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KING&WOOD MALLESONS

CHINA 2020: TOO BIG TO IGNORE

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DOING BUSINESS IN CHINA

Doing Business in China

Last updated in June 2020

Introduction

In this publication, we explore the key questions being asked by clients looking to unlock investment opportunities in the People's Republic of China (China) such as:

- What are the best opportunities for investing in China?
- What are the challenges?
- How do other investors deal with the key issues?
- How do I deal with regulatory change?

2019-2020 have been challenging years for both China and the world. China has had to contend with both the fallout from the Covid-2019 pandemic as well as the trade conflict between China and the US.

China's response has largely been to think BIG. Regulatory reform, rebalancing a transition to an innovative economy and embracing globalization. In addition China has shown it can still think BIG domestically with the Greater Bay Area initiative. In China the only constant is change!

China's commitment to further open up its markets to foreign investors is providing new opportunities in the world's most dynamic economy. A notable milestones was the Foreign Investment Law which was adopted in early 2019 and underscores this commitment to continue to open up industry sectors, level the playing field for foreign businesses and protect the IP of Chinese and international companies alike.

The world is entering a challenging period. China may well be a rare source of growth in a bearish world. The greatest opportunities are for investors targeting the hottest sectors of the economy and where foreign investors have the most value to add. On the next page, we summarize the key questions investors and directors of companies in China should ask.

China is uniquely crucial to our firm and we hope that this publication will demystify the China challenges but also the China opportunities.

We hope that we can add value to your business in China and would be delighted to discuss opportunities with you further.

Zhang Yi
Chairman of China
Management Committee

Xu Ping
Head of Corporate
Practice

Investors and directors will be well served by considering and asking the following questions:

1. Evidence-based decision making

Is your company's China strategy based on evidence and data? Has your company done its homework?

2. Systematic risk management

Does your company have a system in place to assess risks? Are risks elevated to and considered by the board in a timely manner? Is risk management part of your company's DNA?

3. Take compliance seriously

Does your company have clear compliance policies relating to your China business that all relevant staff have been trained on? "Everyone else does it" is not a defence.

4. Disclosure policy

Does your company have a disclosure policy which includes regular and timely disclosure of material information relating to its China business? What communication should be made public when facing imperfect information and data?

5. Travel

Do executives check if there are risks in travelling to China before doing so, such as unresolved disputes with large Chinese companies? When facing these circumstances should they defer any non-essential travel?

6. Regular briefings

How often are you briefed on your company's China activities, strategy and risks?

7. Assess the impact of regulatory change

When did you last receive an update and how susceptible are your overseas revenues to regulatory developments in China?

8. Due diligence on counterparties

Before consummating a deal, hiring a new employee, or taking on a new Chinese supplier, does your company routinely check government records, consider litigation history, and undertake social media searches to understand the business practices of the Chinese company or individual you are dealing with?

9. Crisis and public relations management

Does your company have a crisis management plan in place and a robust public and investor relations strategy that can be called upon when unexpected business disruption in China occurs?

10. Funds transfer strategy

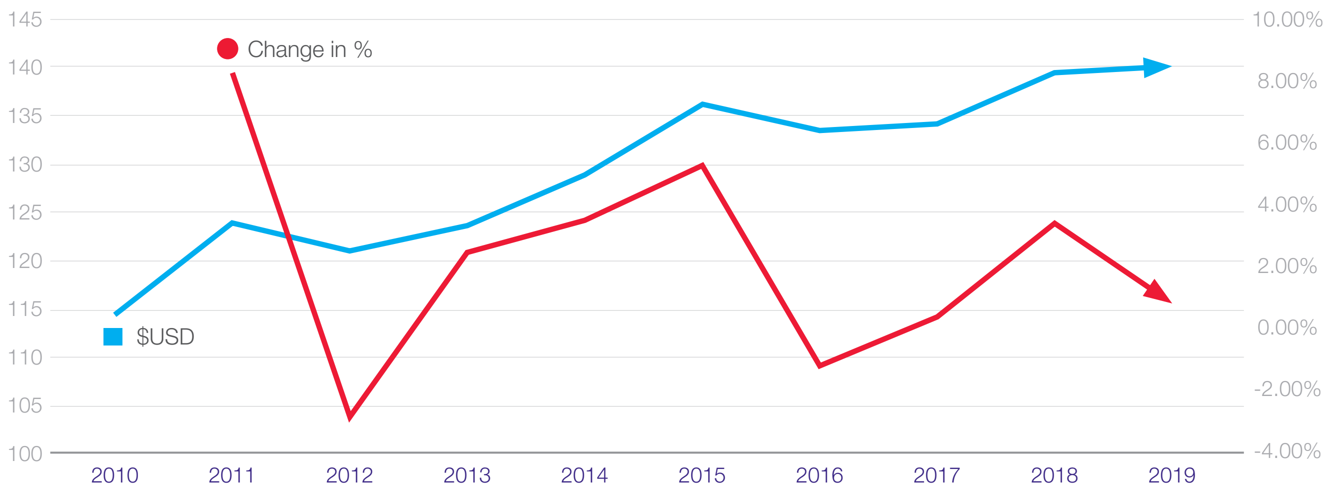
When did your company last review its inter-company agreements and strategy for funding its China business or repatriation of Chinese profits?

China 2020: Too big to ignore

China's investment environment

Since the 2008 global financial crisis, China's inflow of FDI continued to steadily grow. Between the years 2010 and 2019, China's inflow of foreign direct investments grew by 22%.

China FDI Inflow in million $USD



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
■	114.734	123.985	121.08	123.911	128.5	135.61	133.71	134.063	139.043	140
●		8.06%	-2.34%	2.34%	3.70%	5.53%	-1.40%	0.26%	3.71%	0.69%

Source: *UNCTAD*

In 2019, the total inflow of foreign direct investments to China was $140 billion. China ranked the world's second largest FDI recipient after the United States. Even amidst trade tensions, China remained an attractive market for foreign investors. Over the years international investors have moved from viewing China as an economically attractive production site to a market too big to ignore. Domestic economic growth has led to ever increasing disposable income amongst upper- and middle-class consumers.

Realizing the China dream – innovation | sustainability

China and the world are facing strong headwinds.

However, every crisis does bring with it opportunity. Accordingly, while many clients are finding China challenging there are also great opportunities.

Many of the greatest opportunities for international investors target Chinese consumers. A push by consumers towards a more sustainable and better quality of life has created new opportunities in education, health and wellness, creative, elderly care and green industries. The global pandemic has also resulted in greater interest in the digital sector.

This increased opportunity has been coupled with a China that is becoming easier to do business with. According to World Bank Group's ***Doing Business 2020*** study China showed the greatest improvement in ease of doing business by a world top 10 economy. China improved its rank to 31st up from 46th a year earlier.

China's 13th Five-Year Plan (2016-2020) (the "**Five Year Plan**") targets a 6.5% average annual GDP growth rate to drive the development of a 'moderately prosperous society'. It was clear that the frenetic growth of the last 30 years had run its course and now was time for more thoughtful reform. The pandemic has meant that growth may need to be adjusted further downwards. However, the course for the coming years will not change - we expect to see reforms focused on nation building and inclusive, sustainable development rather than a headlong drive for growth.

Big plans

To this end China will launch great national schemes. Smart cities, autonomous cars, Greater Bay initiative, IoT manufacturing – the list goes on. Both domestic and foreign enterprises will find opportunities to develop their business in cutting edge manufacturing. In the coming years if you are not competitive in China you may not be competitive in your home market. However, the interest will not be all one way traffic. China will look for international flair, experience and expertise in service sectors that support production activities, such as industrial design and innovation, project consulting and logistics.

The 13th Five-Year Plan has ambitious plans to counter poverty and pollution, implement supply-side reforms to tackle overcapacity and build up the service-based economy to provide the majority of China's growth going forward. International investors will still have many opportunities in this 'new normal' era of a China with a more sustainable economic growth.

Middle class consumers

The demand by China's middle class for foreign goods and services will likely return in the near future. Indeed, it is likely to continue to grow in line with the growing size of the Chinese middle class. 'Internet+' and further reforms targeted at increasing internet penetration among China's population will further increase the world's greatest ecommerce marketplace. There will be continued growth in cross-border e-commerce ("**CBEC**") platforms and this will be also fueled by the creation of 59 new e-commerce Pilot Zones that were established at the end of 2019. Cross border ecommerce does face increasing regulation with the implementation of the E-Commerce Law and the new CBEC policies. However, few international companies will be able to resist the opportunities offered by the world's largest marketplace.

Health

The 'Healthy China' initiative has created a new market for private investors seeking to capitalize on the Chinese government's desire to increase both the reach and quality of its domestic healthcare system. Foreign investment is welcomed as China recognizes the need to bring international best practices and innovations in medical research and online healthcare platforms.

A global champion of globalization

As much of the world retreats from trade China has continued to promote trade liberalization both regionally and globally. China has done this by its growing Free Trade Agreement ("**FTA**") network and perhaps more ambitiously the Belt and Road initiative. China has continued to side firmly with international trade promotion over protectionism. China's pro-trade position and growing domestic market may see China develop into an ever more attractive investment option for international business starved of growth elsewhere.

Relaxed restrictions on foreign investment

The new Foreign Investment Law and the introduction of a negative list (2020) for investment sees a relaxation on restrictions on foreign investment in various sectors. The PRC National Development and Reform Commission ("**NDRC**") have indicated that all restrictions on foreign investors beyond the negative list will be cancelled.

Domestically, China has continued to grow its web of Free Trade Pilot Zones, particularly in central and western regions. These inland investment hubs will allow foreign investors to capitalize on the rapid growth of China's lesser-developed areas as the costs of doing business rise in Tier 1 and 2 cities. Some hubs will be able to offer a lower corporate income tax rate of 15% compared to the regular rate of 25%.

Innovative economy

An innovative economy needs to protect intellectual property ("**IP**") rights. China has made great progress in many aspects of IP protection with newly revised Trademark Law, Regulations on Patent Agency, a new E-commerce Law and the new Foreign Investment Law all improving the IP protection system.

However, China's efforts have gone beyond just passing laws and regulations. The administrative enforcement of IP protection has been improved. Like so many things, the improvement of IP enforcement has involved a digital aspect. The authorities have explored ways to set up IP courts to improve the efficiency and allow for specialization of IP courts. The IP protection environment has greatly improved and the enforcement mechanisms are increasingly sophisticated and foreign investors enjoy better protection of their IP.

Cyber-security

National security is a fundamental part of the Five-Year Plan. To this end China's new Cyber Security Law and the impending Measures on Security Assessment of Cross-border Transfer of Personal Data will regulate more strictly the transmission of personal information and data outside of China. China is seeking to balance the internet as a means to encourage growth and enable innovation in the digital industry but on the other hand ensuring that individuals protect their privacy and personal information.

New era for foreign investment regime in China

It has been forty years since China promulgated its first law on foreign direct investment.

Over the past decades, China has established a detailed legal framework for foreign investment. In 2019 the most significant legislative move in this area was the Foreign Investment Law of the PRC (the "**FIL**") approved by the National People's Congress and the Implementing Regulations for the Foreign Investment Law of the PRC (the "**FIL Implementing Regulation**") approved by the State Council. These laws unify the fragmented laws and regulations related to foreign-invested enterprises (the "**FIEs**"). Both pieces of legislation came into force on 1 January 2020 and – they will play a significant role in reshaping how the foreign investment regime in China works.

The previous case-by-case approval/filing system that existed for decades has been replaced by a much simplified regime. National treatment is one of the key words for the FIL and the FIL Implementing Regulation. Except as required pursuant to a negative list for foreign investment (the "**Negative List**"), the competent PRC authorities will treat foreign investors on an equal footing with domestic investors. Two key aspects of the new regime are the Negative List and information reporting (the "**Information Reporting**").

- **Negative list** - The negative list consists of industry sectors in which foreign investment is prohibited (the "**Prohibited Sectors**") or restricted (the "**Restricted Sectors**"). Foreign investment is banned in Prohibited Sectors. Examples include the manufacture of nuclear fuel or compulsory education. If the investment falls within a Restricted Sector then it will be subject to restrictions on shareholding or investment form. If a sector is not included in the Negative List, then foreign investors are entitled to the same treatment as domestic investors. The latest version of the Negative List was issued on 23 June 2020. This was also significantly shorter than the first one issued in 2013. In the latest Negative List, foreign shareholding restrictions on financial companies such as securities companies and life insurance companies are lifted, one year earlier than expected and as a result, there is no foreign investment restriction in the financial sector. Further streamlining is expected. Examples of restricted areas being opened up include the lifting in 2022 of restrictions on the foreign shareholding in a passenger vehicle joint venture and number of such joint ventures. The Negative List reflects China's approach to continue to liberalize foreign investment. It is worth noting that, even if an investment falls within the category of the Restricted Sector, the competent authorities will only review the transaction to determine if the restrictions are complied with and no additional approval or license is required in such respect.

- **Information reporting** – Ministry of Commerce ("**MOFCOM**") – the long-time watchdog for foreign investment – now takes a back seat in monitoring foreign investment through its information reporting system. This means no approval or record filing will be required from MOFCOM for incorporation of or any change related to an FIE. FIEs will be required to submit information such as the initial report, change report, dissolution report and annual report through the Information Reporting system but are explicitly exempted from separate submission of information which can be obtained via information sharing between different governmental bodies, such as information regarding deregistration and domestic investment (including multi-layer investment).

Other considerations

Although China is cutting red tape in respect of inwards foreign investment there are still issues international investors should consider when investing in China:

- **Anti-trust filing** - According to the Anti-Monopoly Law and relevant regulations, if businesses enter into certain mergers and acquisitions transactions (or any other transactions involving a change of control for instance a greenfield project) and the filing tests (i.e. global and China turnover) are triggered, they need to obtain the anti-trust clearance prior to closing. There have been an increasing number of cases where State Administration for Market Regulation ("**SAMR**") impose fines to companies for failure to notify before closing. In the first half of 2019, there have been four cases where companies have been fined for failing to make the anti-trust filings. Companies should notify SAMR to receive clearance before closing the transactions if the thresholds are met.
- **National security review** - Foreign investment in domestic enterprises falling within certain sensitive sectors (such as finance, resources and energy, food safety) require a review to ensure the transaction will not harm national security. At present, a notice issued by the State Council and one rule issued by MOFCOM are the only regulations dedicated to national security review related to foreign investment. Both are relatively brief. Neither the FIL nor the FIL Implementing Regulation provides any further clarity in this regard. Given that protectionism is gaining momentum around the world and a number of major Western countries are tightening scrutiny on foreign investments, it is likely that the Chinese government will also create separate legislation on foreign investment national security review to better protect its own national interest.

Structuring your business in China

Business models available and considerations

Foreign investment in China typically occurs by way of establishment of a wholly owned entity on a stand-alone basis, formation of a joint venture with a Chinese partner or by way of a merger or the acquisition of an existing Chinese owned business.

In addition, a relatively recent development is for foreign investors confronted with restricted sectors to enter into contractual arrangements or hold restricted licenses in nominee company (this is known as a variable interest entity ("**VIE**") structure).

Greenfield projects

The main forms of FIEs for investing in a greenfield project in China are:

- Wholly Foreign Owned Enterprise;
- Sino-foreign joint venture.

Establishment process

The FIE establishment process has been simplified with the implementation of the FIL from 1 January 2020.

The FIL cut red tape and moved China from a prescriptive list of which sectors allowed foreign investment to a Negative List approach, and no pre-establishment approval or filing is required from MOFCOM.

Which authorities are involved?

A number of authorities interact with FIEs. The main ones include:

SAMR. SAMR and its local counterparts are in charge of company registration and filing. The SAMR is one of China's super authorities which regulates broad areas of the economy including market competition, monopolies, intellectual property and drug safety. For most foreign businesses setting up in China SAMR will be the primary government agency. Business sectors requiring special operational license or permits will also need to interact with the relevant authority in charge of such specific industry sector.

National Development and Reform Commission ("**NDRC**"). NDRC retains its authority to approve/maintain record filing of foreign investment projects. Industry authorities retain authority to issue industry specific licenses, for instance, ICP license in the telecommunication industry.

MOFCOM now has a less active role as the foreign investment process becomes more hands off. The move from approvals to a monitoring system through its information reporting system. This represents a significant change from the previous foreign investment regulatory regime.

Additional regulatory approvals will be required in sensitive/restricted sectors or those involving state-owned enterprises ("**SOEs**"). If SOE assets are involved, a formal valuation by a licensed appraiser of the relevant assets and approvals or filings from the State-Owned Assets Supervision and Administration Commission ("**SASAC**") and its relevant local counterpart will need to be obtained.

What are the trends?

As outlined above there is a trend towards reducing red tape. A key simplification is that a NDRC project approval is no longer required for the establishment of manufacturing FIEs in a non-restricted industry. Previously the NDRC project approval was a time consuming and uncertain standalone process.

In some localities it is possible to lodge a single application to obtain a comprehensive Business License that includes a unified registration number to cover all requisite certificates. This includes the Organization Code Certificate (originally issued by the Quality Supervision Inspection and Quarantine Bureau), Social Insurance Registration Certificate (originally issued by the Social Security Bureau), Company Stamp Carving Certificate (originally issued by the Public Security Bureau) and Tax Registration Certificate (originally issued by China's Tax Bureau).

Timing

It is rare for the Chinese authorities to cause a delay in establishment.

In most cases time-consuming aspects of establishing a FIE include agreeing the JV contract or shareholder agreement with the Chinese partner, or negotiating and entering a suitable leased premises for a WFOE; determining the business plan for the company. As such, appointing an individual with strong project management skills is often critical to success and helps expedite the establishment process. In most cases a FIE can be established within 1 to 2 months. Advance planning and coordination can help minimize disruptions throughout the process.

Choosing the right structure from the start...

JV or WFOE?

In sensitive industries and markets, restrictions on foreign investment mean that investors are limited to joint venture structures ("**JV**") with a Chinese partner. Many early JVs did not meet investor needs and were restructured – often due to insufficient due diligence, misaligned interests or management conflicts.

Key reasons for selecting a JV structure are:

- Legal restrictions (i.e. in certain restricted industries set out in the Negative List);
- Equity investment into an existing company with a shareholder that does not wish to exit;
- Reliance on a Chinese partner is deemed to be strategic or critical (JV contracts can contain a call option mechanism to transform the JV into a WFOE when conditions require);
- Private equity partner (in China it is common for private equity investors to hold a minority position).

Restructuring your business

Foreign investment has been flowing into China for over 30 years. As a result many foreign invested businesses are finding that their China operations no longer fit the current state of China. This has become even more pronounced due to the pandemic.

Many FIEs have excess business capacity; are located in areas that were previously industrial but now increasingly residential; or in some cases China has become just too competitive. For this reason many FIEs are considering downsizing or even exiting the China market.

On the other hand there are multinationals that are enlarging their footprint in China by taking stakes in Chinese businesses or cooperating with partners to build a stronger business through mergers and acquisitions (the "**M&A**"). The Negative List will apply to such M&A transactions and therefore these investments will need to comply with any relevant restrictions on foreign investment.

M&A transactions

While the number and scale of greenfield projects may be decreasing, M&A transactions have become an increasingly important route of investment in China by foreign investors. Typically such transactions are made by way of acquisition of equity interests/shares in or assets of a private company or a public company. Overall, M&A transactions in China follow a similar pattern to other jurisdictions. The main distinguishing feature may be certain that restrictions remain on foreign investment in certain sectors as set out in the Negative List. The acquisition of private companies (i.e. not listed on a stock exchange in China) is comparatively straightforward. Acquisition of public companies (i.e. listed companies) is more complicated and subject to stricter scrutiny and procedures (discussed in greater details in a separate chapter).

A comprehensive due diligence covering at least legal, financial and operational aspects is the first step in an M&A transaction. In light of increased enforcement activity on the part of the Chinese regulators, international investors are well advised to be concerned as to compliance risks associated with unfair-competition, bribery or corruption issues.

The new foreign investment regime is expected to boost M&A transactions as it has removed rules that while not designed to restrict M&A transactions did so in practice.

- **No substantial review of transaction documents**. A major advantage is that the competent PRC authorities regulating foreign investment no longer undertake a substantive review of the transaction documents. The substantive review and approval of transaction documents have caused uncertainty or at least a lengthy gap between execution of documents and closing of the transaction. This new move restricts the discretion of the competent authorities and means parties have far more flexibility as to how the commercial arrangements are structured.
- **No restriction on onshore equity investment using foreign currency in capital accounts**. Continuing relaxation of foreign exchange control in China will also boost M&A transactions by foreign investors by way of their local subsidiaries. The use of foreign currency in the capital account of FIEs (excluding special investment companies) was previously strictly restricted to operational matters and funds needed to be sourced by other means to finance onshore equity investments. In 2019, the State Administration of Foreign Exchange finally lifted the restriction on onshore equity investment using foreign currency in the capital account of a FIE. This long-awaited change not only represents another major step in the trend of relaxed foreign exchange controls but will also ease financing requirements upon FIEs when making further investments in China.

Despite encouraging trends for M&A transactions generally, the tightening of anti-trust filing/merger filing, which seems to be a trend in other jurisdictions as well, is an issue that foreign investors or their FIEs increasingly need to grapple with. M&A transactions meeting the below global or Chinese turnover thresholds trigger an anti-trust filing (this is equally applicable to greenfield projects). The turnover thresholds are low and easily triggered:

(i) the total worldwide turnover of all parties to the transaction in the previous financial year exceeded 10 billion yuan and the PRC turnover of each of at least two parties to the transaction in the previous financial year exceeded 400 million yuan; or

(ii) the combined PRC turnover of all parties to the transaction in the previous financial year exceeded 2 billion yuan and the PRC turnover of each of at least two of the parties to the transaction in the previous financial year exceeded 400 million yuan.

The anti-trust filing can significantly impact the timing of a proposed deal, particularly where the transaction does not qualify for a simplified filing procedure. A simplified filing procedure will generally take approximately six to eight weeks. Other procedures will take approximately 20 weeks. Increased coordination between competition regulators worldwide means that most sizeable M&A transactions will require a global strategy on the part of investors.

A further regulatory hurdle is that China has implemented a national security review for certain transactions. National security review is increasingly relevant as reforms have broadened the scope of "national security".

Other options

Contractual options

Contractual arrangements appointing Chinese partners to act as distributors or trading and sourcing agents may be appropriate where a foreign party wants to distribute and sell its products in China, or source input material for manufacturing or assembly overseas without having to establish a permanent presence onshore.

Franchising is an option for businesses seeking to launch and expand the market for its branded goods or services. Many defer to contractual distribution models given the regulatory roadblocks that accompany a franchise model in China.

VIE structures

One type of contractual structure that has exploded in popularity, and controversy, is the VIE structure. Where a proposed investment is subject to foreign investment restrictions (e.g. "value–added" internet services), parties commonly use a VIE to access the market. A VIE refers to a structure where a wholly or partially foreign owned entity enters into contracts with a Chinese operating company that has the approved business scope and holds the necessary licenses to operate in a foreign investment restricted or prohibited sector (Local License Company). The first well known VIE structure was adopted by the Chinese online media company, Sina Corp., in its 2000 listing on the NASDAQ. Other high-profile companies that have adopted VIE structures include China's largest internet companies Alibaba, Baidu and Tudou, interactive digital media advertising company Focus Media and education services company New Oriental.

To obtain control over the operation and management of the Local License Company, various contractual arrangements are put in place between the WFOE, the Local License Company and its domestic shareholders.

The controversy surrounding the VIE model stems from legal uncertainty inherent in its structure. No Chinese regulatory body has officially approved a VIE structure and controls have tightened over VIE structured candidates that wish to list on the Hong Kong Stock Exchange.

In recent years there have been several challenges by regulators based on allegations that VIE structures were used to circumvent industry investment regulations and restrictions. A well known example is the 2011 case where Delaware-based Buddha Steel was required to withdraw its registration statement for its US public offering because the Chinese authorities considered its use of VIE agreements to have contravened foreign-investment restrictions and were against public policy.

FIL and the FIL Implementing Regulations made a conscious choice to remain silent on the topic. Considering the large number of enterprises currently taking advantage of the VIE structure, the potential repercussion if the status quo was broken could be significant and would hardly support China's position as a champion of global trade and investment. So the silence in the new foreign investment regime on this point was widely expected.

Investing in China via Hong Kong

Structuring China-related investments through a Hong Kong holding company is another alternative and we have seen many foreign investors choose to do so. It can provide the multiple benefits, including:

- **Tax advantage**. Dividends received by a Hong Kong holding company from a Mainland subsidiary are unlikely to be taxable in Hong Kong, no dividend tax is levied on a Hong Kong holding company when distributing dividends to investors, and a lower income tax is levied on the Hong Kong company compared to its Mainland counterparts;
- **Flexibility**. There is greater flexibility to tailor multiple investors' rights and obligations and governance provisions in a Hong Kong holding company due to less restrictive corporate legislation;
- **Funds access**. As an international financial center, naturally, investors will have quick access to both domestic and international funds, under a stable regulatory framework; and
- **CEPA**. Qualified Hong Kong companies can take advantage of preferential treatment under the Mainland and Hong Kong Closer Economic Partnership Arrangement ("**CEPA**") to invest in areas that are partly or fully restricted to other foreign investors and enjoy favorable tariff treatment when export qualified products to the Mainland.

Acquisition of public companies

Over the past few years, regulators of the PRC securities market have reformed the securities regulatory regime to loosen various stringent approval requirements and make the capital market more accessible to investors. While mergers and acquisitions of public companies remain much more complex than private M&As, foreign investors now have better access to listed companies in China more than ever, and the market is witnessing an increasing number of acquisitions of public companies by foreign investors as securities market regulations continue to relax.

A. Key regulators

Acquisition of a public listed company in China will likely involve the following key regulators:

- **China Securities Regulatory Commission ("CSRC")** is responsible for formulating and implementing rules governing public M&A transactions in the PRC. CSRC approval is required for public offering and private placement of shares by public companies.
- **Shanghai Stock Exchange ("SSE")** and **Shenzhen Stock Exchange ("SZSE")** are the two stock exchanges in PRC Mainland, which have detailed listing rules in accordance with upper-level regulations issued by CSRC, and supervise listing and trading of the securities. Compliance of information disclosure is mainly monitored by SSE and SZSE.
- **SAMR** is the company registry of PRC and also responsible for merger control filing.
- **SASAC** is the PRC authority responsible for supervising activities of state-owned enterprises and disposal of state-owned assets. SASAC rules shall be complied with when the transaction involves public companies controlled by the state. Certain matters in SOEs are reserved for SASAC to approve, such as disposal of shares in a listed company exceeding certain threshold, or transactions resulting in change of control in any state controlled listed company.
- **MOFCOM** is one of the main PRC authorities administering foreign investment. In the context of public takeover, investment by foreign investors into PRC listed companies is subject to approval by or filing with MOFCOM under current regulatory regime, which is being reviewed by MOFCOM in light of the new Foreign Investment Law.

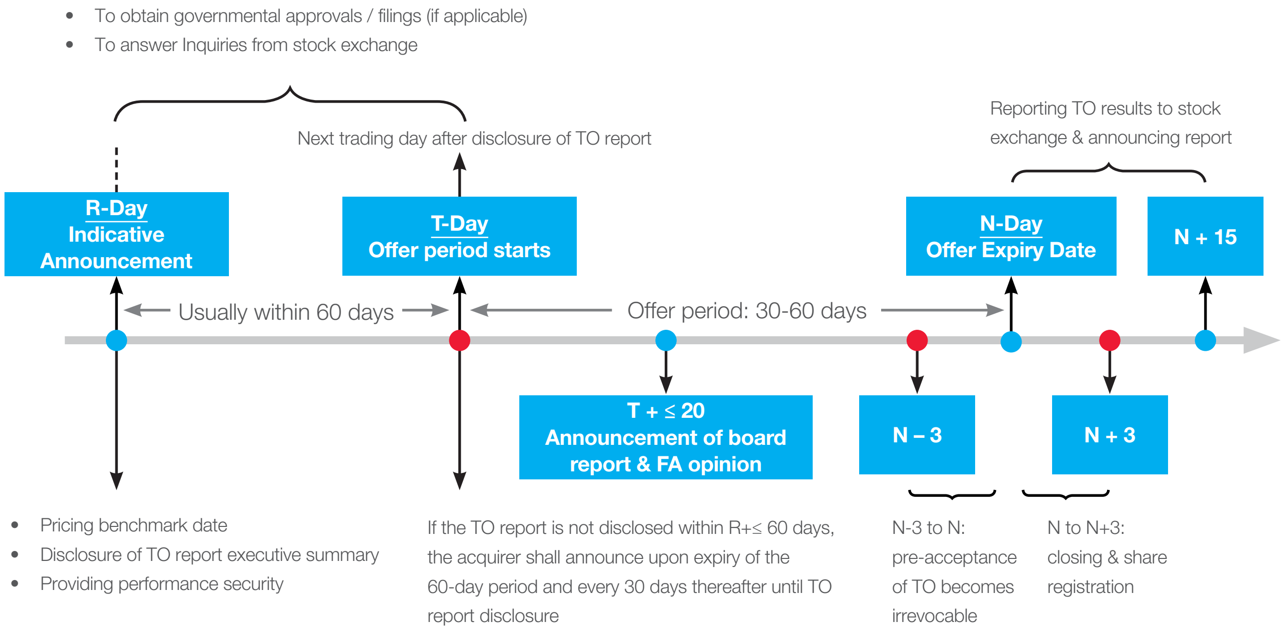
B. Acquisition methods

(i) Tender offer

Tender offer is a common way for acquiring control of a public company. The general principle for tender offer is to fairly treat all shareholders, and provide equal treatments to all holders of the same class of shares.

- **Mandatory general offer ("MGO")** is triggered if acquisition of shares in a listed company would result in the acquirer holding more than 30%, in which case the acquirer is required to make tender offer to all shareholders in the listed company. Certain grounds for exemption of MGO are provided under CSRC rules, such as acquisition of no more than 2% in 12-month period, acquisition via private placement approved by independent shareholders where the acquirer commits to a 36-months lock-up of its shares (i.e. the "whitewash" concept), etc.
- **Voluntary partial tender offer** is permitted if MGO is not triggered. The minimum stake to be tendered is 5%.
- **Minimum tender price** shall be the highest price at which the acquirer purchased any share in the listed company in the past 6 months prior to the indicative announcement of the tender offer.
- A tender offer report shall be prepared and disclosed by the acquirer before making the tender offer, in which the acquirer shall specify its acquisition plan, objects, number of shares to be tendered, offer price, conditions (if any), offer period, impacts upon the target, etc.
- There is no statutory right to squeeze out minority shareholders under PRC law, regardless of the stake of the majority shareholder.

Indicative timeline of a tender offer



(ii) Private placement

In a private placement, a listed company can issue new shares up to a number equal to 30% of its total share capital prior to the placement to no more than 35 purchasers.

A private placement of new shares would result in increase of registered capital of the listed company, which is subject to approval by 2/3 vote at the shareholders meeting by law. As such, if the stake of an acquirer becomes more than 30% shares after it subscribes for shares issued in a private placement, MGO would be exempted as long as the acquirer commits not to transfer the new shares it acquires for a "lock-up period" of 36 months, because the transaction would have been approved by the shareholders meeting (a.k.a. "whitewash").

A private placement is also subject to CSRC approval, which would involve substantive review and could take months in practice. In practice, the impact of the CSRC approval on deal certainty and timetable would be a key issue to be considered.

- The per-share price of the new shares shall be determined based on the volume-weighted average price ("**VWAP**") in the 20-trading-day immediately prior to the pricing benchmark date, and shall not be lower than 80% of the VWAP. For issuance to the controlling shareholder or its affiliates, or to a "strategic investor" defined by CSRC rules, the parties may also choose one of the following dates to be the pricing benchmark date: (i) the date of announcement of the board resolution approving the issuance (in which case the acquirer would be able to lock-in the price upon announcement of the deal); or (ii) the date of shareholders' approval of the issuance; and (iii) date of the issuance (a.k.a., the first date of the issuance period). For issuance to other investors, the pricing benchmark date must be the date of issuance.

The new shares issued in a private placement generally cannot be transferred for a lock-up period. For the investors specified which may choose one of the three dates to be the pricing benchmark date, the lock-up period shall be 18 months; for issuance to other investors, the lock-up period shall be 6 months.

(iii) Transfer by agreement

By entering into a written share purchase agreement ("**SPA**"), shares in a listed company can be transferred by private agreement between the parties.

The minimum stake to be acquired through a transfer by agreement is 5%. The floor price for each share in a transfer by agreement is 90% of the closing price of the lasting trading day prior to signing of the SPA. The parties are generally free to negotiate the purchase price subject to the floor price.

Sometimes public takeovers in PRC are done by transfer by agreement alone, but more often in combination with tender offer or private placement.

(iv) Trading on secondary market (i.e. collective bidding and block trade)

These are standardized transaction with high convenience conducted through securities trading system of the stock exchange, and are commonly used in combination with other methods of takeover. Currently there is no clear regulatory path for foreign investors to directly acquire shares in a PRC listed company through collective bidding and block trade, but PRC subsidiaries would be able to acquire shares in a PRC listed company through these methods.

Trading through collective bidding is at real-time price. The price range for block trade is 90-110% of the closing price of the last trading day. The parties to a block trade may agree on a price within this range by negotiation.

Investors who possesses non-public and price-sensitive information are generally required to refrain from trading on the secondary market.

(v) Indirect acquisition

Indirect acquisition of a listed company is also regulated by CSRC rules, which generally refers to transactions where the acquirer acquires interest in the shares of a listed company without directly acquiring title to shares, such as acquisition of control over shareholders in a listed company from upper level, or by taking control of voting rights of other shareholders by contractual arrangements. Indirect acquisition is subject to the same requirements for disclosure and suspension of trading as if the acquirer directly acquires shares in the listed company.

C. Disclosure thresholds

The requirements on disclosure and suspension of trading apply to all acquisitions, which are summarized as follows:

- **When interest of the acquirer reaches 5%, and whenever interest of the acquirer increases or decreases by 5% thereafter**, then within 3 trading days, the acquirer shall (i) disclose an interest change report (see below), (ii) report to CSRC and the stock exchange, (iii) notify the target company, and (iv) refrain from trading share of the target until expiry of another 3-trading-day period after it discloses the Interest Change Report.
- **After interest of the acquirer reaches 5%, whenever interest of the acquirer increases or decreases by 1% the acquirer**, then on the next trading day, the acquirer shall notify the target and disclose a simple interest change form.

If interest of the acquirer is to become 5% or more but less than 20%, the acquirer should prepare and disclose a short-form interest change report. If interest of the acquirer is to become 20% or more, the acquirer should prepare and disclose a long-form interest change report.

In both short-form and long-form interest change report, the acquirer is required to disclose, among others its basic information, structure of the transaction, source of funds, its trading of share of the target in past 6 months, and any plan for further increasing its stake in the next 12 months. The long-form interest change report would need to include additional information such as control structure behind the acquirer, competition and connected transaction with the target, any plan to restructure the target in the next 12 months, and material transactions with the target in past 24 months.

D. Approval/filing of strategic investment by foreign investors in PRC listed companies

Under current regulatory regime, except for limited carve-outs (such as investment by "Qualified Foreign Institutional Investor" with special approval), direct investment by a foreign investor in a PRC listed company is generally subject to approval (applicable to investment in a target business on the Negative List) or filing (applicable to investment in a target business not on the Negative List) with MOFCOM with respect to "strategic investment by foreign investors", and such approval/filing is pre-requisite for a foreign investor to open a securities trading account in the PRC.

Rules for strategic investment by foreign investors in listed companies were first introduced back in 2005 and later amended in 2015. Reform of the rules have been discussed for years and have been expected by the market to occur in 2020 after the Foreign Investment Law came into force on 1 January 2020. The latest consultation draft was released by MOFCOM on 18 June 2020 to solicit public comments ("**2020 Draft**"). Below we summarize key issues and requirements in the MOFCOM rules regarding "strategic investment by foreign investors", with contemplated changes in the 2020 Draft included for comparison, which have not been adopted but demonstrate MOFCOM's tendency for reforming the regulatory regime.

Issue/requirement	Current regulatory regime	2020 draft
Approval/filing	Approval/filing with MOFCOM is required, which is prerequisite for the foreign investor to open securities trading account.	Approval/filing with MOFCOM is no longer required, and no longer prerequisite for opening securities trading account.
Regulated methods of investment	Private placement and transfer by agreement	Private placement, transfer by agreement, and tender offer
Investor qualification	Total asset of the foreign investor shall be no less than USD 100 million, or the size of assets managed by the foreign investor shall not be less than USD 500 million.	Total asset of the foreign investor shall be no less than USD 50 million, or the size of assets managed by the foreign investor shall not be less than USD 300 million. If the foreign investor takes control over the listed company, the requirements would be USD 100 million / 500 million.
Verification of investor qualification	MOFCOM will review investor qualification.	Counsels/advisors engaged by the foreign investor and the listed company are responsible to verify investor qualification.
Lock-up Period	36 months	12 months
Minimum investment	The foreign investor in principle shall acquire at least 10% in the listed company.	No minimum shareholding requirement
Shareholder approval	Approval by the shareholders meeting of the listed company is required, regardless for form of transaction.	Approval by the shareholders meeting of the listed company is required only for investment via issuance of new shares.

Another key change is that the 2020 Draft has set out regulatory requirement for foreign investors to offer shares in non-PRC companies as consideration to acquire shares in PRC listed company, which is usually referred to as “cross-border share swap”. Up until now there is no clear regulatory path under PRC law for cross-border share swap, and successful precedents are very rare. The provisions in the 2020 Draft would create new possibilities for foreign investors to structure their investment in PRC listed company, for example, to inject its offshore assets into PRC listed company to subscribe for private placement to take over the listed company.

Glance at sectors: A market not just a factory

Over the course of the past 40 years, China has achieved rapid, sustained economic growth and is now the world's second biggest economy. Despite the pandemic it is likely that the "new normal" of 6% annual growth is still a realistic target.

Economic success has led to increasing living standards and purchasing power. Although this is good for China it does mean the old economic playbook needs to be tweaked as certain forms of manufacturing look for ever cheaper locations. The new economic playbook will inevitably push domestic consumption as being integral part of China's continued development.

Today the Chinese consumer represents much of the world's actual growth. This growth has led to new types of international investors targeting the China market, often as their number one global priority.

In this section we look at some of the hottest sectors for international investors – most target the Chinese consumer – healthcare, automotive, education, digital. The others reflect China's intertwined nature with the world – opening up of financial services and importing of technology.

Healthy China: China's healthcare industry

Recognizing the potential opportunities arising from China's aging population and increased demand for improved healthcare in China, healthcare industry is undoubtedly one of the most fast developing industries in China. With the dominant growth rate of disposable expenditure in healthcare industry by Chinese consumers, people are expecting high-quality while affordable medical services, which in turn has attracted investors from home and abroad. With outbreak of Covid-19, the healthcare industry will be more appealing for investors than ever.

New rules have been promulgated to introduce new trends and reform in pharmaceutical registration, procurement and distribution of drugs and medical devices, which imply investment opportunities for foreign investors.

Marketing authorization holder

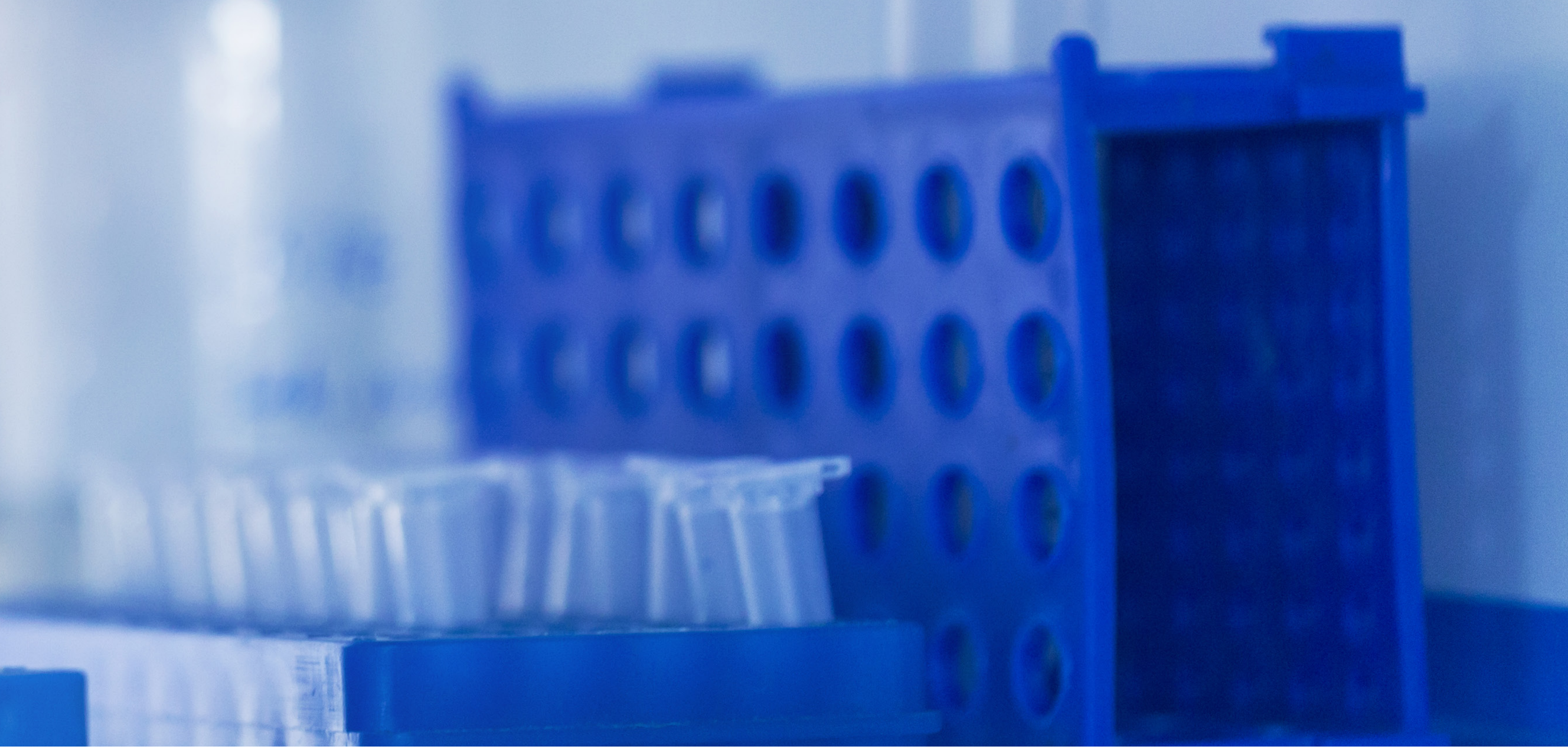
One of the most significant changes is the introduction of the regime of Marketing Authorization Holder ("**MAH**"). Under the Drug Administration Law amended in 2019, this MAH system has been operated in some pilot cities before it is adopted under the new law on a nationwide basis. MAHs refer to companies, drug research institutions and others that have obtained the drug registration certificates. A MAH is required to manage the full lifecycle of drugs, including R&D (non-clinical and clinical processes), manufacturing and supply, post-marketing study, adverse effect monitoring and annual reporting, etc. For a foreign MAH, the relevant responsibilities should be carried out by its designated onshore entity in China. A foreign company can also be a MAH under the Drug Administration Law provided that its designated business entity in China shall perform its MAH obligations and bear joint and several liabilities with the foreign MAH.

With the MAH regime, the holder of a drug market authorization can be separated from actual manufacturing activities. Specifically, a MAH can engage third parties for drug manufacturing and sale, though it is obligated to conduct periodical audit of the third parties' quality management system in order to ensure drug safety. This will have profound impact on the drug sector and allow more flexibility in contract manufacturing arrangements.

Foreign invested medical institutions

Although caught in the constant shifting of policy between encouraged and restricted, investment in medical institutions is still in the spotlight for foreign investment. Under the current Negative List, the form of foreign investments in medical institutions is still restricted to joint ventures and cooperative arrangements. Despite the restrictions, we have seen investors setting up various forms of foreign invested medical institutions.

And there are other positive changes, too. According to one of the guiding opinions issued by State Council to promote private invested medical institutions in 2019, the quantity and scale of public hospitals will be controlled to leave room for private investment in funding medical institutions. Public medical institutions are also encouraged to cooperate with private invested medical institutions. With the promotion of private invested medical institutions by the government, it is expected that joint venture, M&A and other forms of investment in medical institutions will be active in the following years.



E-Healthcare

This is an already growing market in China. Numerous start-ups, in collaboration with active healthcare investment funds, are developing a new “internet + healthcare” industry and testing both the market and regulatory tolerance as there is a lack of clear guidance.

With the development of e-Healthcare services, online sales of prescription drugs becomes to be a hot topic for discussion among regulators, pharmaceutical market players and consumers. Besides, several new rules regarding the data privacy and cross-border data exchange show that regulators also raise their concerns in field of data protection along with the development of big-data in the healthcare industry. Under the double scrutiny of two highly regulated sectors (healthcare and information services), foreign investors need to be careful when navigating through these new market opportunities among regulatory challenges.

Biologics

China has been left behind in the biologics industry for systematic reasons. To combat this, the Chinese government is encouraging spending in R&D. We foresee more joint development and various R&D collaborations to upgrade the biologics industry. For other pharmaceutical and medical device investors, further mergers and acquisitions are expected. The higher quality management standard being applied means a number of smaller players may be squeezed out, while larger players are looking to add to their portfolios and expand their capacity.

Compliance

Since 2017, a number of policy documents published to clarify the scope of academic promotion and the responsibilities of medical representatives. Medical representatives, who are usually responsible for drug promotion, should not undertake sales responsibilities, engage in collection of the quantity of the drug prescribed by the doctor, direct sales of physical drugs, receive payment, or deal with the purchase/sales invoice, among others. Vigorous internal compliance system and regular checks need to be in place to ensure compliance with the anti-bribery and anti-corruption laws in China.

Senior and infant care

The elderly population in China grows at an accelerating rate. The proportion of people aged 60 years and above is expected to increase to 487 million (about one third of the total population) by 2050 and the ratio for senior care consumption in 2015-2050 will increase from 7.33% to 26.24% of the GDP. With several policies promulgated for promoting the social capital to invest in the healthcare services, private hospitals have expanded quickly in the past few years. Moreover, the Chinese government implemented the two-child policy and is conducting stricter supervision and administration of infant formula food.

With the great potential in the market, we believe opportunities for foreign investment in senior and infant care industries will expand. Foreign companies operating in these industries can take advantage of the incentives provided by the Chinese government, adjust operation models to comply with regulatory documents and remain competitive in the Chinese market.

China's auto industry: A country on intelligent wheels?

China's auto market is in the doldrums after peaking in 2017 – it has suffered almost two-years of starkly declining sales and now the Covid-19 pandemic has crashed the already anemic sales and thrown global supply chains into chaos. China signaled its intention to play a central role in the future of auto manufacturing when 11 central level Chinese governmental departments jointly issued the *Strategy for Innovation and Development of Intelligent Vehicles* (the "**Strategy**") on 24 February 2020. Considering all the restrictions on the auto industry will be removed by the end of 2020, this may imply huge opportunities for foreign investors.

The Strategy has been warmly welcomed by China's auto market. It has laid out a comprehensive and detailed plan for the development of autonomous vehicles in China. China clearly recognizes the advantages it has in data, market, technology innovation and environment to build an autonomous car manufacturing titan. The Strategy also recognizes and seeks to address some of China's disadvantages – restrictions on mapping and slow changes to relevant laws. As a blueprint as to how the Chinese government will boost the development of autonomous vehicles over the next thirty years, its highlights are as follows:

We are all in it together - cross governmental cooperation

The Chinese government at local levels are united in pushing forward autonomous cars. This level of cross department involvement makes it clear that there is a consensus that intelligent vehicles will be disruptive and will also cut across crucial sectors such as automotive, transportation, telecommunications, mapping etc. Dealing with the disruption will require coordination between governmental departments.

Development trend

The Strategy makes it clear that intelligent vehicles are the future of the global automotive industry and that China is no exception. Rather than shying away from the disruption of a key pillar of industry the Chinese government believes China has strategic advantages in the development of intelligent vehicles – including the mass market; new technologies; 5G; infrastructure; Beidou satellite system; and smart city development level. However, it is not just China business that confers an advantage but also Chinese consumers and their willingness to adopt autonomous technology are seen as a strategic advantage.

Strategic vision

The Strategy provides an exciting but realistic vision that by 2025 a comprehensive system comprising of technological innovation, industrial ecosystem, infrastructure, regulations and standards, product regulating and cybersecurity has been basically established - all aimed at providing an ecosystem for intelligent vehicles to develop in China. By 2025 the goal is to have conditional autonomous vehicles (i.e. L3) in large scale production and high-level autonomous vehicles (i.e., L4 or above) commercialized for specific environment; smart cities will have intelligent transportation systems; and 5G should be

blanketing cities and highways. The second phase (2035-2050) – is understandably less mapped out. The goal is for the China standard intelligent vehicle system to have been fully completed, and that China has achieved its goal to be an intelligent vehicle powerhouse.

Key missions

The Strategy outlines certain key missions as pillars to support the realization of the development of the intelligent vehicles, including:

- **Open technology innovation system.** It aims to make breakthroughs in key fundamental technologies such as complex system architecture, environment perception, intelligent decision control, human-computer interaction and human-computer co-driving, vehicle-road interaction and cybersecurity, high-precision spatiotemporal benchmark services and basic maps for intelligent vehicles.
- **Ecosystem.** R&D in new areas such as high-precision automotive sensors; vehicle grade chips; and intelligent operating systems are encouraged, so is disruption. Both auto companies need to and components suppliers need to step up to facilitate development of intelligent vehicles. The Strategy encourages domestic and international companies to strengthen cooperation, jointly carry out basic research, technological development and commercialization, and encourage international companies to actively participate in the development of the intelligent vehicles in China. The Strategy also envisages international industrial cooperation platforms and intends to reinforce the international mutual recognition and adoption of certification and accreditation results.
- **Advanced infrastructure system.** The intelligent infrastructure for intelligent vehicles to be built include intelligent road infrastructure, 5G commercial applications, wide-ranging wireless communication network for vehicles; and narrowband Internet of Things in bridges, tunnels, parking lots and other transportation infrastructure. High-definition ("**HD**") map is a crucial technology in autonomous driving technology. However, in China, mapping activities are strictly regulated due to national security concerns. So the development of basic maps for intelligent vehicles as set forth by the Strategy is an effort by the Chinese government to meet the needs of HD mapping in the market by relaxing regulations in mapping activities.

Financial and capital market: Opportunities or challenges?

Under the current Negative List, all the restrictions on the foreign investment in the financial sector have been lifted in 2020, one year earlier than expected by the market. In addition, the past years also saw encouraging reforms in the capital market worth highlighting, including launch of the registration system under the amended Securities Law. As the second largest economy in the world, these changes imply both huge opportunities as well as daunting challenges for foreign investors.

Financial market

Foreign shareholding in a securities company, a securities fund management company, a futures company or a life insurance company used to be capped at 51% before the latest Negative List was issued on 23 June 2020. The long-awaited lift of such restrictions means there will be no foreign shareholding restriction in any sector within the financial services. In other words, foreign investors can establish their wholly owned subsidiaries in these sectors. Echoing the FIL, the general trend is to grant the national treatment to foreign shareholders through measures such as lifting the foreign shareholding restriction, unifying the market entrance requirements and permitting the foreign invested financial institutions to engage in more lines of business.

China Banking and Insurance Regulatory Commission ("**CBIRC**"), regulator of the banking and insurance sectors, also announced further changes to be rolled out to establish a more level playing field for foreign investors. The highlights of the changes are as follows:

- **Banking.** The majority are in respect of opening up of the banking sector, including (i) removal of shareholding limit on both foreign and domestic banks when investing in a PRC commercial bank (in practice, the previous shareholding of a single shareholder is limited to 20%); (ii) removal of asset requirements for foreign banks to set up PRC registered banks (current threshold is USD 20 billion) and branches (current threshold is USD 10 billion); and (iii) removal of the requirement that the foreign investor would need to cooperate with a Chinese financial institution in a Sino-foreign joint venture bank. Accordingly, this change greatly expands the pool from which foreign investors can select a Chinese partner and removes the requirement to co-operate with a competitor.
- **Insurance.** The proposed regulatory changes in the insurance sector are also significant, including (i) allowing foreign financial institutions to invest in foreign-invested insurance companies; (ii) allowing foreign insurance group to establish and invest in insurance-related companies (this carries forward the trend of further relaxing foreign investment in the PRC insurance sector); (iii) allowing foreign-invested insurance companies to establish insurance-related companies as promoters on a level playing field with PRC insurance companies; and (iv) encouraging foreign financial institutions to invest in non-SOE insurance companies.

Some foreign investors are optimistic about the changes and have tried to ride the tide. Allianz, a German insurance company, received the first-ever approval by CBIRC for preparatory establishment of 100% foreign insurance holding company in November 2018 and Standard & Poor obtained the first CRA license for a foreign-invested company on 28 January 2019. In the long run it is increasing flexibility in the financial sectors that will likely see international companies playing a larger role within the Chinese market.

Stock market

The stock markets have seen steady growth, with a total of 201 IPOs filed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange stock exchanges in 2019, indicating a 91% increase from the previous year. It is anticipated that the stock markets will continue to grow in 2020, particularly with the full implementation of the IPO registration system.

The registration system may be one of the most significant changes for the Chinese stock market and will replace the case-by-case approval system that has granted great discretionary power to the regulators. The launch of the registration system, together with enhanced disclosure requirements and investor protection rules, will surely help build a comparatively market-oriented capital market and increase the appeal of China's capital market to foreign investors. However, how the registration-based IPO regime is to be rolled out (for instance, one similar to that adopted in the U.S. capital market or a quasi-approval one) remains unclear as State Council is designated under the new law to draft and issue the registration rules.

Other major changes that affect the stock market can be outlined as follows:

Official launch of Science and Technology Innovation Board ("STAR Market").

The STAR Market is designed to broaden the financing channel of growth-oriented technology innovation enterprises and was officially launched in July 2019. More flexible arrangements are permitted for companies in the STAR Market, for instance, the absence of a daily limit on price movement during the first five trading days and possibility of pricing their shares at a valuation exceeding 23 times their last earnings. The STAR Market is expected to boost the growth and development of technology companies in China.

Shanghai-London Stock Connect.

The Shanghai-London Stock Connect has been successfully launched on 17 June 2019, following the successful launch of the Shanghai-Hong Kong Stock Connect in 2014 and Shenzhen-Hong Kong Stock Connect in 2016. Shanghai-London Stock Connect brings together one of the world's largest domestic capital markets with the world's leading international market, enhances financial cooperation between China and the UK, and expands the opening up of China's capital market. With the Shanghai-London Stock Connect, SSE listed companies can issue Global Depositary Receipt ("**GDR**") representing both existing and newly issued shares under the westbound business to raise capital, and can keep the capital raised in foreign countries and use it directly for foreign investment. It will increase China's attractiveness as an investment hub and with stabilizing growth and the various regulatory reforms underway, Chinese capital markets will maintain their advantages and play a greater role in global capital markets.

Technology: New opportunity for foreign investors?

China is well-known for its appetite for foreign technology. This remains true after China has become a technology superpower. In the post-Covid-19 world, we will almost certainly see increased rollout of technologies used during the crisis. Drone technologies in logistics, digital applications in healthcare, remote working platforms and online education are natural starting points for the new China technology revolution. All this without mentioning the increased appetite for digital delivery of entertainment such as video streaming, personal development (e-learning), social/chat technology (keeping up with friends and family), videogames (mobile, computer and console) and more.

China has realized that it will need to continue to deploy cutting-edge technology into its economy. Demographics are moving against China and therefore it cannot rely upon factories alone to drive growth.

China as an innovator … and disruptor

The growing concern for China's reliance on foreign technology prompted launch of a number of technology driven initiatives. The most famous being "Made in China 2025" - a 10-year strategy launched in 2015 to modernize China's industrial capacity and secure China's global competitiveness in the high-tech industries (such as robotics, aviation and new energy vehicles, etc.) for decades to come.

Despite this local innovation, a sizeable appetite remains for foreign technology. China's demand for foreign technology has always been relatively high, but in the new post-COVID19 world, we are likely to see increased demand for a variety of technologies. Technology comprises of 21% of China's imports, totaling $449 billion in 2018 and it is grew by 19% year-on-year. Technology imports is the largest part of China's total import pie. The sources of technology are highly concentrated geographically – 65% from the United States, Japan and Germany. Key sectors include transportation, communications, computer/electronic equipment, chemicals, and advanced equipment manufacturing. Semiconductors alone have annual imports totaling over $300 billion.

In this new technology era, large domestic technology companies like Alibaba, Tencent, JD, Huawei, Baidu, etc. have already began increased rollout of digital services to meet the public demand and access to online features. Chinese tech startups are also rising to meet the demand, for instance Bytedance (streaming platform debuting Chinese feature film Lost in Russia since theatre closures).

China as a market and a partner

China is the largest or second largest market in almost all sectors. As such, China is too big to ignore for international companies. However, many European and US companies find China is a challenging market for a variety of reasons. These

include regulatory and cultural differences but also concerns about intellectual property rights and compliance. Many of high tech companies are happy to have a Chinese partner but less keen on a Chinese owner.

At the same time many Chinese companies have found overseas acquisitions to be frustrating and challenging. There is a growing sense amongst many Chinese investors that it may be easier to import technology into China via technology license or joint venture rather than attempt acquisitions that have never been easy but are now occurring against an increasingly hostile overseas jurisdiction. At the same time many Western tech companies are intrigued by the massive opportunities of the Chinese market but are deterred by what they see as being a very challenging and different market. These Western tech companies often feel confident in dealing with the Western markets (i.e. Europe and USA) but seek a local partner for China.

Solving the dilemma: finding a new way forward

The dilemma is how can Chinese and foreign companies alike collaborate in tech and have access to markets while avoiding regulatory and implementation challenges? Somewhat surprisingly, the joint venture may be a possible solution and for this reason we believe the Sino-foreign joint venture is posed to make a comeback. The most likely questions for such joint venture projects will be:

- **Attracting Chinese investors.** There is great appetite in China for the right technologies. Hot sectors include autonomous cars, AI, big data, and robotics to name a few. Additionally, Chinese local authorities are highly motivated to attract the right kind of technologies to their regions. Many of these tech heavy projects have a lead investor that has a close relationship with the local government. For the right projects local authorities are willing to shower companies with subsidies and preferential policies.
- **How to structure?** Structuring the joint venture will require consideration of whether there are any restrictions on foreign investment in the sector and what is the favoured exit. The most traditional option is for the international and Chinese partner(s) to establish an operational joint venture in the Chinese Mainland. If the intended China business strays into areas that are restricted to foreign investment (for example value added telecoms), then the China entity may need to be either a joint venture or the structure may include a VIE. A VIE is a structure whereby the business that is off limits to foreign investment is placed in a captive entity that is bound contractually to the joint venture or WFOE. The advantages are that it will be easier for Chinese investors to invest; and the exit may be more lucrative.

  We have seen some companies establish a Hong Kong holding company for the technology license and have this company establish a wholly foreign owned enterprise ("**WFOE**") that operates in the China Mainland. The Chinese investors would then participate at the Hong Kong SAR or China Mainland level. The main reason for interposing a Hong Kong structure is to either have an Asian wide holding structure or if there is an intention to have investors from beyond China involved or that an exit is planned on the Hong Kong exchange or due to tax considerations or familiarity with the Hong Kong legal system.
- **How to protect the technology?** Both foreign and Chinese investors need to be very clear at the outset about what technologies will be contributed to the JV and what will not; whether the technology will be contributed to the JV via license or assignment, etc. Outlining the scope of technology and type of contribution is crucial to determine possible infringement and thereby seek for protection in the future. In addition, foreign companies and the Chinese investors or strategic investors will have a strong interest in ensuring that the JV obtains hi-tech status, which would greatly facilitate the JV's development and secure multiple preferential policies (especially much lower income tax rate for the JV). Such hi-tech status will require certain core technologies to be owned at the JV level. Technology transfers will be sensitive while it is common for foreign companies to encumber IP assets. Obtaining control over the JV, especially the technology-related position, will also help supervise the JV's use of the contributed technology. On the other hand, protecting technology from third parties is equally, if not more, important.
- **How to exit?** Unlike most traditional joint ventures, these new technology centric joint ventures are often focused early on in respect of the favoured exit. The reason being is that the Chinese joint venture may well develop distinctly from the foreign company in its traditional markets. The most common possible exits are listing, strategic sale or, upon satisfaction of certain requirements such as a proper capital decrease proceedings, equity redemption.

Education: A goldmine

The education sector is increasingly seen as a potential goldmine for foreign investors looking to capitalise on the rapid expansion in both industry size and market activity. The size of the industry in 2018 was nearly RMB 2.68 trillion, and expected to increase to nearly RMB 3 trillion in 2020. The rising middle class and the implementation of China's two-child policy means the largest market for education in the world can only be expected to grow.

The State Council's Guiding Opinions as well as the Five-Year Plan indicate that China will encourage non-governmental players, including foreign investors, to participate in the education industry through independent investment, joint ventures, partnerships and other arrangements. It is evident that overseas education companies, particularly those with an emphasis on innovation, will have the opportunity to invest in the growing Chinese market.

Investment strategies

There are three main strategies for investing in education: establishing an educational facility in the country, cooperating with local partners, and utilizing a structure that allows for advertising and the recruitment of students without a campus in China. The appropriate structure for a company investing in education in China will depend on the strategy chosen, as legislation and regulations will largely differ.

Establishment of educational facilities

Compulsory education is still a prohibited area for foreign investors despite China has gradually begun to open its education market. So under current regulations foreign investors can only operate non-compulsory education institutions (e.g. pre-schools, senior secondary schools, universities, vocational school and training centers). Chinese partner institutions are required to hold majority control if the education institution is a pre-school, a senior secondary school or a university.

The limitations imposed by Chinese law mean that a foreign educational provider wanting to provide courses or teach students in China must establish a Sino Foreign Cooperative School. This is effectively a joint venture between a recognized foreign education entity and a Chinese entity. Such a venture must comply with the *China's Guidelines for Running a Sino Foreign Cooperative School,* which include guidelines pertaining to equity ownership, board composition and the reinvestment of profits. The aforementioned regulations do not apply where the school is exclusively for the children of foreign workers.

To resolve the restrictions on foreign investment in the education sector, some foreign investors adopted a VIE structure. VIEs are domestically incorporated entities held by nominees and controlled by the foreign entity by means of contractual arrangements. Under a VIE structure, the "controlled" domestic entity obtains the requisite licenses to operate the education business and contributes its profit to the foreign investor by s set of services agreements. It is worth noting that the recent legislation trends reveal a negative attitude towards the VIE structure in compulsory education as well as the non-profit pre-schools, but there is no substantial regulatory change to other education institutions so far.

Cooperation with local partners

The second investment strategy is to cooperate with local partners in China. Typical cooperation arrangements include use of brand, providing support on curriculum, management, corporate governance, advising on educational issues and etc. Such investment model is relatively straightforward to ensure that no issues regarding foreign investment restrictions will be triggered or involved on the one hand, and steady revenue generated in the form of license fee for foreign investors on the other hand. With this option, two matters are extremely crucial: (i) a local partner with resources that can be trusted and is willing to cooperate; and (ii) a properly drafted and negotiated development and license contract. They are equally

important, and their importance can never be overstated as the cooperation is a long term one and may last for two or three decades. Needless to say, a clear branding strategy and vigorous IP protection measures are also among the top issues to be considered by foreign investors when exploring the cooperation model.

Consulting company

If the purpose of establishing a presence in China is primarily to build the presence of the education provider without directly or indirectly running schools or providing education-related services as mentioned above, a wholly owned consulting company may be the appropriate strategy. A consulting company is unable to provide courses or issue degrees. However, they are able to recruit students, develop internships and exchange opportunities, and advertise the services and courses they provide in their home country. Given the exponential increase in the number of Chinese students seeking overseas education, the ability to advertise to and recruit these students, without the financial investment or regulations that comes with establishing a campus overseas, is a significant advantage.

Potential growth opportunities

- **Online education**. The past five years witnessed a boom in the online education sector in China with annual revenues increasing from RMB 122.54 billion in 2015 to RMB 435.8 billion (forecast) in 2020. The rapid expansion is attributable to consumers' love of the internet, the continued growth of the middle class combined with the high regard in which education is held in China. This trend undoubtedly will continue, in particular after the outbreak of Covid-19.

  However, as a sector combines two highly sensitive areas of the Chinese economy – the internet and education - online education involves various licenses (for instance, ICP license for providing value-added telecommunication services). This is not going to be an easy road, if not mission impossible for foreign investors, because of difficulties in obtaining the required licenses. We have seen cases where some offshore listed online education companies adopt the VIE model discussed above to circumvent the regulatory hurdles. As an alternative, some companies are operating a "purely" offshore model to distribute online education services to Chinese students. From a practical perspective, it is difficult for the PRC government to exert any substantial supervision over a website whose servers are situated outside of China. However, the offshore model is not fully compliant, and does still face restrictions under PRC law in respect of interaction with Chinese consumers; issues with transfer of funds out of China; invoicing; permanent establishment risk, privacy etc.

- **Early childhood education**. Since November 2018, the investments in pre-school education (which is understood to refer to the kindergarten) have been dropping sharply due to the State Council's policy preventing social capital flowing into the pre-school education sector. However, literally speaking, the early childhood education segment, covering the years of 0-3, is still an accessible market for foreign investors. Under the current legal framework, early childhood education does not fall within the scope of pre-school education. Unlike kindergartens, early childhood education centers provide mostly parent-child activities rather than academic education. With the increasing demand for early childhood education centers, especially in the first-tier cities such as Beijing, Shanghai, Shenzhen and Guangzhou, the market size is expected to increase to more than RMB 300 billion in 2020. This highlights a gap in the market that foreign investors can potentially fill. Importantly, as early childhood education is not classified as pre-school education, the restrictions in the education sector outlined above are not applicable.

Cosmetics: Beauty in China

On the one hand China represents the single greatest market in the world for cosmetics – and one that is still growing at 10% a year. And there is more to come with a new high spending generation of Chinese consumers eager to look their best and with the disposable income to do so. On the other hand, China still requires animal testing for cosmetic products which may lead to a consumer backlash in established Western markets (such as Australia, Canada, European Union and many others which have banned animal testing). All international cosmetics brands need a China strategy – so how to deal with this dilemma?

Although the situation is improving, and the new *Regulations on Supervision and Administration of Cosmetics* (<化妆品监督管理条例>) will be enacted from 1 January 2021 to replace the existing regulation, it remains unclear if and when China will fully ban animal testing. Accordingly, until a full ban is in place international cosmetics brands will need to consider to what degree they are comfortable in entering the Chinese market. The most common ways international cosmetics brands skirt animal testing are either local (often limited) manufacturing or cross border e-commerce (see next section).

Going local

All cosmetics imported into China by way of general trade are required to conduct animal testing. There is, however, a range of products (non-special purpose cosmetics) that can be produced domestically without animal testing provided a risk assessment has been passed. Non-special purpose cosmetics are largely ordinary cosmetics other than products such as hair dye, perming, spot removal, skin whitening, sunscreen, hair prevention and other products which claim to have new functions.

This solution to avoid pre-market animal testing has been available for years but in practice rarely pursued. Many international cosmetics brands decided the potential reputational damage was too great due to the risk of post-market testing coupled with concerns about whether their Chinese suppliers would strictly comply with no animal testing requirements.

Increasing interest in local manufacturing is mainly due to initiatives in zones where the authorities are very clear about the importance of excluding animal testing; increased transparency in the supply chain; and authorities increasing reluctance to use animal testing. Brands wishing to manufacture cosmetic products locally in China can elect among the following three options:

- **Local manufacturing factory in China**. Perhaps the obvious way for an international cosmetics brand to produce locally in China would be to set up a dedicated factory. However, this can be time consuming and capital intensive. In particular, cosmetics manufacturing is technically challenging and requires a series of operational licenses. The days when international companies established manufacturing operations in China to profit from lower production costs and loose local policies are long gone. Increasingly international brands are establishing manufacturing operations in China to access the local market rather than to export.
- **Outsourcing manufacturing to an OEM**. OEM contracts has been a popular way for international companies in a variety of sectors to localize production in China. Cosmetics are no

exception. The OEM option is appealing in a number of ways. Firstly, working with an OEM is a much quicker and less capital intensive approach compared to setting up one's own manufacturing capacity. Secondly, in practice the local OEM will help substantively shorten the supply cycle to the local market. Thirdly, the OEM's insights, detailed knowledge on local consumers and local connections can provide a closer perspective for international brands to understand the local market.

In practice, a cosmetics product can be considered domestically manufactured if at a minimum the bottling process has conducted and completed in China. Therefore, it is easier and more straightforward for international cosmetics companies to qualify their products as "domestic" by ensuring the crucial "local" element with the final bottling is done by a local manufacturer within China. Such approach, while enabling international cosmetics brands to enjoy an exemption from animal testing will also ease concerns international brands may have about the OEM model such as IP protection and quality control.

- **Private label arrangement**. Another option for an international cosmetics company is to have a private label arrangement to with a ready-made, tailored product manufactured locally. This is more suitable for international brands whose business intention is to have a new product line in China within a relatively short timeframe or to expand its brand awareness in the local market in a cost-efficient manner.

  As mentioned above, the private label arrangement, similarly to the OEM option, requires vigilance in the protection of intellectual property (mainly trademarks) rights of the international brand. From a legal perspective, it is important to ensure the relevant contracts provide maximum protection and in a worst case scenario that maximum possible remedies can be sought.

E-commerce

Cross-border e-commerce ("**CBEC**") is an alternative way for foreign cosmetics companies to enter the Chinese market while keeping their current production arrangements in place (i.e. outside of China). Cosmetics products shipped through CBEC are exempt from filing and registration requirement and thus no animal testing is required.

Under the CBEC model, a foreign cosmetics company selling to Chinese consumers, as the CBRE retail importer, shall be responsible for product quality control, consumer protection, product safety and must appoint a qualified domestic company to be responsible for relevant declarations and such local company shall be jointly and severally liable for any civil liability with the foreign cosmetics company. Relevant government authority will supervise the actions of CBEC retail importers and may impose liabilities for their wrongdoings. The CBEC retail import must be carried out using either "direct purchase import" or "bonded purchase import" model.

"Direct purchase import" means that the relevant customs formalities will be conducted and the products will be shipped after an order is placed on the e-commerce platform. In comparison, "bonded purchase import" is much faster and less costly for international cosmetics companies, because under this approach, the foreign products should have already arrived in a special bonded zone (e.g. Shanghai Waigaoqiao Bonded Zone) and will be released and delivered to the consumers upon completion of the requisite customs formalities for import after orders are placed online.

Both options can result in avoiding (at least to a degree) animal testing on cosmetic products. The advantages and disadvantages of domestic production and e-commerce need to be evaluated from a business perspective. Domestic production is likely needed by any brand with massive plans for the China market.

Digital

China's digital opportunity

Due to outbreak of Covid-19, people in the business world probably joined and will join more video calls in 2020 than in the rest of their life put together.

The shift to a digital lifestyle has gone beyond surfing the internet. Across all metrics (age, location, social class, income level, etc.), digital is changing how we work, consume entertainment, learn, shop and communicate. Soon most companies will need to transform into digital companies at least in part.

Overview of digital opportunities

For some, the shift to digital may be a temporary answer to a temporary problem of Covid-19. But this is probably wrong. Many businesses will rather see how they can harness the lessons learnt to be ready for a more digital world.

In China's digital is transforming business (in both the State and private sectors):

- Traditional brick & mortar retailers driving their online promotions and ecommerce sales;
- Education companies, schools and universities establishing eLearning curriculums, utilizing edtech and offering accreditation programs digitally;
- Creative industries (gaming, museums, film/TV, marketing, etc.) adapting how their products are consumed digitally;
- Robotics (healthcare, autonomous vehicles, drones, supply chain, etc.) as China shifts from the world's factory to a technology driven economy;
- Data centers storing, handling and transmitting electronic information for all the above examples domestically and internationally; and
- Communication – this is not limited to video conferencing but exhibitions, PR events... indeed all forms of communication.

In addition there is huge scope for technology companies to build the infrastructure, cloud services, digital storage, managing membership accounts and personal information, developing office collaboration systems and offering a wide array of digital services and products at an unseen scale and speed.

This trend towards digital existed well before Covid-19 appeared on the scene. National initiatives such as "Made in China 2025" also had a focus on digital as part of a strategy to modernize China's global competitiveness in high-tech industries. China's role in these fields have not been limited to strategy papers and discussions, China is a leader in future technologies such as 5G, AI and big data just to name a few.

While China may be promoting a surge of indigenous innovation and R&D, there is no doubt that foreign technology will play a critical part of China's digital aspirations. Joint ventures, M&A, license agreements and other forms of cooperation will undoubtedly rise to meet demand.

Overview of challenges

Digital in China is a great opportunity for international and Chinese companies alike. However, digital's ability to touch consumers, share information instantaneously, allow remote access, control crucial infrastructure all means that regulation and oversight by the authorities is required.

Like most countries, China's regulations on digital products, services and applications are not covered by a single, all-encompassing law. The degree that your business will be regulated or how strictly you are subject to oversight will, logically enough, depend upon what you are doing.

At one end of the scale a brand wishing to establish its own direct ecommerce storefront (i.e. for its own products) in Mainland China will face light regulation such as:

- Operating a website in China (subject to ICP Filing regulations);
- Operating an App in China and listing on the various Chinese App Stores (a variety of App regulations and policies exist);
- Dealing with the collection, storage and transmission of consumer information (this will entail privacy protection, issues in respect of the offshore transmission of personal data).

Although this looks somewhat concerning in practice the requirements are easy to fulfill and tend to be less onerous than Western jurisdictions. For more technology focused businesses, additional challenges may arise:

- Is the business scope limited or restricted in China (e.g. banking, education, businesses requiring ICP Licenses, "critical network operators", critical information infrastructure etc.)?
- What licenses are required for the intended operation? Can such licenses be legally obtained by a foreign invested enterprise? Can they practically be obtained? If difficulties exist in obtaining licenses is a VIE a possible workaround?
- What are the potential liabilities/risks for non-compliance in respect of licenses or operations?

For many companies the main issues are not specific legal points but rather structural issues. Much is bespoke to the specific business. There is much nuance in how each business will approach and structure their solution for China. Main structural issues to be considered when they need addressing how to do business digitally with China include:

- **Offshore model** – Is it possible to provide the services to China remotely – that is an offshore model? What limitations does an offshore model entail for the business; what onshore structure should be utilized; what licenses am I eligible for and are required?
- **Onshore model** – Almost any ambitious company will at some stage need to be able to offer its services onshore. When going onshore the main issue is to consider what specific licenses are required to operate.
- **Data** – Data is understandably a highly sensitive issue globally. It will be important for companies to consider whether their business complies with China's cybersecurity law; what are the potential issues when collecting data in China? Privacy concerns? Who owns the data? Can the data be transferred offshore?
- **Intellectual property** – first-to-use versus first-to-file; what about any existing patents? Trademark filing is relatively inexpensive; is my trademark registered in China? Should I have a Chinese version? Do I need to reveal my source code to protect my IP in China?

Common-sense approach to PRC digital laws

The above list of questions may be unsettling to most international companies. However, with limited exceptions these issues are relatively easy to deal with.

Although there is no shortage of journalists in the West screaming that the sky is falling every time a new regulation is passed in China, especially so if the regulation is related to digital or data. As a result many international companies have a preconceived (and often incorrect) view that PRC regulations are onerous to comply with, intrusive and unreasonable in scope. In most cases much of the regulation which is of primary concern does not apply to their business. Ironically, while worrying about irrelevant bogeyman the international companies end up being unprepared for the regulations that actually do apply to them.

So how can international companies separate hype from fact and identify the legitimate legal and commercial obstacles? The answer to this crucial question is unfortunately ... it depends. An international bank will be impacted in a very different way from a cross-border technology company bringing a tech product to China or a brand setting up an ecommerce sales channel.

For technology and digital-centric businesses we suggest issues to consider include:

- How to deal with large Chinese SOEs or businesses in sensitive sectors (such as financial sector; infrastructure; telecoms; medical etc.) can impact how data can be dealt with and the role of the PRC government and restrictions international companies will face;
- Understanding business contingency risks and potential impact to your revenue (i.e. authority prohibits further use of your companies' services/product; if you are blocked from procurement; security checks);
- Data localization requirements mean utilizing new data services in China or renting from local server providers (e.g. more likely Huawei, Tencent or Alibaba than Amazon);
- Bringing data under Chinese jurisdiction does elevate risk of prosecution if you violate China's digital laws; and
- PRC policy of promoting indigenous innovation is a concern for those that do not wish to divulge IP (like source code) to the PRC government due to concerns what may happen to that data once released.

For most businesses generally, the most commonly encountered issues are:

- How is user data collected?
- What are the primary techniques or channels used to acquire data?
- Are there explicit prompts for the user?
- Are we authorized to collect data? What is the scope of authorization?
- What internal control systems are in place?
- Should we report to authorities? Do we require licenses?
- Who owns the data?
- Are our procedures standard similar to other companies in the industry?
- What backup measures are in place?

Embrace challenges

The digital economy is booming in China. However, digital is not just an opportunity in many ways it is an evolutionary test – embrace digital and succeed or ... do not and wither.

This change in attitude will impact both companies that are digital by nature (i.e. SaaS companies) as well as those that are digital in part or as a complement to their main business (i.e. education or health apps).

Although digital companies are varied the challenges they will face are remarkably similar. Will they provide their services via an offshore model or an onshore model? How to deal with data? What licenses do I need? Do I need a partner? How can I connect to the PRC's wider digital eco-system? The good news is that for most companies the legal challenges are actually less onerous than expected. The main issue is to work out how best to enter the market.

Initiatives: China doubles down on globalization

Great projects: Belt and Road Initiative

The Silk Road Economic Belt and the 21st-Century Maritime Silk Road (previously known as "One Belt, One Road") was first raised by Chinese President Xi Jinping in 2013, as a government initiative to deepen relationships, increase connectivity and encourage trade liberalization around the world. The expansive project includes South East Asia, the Middle East, Europe, and Africa (and even touching South America).

The initiative is to build infrastructure projects to revitalize the historic Silk Road trade routes with an overland "Belt" and with a "Road" that creates a new maritime route through South East Asia.

Data from the Chinese government shows that from 2013 to 2018, the total volume of trade between China and other Belt and Road economies surpassed US$6 trillion, accounting for 27.4 percent of China's total trade in goods. A World Bank study also points out that the Belt and Road Initiative has increased trade flows among participating economies by over 4 percent. In addition in the same time China's direct investment in the Belt and Road countries surpassed US$90 billion and a US$400 billion worth of foreign contracted projects in these countries.

The scale of the Belt and Road initiative has significantly boosted international trade and investment and has therefore created great opportunities for participation by both Chinese state-owned enterprises ("**SOEs**") and private companies as well as foreign enterprises and entities.

Foreign participation in projects along the Belt and Road

The investment projects by Chinese enterprises in Belt and Road countries have also led to new opportunities for international companies. Leading US equipment manufacturer, Caterpillar Inc. has carried out cooperation with Chinese SOEs on a variety of projects in over 20 countries along the Belt and Road, including cooperation in the form of signing strategic cooperation agreement with Chinese SOEs regarding equipment sales/leasing and technical support and even providing project financing for certain Chinese enterprises. In addition European countries are also actively working with Chinese enterprises on Belt and Road projects, a notable example is the ABB Group headquartered in Switzerland which has participated in EPC projects carried out by Chinese enterprises in over 70 countries by providing technical consulting services as well as supplying equipment.

Participation in cross-border financial cooperation

Foreign banks, managed funds, investment funds, private equity and insurers are important sources of capital and financial expertise for Belt and Road projects. The Belt and Road initiative has led to innovative funding models such as the state-owned China's Silk Road Fund. An example of such innovative financing including foreign parties is the General Electric Energy Financial Services' establishment of a joint energy infrastructure investment platform with the Silk Road Fund in November 2017. This fund allows joint financing projects in Belt and Road countries in the fields of power grid, new energy, oil and gas.

Investment in China's domestic projects related to the Belt and Road Initiative

Notwithstanding the considerable focus on outbound investment under the Belt and Road Initiative, many foreign investment opportunities are also arising from the extensive domestic initiatives in China aimed at linking Belt and Road economies.

Firstly, various infrastructure developments are being made in western and southern provinces in China to promote connections with surrounding regions. Many of these development projects are or will be carried out under the Public Private Partnership ("**PPP**") model. The Chinese government has constantly committed that foreign investors are encouraged to participate in PPP projects. Accordingly, the Belt and Road initiative is opening up opportunities for foreign investors in high-yielding investments that are otherwise restricted.

Secondly, the Chinese government has already established fourteen free trade zones ("**FTZs**") in China to serve as the frontline to connect with Belt and Road countries. This coupled with the on-going major reform of foreign investment laws in China means that the expansion of FTZs will provide new platforms and opportunities for foreign investors to take advantage of the development in China and abroad.

The Greater Bay Area

The most significant Belt & Road Project is the Greater Bay Area Initiative. The Greater Bay Area Initiative is the central government's plan to link the cities of Hong Kong, Macau, Guangzhou, Shenzhen, Zhuhai, Foshan, Zhongshan, Dongguan, Huizhou, Jiangmen and Zhaoqing into an integrated economic hub. The current population of the Greater Bay Area (the "**GBA**") is approximately 68 million people with a combined GDP of over US$1.3 trillion. By 2030 it is forecast to grow to 86 million people with GDP expected to exceed US$4.6 trillion.

On 18 February 2019, the long-awaited *Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area* (the "**Outline**") was finally released as an outline document guiding the current and future cooperation and development of the Greater Bay Area. The Outline provides a direction for the future development of the GBA and a new model for China's economic growth. The outline demonstrates the central government's ambition to build the Greater Bay Area into a world-class city cluster that houses an international innovation, science and technology hub, a series of interconnected financial markets, trade centers and smart cities, some of the world's leading academic and research institutions, an advanced manufacturing and IT powerhouse as well as an important pillar for the Belt and Road Initiative.

The sheer scale and development ambition of the GBA as set out in the Outline provides opportunities to both local and international business.

Transport infrastructure

To encourage this growth, significant investment is being made to link the cities in the Greater Bay Area, including the development of road, rail, seaport and airport infrastructure such as:

- The Hong Kong – Zhuhai – Macau Bridge, which will reduce travel times between Hong Kong, Zhuhai and Macau;
- the Guangzhou – Shenzhen – Hong Kong Express Rail Link (Hong Kong section), which will reduce travel times between these cities;
- The Humen Bridge No. II;
- The Shenzhen to Zhongshan Bridge; and
- The Macau – Zhuhai new border crossing facility.

The above list is only a small sample of the many transport infrastructure projects that are being, or will be, undertaken as part of the Greater Bay Area Initiative.

Social infrastructure – an interesting opportunity

As the benefits from the integration of the region are realized and as the region grows in both population numbers and wealth, there will be increasing demand for social infrastructure, such as entertainment, sports and recreation facilities. Although Hong Kong and Macau have a head start in terms of existing social infrastructure, in order to satisfy the increasing demand of the domestic population and the growing tourist visitor numbers, significant investment will be necessary to improve the existing, and develop new, infrastructure and bring the major cities in the Greater Bay Area all to a comparable level.

Below are examples of social infrastructure projects on the development board:

- **Sports**. The Chinese Government has an aggressive plan to grow the sports industry to an RMB7 trillion by 2025, with the Guangdong sports industry to reach RMB900 billion by 2025. To achieve these goals ambitious targets have been proposed, including the development of a major community sports park in every city in Guangdong by 2025 and 3,000 new soccer pitches by 2020. In addition the Hong Kong Government proposes HK$20 billion of investment in community sports facilities by 2022.
- **Convention/exhibition space**. In 2016 Hong Kong held more conference / exhibition meetings than any other city in the Greater Bay Area. However, in the Asia Pacific region Hong Kong was ranked fifth overall in terms of number of conference / exhibition meetings held. Macau was ranked 17th, Guangzhou 37th and Shenzhen 51st. As the Greater Bay Area becomes increasingly connected as an economic hub there will be opportunities for significant investment in conference/exhibition infrastructure. In Hong Kong, Guangzhou and Shenzhen alone exhibition space is expected to grow to over 1,400,000 square meters in the 2020s from the existing combined space of approximately 800,000 square meters.
- **Cultural centers**. The Greater Bay Area has no museums that are ranked within the top 20 globally and only one museum ranked within the top 20 in Asia Pacific region. As part of the Greater Bay Area positioning itself as a global hub, in competition with other developed hubs, it is expected that investment in all types of cultural centers, including museums, will be a focus of the government.
- **Amusement parks**. In 2016 Hong Kong had the 17th and 18th most visited amusement parks in the world, while Guangzhou had the most visited water park in the world. There is already significant demand for amusement parks in the region, which demand is forecast to increase with the development of the Greater Bay Area. To meet this demand, additional facilities will be required in addition to the following expansions that are already planned:

  - A new water park at Ocean Park – this is expected in 2018/2019 and has an anticipated investment of HK$2.9 billion;
  - A new hotel at Ocean Park in 2017 with an anticipated investment of HK$4.1 billion;
  - Disneyland Phase 1 development expansion, with an anticipated investment of HK$11 billion; and
  - Four new Chimelong theme parks in Zhuhai with a total investment of RMB50 billion investment.

- **Who will benefit**? The demand for all manner of social infrastructure in the Greater Bay Area presents significant opportunity for developers, EPC contractors, operators and maintenance contractors. However, this infrastructure does not exist in a vacuum and increased development of social infrastructure will have a multiplier effect on other infrastructure needs and will present opportunities to investors in many industries, including:

  - Hotel developers and operators to meet increased demand from tourists and convention/exhibition attendees;
  - Stadium operators;
  - Food and beverage providers;
  - Retail developers and operators to take advantage of the increased visitors to the region;
  - Tourist service providers; and
  - Events management companies.

The increased connectivity and integration of the Greater Bay Area will make it easier for investors, contractors and other goods and services providers active in the region to take advantage of these new opportunities.

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