China's highest legislature met to ratify the 12th Five Year Plan.

The commentaries of course discuss the planned 7% sustained growth over the next five years, inflation to be kept below 4%, urbanisation to reach 51.5%, the welcoming of foreign investment, coastal regions to become high-end R&D and manufacturing hubs, but to focus on these statistics would be to miss the fundamental shift in economic policy.

There have been growing concerns with the environmental and social impact of unbridled growth and disparity of wealth between urban and rural areas. The 12th Plan focuses on rebalancing the China economy in order to achieve sustainable growth across China, reduce the income gap, mitigate environmental concerns and thereby alleviate concerns of growing social discontent.

But what does it mean for UK business with operations or interest in China? After years of double digit growth is the flame subsiding and progress slowing in China? With a focus on domestic development, does this mean Chinese business is less likely to expand abroad? We don't believe so.

Here, we predict the five best opportunities for UK businesses in China over the next five years.

Increased sale of consumer goods into China

It is well known that China has become a key consumer on the world stage, with a population of 1.3 billion it is a huge consumer market. However, the population of tier 1 cities is approximately 36.7 million and most foreign businesses are already focusing on these markets. Of the remaining 1 billion inhabitants, or potential consumers, while many of these currently have a lower spending power than tier 1 city inhabitants this is expected to change.

Over the next five years, China is focussing on moving urbanisation from 47.5% to 51.5%, and increasing the minimum wage by up to 40%. A sector focus will also be made from agriculture to manufacturing. This should result in a huge increase in tier 2 and tier 3 cities, significantly higher aggregate disposable incomes and a much larger market for retail and consumer goods companies.

Moving up the value chain

The new minimum wage will cause some low cost manufacturing businesses to re-think their strategy, and for those UK businesses interested in low cost manufacturing then other rice economies may be a more attractive proposition. China however, is looking to position themselves as a high-tech manufacturer and China can be an ideal location for high-tech companies for a number of reasons.

- With numerous science parks being constructed, and 3 million science graduates leaving university each year there is a real push by the government to be creators of new technology.
- All seven strategic emerging industries are technology led. The Government has suggested they will spend RMB4 trillion (approximately £378.67bn) on these industries in the next five years:
 - biotech
 - new energy
 - hi-end equipment manufacturing
 - energy conservation
 - clean-energy vehicles
 - new materials
 - information technology (IT).
- Numerous tax breaks for hi-tech companies, including reduced tax rates in certain areas.
- Increasing intellectual property (IP) protection, although businesses must still take active measures to protect their IP.

These changes mean that it is now common for technology businesses to locate research and development (R&D) functions in China, with companies such as AstraZeneca and Microsoft leading the way, we expect this trend increase.

UK technology companies, particularly those in important China sectors such as automotive and aerospace, should also seek to benefit from these opportunities.

Infrastructure, healthcare and green-tech sectors

These sectors are critically important in the Five Year Plan.

The focus on increasing the standard of living and encouraging urbanisation will give rise to huge opportunities in the service and energy sectors. Urbanisation will require a huge investment in infrastructure.

The rapid growth of China's cities is fuelling high demand for British architectural and engineering expertise across the country. Many British architects are designing and building China's megacities. In fact, well known British architect Sir Terry Farrell, is completing the tallest skyscraper ever designed by a British architect, the 100-storey, 441 metre Kingkey Finance Tower in the city of Shenzhen.

Healthcare is another important sector, with particular focus is research and development of medicines, vaccines and other antibody products to treat tumours, immune deficiency, infectious and cardiovascular diseases. In fact, 18 of the top 20 global medicine manufacturers currently operate in China and there is growing M&A activity in the sector. China was also ranked number 1 as acquirer of biotech companies in 2010.

UK companies also play a large part in this sector with Alliance Boots joint venture (JV) with Guangzhou Pharmaceutical Corporation, the largest Chinese distributor and wholesaler of pharmaceutical products in China.

Green energy solutions is also a focus sector with the Premier and Party Secretary of the State Council of the People's Republic of China, Wen Jiabao, stating in China's 2011-15 economic plan that they would lower the target for annual GDP growth "to raise the quality and efficiency of economic growth". He continued "We absolutely cannot again sacrifice the environment as the cost for high-speed growth. To have blind development, and in that way to create over-capacity and put greater pressure on the environment and resources. That economic development is unsustainable."

China has set an annual growth target of 7%, lowered from 8%, to ensure sustainable development during the next five years. Specifically, the green technology sector is predicted to grow by 15-20% annually over the next five years. Some of the targets are electrifying with China hoping to produce 1 million electric cars by 2015 and three trillion yuan (approximately £284bn) to be spent on environmental protection over the period – double the amount spent from 2006-2010.

UK companies, many of whom lead the way in green technology, should seek to benefit from these opportunities.

Focus on second and third tier cities

In the first half of 2010, first tier cities including Beijing, Shanghai, Guangzhou and Shenzhen, achieved an average growth rate of 12%, whilst second tier cities Changchun, Yinchuan and Hefei achieved an average growth rate of 18.5%. As with many second tier cities, 75% of the GDP came from private enterprises and only 25% came from state-owned enterprises.

We expect second and third tier cities to emerge into the spotlight in the next few years. Recently, Chengdu and Chongqing,

both in Western China, were predicted by Forbes Magazine to be two of the world's fastest growing cities in the next decade.

With rising labour costs in coastal provinces and better transportation links to the inland areas, the second and third tier cities like Wuhan, Ningbo, Dalian and Shenyang will continue to attract more investment. For example, the low prices for land and high quality/ low cost labour, together with the beneficial fiscal policies have attracted Intel to move to Dalian.

UK companies should seek to benefit from the low costs, incentives and growing markets in the second and third tier cities, where competition is often less fierce than in Shanghai and Beijing.

Merger and acquisitions opportunities

With the focus of China's most recent Five Year Plan being on domestic development, does this mean companies are not looking at expanding overseas? In the recent Grant Thornton International Business Report (IBR) survey, almost half of the privately held businesses (PHBs) in mainland China expect to grow via acquisition in the next three years while almost a quarter plan to raise funds on the stock market.

45% of Chinese respondents are planning acquisitions compared to only 26% of respondents surveyed a year earlier. 24% of senior executives surveyed were also planning to raise capital via a public listing in the next three years an 13% upswing (from 11%) from 12 months earlier.

These results mirror the increased activity in China generally. In 2010, outbound foreign direct investment (FDI) from China grew 36% to USD\$59bn in 2010. In addition, USD\$28bn was raised by Chinese private equity (PE) houses in 2010 – more than double on the previous year.

UK companies looking for joint venture partners should consider Chinese tie-ups, whilst joint ventures were out of fashion until recently, they are becoming much more common as Chinese and UK businesses look to share skills and access to markets.

Although there has been limited capital-raising activity in the two years running up to the Five Year Plan, the opportunities of the UK Markets to provide funding to Chinese businesses should not be discounted.

Who should I contact?

Whether you are looking to grow your business by exporting, investing or doing business in China, Grant Thornton's dedicated China Britain Services Group has the international capability, the cultural understanding and the joined-up approach to help you drive your business forward.

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