



STRATEGIC & COMMERCIAL INTELLIGENCE

Changsha Investment Environment Study 2006

ADVISORY

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Preface

This publication presents an overview of matters to be considered by those contemplating investments in Changsha, the capital of Hunan Province in south-central China. The original version of this booklet was released in May 2003 and updated in April 2005; this April 2006 publication is the third edition.

The sources of information in this booklet have been attributed throughout; the assistance of the Changsha Municipal Bureau of Commerce (MBC) is gratefully noted. In addition to secondary information, KPMG analyzed data from foreign invested companies in March 2006 with regard to their actual costs and operating practices; this data is included in this booklet. This booklet contains information available as at mid-March, 2006.

Over the past year much has changed in China and specifically in Changsha.

Changsha itself has seen great development in the last year. During the 2004-2005 period, the city's economy has grown at an annual rate of 15%. The city is working hard to realize Mayor Tan Zhongchi's vision of Changsha as "a modern central city that is prosperous, opening up, civilised and beautiful". Other notable developments include:

- Changsha was linked to the natural gas pipeline from western China in 2005
- A Free Trade Logistics Center was set up in 2005 and will begin operations in 2006
- In 2005, Changsha attracted a record amount of inbound investment, roughly USD 900 million. With six Fortune 500 companies (including Time Warner, Pepsi-Cola, Hutchison Whampoa, NEC, Mitsui and Mittal), this was the highest number of Fortune 500 firms to invest in Changsha since China's reform and opening-up policy began in 1978

One aspect of investing in China has not changed, however, and that is the importance of careful planning. We recognize that the lack of reliable information such as cost data can be an impediment to the investment process. This publication, commissioned by the Changsha Municipal Government, is designed to address the needs of foreign investors for accessible, independently researched information on the business environment and costs in Changsha.

The business environment, especially with regard to costs, can change quickly in China. Moreover, cost and operational issues vary from company to company and from industry to industry. Companies doing business in China, or planning to do so, are advised to obtain current information and company-specific advice from experienced professional advisors.

1 Changsha in Context

- Location
- City introduction
- Economy
- Consumer market
- City planning

Changsha, the capital of Hunan Province, lies in eastern Hunan in south-central China. A key transport hub linking eastern and western China, Changsha has a sizable population and a diversified economic and industrial base.



Location

Changsha is situated in Hunan Province, in south-central China

Hunan Province is a fertile and densely populated inland province. Changsha is its capital. Changsha is under two hours' flight-time from Guangzhou, Hong Kong and Shanghai.





City introduction

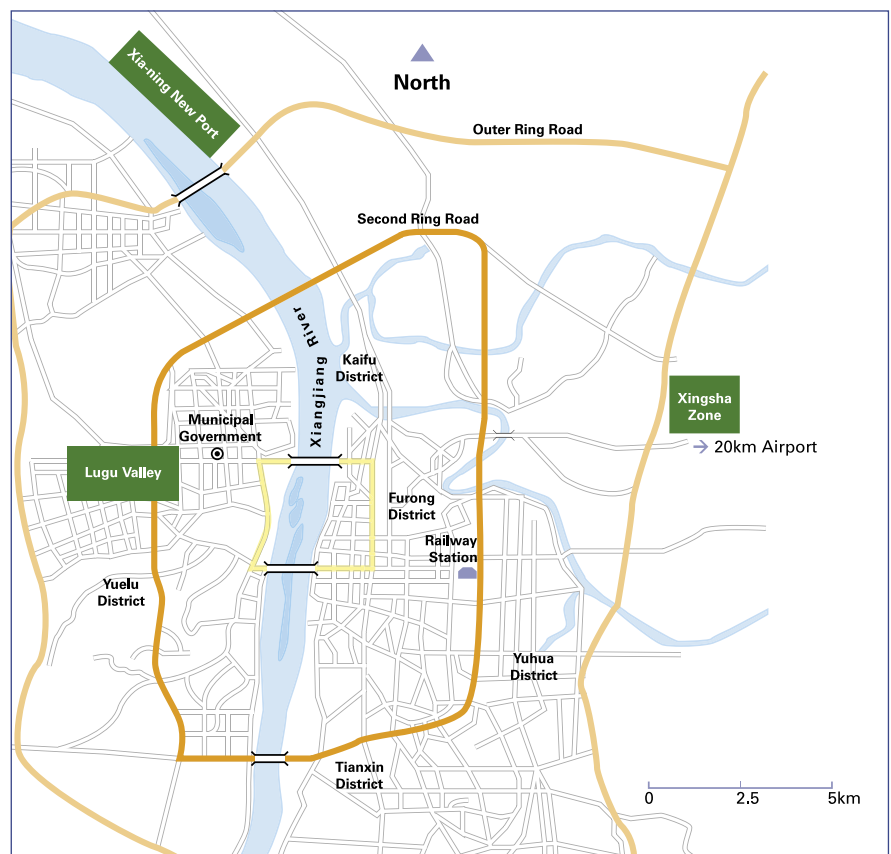
Changsha has a 3,000-year history and a population of 6 million

Changsha means “long sand”. The city is situated in the east of Hunan Province, on the Xiangjiang River.

- Written histories as early as 1600 BCE refer to Changsha and by the 17th century CE, the imperial government had established Changsha as the capital of Hunan province
- Administratively, Changsha covers an area of 11,800 km², made up of five urban districts, four counties and 75 towns in the suburbs
- Changsha had a total population of 6.13 million in 2005, of which 2.16 million were urban residents
- Hunan is one of China’s major grain production areas; agriculture represents a significant portion of Changsha’s economy

Changsha has established “sister city” relationships with St. Paul (MN) in the US, and Gumi in South Korea.

Map of Changsha urban area





Economy

Changsha's economy is growing rapidly, with a focus on services and manufacturing

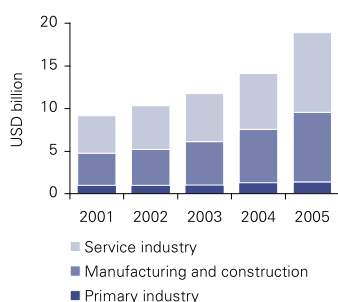
Changsha is one of China's top 20 "economically advanced" cities. Its gross domestic product (GDP) has grown at an average of 14% per year from 2001-2005, compared with the national average of 9%.

In 2005, the service sector represented roughly half of Changsha's GDP (49%), up 112% since 2001; this sector is expected to continue to drive the city's economic development.

The manufacturing and construction sectors have also grown steadily, increasing 116% from 2001 to 2005.

The primary industry sector (agriculture, forestry, animal husbandry and fishery) has grown only slightly over this period.

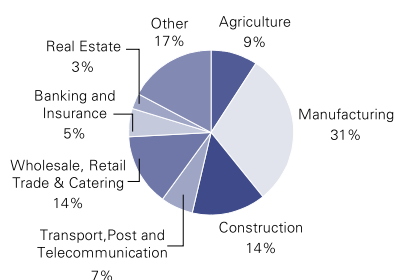
Changsha's GDP by industry 2001-2005



Note: 1 USD = RMB 8.04

Sources: (1) Changsha Statistical Yearbook 2005
(2) Changsha Domestic Economy and Social Development Statistics Report 2005

Changsha's GDP by sector 2004



Source: Changsha Statistical Yearbook 2005

Within the manufacturing sector, hi-tech manufacturing is an increasingly important component

Manufacturing continues to be a pillar of the local economy, with production reaching USD 16.2 billion^(a) in 2005, an annual average growth of 18% from 2001.

- The main local industries are electronics, machinery, fireworks and food processing
- Output of the hi-tech sector reached USD 3.3 billion in 2005, accounting for 20% of manufacturing output
- 12% of manufacturing output was from foreign-invested enterprises

A number of other cities within an hour's drive from Changsha form an "Economic Circle"

Eight cities are within a one-hour drive from Changsha: Zhuzhou, Changde, Yiyang, Xiangtan, Yueyang, Hengyang, Shaoyang and Loudi.

These cities have growing economies in their own right, but with strong economic and transport links to Changsha form an "economic circle" around Changsha. Together with Changsha, these cities form an extended economic region with a GDP of USD 65.1 billion, comprising 81% of Hunan province's 2005 GDP (USD 80.5 billion).

Note: (a) Gross Industrial Output Value was compiled using a different statistical methodology from GDP



Consumer market

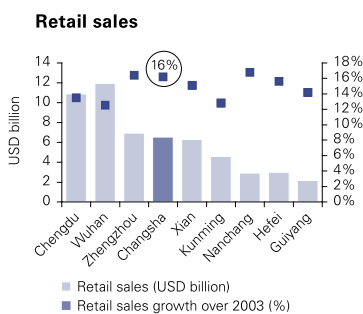
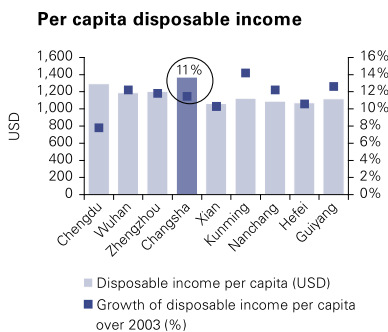
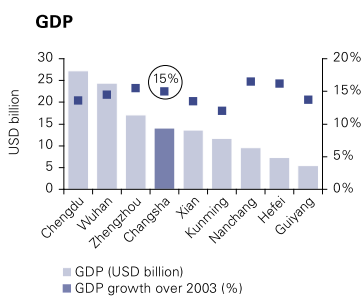
Changsha represents a major consumer market when compared to other major inland cities

Changsha residents have seen increasing income levels; urban residents had an average per capita income of over USD 1,500 in 2005, 15% higher than the national average.

Changsha's economic growth has led to an annual increase in per capita income of around 10% from 2001 to 2005.

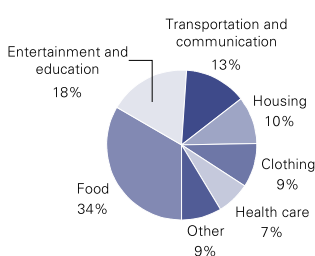
- The population is now spending more on housing and healthcare since the government introduced new welfare and housing reform policies in 2001
- With increasing income, residents are expected to spend a greater percentage of income on other items such as clothing and entertainment
- Retail sales reached USD 9.2 billion in 2005, representing a CAGR of 21% over the 2001-2005 period

Comparison with inland provincial capitals 2004



Source: Changsha Statistical Yearbook 2005

Changsha urban consumer expenditure 2004



Source: Changsha Statistical Yearbook 2005



City planning

Changsha has a clear city planning strategy which covers infrastructure, industrial development and living environment

The government continues to strengthen infrastructure links to provide improved access in and out of Changsha.

- In 2005, roughly USD 1.7 billion was invested in urban infrastructure construction, including USD 160 million in transportation facilities
- From 2006 to 2010, a total investment of USD 25 billion will be invested in infrastructure construction with a focus on transportation system, energy security system, IT infrastructure and water facilities

Changsha Jin-xia Free Trade Logistics Center

- Located in Changsha Economic & Technical Development Zone
- Under construction and expected to operate by June 2006
- The third such center in China (the others are in Shanghai and Suzhou); the first one in inland China
- Focus on tax refund for export and duty-free import

Changsha's government is focusing investment on six key sectors

- The government expects to attract actual foreign investment of USD 5.6 billion from 2006 to 2010, with an emphasis on machinery, IT, advanced materials, leisure, real estate and primary products processing
- More investment is planned on information technology to help traditional industries upgrade to advanced IT systems
- Several industrial parks with a focus on logistics are being set up by the government

Changsha's living environment is also being enhanced

- The real estate sector attracted USD 3.2 billion in investment during 2005, a growth of 46% from 2004; a further USD 17.5 billion is planned for investment by 2010
- Per capita living area of urban residents reached 27.2 m² in 2005; the government is expecting to increase this figure to 32 m² by 2010
- A series of regulations on environmental protection have been issued recently; the Hunan Provincial Government has issued an "Environment Protection Plan for 2005-2007" which regulates the disposal and treatment of waste water, air pollution and solid waste
- By 2005, green space in urban areas reached 37.8% with green area per capita at 7.7 m²; the government plans to increase the figures up to 40% (9.5 m²) by 2010



2 Foreign investment in Changsha

- Foreign investment trends
- Top sectors for foreign investment
- Industrial zones in Changsha

In recent years, foreign inward investment has been directed to inland locations as well as coastal cities, with the result that in 2005, Changsha attracted nearly USD 1 billion of foreign direct investment. Investments have been made in a variety of sectors, including hi-tech manufacturing, food production and services.

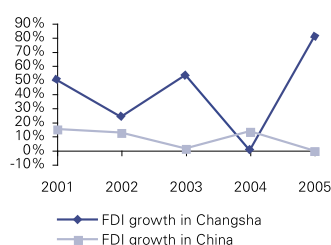


Foreign investment trends

Foreign Direct Investment (FDI) to China is having a growing impact on Changsha's economy

- The first foreign-invested enterprise (FIE) was established in Changsha in 1984. Since then, over 2,350 FIEs and/or representative offices have been set up, including more than 220 FIEs with an investment of over USD 10 million each
- Changsha's utilized FDI from 2001 to 2005 has grown on average by roughly 40%, five times as the national rate. In 2005 Changsha utilized USD 902 million in foreign direct investment

Changsha and National FDI growth 2001-2005



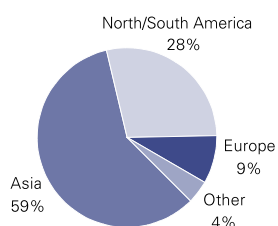
Sources: (1) Changsha Statistical Yearbook 2005
 (2) China Statistical Yearbook 2005
 (3) Changsha Domestic Economy and Social Development Statistics Report 2005
 (4) China Domestic Economy and Social Development Statistics Report 2005

Changsha is a "magnet" for foreign investment within Hunan province

Changsha has attracted 150 new projects, or 45% of Hunan Province's total utilized FDI in 2005; to date, Asia has accounted for most of the FDI into Changsha.

- From 1984-2005, the majority of FDI to Changsha has been from Asian countries and regions, particularly Hong Kong, Korea, Singapore and Japan, accounting for 59% of the total FDI
- North/South America and Europe have been the other two major investors, accounting for 28% and 9% respectively

FDI into Changsha by country of origin 1984-2005



Source: Changsha Municipal Bureau of Commerce

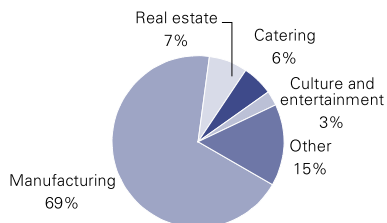


Top sectors for foreign investment

Foreign investment to date has focused on manufacturing, particularly electronics, automotive and home appliances

Changsha has managed to attract major multinational companies to locate operations or representative offices in the city.

FIEs turnover, by sector 2005



Note: "other" indicates wholesale and retail, construction, information technology and transportation

Sources: (1) Changsha Municipal Bureau of Commerce
(2) KPMG analysis

Major multinationals in Changsha			
Company	Sector	Investment (USD million)	Key products
LG Philips	Electronics	420	TV monitor tubes
HEG	Glass products	263	glass panel, glass funnels
Bosch	Automotive	97.5	automotive electric system
Heiwado	Real estate	96.5	department store
Electrolux	Household appliances	87	refrigerator, washing machine

Source: Changsha Municipal Bureau of Commerce

Manufacturing accounts for the lion's share of foreign investment in Changsha to date.



Industrial zones in Changsha

Changsha's two industrial zones provide a convenient base of operations for foreign investors

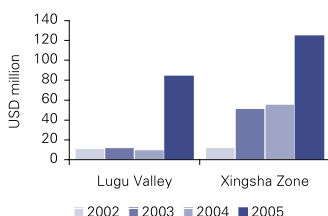
In order to assist foreign investors in establishing operations, the central government has established the following two national-level zones:

- Changsha Hi-tech Technological Industrial Development Zone ("Lugu Valley")
- Changsha Economic & Technical Development Zone ("Xingsha Zone")

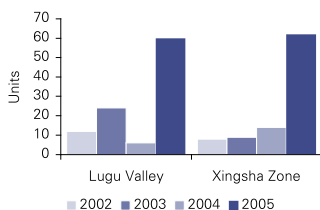
These zones offer standard factory space and industrial land with infrastructure (such as power, road connections), tax incentives, plus a zone administration that can assist investors with routine set-up and operational issues.

Development of Changsha's zones in figures 2002-2005

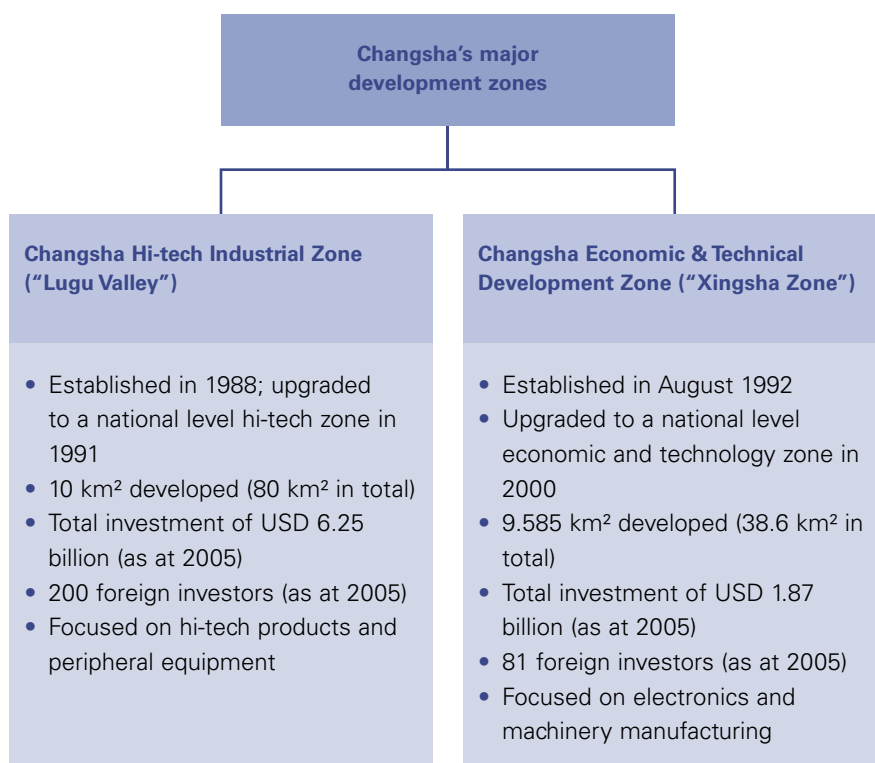
Utilized foreign investment



Number of new projects



Sources: (1) Lugu Valley
(2) Xingsha Zone



Sources: (1) Changsha Municipal Bureau of Commerce
(2) Lugu Valley
(3) Xingsha Zone

3 Infrastructure

- Land
- Factory
- Telecommunications
- Utilities
- Environmental considerations

Infrastructure can be a crucial factor in selecting a plant or office location. Changsha's development zones have been set up to provide specialized infrastructure to cater to the needs of foreign investors.



Land

Foreign companies may buy a “Land-use Right” but cannot own property outright

In China, land is either subject to State ownership or “collective” ownership. In general, urban land is subject to State ownership and land outside cities is subject to collective ownership.

Foreign companies cannot own land; most lease land by paying a one-time fee to the local government in exchange for a land use right certificate, typically 50 years for industrial land.

Land prices are regulated by the government through a system of benchmark prices for different grades of land

- The Changsha government has established a Benchmark Land Price Scale (“BLPS”) for industrial land with basic site services such as supply of water and electricity, and connection to a main road
- Land grading is based on zoning by the Land Administration Bureau
- The actual price of a lot may vary from the benchmark price, from USD 11 / m² up to USD 146 / m², but the deviation from the benchmark price will not be less/more than the benchmark price of the next higher/lower grade of land
- The industrial zones in Changsha have their own land price schedules; actual prices may be adjusted based on negotiations with zone management
 - both the Xingsha zone and the Lugu Valley lands are USD 34 / m²

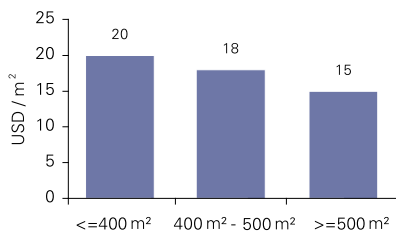


Factory

Purpose-built factories can be constructed in Changsha in 45 days using a simple steel-frame structure

- The cost to construct a single story steel-frame plant ranges from USD 43 / m² to 61 / m² (based on a 1,000 m² size and height of 8-15m)
- The cost to construct a 3-6-story steel-reinforced concrete factory is roughly USD 74 / m² to 98 / m² depending on the number of floors (based on a floor area of 1,000 m² and height of 4-5m per floor)
- The average time to construct a standard steel-frame or reinforced concrete plant is around 45 days and 130 days respectively

Annual factory rental costs (USD / m²)



Source: Lugu Valley

Within the industrial zones, pre-built factory space is available for rent and commercial premises are available throughout the city

- Industrial zones, such as the Lugu Valley Zone, have standard factory space available for rent
 - the annual rental varies from USD 15 - 20 /m² depending on the amount of space taken
 - “Standard factory” refers to space in a 6-floor reinforced concrete factory with a floor area of 1,000 m² and a height of 4-5m

Rental for first-class office buildings is under USD 6 / m² per month

- Top office buildings are located in the center of the city, with easy access to the airport, railway stations, etc.
- Space in these buildings rents for roughly USD 0.2 / m² per day, or just under USD 6 per month

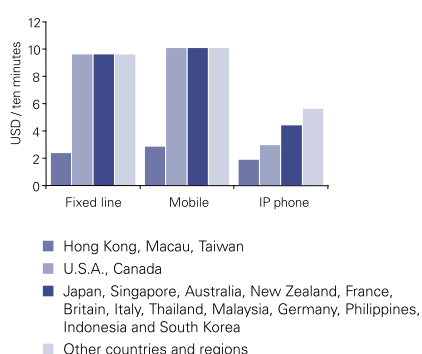


Telecommunications

Telephone options include fixed line services, mobile phone services and Internet Protocol (IP) services

In Changsha, China Telecom is the primary service provider for fixed line service and China Mobile is the primary mobile telecom provider. For IP services there are a number of firms to choose from

**Cost of overseas call
(USD / ten minutes)**



Source: China Telecom, Hunan

Telephone charges (USD / minute)

Local call		Domestic call	Overseas call	
Fixed line	0.03 for the first 3 minutes and 0.01 thereafter	0.09	HK, Macau, Taiwan	0.24
			Other countries	0.96
Mobile	0.05	0.13	HK, Macau, Taiwan	0.29
			Other countries	1.01
IP phone	N/A	0.04 per minute plus local call charge	HK, Macau, Taiwan	0.18
			US, Canada	0.29
			Japan, Southeast Asia	0.43
			Other countries	0.55

Note: "Local call" refers to the calls within the city; "domestic" call refers to calls from Changsha to any places within China. Overseas call refers to calls to Hong Kong, Macau, Taiwan and other countries and regions. Off-peak discounts of 40% discount are granted for calls to 15 countries, including Japan, U.S., Singapore, Australia, Britain, Canada and Germany. Costs are rounded to the nearest cent

Source: China Telecom, Hunan

Fixed line telecommunications are reliable, although Internet calls are an economical alternative

- IP call service is a lower cost option for domestic and international calls
- As shown, international IP calls are approximately half to one-third the cost of a comparable fixed line or mobile telephone call



Data line connections are available to 40 countries from Changsha

- In Changsha, digital data network (DDN) is the data line most widely used by corporate customers
- DDN lines can be used for secure and reliable high-speed internal connections between company sites, and for high-speed access to the Internet
- A DDN line from China Telecom can be connected to 40 countries by optical cable and satellite, routed through one of China's three international DDN gateways (Beijing, Shanghai and Guangzhou)

DDN annual rental (USD)

Speed (kbps)	Rental (local connection)	Rental (domestic, outside Changsha)
9.6	120	301
19.2	145	325
64	181	422
128	241	602
256	301	663
384	386	747
512	458	843
768	518	964
1,024	602	1,084
2,048	723	1,446

Note: DDN prices may vary based on access speed, service area and distance
Source: China Telecom, Hunan

Various forms of Internet access are available in Changsha

- Dial-up is the most common Internet access, charged by actual use (USD 0.525 per hour)
- Broadband network access services such as DDN, local area network (LAN) and Asymmetrical Digital Subscriber Loop (ADSL) are widely available in Changsha
- The annual cost for a leased LAN or DDN with a 10 Mbps transfer rate is USD 1,446 and USD 7,229 respectively; various ADSL packages are available, e.g. USD 8.75 for 60 hours with a 1 Mbps transfer rate



Utilities

As with many cities in China, Changsha's rapid growth is putting strains on its power supply during peak summer months. FIEs generally report that any power problems are manageable, and new generating capacity is being added to meet peak demand

- Changsha's power generation and transmission facilities include:
 - 101 substations with over 35kV voltage
 - main transformers with 8.65 million kVA of capacity; the peak load is 2,000 MW
- For ordinary commercial and industrial consumers, the cost of electricity is about 7 cents / kWh
- For large-scale industrial consumers (i.e. operations with over 350 kVA transformer capacity such as electroplating factories), there are two charges for electricity:
 - a basic monthly charge, payable regardless of the volume of power consumed, at roughly USD 2.5 / kVA of the transformer capacity
 - an additional consumption charge of about USD 0.06 / kWh

A national gas pipeline has been developed to connect Changsha's industrial areas to China's gas resources in the West from August 2005

- Currently coal gas is the main industrial gas used in Changsha
 - the current price of coal gas is USD 0.1 / m³
 - the caloric value is 14.7 mega joules (3,500 kCal / m³) per cubic meter
- Natural gas has been piped to Changsha from western China since August 2005
 - the current price of natural gas is USD 0.29 / m³

Changsha is surrounded by several rivers and has considerable water resources

- Changsha has six waterworks with a water supply capacity of 1.6 million tons a day
- The price of industrial water is currently USD 0.2 / ton, inclusive of waste water discharge fee of USD 0.05 / ton



Environmental considerations

Laws on environmental protection in China have been progressively strengthened

A number of new environmental laws have been introduced in China over the past 25 years.

Major Environmental Regulations	
Law	Date issued
Radioactive Waste Pollution Prevention and Control Law	2003
Law on Promoting Clean Production	2002
Noise Pollution Law	1996
Solid Waste Pollution Prevention and Control Law	1995
Environmental Protection Law	1989
Air Pollution Prevention and Control Law	1987
Water Pollution Prevention and Control Law	1984
Marine Environment Protection Law	1982

Source: Hunan Environmental Protection Bureau

- Additional regulations deal with approvals and permits, tolerance standards and pollution discharge levies
- In Changsha, the Environmental Protection Bureau and the Municipal Utilities Bureau are the authorities in charge of environmental issues
- Environment approvals are an integral part of the series of approvals required to authorize a project. There are five key stages:
 - 1 Proposal and approval of projects
 - 2 Feasibility study
 - 3 Design stage
 - 4 Construction stage
 - 5 Trial run
- Currently there are several standards that apply to waste water and air pollution, chiefly:
 - Integrated Wastewater Discharge Standard
 - Comprehensive Emission Standard of Air Pollutants
 - Wastewater Discharge Standard for Urban Wastewater Discharge Factory

4 Labor Force

- Labor availability
- Recruitment
- Education level
- Salary and non-salary costs
- Work week and annual leave
- Termination and turnover
- Unions

Changsha has a sizeable local workforce; employers can also easily draw on workers from other locations within Hunan Province. This chapter provides details on the availability and quality of labor, and on the typical salary and non-salary staff costs foreign investors can expect to find in Changsha.

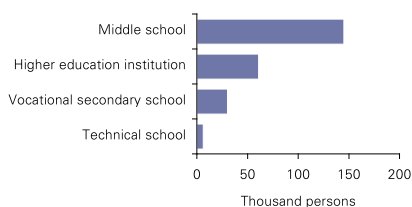


Labor availability

Changsha has a large workforce, with over 160,000 people entering the labor market every year

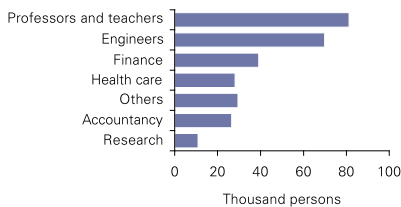
As the capital city of a populous province, Changsha has a sizable workforce, which is supplemented by new graduates from its middle schools, technical institutes and universities.

Number of new graduates in Changsha 2004



Source: Changsha Statistical Yearbook 2005

Professionals in Changsha by occupation 2004



Source: Changsha Statistical Yearbook 2005

- Changsha has 347 middle schools, 33 technical schools, 39 universities and 112 vocational secondary schools
- Major educational institutions in Changsha include the National Defense University of Science & Technology, Central South University and Hunan University
- In 2004, approximately 3,200 and 490 university students obtained a master's degree or a doctorate, respectively
- Changsha has an abundant supply of general workers, many of whom have had formal training in their respective fields

Most professional disciplines are well represented in Changsha

- There are over 100,000 members of the workforce in Changsha that are practicing a profession such as healthcare or education
- Based on membership in their respective professional associations, there are over 600 CPAs in Changsha, and over 500 lawyers
- In some professional areas that are comparatively new to China, such as marketing, trademark law or PR, the pool of available resource may be relatively limited

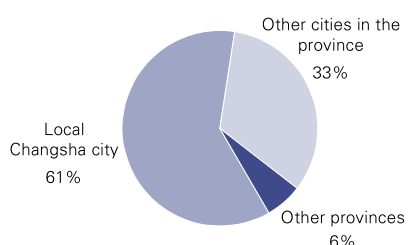


Recruitment

Job centers can help investors to recruit both skilled and unskilled staff

- Several job centers have been set up in Changsha. Individuals register with the centers which maintain databases of job seekers
- In addition to using a job center to recruit staff, FIEs can also recruit through newspaper advertisements or other channels
- Staff employed by a FIE must have their details registered with one of the three job centers authorized by the local labor bureau (Human Resources Administrative Right, or HRAR). These centers are:
 - Changsha Human Resources Market
 - Changsha Career Service Center
 - Changsha Labor Center

Origin of workforce



Source: Company survey in March 2006, KPMG analysis

Foreign companies can hire people from any location, but most workers tend to be from Changsha or elsewhere in Hunan

- KPMG's 2006 analysis of FIEs in Changsha shows that 61% of their staff is from Changsha; only a small number (roughly 6%) is from outside Hunan Province
- As is the case throughout China, foreign nationals who wish to work in Changsha must secure a Work Permit



Education level

Most employees in FIEs have received at least a high school or technical school education

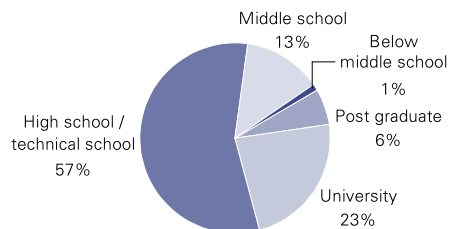
- The Chinese government provides free basic education to citizens (9 years)
 - primary school (6 years)
 - junior high school or middle school (3 years)
 - technical school and high school provides an additional 3 years of education

- Over 85% of the employees in FIEs have received at least 12 years of education

Employees working for foreign employers have typically receive further training

- Over half of the employees in FIEs in Changsha receive at least two weeks' training annually
- Roughly 35% of foreign companies provide four or more weeks of training annually

Education of workforce



Source: Company survey in March 2006, KPMG analysis



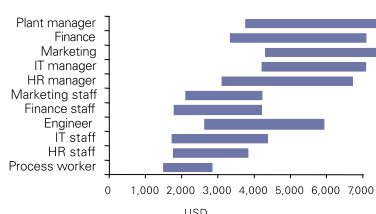
Salary and non-salary costs

Salaries for locally-hired staff are generally below USD 4,500 p.a.

- The total cost of employment consists of a basic salary and “social welfare” benefits, such as pension contribution
- The range and average of annual salaries (including bonus) for employees in common job categories in FIEs in Changsha are shown on the left
- Salaries for higher-level staff (such as a plant manager or marketing manager) tend to be related to the size of the company and thus have a relatively wider range than for line staff

Distribution of salary level

Annual salary levels



Source: Company survey in March 2006, KPMG analysis

“Social welfare” benefits must also be paid by the company and must also be considered when estimating total staff costs

- All enterprises incorporated in Changsha must contribute to a range of benefits on behalf of employees, including pension, unemployment insurance, medical insurance and union fees
- The level of contribution is based on a percentage, set by the local authorities, of an employee’s salary (see table below)
- A 5% contribution to a housing fund is mandatory; some companies also choose to pay a housing subsidy

Welfare obligations	Percentage of salary
Social welfare	
Pension fund	20
Basic medical insurance premium	8
Unemployment insurance premium	2
Staff and worker’s injury insurance premium	1
Housing fund	5
Enterprise welfare	
Staff and worker’s education fees	2
Labour union fees	2
Total	40

Sources: (1) Changsha Labor Bureau
 (2) Changsha Housing fund Administrative Center
 (3) KPMG analysis

- These non-salary costs amount to roughly 40% against an employee’s basic salary; i.e., the total employment cost of a worker on an annual salary of USD 2,000 will be roughly USD 2,800 (USD 2,000 plus USD 800 in “social welfare” benefits). There is however a cap of USD 213 per month of social welfare benefit per employee, and a minimum of USD 35 per month



Workweek and holidays

Changsha companies have a standard workweek and a number of public holidays per year

- The normal working week is up to 40 hours, from Monday through Friday
- Overtime is not prohibited but must be based on mutual agreement between employees and employers
- Public holidays include New Year's Day, Chinese New Year (3 days in late January or early February), Labour Day (May 1-3) and National Day (October 1-3). Many local companies typically give longer breaks at Chinese New Year and National Day but this is less common in FIEs

Most employees have at least one week of annual leave each year

- The amount of vacation time varies from industry to industry and among companies, but most workers receive one week's paid vacation, with additional time off based on seniority
- Half of foreign companies in Changsha give employees between 5 and 15 days of annual leave

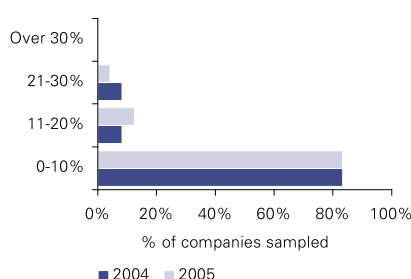


Termination and Turnover

Termination procedures are straightforward, but some regulatory arrangements should be observed

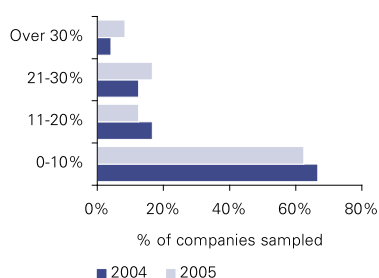
- Most employers customarily give at least one month's notice before termination of an employee; companies must also provide mandatory severance pay, normally determined by length of service
- There are two major legal documents governing the labor issues in China: the Labor Law applies to all companies in the PRC, while the "Regulations on Labor Management in Foreign Investment Enterprises" ("1994 Regulations") applies to FIEs only
- If an employer terminates an employment contract, it must first notify the union before taking action. The Labor Bureau must also be notified in the case of mass dismissals

Turnover rate of management staff in FIEs



Source: Company survey in March 2006, KPMG analysis

Turnover rate of junior staff / process workers in FIEs



Source: Company survey in March 2006, KPMG analysis

Most FIEs have staff turnover of 10% or below

- Based on KPMG's analysis of FIEs in Changsha, almost all FIEs analyzed reported annual management turnover of 10% or less
- The average turnover rate for management staff and junior staff in 2005 was 5% and 11% respectively

Unions

Few FIEs have a union in Changsha

Employees in FIEs are entitled to establish a union of their own, but establishment is not mandatory; in practice, few FIEs have a union in Changsha.

- In FIEs, the union is entitled to express its opinion (but does not have a voting right) on issues such as salaries, social benefits and working conditions
- The labor union also has the right to express objections to inappropriate termination of an employment contract. It may also support employees during the process of the resolution of labor disputes
- An FIE, if it has a union, must pay 2% of the aggregate salaries, including expatriate salaries, into a fund controlled by the union

5 Transportation

- Shipping
- Rail, road and air

Changsha is well connected to other major cities in China, by rail, air and a growing network of highways. It also has a port. International shipments of containers are usually effected via Shanghai and the Pearl River Delta.



Shipping

Changsha's new port has an annual handling capacity of 74,000 twenty-foot equivalent units ("TEU")

- Xia-ning port, Changsha's new port on the Xiangjiang River, opened in 2004 and is one of the 23 main inland ports in China. Its current annual container handling capacity is 74,000 TEU
- River transport is the most cost-effective method of long-distance domestic transport. Normally goods are transported via Shanghai to other coastal cities such as Guangzhou, Qingdao and Tianjin
- The price to ship a 20-foot container of general cargo from Changsha port to Shanghai is USD 240, inclusive of all port charges. The transit time is around 4 days

For international shipping, Shanghai and Shenzhen are the major transit ports

- Shanghai and Shengzhen are the most frequently used seaports for shipping goods internationally from Changsha
 - to Hongkong, Europe and North America, goods are usually transported to Shenzhen by railway
 - for cargo to Japan, Shanghai is the usual transit port
- The table below shows the aggregate cost (inclusive of inland transportation) for shipping a 20-foot container of general cargo from Changsha to various international ports

Cost and time of sea transportation

	Cost (USD)	Days
Hong Kong	600	10
Osaka	600	11
Rotterdam	1,400	40
Hamburg	1,400	40
Los Angeles	1,800	20
New York	2,700	40

Note: Cost of sea freight means the tariff for shipping a 20 foot container of general cargo from Changsha to the selected destinations; cost may vary depending whether shipment is via Shenzhen or Shanghai

Source: Hunan COSCO



Rail, road and air

Changsha is well served by rail, with several major national rail lines routing through the city

- Changsha is a large hub of railway transportation in China. Three major railway lines pass through Changsha: the Beijing-Guangzhou line, the Zhuzhou-Quizhou line and the Hangzhou-Zhuzhou line
- The cost of railway transportation for a 20-foot container of general cargo is over twice as much as the cost of shipping cargo by river, although several days faster

Cost and time of railway transportation

	Cost (USD)	Days
Guangzhou	280	4
Shanghai	350	6
Beijing	460	7

Note: Cost of railway freight means the tariff for shipping a 20 foot container of general cargo from Changsha to the selected destinations

Sources: (1) Changsha Train Bureau
(2) Changsha Container Transportation Co., Ltd.

Changsha is connected to the national highway network, although long distance trucking is not common

- Changsha is situated on a number of national and provincial highways, including the 107 north-south Beijing to Shenzhen highway, and the 319 east-west Xiamen to Chengdu highway. Local highways connect Changsha to other cities in Hunan Province
- Highway transportation is still relatively expensive at roughly USD 450 /TEU to Shanghai and USD 650 /TEU to Guangzhou; although very fast at 1-2 days transit to Shanghai and Guangzhou, the highways are seldom used for long-distance container transport



It takes three days for airfreight shipments from Changsha to reach the West coast of the US

- Many companies, such as COSCO Express or DHL, provide domestic and international airfreight express from Changsha to destinations all over the world
- It takes two days for cargo to reach other Asian cities from Changsha, three days to Australia and the west coast of the US, and four days to the east coast of the US and Europe

Cost of air express transportation for general cargo (USD)

	<=0.5 kg	Every additional 0.5kg
Hong Kong	6	2
Macau	12	4
Japan	11	4
Korea, Taiwan	10	4
Other countries in South Asia	12	4
Australia	17	5
Western Europe	18	7
US and Canada	17	7
South America	28	11
Eastern Europe	30	11
Middle East & Africa	30	11

Source: China Air Express (Hunan) Co., Ltd.



6 Taxation

- Taxation in Changsha
- Types of taxes

Changsha's tax environment is similar to that in other locations in China, and its development zones offer location incentives, which are broadly similar to those of zones elsewhere in the country.

Companies are advised to carefully consider potential taxation issues prior to making investments. This chapter provides general taxation information for reference only.



Taxation in Changsha

The tax regime in Changsha is similar to that in other cities in China, with few local characteristics

The taxation year in China runs from 1 January to 31 December

Foreign investment companies need to register with the Changsha tax authorities

- FIEs, and those foreign enterprises which constitute a permanent establishment, must register with the local tax authorities within 30 days after completing their business registration. A tax registration certificate will then be issued to the FIEs
- When an enterprise restructures or terminates its operations, its tax registration certificate must be amended or cancelled accordingly. Tax payers should also notify the local tax authorities of any changes in their major registration details

There is a set schedule for documents that must be filed with the local tax authorities

- Provisional income tax returns are due within 15 days after the end of each quarter
- Final income tax returns are due within four months after the end of the tax year together with:
 - the financial statements
 - an audit certificate issued by a Certified Public Accountant registered in China

China tax authorities are tightening the control on transfer pricing issues

- China tax authorities revised the rules for the Administration of Tax on Business Transactions Between Affiliated Enterprises in late 2004
 - the Rules specify that advanced pricing arrangements are allowed for future business transactions between affiliated enterprises upon approval by the tax authorities
 - transfer pricing tax audits, investigations and adjustment are becoming more common
 - China tax authorities are planning to introduce a mandatory requirement for enterprises to prepare transfer pricing documentation



Corporate income tax

FIEs' tax rate can be as low as 15% in designated locations, but changes are on the horizon

The income tax on FIEs and Foreign Enterprise is normally charged on a company's taxable profits at 30%, plus a 3% local surtax. However:

- The income tax rate is reduced to 15%, without any local surtax, in certain special zones or designated cities
- FIEs of a manufacturing nature with an operating period exceeding 10 years are exempted from income tax for two consecutive years commencing from its first profit-making year and are entitled to a 50% income tax rate reduction in the subsequent three years of operations
- FIEs in Changsha that export more than 70% of their production may be approved as an Export Oriented Enterprise and can enjoy an income tax rate of only 10%

Currently, there are two corporate income tax laws running in parallel for FIEs and domestic Chinese enterprises. Generally, FIEs enjoy more preferential tax treatment than domestic Chinese firms.

China's accession to WTO is expected to impact the taxation system

The current discriminatory taxation systems will be abolished to provide a level playing field for both FIEs and domestic firms. The income tax laws for FIEs and domestic enterprises are expected to be unified, though an official timeline has not yet been fixed.

General speculation is that the income tax rate for FIEs will be increased, and tax incentives currently available only to foreign investors will be abolished, although there are indications that existing FIEs could be "grandfathered" in some way.

Foreign investors in Changsha's two development zones are eligible for tax reduction and exemption

FIEs in the Changsha National Hi-Tech Industrial Development Zone and the Changsha Xingsha National Economic & Technical Development Zone are entitled to preferential income tax treatment:

- Income tax is charged at a reduced rate of 15% for high-tech FIEs (government approval is needed to acquire "high-tech" status)
- High-tech manufacturing FIEs with an operating period exceeding ten years are exempted from income tax for two consecutive years commencing from their first profit-making year followed by three years of 50% reduction in the income tax rate. An "advanced technology" manufacturing FIE is entitled to an extended three-year tax holiday with a tax rate reduced to 10%
- Such tax treatment is subject to confirmation by the Changsha Tax Bureau



Turnover taxes

Turnover taxes include Value-added Taxes, Business Tax and Consumption Tax

According to the PRC value-added tax (VAT) regulations, companies engaged in the sale of goods, provision of services of processing, repairing, and the importation of goods into Chinese territory must pay VAT at a rate of 17%, subject to the following exceptions:

- A special 13% VAT rate is applied to sales of certain goods such as cereals and vegetable oils, and some categories of printed materials, utilities/fuels, and agricultural supplies and equipment
- Taxable goods refer to tangible moveable properties, and include certain utilities such as electric power, heating power, and gas. A small number of goods are exempt from VAT. These include contraceptive drugs and devices; antique books, and imported equipment for use in scientific research, scientific experiments, or teaching
- Most exports are entitled to VAT refund with a rate ranging from 9% to 13%

Providers of services are subject to Business Tax (BT) based on the gross receipts for the services. Taxable services include any service related to transportation; construction; finance and insurance; post and telecommunication; cultural activities and sports; and entertainment.

- BT rates are generally either 3% or 5%. However for entertainment businesses, applicable rates range from 5% to 20%
- BT is payable in Renminbi (RMB). Taxable amounts in foreign currencies are converted into RMB using a prescribed conversion method which must be applied by the taxpayer
- It should be noted that a transaction is generally not subject to both VAT and BT

Consumption tax (CT) is levied on the importation into or the production and processing inside China of luxury or high-end goods, including tobacco, alcoholic drinks, cosmetics, skin and hair-care products, jewelry, fireworks, gasoline, diesel, tyres, motorcycles, and motorcars.

- Taxable goods exported by a taxpayer will be exempt from CT, unless stipulated by the State Council
- CT is levied at a rate ranging from 3% to 48%, based either on the goods' price, or on the quantity (e.g. weight)



Other taxes

Customs duties on imported goods are charged on the landed price and are being reduced in stages

Customs Duty is charged on the importation of goods into China. The various rates of Customs Duty can be found in the "Import and Export Tariff of the PRC", which is part of the Customs Regulations.

- For many years China has been significantly reducing its customs duty rates on most imported goods. WTO membership has bound China to a program of further reductions
- The dutiable value of an import is calculated on its landed price, including the price of the import, packing expenses, freight, insurance and other services incurred before unloading the import at the port of discharge. The dutiable value of an import item is converted into RMB according to rules set by the State Administration of Foreign Exchange ("SAFE")

Withholding tax is charged on certain remittances outside China

For any rental, interest, license fee and royalties remitted outside China, overseas companies which receive any of the above income are subject to a PRC income withholding tax.

- The percentage withheld is based on the rate set out in the tax laws and is applied to the amount of the remittance. Generally, the withholding rate is 10% in China. Under certain circumstances, 5% BT can also apply and then the combined rate is 14.5%. Foreign loans should be registered with SAFE as foreign debt within the maximum foreign loan borrowing capacity (difference of total investment and registered capital). Remittance of service fees can be complex; PRC tax implications are different for onshore and offshore services
- Companies are subject to the withholding tax either at the point of making overseas remittance by the PRC payer or at the point of making an accounting accrual for the above fees in their financial accounts
- Dividends paid to foreign investors are currently exempted from China's withholding tax



Individual Income Tax (IIT) is a progressive tax with a maximum rate of 45%

Individual Income Tax

Taxable income (USD)		Tax rate	Quick deduction factor (USD)
From	To	%	
–	60	5	0
60	241	10	3
241	602	15	15
602	2,410	20	45
2,410	4,819	25	166
4,819	7,229	30	407
7,229	9,639	35	768
9,639	12,048	40	1,250
Over		45	1,852

Note: Taxable income for domestic employees is the balance of their monthly income after deducting USD 200 for personal expenses

Source: PRC IIT Law

- Employers or salary payers are legally obligated to withhold the appropriate amount of IIT from the employment income of employees and directly remit the tax to the PRC tax authorities.
- The employer is responsible for any tax under-withheld or underpaid
- The basic formula is:

$$\text{IIT} = \text{taxable income} \times \text{tax rate} - \text{quick deduction factor}$$

IIT returns are filed on a monthly basis. For expatriates, monthly exemption amount is USD 600; in addition certain expenses are tax deductible such as housing and education.



Stamp duty

Stamp duty is applicable on certain types of documents in China

All parties executing or receiving dutiable documents in the PRC are subject to Stamp Duty. Dutiable documents include:

- Contracts or similar documents on sales, processing, contracting of construction and engineering projects, property leasing, goods transportation, storage and custody, loan, property insurance and technology
- Deed of property transfer
- Business account books
- Permits and licenses
- Other documents determined as dutiable by the Ministry of Finance

Overseas contracts are not subject to stamp duty so long as they are not executed in the PRC. If signed outside of China but executed in China, the contracts will be subject to Stamp Duty when brought into China.

Electronic contracts and accounting records are not subject to Stamp Duty provided these documents are not printed and filed for recording purposes.

An aerial photograph of Changsha, China, showing the city's dense urban landscape and the Changjiang River flowing through it. The image is overlaid with a semi-transparent blue filter.

7 Living in Changsha

- Travel
- Housing, hotels and healthcare
- Shopping, recreation and education
- Climate

Changsha is a large urban city in the “heartland” of China. It has a long history and strong traditional culture; and with increasing levels of foreign trade and investment, it is becoming more “user friendly” for foreign visitors and residents.



Travel

Changsha is within easy reach of major Chinese cities - about one and a half hours by air from Hong Kong or Shanghai

- The airport currently operates roughly 40 domestic routes non-stop to major domestic destinations such as Beijing, Shanghai, Guangzhou and Shenzhen, and destinations further afield, including Hong Kong SAR and Bangkok
- The Changsha Huanghua Airport is a 30-minute drive from downtown Changsha
- China's first private airline, Okay Airlines, selected Changsha as one of its two regional hubs for passenger operations in 2004

Travel by air

	Ticket price (USD)	Flying time (hours)	Number of flights per week
Shanghai	110	1.5	42
Beijing	150	2	46
Guangzhou	86	1	42
Chongqing	93	1	22
Hong Kong	106	1.5	8

Note: Economy Class
Source: Huanghua Airport

Train is a popular means of travel in China, and Changsha is on the main national railway lines

- Changsha is also a railway hub connected to other major cities in China. The main railway station is located downtown and has daily express trains to major cities such as Beijing, Shanghai and Guangzhou

Domestic travel by train

	Ticket price (USD)	Travel time (hours)
Shanghai	50	15
Beijing	64	16
Guangzhou	40	10

Source: Changsha Railway Station



Housing, hotels and healthcare

A variety of housing options are available in the city, including a number of 5 star hotels

Number of hotel rooms and average price

Rating	Number of rooms	Average charge per night (USD)
5-star	1,788	59
4-star	2,926	39
3-star	6,782	20

Sources: (1) Changsha Tourism Bureau
(2) KPMG analysis

- Long term residents in Changsha have several housing options, ranging from renting apartments to serviced rooms in one of Changsha's hotels
 - the cost of a 3-bedroom, 130 m² (1,400 ft²) apartment in the downtown area is approximately USD 300 per month
- Changsha has six 5-star hotels, 12 4-star hotels and 46 3-star hotels. The standard daily rate for a room ranges from USD 24 to 60, with discounts available for longer stays
- Larger hotels offer a range of facilities including conference/ballrooms, western restaurants, gymnasium and sports facilities

Many hospitals and clinics provide basic and specialist medical care

- Over 250 hospitals serve the residents and visitors in Changsha. A joint venture healthcare facility is currently planned



Shopping, recreation and education

Changsha's shopping and entertainment options are expanding, with many international retailers setting up in the city

- Changsha now has a number of multinational hypermarket chains, including Carrefour and Metro; and chain restaurants such as Pizza Hut, McDonalds and KFC
- Gyms, golf, history museums, parks and other recreation facilities in and around Changsha provide plenty of weekend entertainment options to residents and visitors

An ancient city, Changsha has many scenic sites

- Yuelu Hill lies on the western banks of the Xiangjiang River and is one of Changsha's most historic spots. The Yuelu Academy was a Song Dynasty (960-1279 CE) institution that trained scholars for the civil examinations
- The Hunan Provincial Museum is famous for the Western Han (206 BCE-24 CE) tombs that were discovered in 1972 at Mawangdui, four kilometres northeast of Changsha

Changsha has a strong academic community including 39 colleges and universities

As a provincial capital, Changsha is home to a number of institutes of higher education, and an international school is planned for Changsha.



Climate

Changsha has long and humid summers and mild winters

- Annual average temperature is roughly 18 °C, with an annual average rainfall of roughly 1,300 mm and an annual average frost-free period of 280 days
- Summers are hot and humid, with the annual rainy season between June and August; in winter the mercury seldom dips below zero – the average winter temperature is around 5 °C
- Changsha's humidity levels are relatively constant all year round at roughly 80%

Climate in Changsha

	Sunshine (hours)	Rainfall (mm)	Average temperature (°C)	Average humidity (%)
Jan	27	75	3.2	85%
Feb	38	191	3.6	85%
Mar	81	106	10.4	77%
Apr	158	92	20.5	72%
May	80	401	22.2	84%
Jun	149	272	27.2	80%
Jul	249	67	30.2	69%
Aug	182	80	27.0	78%
Sep	144	48	24.6	82%
Oct	117	64	18.2	78%
Nov	92	159	15.1	81%
Dec	27	34	6.2	69%
Average	119	133	17.5	78%

Source: Changsha Weather Bureau, 2005 data



8 Useful contacts in Changsha

- Changsha Municipal Bureau of Commerce
- Other Government contacts
- Other useful internet links



List of useful contacts in Changsha

Changsha Municipal Bureau of Commerce

10th Floor, Municipal Government Mansion
No. 218, Yuelu Road, Changsha
Postcode: 410013
Website: <http://www.cstrade.gov.cn>

Foreign Investment Liaison Department
Tel: +86 (731) 8665557
Email: hninvest@yahoo.com.cn

Foreign Investment Administration Department
Tel: +86 (731) 8666056
Email: csinvest2006@yahoo.com.cn

Foreign Trade Department
Tel: +86 (731) 8665556
Email: cswm2006@hotmail.com

Other Government Contacts

Changsha Municipal Administration of Industry and Commerce
No. 411, 1st sect, 2nd South Ring Road, Changsha
Tel: +86 (731) 2891606

Changsha Municipal Land Administration Bureau
No. 150, Evening News Avenue, Changsha
Tel: +86 (731) 2183182

Changsha Environmental Protection Bureau
No. 138, Chaoyang Road, Changsha
Tel: +86 (731) 4129654

Changsha Utility Administration Bureau
No. 231, Jiucaiyuan Road, Changsha
Tel: +86 (731) 4435267

Changsha Local Tax Bureau
No. 1, Baisha Street, Changsha
Tel: +86 (731) 5118960

Changsha State Tax Bureau
No. 269, North Shaoshan Road, Changsha
Tel: +86 (731) 4185602



Changsha Bureau of Communications
No. 290, Xiangchun Road, Changsha
Tel: +86 (731) 4313479

Changsha Labor And Social Security Bureau
No. 57, 2nd sect, Middle Furong Road, Changsha
Tel: +86 (731) 4424907

Administrative Committee,
Changsha High-Tech Industrial Development Zone
No. 668, Lugu Avenue, West Riverside, Changsha
Tel: +86 (731) 8995518
Website: <http://www.cshtz.gov.cn>

Administrative Committee,
Changsha Economic and Technology Development Zone
No. 2, Sanyi Road, Xingsha County, Changsha
Tel: +86 (731) 4011101
Website: <http://www.cetz.gov.cn>

Others useful internet links

Changsha Government "Window"
Website: <http://www.changsha.gov.cn>

Changsha Business "Window"
Website: <http://www.cstrade.gov.cn>

Changsha Customs
Website: <http://customs.hunan.gov.cn>

Changsha Tourism Information
Website: <http://www.hn1226.cn>

Changsha News
Website: <http://www.csonline.com.cn>

Changsha Real Estate
Website: <http://www.haofz.com>

Changsha City Map Online
Website: <http://changsha.map.banruo.net/mapredirect.asp>

China Telecom, Hunan Province
Website: <http://www.hntelecom.net.cn>

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