29TH YEAR OF PUBLICATION AUGUST/SEPTEMBER 2012


asia today® INTERNATIONAL

# Reshaping SHENZHEN

## Emerging industries, high-end services replace yesterday's factories

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Print Post Approved PP240725/00001

# TURNING A NEW PAGE

## Shenzhen embraces emerging industries, financial services

**SHENZHEN** is China's fourth-largest city in terms of GDP and first in terms of GDP per capita. It is also China's largest exporter and second-largest importer. Having originally kick-started its economy on the back of factories flooding across the Hong Kong border, Shenzhen in the past decade has turned its focus to high-tech manufacturing, R&D, emerging industries and services. Now, with approval from China's State Council, work is beginning on development of a financial services precinct in Shenzhen's Qianhai Special Co-operation Zone. It is a move that will directly challenge the economic strengths of Hong Kong, just 15 minutes by road or rail from Shenzhen (*see page 11*) . . .

**Shenzhen 1984—2012.**

**Barry Pearton**
Publisher, *ATI Magazine*

**SHENZHEN**, China's first and, by far, most successful Special Economic Zone (SEZ), has, over the past decade, been accelerating the pace of its move away from lower-end manufacturing towards an economy clustered around four pillar industries – high-tech manufacturing, logistics, finance and culture.

Today, the economic focus is on six emerging sectors – Internet industries; NextGen communications; new materials; new energy/green tech; medical/pharmaceutical; and innovative industries.

Driving the change is, of course, sheer ambition (Shenzhen officials clearly draw much of their inspiration from neighbouring Hong Kong), but the reality also is that Shenzhen had been literally running out of land to house the factories that formed the backbone of its economy in earlier days.

In total, the Shenzhen SEZ covers just shy of 2,000 square kilometres.

At the peak of the manufacturing boom, Shenzhen was hosting up to five million migrant factory workers. Officials are now working with their counterparts in 10 provinces, including Sichuan, Hubei and Hunan, to facilitate relocation of factories to these areas.

Many of Shenzhen's larger manufacturers already had established operations in other cities, so relocation has been relatively easy. In Shanwei, in Guangdong Province, Shenzhen is working with local officials to build an industrial park – the Shenzhen-Shanwei Economic Co-operation Zone. "The impetus now for Shenzhen in manufacturing is R&D," says Shorf Fu, Representative and Managing Director of the Shenzhen Economic and Trade Representative Office (SETRO) in Australia.

"About 60 per cent of our manufacturing value is now in high-tech products.", he says.

Sydney is one of six offshore offices promoting Shenzhen (the others are in Los Angeles, New York, Nuremberg, Brussels and Tokyo).

In the 1980s, many of Hong Kong's thousands of factories came to Shenzhen, but as costs increased and labour became increasingly scarce (migrant workers finding new jobs in their home towns), factories in many cases were replaced by new industries requiring higher skills. Lower-end manufacturers have been progressively moving to adjoining, lower-cost areas.

As the factory workers involved in low-end processing moved out, Shenzhen encouraged those with the skills to staff its new high-tech and knowledge-based industries to move in. It is an ongoing process.

Shenzhen is, basically, a migrant city, and the average age of people living there is just 30.

Now, a major makeover is under way, with work starting on development of a new financial services precinct in Shenzhen's Special Co-operation Zone of Qianhai, directly opposite Hong Kong. The RMB580 billion, eight-year redevelopment was approved by China's State Council on June 27 *(see report page 11)*.

Shorf Fu wants to see Australia's four major banks – ANZ, Commonwealth, NAB and Westpac – establish representative offices in Qianhai's Special Co-operation Zone.

He told *ATI*: "We want those banks, and also Australia's top logistics companies, Toll and Linfox, to be fully involved in the development of Shenzhen." (Qianhai District is also a major logistics centre). A high-level delegation of city officials and business leaders will visit Australia

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**Shenzhen and Hong Kong: Partners or competitors? Hong Kong's Central financial district will be just 15 minutes by road or rail from Shenzhen's Qianhai Co-operation Zone.**

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to promote Shenzhen at seminars in Sydney and Brisbane in early September. Members of the delegation will be searching out business opportunities in Australia for Shenzhen-based companies, and also encouraging Australian businesses to either start up operations in Shenzhen's high-tech sector, or to consider part or full relocation to Shenzhen. Special recruitment fairs for skilled workers able to contribute to the development of Shenzhen's emerging industry sectors are also planned.

More than 40 Shenzhen companies will be seeking to promote R&D co-operation with Australian firms, and to recruit talented students and high-tech specialists and teams to work in Shenzhen. They will also seek to establish closer links with universities and higher education facilities, which in Australia form the core of new research in emerging industries.

To attract and retain skilled talent from overseas, Shenzhen has developed what it calls its *Peacock Programme*. In Chinese idiom, the peacock flies to the Southeast of a country to seek jobs and opportunity. Shenzhen is at the Southern tip of China.

The Peacock Programme offers a range of incentives for entrepreneurs, including rental subsidies, R&D funding, research transfer funding, innovation team funding and matching subsidies. Says Shorf Fu: We want to encourage team leaders and others with skills and talent to come to Shenzhen to work in our emerging industries. We also want to introduce Australian companies involved in R&D and new technology to Shenzhen enterprises, and to encourage Australian companies to establish partnerships in Shenzhen to develop new ideas through to commercialisation. "

There are many start-up Australian companies with great ideas and sound R&D capability, he says. "The competitive strength of Australia in R&D is not in question. But Australia often does not have enough funds available to take innovation to the next stage – Shenzhen does. Shenzhen can be fully involved in the industrialisation or commercialisation of R&D in any of the six emerging industries."

In Shenzhen today, many of the larger companies commit up to 50 per cent of their staff to research and development of new products and applications in the IT and new industry sectors. Shenzhen City itself each year commits 3.5 per cent of total GDP to help fund new technology and innovative start-up industries.

Says Fu: "In Australia, we want to showcase Shenzhen as a city of innovation for business, a city of entrepreneurs that have thrown up a lot of opportunities and networks for emerging industries over the past decade.

"In China, Shenzhen is the one city that has given birth to a number of multinational companies – last year, for example, Huawei, which is headquartered in Shenzhen, became the world's leading telecommunications equipment and service provider.

"But it is not just local Shenzhen SMEs that have grown up into international companies; foreign-invested companies have been able to do that as well. For Australian SME and start-up companies in emerging industries, there are immense opportunities to develop and expand out of Shenzhen."

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# A City of Innovation, a City of Entrepreneurs

**FREED** of many constraints on business operating elsewhere in China, Shenzhen has given birth to some of China's most successful global corporations – and some of its wealthiest people . . .

**SHENZHEN** brands itself as the *City of Innovation*. A migrant city – only 2.7 million of Shenzhen's 10.5 million people have permanent residency, only two million were born there – it has become a magnet for China's young entrepreneurs.

Freed of many of the constraints on business operating elsewhere in China, these entrepreneurs have given birth to some of China's largest and most successful global corporations and, in the process, created enormous wealth.

Like BYD founder, Wang Chuanfu, born into a poor farming family, raised by an elder brother and sister after his parents died, and now ranked among the wealthiest of all Chinese people.

Wang studied chemistry, graduating in 1990 with a Masters degree, then working as a Government researcher until 1995 when he set up a business in Shenzhen. BYD is an acronym from a translation of the company's Chinese name, '*Build Your Dreams*'.

Wang set out to build his dream through the manufacture of rechargeable batteries, in direct competition in the Chinese domestic market against Japanese imports.

Within 10 years, BYD held more than half of the total world market for mobile phone batteries, and along the way (in 2002) listed on the Hong Kong Stock Exchange.

Also in 2002, BYD bought the Tsinchuan Automobile Company, which, by 2010 had become China's sixth-largest car manufacturer.

Having gone from just 20 employees in the earliest days to more than 150,000 spread across 10 industrial parks in China, BYD is now the world's largest supplier of rechargeable batteries, with a firm focus on information technology, the car sector (it plans to manufacture China's first commercially-viable electric car) and new energy. It has sales and marketing operations in the United States, Europe, Japan, South Korea, Taiwan and Hong Kong.

Also among China's wealthiest are Li Li and his wife, Li Tan, who jointly own 70 per cent of Shenzhen Hepalink Pharmaceuticals, which manufactures the blood-thinning agent Heparin and related products for world markets, distributed essentially through the global pharmaceutical majors.

The couple, who first met while studying chemistry at Sichuan University, keep a very low public profile.

They originally held 80 per cent of Hepalink, but sold 10 per cent in 2010 in an IPO on the Shenzhen Exchange, which valued the company then at US$6.2 billion. At RMB148 per share, the Hepalink IPO price was the most expensive ever offered in China.

Li Li worked with a meat company in Chengdu, then with a biotech company in Chongqing, before forming Hepalink in Shenzhen in 1998. It is the only Chinese company accredited by the US Food and Drugs Administration to export the active ingredients of Heparin, which is derives from pig intestines.

The list of other corporate successes born and still headquartered in Shenzhen is impressive . . .

■ **Huawei**, now possibly the world's largest telecommunications networking, equipment and services provider, which saw 2011 profit numbers increased by 30 per cent to US$3.64 billion.

Founded in Shenzhen in 1987 by Ren Zhengfai with capital of just RMB21,000, Huawei is still privately owned by its employees – 46 per cent of whom are engaged in R&D.

Huawei has 17 global R&D centres, and 10


**BYD's Wang Chuanfu – Made a fortune in rechargeable batteries, now planning China's first commercially-viable electric car.**

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per cent of all revenue is committed to research and development.

■ **Tencent** – founded in Shenzhen in 1998 and now one of China's largest and most used internet providers – in September 2011, Tencent had 711.7 million account holders in China. Half of all employees are involved in R&D.

Tencent listed on the Hong Kong Exchange in 2004. In 2007, it invested more than RMB100 million to set up the Tencent Research Institute, China's first Internet research facility, with campuses in Beijing, Shanghai and Shenzhen. The Institute focusses on self-development of core internet technologies.

■ **ZTE Corporation** – a leading global provider of telecoms equipment and network solutions in 140 countries, ZTE is China's largest listed telecoms firm and the world's fifth-largest telecoms maker in terms of revenue.

Founded originally by a group of companies, ZTE listed through an IPO on the Shenzhen Exchange in 1997 and then through a further IPO with the Hong Kong Exchange in 2004. In 2011, it was ranked No 1 among global competitors in terms of PCT patent filings (2,826 applications).

■ **Mindray** – founded in Shenzhen as a developer, manufacturer and exporter of patient monitoring, diagnostic and ultrasound imaging systems, Mindray listed on the New York Exchange in 2006 and now exports to 190 countries.

Mindray has a global R&D network with research centres in Shenzhen, Beijing, Shanghai, Chengdu, Xian, Seattle, New Jersey and Stockholm. It reinvests 10 per cent of all revenue in R&D.

■ **Han's Laser** – founded in Shenzhen in 1996 and now a global leader in the manufacture of professional laser equipment. It exports to more than 20 countries.

> "Not every success story in Shenzhen belongs to the Chinese. Shenzhen is, after all, a migrant city"

The list goes on. By mid-2012, 30 years after Shenzhen became China's first Special Economic Zone (SEZ), more than 180 of the Fortune Global 500 companies had a presence there.

But not every success story in Shenzhen belongs to the Chinese. Shenzhen is, after all, a migrant city.

Shenzhen in 1996 saw Irishman Liam Casey set up a fledgling sourcing company called PCH (he named it after the Pacific Coast Highway of southern California).

PCH has evolved into PCH International, employing more than 1,000 people in China and around the world.

Established as a trading company in Cork, Ireland, with capital of US$20,000, PCH from Day One firmly cemented its operational heart into Shenzhen, concentrating on the consumer electronics sector. For the first two years, Casey was a sole trader.

**Liam Casey – Creating connections through PCH.**

He had worked in the United States for a company importing from China. During a visit to Shenzhen, he immediately recognised the opportunity to match Chinese manufacturing with western markets.

Says Casey: "PCH started as a small sourcing company, and in just a few years we evolved far beyond merely importing products: we were learning what the world's best companies wanted to build, and we created the connections to make it happen."

Product design and logistics became key elements of the business.

Says Casey: "We are the partner behind-the-scenes responsible for some of the most successful consumer electronics accessories launches. PCH has become an enabler, turning an idea into a physical product in the hands of a consumer — while optimising quality, cost, and time-to-market."

Today, Liam Casey is often referred to by westerners as "*Mr China*" because of his immense knowledge of, and range of contacts in, the Pearl River Delta's manufacturing sector. Turnover of PCH International in 2011 was reportedly US$400 million.

**Intelligent factories, R&D centres for emerging industries — the new face of Shenzhen.**

## Shenzhen by the numbers

**High-tech manufacturing:** added value (2011), RMB373.8 billion, up 22.2%.
**Financial industry:** added value (2011) RMB156.24 billion, up 8.6%.
**Logistic industry:** added value (2011) RMB112.24 billion, up 14.9%.
**Internet industry:** added value (2011), RMB138.07 billion; up 18.9%.
**Bio-industry:** added value (2011), RMB17.5 billion, up 24%.
**New energy industry**: added value (2011), RMB25.4 billion, up 20.7%.
**GDP:** RMB1150.21 billion (2011), up 10%.
**Industrial added-value:** RMB 522.88 billion (2011), up 12.6%.
**Retail sales, consumer goods:** RMB352.09 billion (2011), up 17.8%.
**Real FDI:** US$4.6 billion (2011), up 7%.
**Total exports:** US$245.53 billion (2011), up 20.2%.
**Total imports:** US$168.57 billion (2011), up 18.2%.

## China's first four SEZs

**THE** cities of Shenzhen, Zhuhai and Shantou, together with Xiamen in Fujian province, were given the green light in 1979 to establish what were later called Special Economic Zones. The SEZs were allowed to practice special policies and to employ flexible measures on foreign economic and trade issues. The zones later became important symbols of China's determination to reform and open to the world.

Shenzhen, situated just to the north of Hong Kong, became China's first – and ultimately most successful – Special Economic Zone, due to the economic liberalisation policies of reformist leader Deng Xiao-ping.

Zhuhai benefitted greatly from its proximity to Macau, as did Shenzhen from its proximity to Hong Kong (as tens of thousands of factories relocated across the border).

Shantou, a city significant in 19th-century Chinese history as one of the treaty ports established for Western trade and contact, failed to blossom like Shenzhen, Xiamen and Zhuhai, but it remains East Guangdong's economic centre.

**FURTHER** details of the Shenzhen seminars in Sydney and Brisbane in September are available from the SETRO office at Level 14, Goldfields House, 1 Alfred Street,. Sydney NSW 2000, tel (61 2) 9247-8588, fax (61 2) 9247-7188, email info@setro.org.au

# Will Qianhai directly challenge Hong Kong?

**WILL** the new financial district being developed in Qianhai, Shenzhen, undermine Hong Kong's position as the leading global financial centre of South China by providing identical services at lower cost? A decision by China's State Council to develop the Qianhai Special Co-operation Zone, just 15 minutes away from Hong Kong's central business district, has set some alarm bells ringing. A total RMB220 billion was committed by the first 37 companies signing up to Qianhai on July 18 . . .

**Shenzhen Stock Exchange – a challenge to Hong Kong or a relief pressure valve?**

**HONG KONG –** China's State Council has given its official seal of approval to establishment of Shenzhen's Qianhai Special Co-operative Zone, which will be developed as a mini-Hong Kong offering low tax rates and investment incentives – and encouraging increased involvement of Hong Kong-based professionals in Mainland business.

Qianhai's role will include responsibility to drive reform of China's financial and taxation systems.

Hong Kong and Qianhai will also be encouraged to co-operate in areas ranging from international arbitration to health and education.

The 15 sq km Qianhai Special Co-operation Zone will be 12 times the size of Hong Kong's Central Business District (and ultimately only 15 minutes by fast rail from Central Hong Kong).

Apart from financial services, the QEZ will be seeking to attract IT, logistics and high-tech service industries.

The development has an estimated completion date of 2020.

For approved corporations establishing and/or investing in Qianhai, there will be a flat 15 per cent corporate tax rate (the same as Hong Kong). In addition, some finance professionals, accountants, lawyers, doctors and those in the creative industries working in Qinhai, including those moving in from Hong Kong, will be exempt from income tax.

In a statement released on June 27, on the eve of Hong Kong's 15th anniversary as a Special Administrative Region of China, China's State Council agreed to support construction of what it refers to as the "*Shenzhen-Hong Kong Modern Services Co-operation Zone*." The concept appears to be a direct challenge to Hong Kong's economic strengths, although some observers say it is designed more as a relief pressure valve for Hong Kong as China continues to internationalise the renminbi and see more of its firms reach out as global majors. In time, they say, it is hoped that Qianhai will help stabilise Hong Kong property prices, and share in Hong Kong's dominance in the financial services sector.

"Hong Kong sees itself as something special, and there is too much concentration of money there," one source told *ATI*. "If Qianhai is successful, it will dilute Hong Kong's influence over the long run."

Others take a more sombre view, suggesting that Hong Kong potentially faces mass migration of its professionals to Qianhai, who will seek to take advantage of exemption from personal income tax.

The proposals for Qianhai also appear likely to undermine Hong Kong's position as the leading 'offshore' provider of RMB trade settlements and RMB financial products. And there is direct encouragement for Hong Kong financial services firms to locate their headquarters in Qianhai.

Back in 2007, a blueprint for the greater integration of Shenzhen and Hong Kong, endorsed by China's Ministry of Construction, was published in Shenzhen *(see ATI, August 2010, 'A Tale of Two Cities')*. The vision was that, by 2020, the two cities would be integrated into one mega-city, rivalling New York and Tokyo in terms of gross product.

Under the blueprint, the merger process

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would occur over 13 years through to 2020 – in transportation, customs, ecology, construction, finance and information technology. Part of the vision was to create a high-tech valley in the boundary zones.

The State Council's announcement, made exactly 15 years after Hong Kong reverted to China from British rule, appears, both in concept and timelines, to have an uncanny resemblance to the Ministry blueprint.

Qianhai, a port city in the Nanshan district of Shenzhen, already boasts a sophisticated logistics industry. Said to be the original city centre of Shenzhen, Qianhai is located on the western coast of Shenzhen, east of the Pearl River.

The State Council, in its June 27 statement, said Qianhai will "create a mechanism of innovation for the development of modern service industries in Shenzhen, Hong Kong and the near regions".

"We agree to support innovation for financial reform in Qianhai, to make a demonstration window for the Chinese financial industry," the State Council said.

It added that Qianhai could "explore and broaden the channels of capital flow for RMB, with the support of RMB offshore business in Hong Kong, to build an innovation area of cross-border business for RMB".

"In the frame of the Mainland and Hong Kong Closer Economic Partnership Agreement (CEPA), we allow Qianhai to establish a banking institution to deal with RMB loans for overseas projects," the State Council said.

"We allow eligible companies and financial institutions in Qianhai to issue RMB bonds, to support the development and construction of Qianhai.

"We allow Qianhai to establish an investment fund for stock investment.

"We encourage development of foreign equity investment funds in Qianhai, to create new capital innovation and manage a model for foreign equity investment firms.

"We allow Qianhai financial markets to undertake further promotion and expansion to Hong Kong. In addition, Qianhai can set out access conditions for Hong Kong's financial enterprises to set up and carry out financial business in Qianhai.

"We allow Qinhai to establish innovative financial institutions to enhance financial markets' competitiveness, and to set up a business innovation model for reform of financial institutions in Qianhai.

"We allow and encourage Hong Kong, and other domestic and foreign financial institutions, to set up management headquarters, business operations headquarters in Qianhai, to accelerate and improve international financial integration."

The State Council also said it would allow Qianhai to "test and explore the modern service industry tax system under the framework of (China) national tax reform".


**ATI's cover report on Hong Kong and Shenzhen in August 2010.**

Among other measures:

- "Registered and eligible" modern logistics enterprises in Qianhai will be entitled to "prior tax benefits";
- Qianhai will be encouraged to strengthen "legal affairs co-operation" with Hong Kong, and Hong Kong will be encouraged to establish an "arbitration institution setup branch" in Qianhai;
- Mainland and Hong Kong law firms will be encouraged to co-operate further under the framework of CEPA;
- Qianhai will be authorised to establish what the State Council calls "a Shenzhen and Hong Kong talent SAR (Special Administrative Region) to attract qualified talent to its modern service industries;
- Qianhai is permitted to establish a mutual recognition list for professional qualifications;
- Qualified professionals in Hong Kong can provide service directly to business and residents in Qianhai;
- Hong Kong professionals with CPA certification can partner auditing firms in the Mainland;
- Qianhai is to co-operate in Shenzhen with Hong Kong in the education and health care sectors;
- Hong Kong service providers can set up international schools in Qianhai for the children of overseas Chinese and "returned overseas talent";
- Hong Kong service suppliers can set up a hospital in Qianhai;
- Telecommunications industry co-operation will be encouraged.

## Australian Financial Centre for Qianhai

**THE** Sydney-based AIMS Financial Group is the only Australian company, so far, to be chosen to have a presence in Qianhai. It was among the first batch of 37 companies assigned land for office development.

Others to have been allocated land include large Chinese institutions, such as the China Development Bank and China Merchant Bank, and big Chinese insurance companies.

George Wang, founder and Executive Chairman of AIMS, says his plan is to build an *Australian Financial Building* on the Qianhai site to house the China office of the Asia Pacific Exchange (APX), which is about to become Australia's newest stock exchange.

AIMS, which is behind APX, will locate some back office functions to Qianhai. More than two years after his first discussion with Shenzhen authorities, Wang signed a formal agreement with Shenzhen authorities in July.

Under the new policies, development projects at Qianhai can be funded by RMB bonds raised in Hong Kong. And, significantly, Chinese authorities have said that if there is a business dispute involving a firm based in Qianhai, the parties can have the matter heard in Hong Kong under Hong Kong law.

"This is seen as an important part of the policy," says Wang, "because it will give comfort to those who are uncertain about Chinese legal system." Wang says the financial services area will be concentrated over some five sq km of Qianhai. The remaining 10 sq km will be used for logistics.

In a recent interview with *China Daily*, Zheng Hongjie, Chief Director of the Qianhai Administration Bureau, said 11 underground train lines are on the drawing board. The first two are completed and have begun operations.

A cross-harbour high-speed expressway is also under construction. The *China Daily* said the existing Shenzhen Bay Bridge already links Shenzhen Bay and the Tuen Mun district of Hong Kong's New Territories.

Zheng said that when the Hong Kong-Shenzhen western corridor road networks are completed, it will take less than 15 minutes to drive from Shenzhen Bay to Hong Kong's Chep Lep Kok International Airport.

Wang says an undersea tunnel is planned to provide rapid access between Qianhai and Central in Hong Kong. Zheng said Hong Kong's financial hub in Central will provide the development model for Qianhai — for example, it is intended that all buildings will be interlinked through walkways.

## HK, Shenzhen, Shanghai bourses sign JV

**HONG KONG –** The Hong Kong Stock Exchange (HKEx) has signed off on a joint venture with the stock exchanges of Shanghai and Shenzhen. Each of the exchanges has committed investment of HK$100 million as initial paid-up capital.

In a statement, HKEx said the JV would develop and franchise index-linked and equity derivative products, and, to support this activity, would compile cross-border indices based on products traded on the three markets.

It would also develop industry classification for listed companies, information standards and information products; promote securities markets; and enhance market participant services, technical services and infrastructure establishment.

The JV Board will be co-chaired by representatives nominated by the Shanghai and Shenzhen exchanges, and the Chief Executive will be nominated by HKEx.

The statement said the JV would be established within three months, and that the JV company would enhance the competitiveness of Hong Kong, while helping promote development of China's capital markets and the internationalisation of the three exchanges. www.hkex.com.hk .