



CO-OPERATION PROGRAMME
FOR A SUSTAINABLE PARTNERSHIP BETWEEN
SMES OF THE MECHANICAL INDUSTRY
FROM E.U. AND CHINA

GUIDE FOR BUSINESS ITALY



INTRODUCTION

During the first half of 2005 the Chinese economy registered a growth of 9.5% compared to the same period of the year before, even though Chinese observers' expectations talk about an economic slowdown for the whole year.

Industry is still the GDP driving sector, followed by the services. During this first part of the year the industrial production recorded a growth of 16.4% together with a considerable slowdown in the growth rate of business's profits.

In spite of a decrease in fixed capital investments, a sharp investment increase has been registered in the mining sector, in the energy production and distribution and in the railway construction sector. Inflation has diminished, but the rising cost of raw materials and energetic products keep the production prices high.

The occupational situation is good: 5.9 million new workplaces have been created, the new unemployed people have found a re-employment within six months while 600,000 employed people between 40 and 50 years of age have found a new job.

The available per capita incomes keep increasing together with the currency reserves of the Central Bank.

As for trade, China has registered an increase of 23.2%, with a sharp prevalence of exports over imports (which increased respectively of 32.7% and 14%). Exports concern primary products (7%) and industrial products (93%), mainly machinery and high-tech products. Imports, as well, regard primary products (22.3%) and industrial products (77.7%), especially machinery, followed by chemical products, raw materials and energy raw materials.

Asia represents the main interlocutor in trade matters, followed by Europe, America, Africa and Oceania.

Foreign investments to China show a slowdown trend, contrary to what has been registered for investments concerning the mining, industrial, services and sales sectors destined to other countries, mainly concentrated in Latin America and Asia.



Import-export movements' trend between Italy and China has increased of 22.6% (first four months of 2005). Exports have registered an increase (an annual growth of 7.8%) which mainly concerned the machinery sector, followed by the metallurgical industry and electrical appliances production. The largest slice of Italian export is still represented by instrumental goods, which are essential products for the Chinese project: acquiring foreign technology to develop the process of industrialization and modernization of the existing production facilities and guarantee a high level of productivity and competitiveness.

As for Italian imports, they have registered as well a considerable increase of more than 28% in the clothing industry, in the textile sector and in the production of accessories, electrical appliances and machinery.

With an annual increase of 73.45%, Italy places itself at the fifth place among the European investors. The 75% of Italian investments, largely along the coast of the Country, mainly concern car industry, mechanical and chemical sector and textiles.

For a long time, Italy's economic presence within the Chinese market has been limited to import-export activities. Today, in the light of the importance China has in the global economic development and as a consequence of a largely widespread different image, much more attention is paid to the greater opportunities the Chinese market can offer, as well as to the issue of the productive and distributive settlement. The advantages of the great infrastructural works and modernization of the productive structures, as well as of the population higher living standard, push Italian businesses to considerate the possibility to enter the Chinese market and conceive productive and distributive partnership projects, made also possible by the present privatization process. Some sectors, the mechanical and the machinery industry (textile, tanning and wood processing machines), the car industry and the chemical and pharmaceutical sector have already delocalized and invested in China, thus benefiting from numerous advantages, such as saving on production costs, reducing delivery time inside the home market, management of assistance and post-sale services and the facilities, for local buyers, to use local currency.



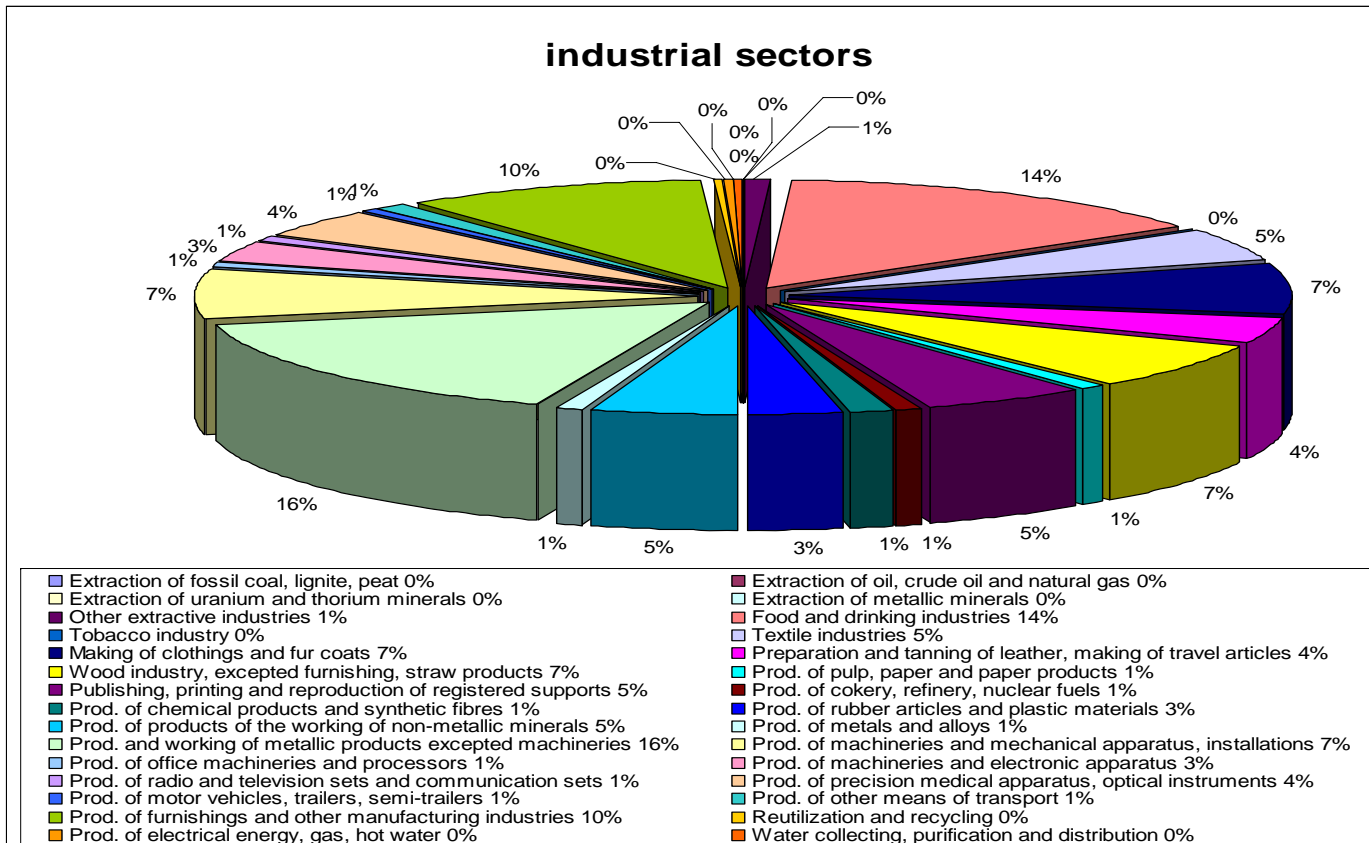
SOCIO-CULTURAL ANALYSIS

- FAMILIES (Average number of family members in 2005) **3,33**
- HOUSING
Average surface **90,0 m²**
Percentage of owned houses **78%**
Percentage of rented houses **22%**
- EDUCATIONAL DEGREE
Degree **7,6%**
Degree: 6,5%
University Diploma: 0,7%
Non-University Diploma: 0,4%
High School Diploma **21,2%**
High School Professional Diploma **4,6%**
Junior High School **30,1%**
Primary School Diploma **25,4%**
Literate People without educational qualification **9,6%**
Illiterate People **1,5%**



INDUSTRIAL SECTORS OF THE DISTRICT

Number of enterprises and percentage of different industrial sectors of the district

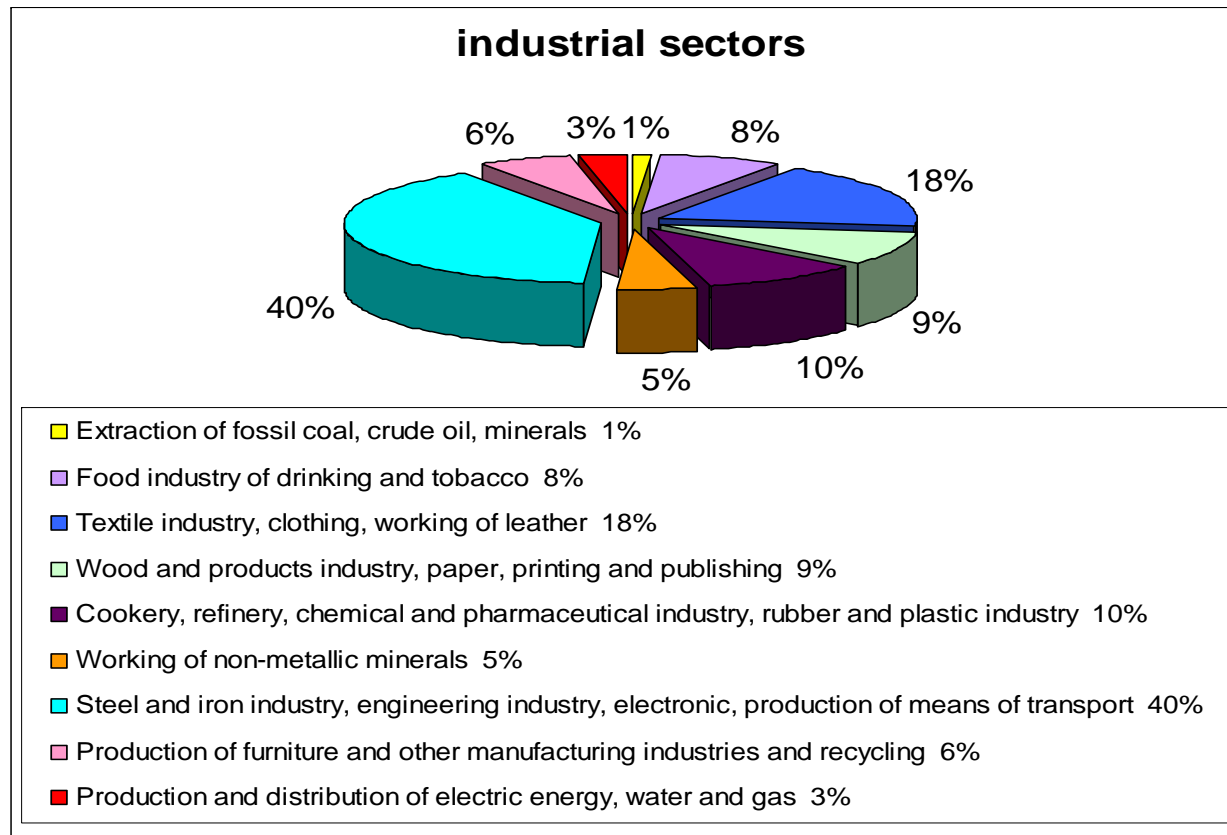


**Total Enterprises:
1.520.400**



INDUSTRIAL SECTORS OF THE DISTRICT

Number of employees and percentage of industrial sectors in the district



**Total employees:
5.329.027**



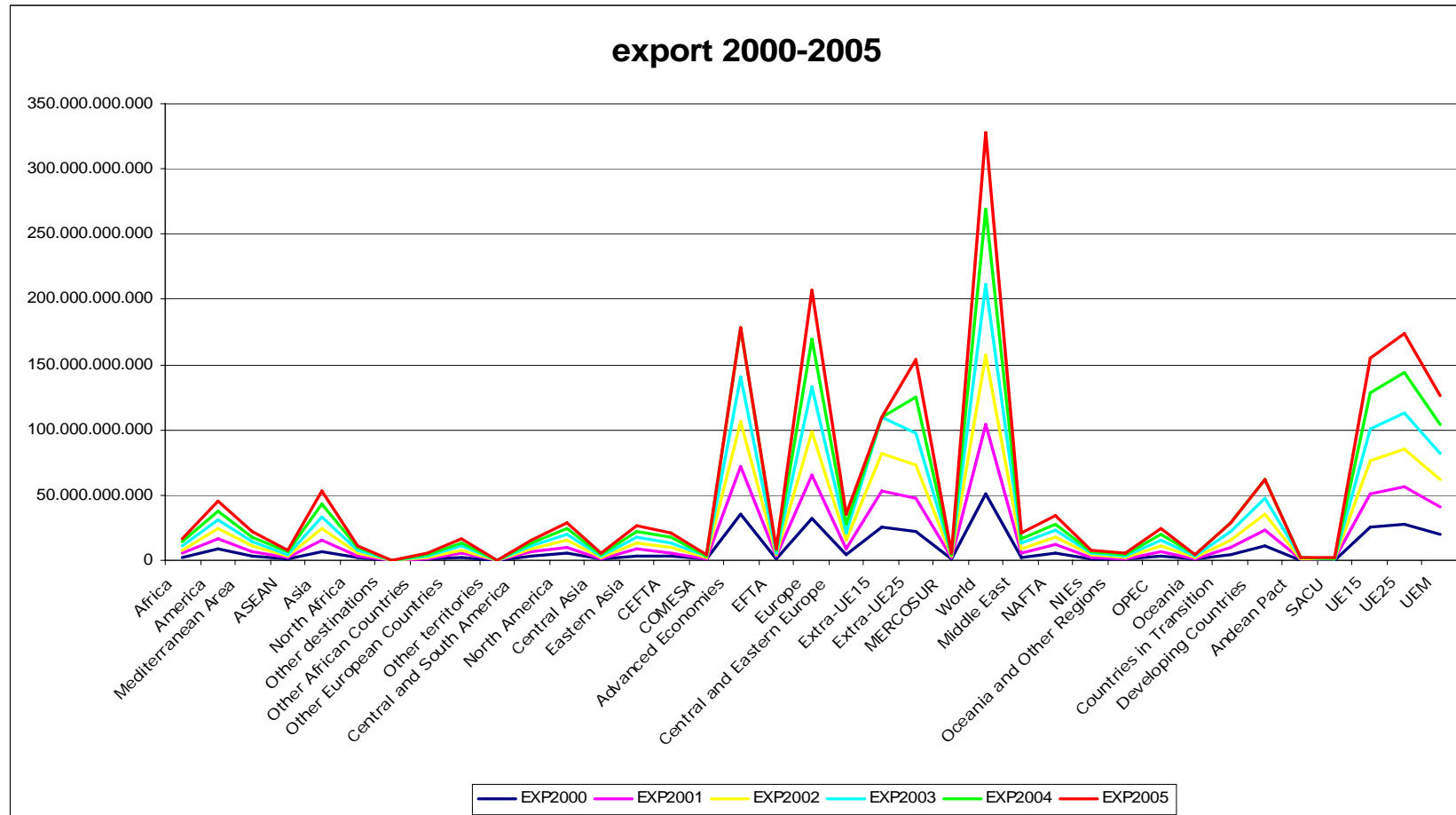
ECONOMIC ANALYSIS

- DENSITY OF ENTERPRISES – nr. of enterprises/surface **20,15**
(enterprises per km²)
- ENTREPRENEURSHIP INDEX – tot. nr. enterprises/res. pop. **0,1**
(10 entrepreneurs on 100 inhabitants)
- BIRTH RATE – nr. new enterprises/tot. nr. enterprises **6,9**
- DEATH RATE – nr. ceased enterprises/tot. nr. enterprises **5,6**



THE MECHANICAL SECTOR: EXPORT

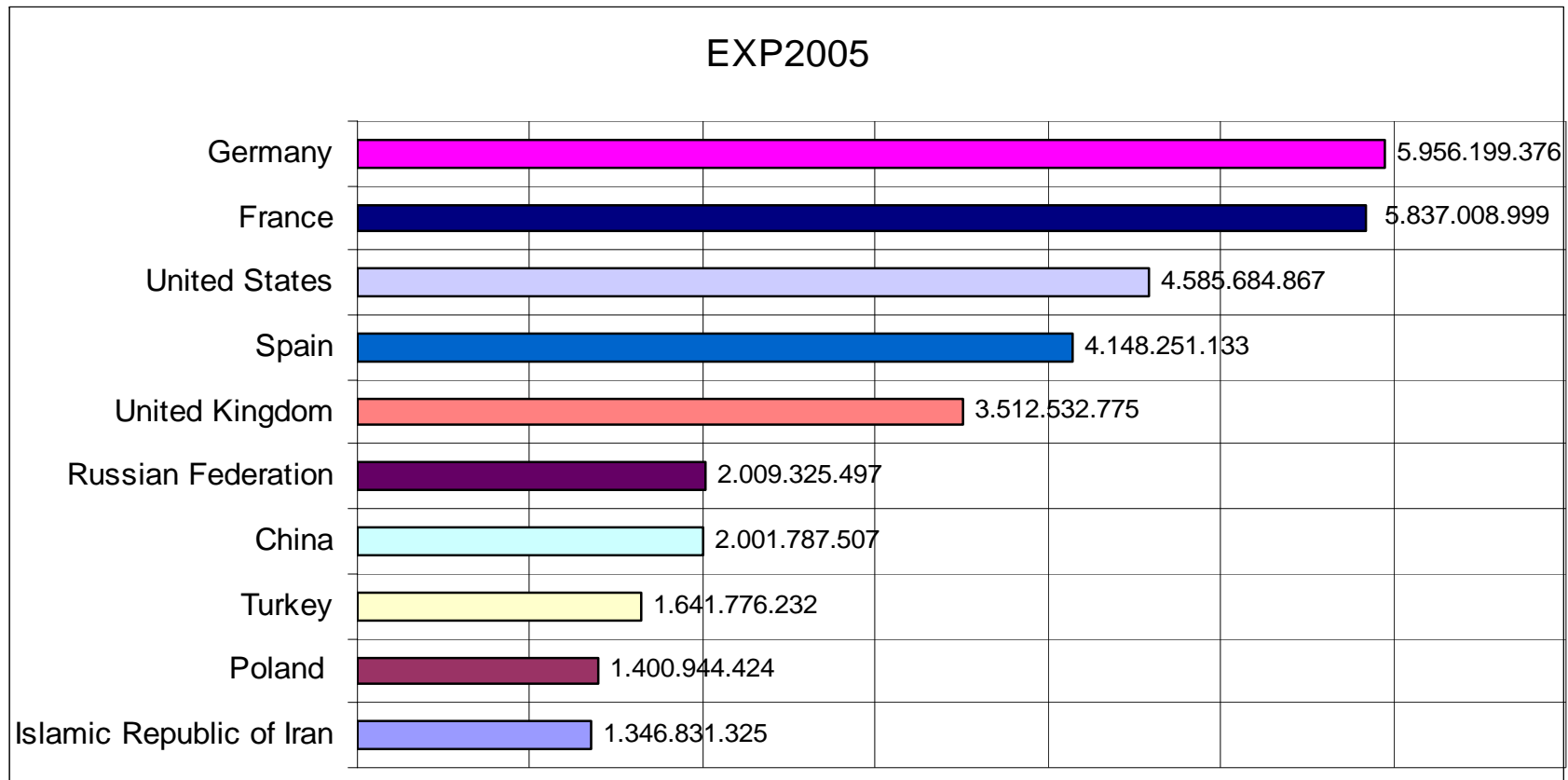
Export trend in the mechanical industry from 2000 to 2005





THE MECHANICAL SECTOR: EXPORT

The first 10 outlet countries, by absolute value (in Euro), for mechanical enterprises in 2005.





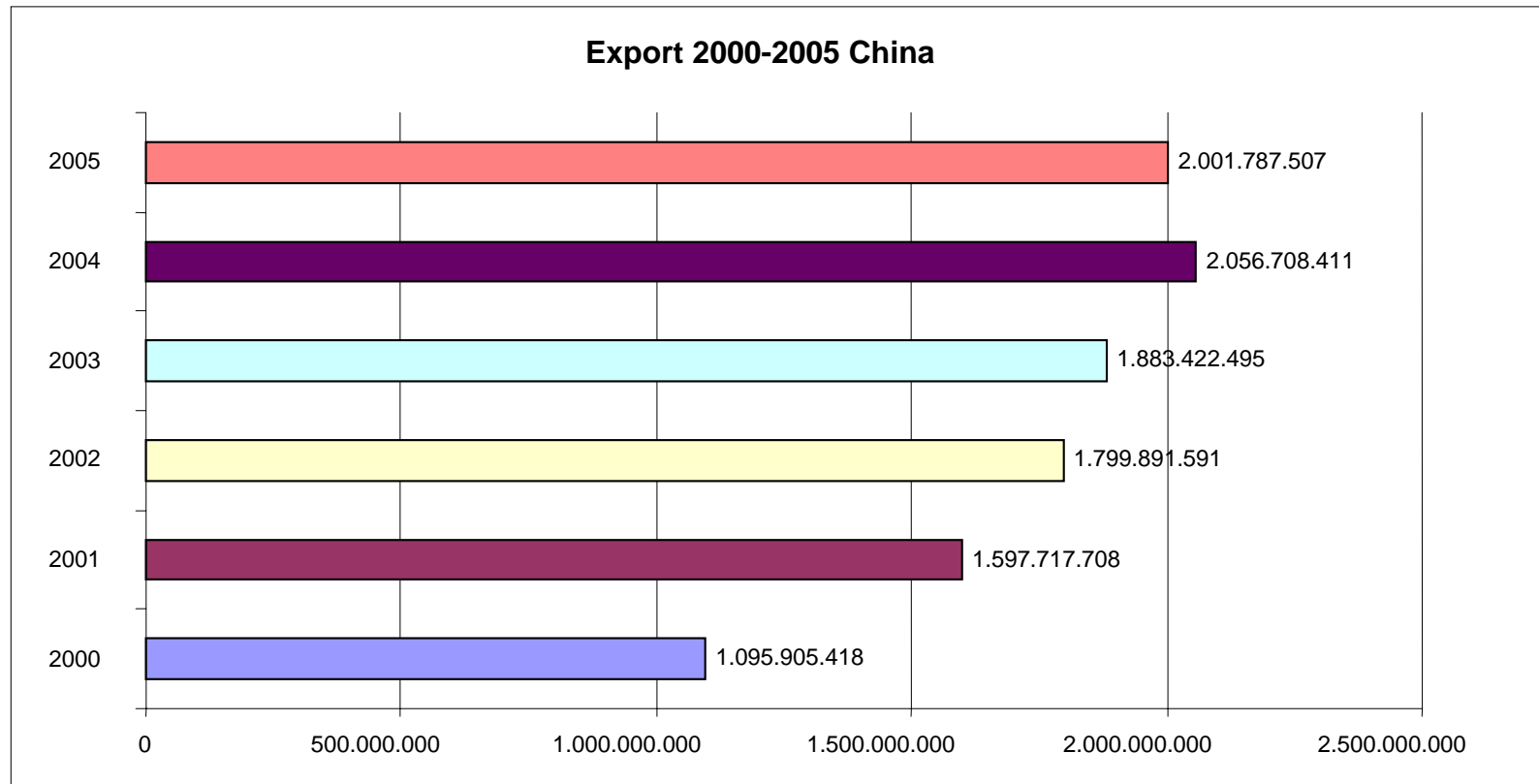
THE MECHANICAL SECTOR : EXPORT

- Expectations of mechanical sector's entrepreneurs about the commercial activities abroad in the period 2006-2007.
- In sharp decrease: **2%**
 - In decrease: **5%**
 - Stable: **64%**
 - In increase: **19%**
 - In sharp increase: **10%**



THE MECHANICAL SECTOR: EXPORT

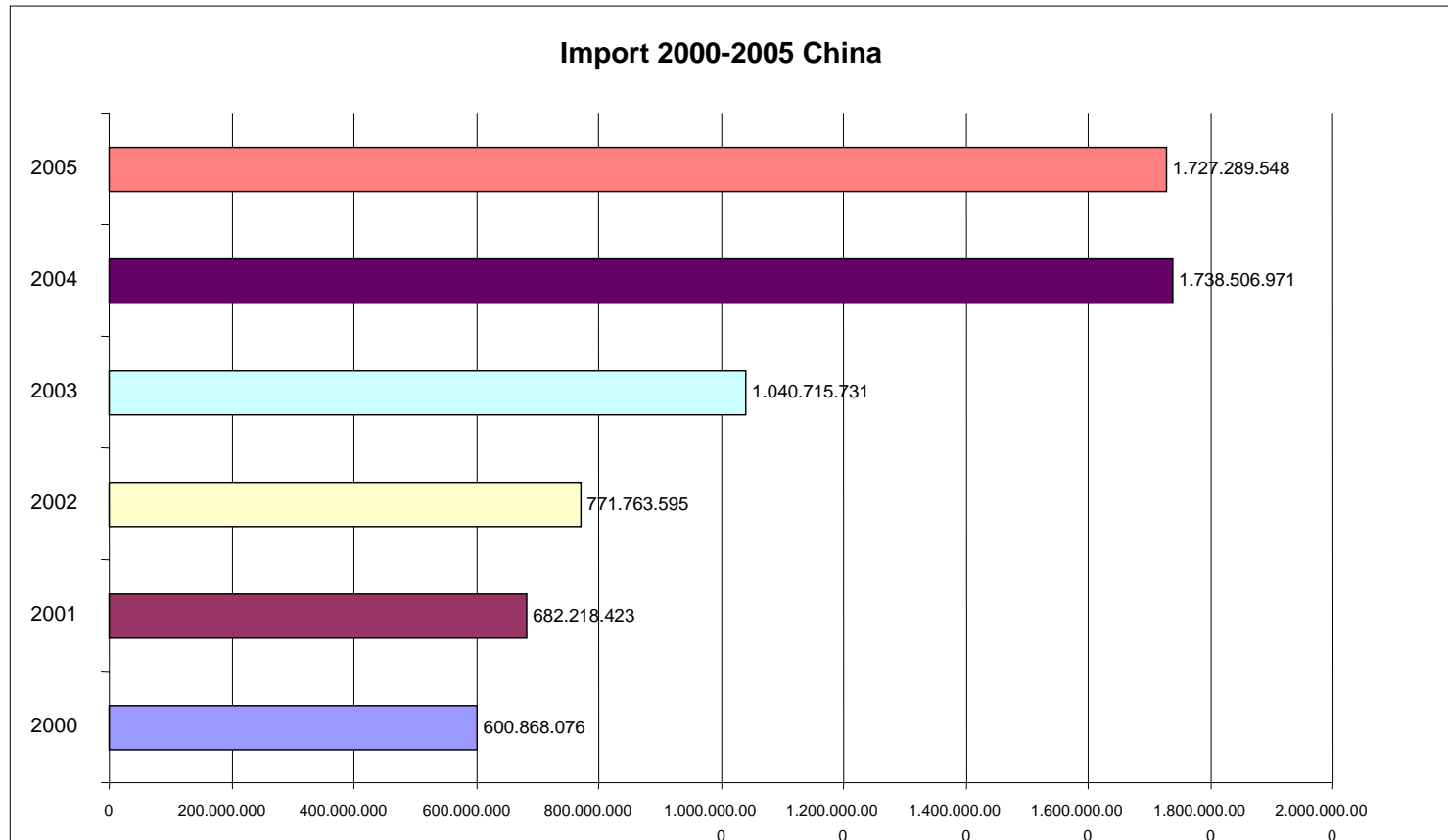
Mechanical industry exports trend (2000-2005) from Italy to China





THE MECHANICAL SECTOR: IMPORT

Mechanical industry imports trend (2000-2005) from China to Italy





RELATIONSHIPS WITH CHINA

China is a huge market with an extraordinary growth and its recent entrance in the WTO, the perspective of the Olympic Games in Beijing in 2008 and the Universal Exposition in Shanghai in 2010 may be an important occasion for the development of relations between EU and Chinese enterprises.

China is a great opportunity for Italian and EU enterprises, especially for those dealing with the mechanical sector, even if they still feel threatened by its growth and by the counterfeiting problems connected to its development.

On the other hand, even if China has been importing machinery from EU over the past 40 years, the Chinese mechanical sector still needs to acquire new technologies and specialized know-how on technical innovation and quality to be more competitive, and has to learn how to meet EU standard requirements.

Italy, as well as each EU country, has a strong mechanical sector but, as the dimension of its enterprises is medium and small, it strongly needs to be assisted and supported in its internationalisation processes towards China; whereas the Chinese companies of the mechanical district strongly need assistance and support on innovation technologies which Italian enterprises and the enterprises of the whole EU can transfer to them. In fact, SMEs are the ones who mostly need being supported in their processes of internationalisation because – given their small size and their limited economic/human resources – they strongly need help from institutions in order to be able to penetrate new markets in the proper way and in order to become more and more independent through the acquisition of new strategies, methods and know-how.



RELATIONSHIPS WITH CHINA

The relationships between Italy and China have considerably improved during the last five years. Globally, the trend of commercial relations between China and Italy seems to be really good, since the volume of the commercial trade is constantly increasing.

According to Chinese statistical data, in the year 2005 the bilateral commercial exchange Italy-China grew up with a percentage of 18,6 in comparison to the year 2004, reaching the value of 18,6 billion US dollars.

The Italian exports concerning the year 2005 (referred to the same data) reached, in value, 6,9 billion US dollars, with a booming percentage of 6,9 in comparison to the year 2004.

In Italy a considerable growth of exports towards China has been occurring. The 85% of export is made up of instrumental goods, such as means of transport and industrial machineries. The export of these products is partially laid on the line from the increasing presence and competition of other western countries and from the same Chinese manufacturing industry that aims at developing in loco the production of these goods.

As far as the remaining 15% is concerned, about 0,6 billion of euro, it is made up of typical "made in Italy" products, such as fashion, furniture and food. These products are addressed to a group of purchasers which is absolutely the minority. Therefore, the export of consumer goods towards China will become significant in the coming years, when the purchasing power of a new social class will arise and develop in the Chinese Country.

In 2005, on the other side, the Italian imports from China reached 11,7 billion US dollars, registering an increasing value of 26,8% compared with the previous year. The main product items of such a commercial flow are represented by the machinery sector (27,5%).



RELATIONSHIPS WITH CHINA

In the European Community field Italy turns out to be the 3rd supplier Country, as far as provisions towards China are concerned, after Germany and France, and the 4th client Country, after Germany, Netherlands and United Kingdom.

The Italian Foreign Direct Investments, according to the data provided by the Ministry of the Chinese Trade, during the year 2005 amounted to 322 million US dollars, referred to 481 new projects. In this way, the cumulated amount of Italian FDI in China reached, in 2005, the value of 2.546,6 million US dollars.

In the same year, Italy confirmed its 5th position among the European investors, after Germany, Netherlands, United Kingdom and France.

According to the same source, the Chinese investments in Italy, cumulated at the end of the year 2005, were equal to 54,75 million US dollars.

On the whole, the Italian enterprises operating in China with a direct presence (excluding Hong Kong) are about 1500.

As far as the choice of the sector is concerned, the Italian investments are quite diversified, showing significant shares in the automobile, mechanical, chemical and textile sectors.

Furthermore, a certain geographical concentration of commercial initiatives inside the Chinese territory is emerging: more than three-quarter of investments carried out until now have concerned mainly 5 of the 31 provinces of the Country, located on the costal areas: Shanghai, Jiangsu, Shandong, Hebei and Tianjin. However, Italian enterprises are present in 25 Chinese provinces.



RELATIONSHIPS WITH CHINA

Commercial exchange between China and Italy

\$ billions

YEAR	2000	2001	2002	2003	2004	2005	Variance % 05/04
IMP. IN CHINA	3,08	3,78	4,31	5,08	6,44	6,93	7,70
EXP. TOWARDS ITALY	3,80	4,01	4,82	6,65	9,23	11,69	26,76
COMMERCIAL EXCHANGE	6,88	7,79	9,13	11,73	15,67	18,62	12,72
BALANCE FOR ITALY	-0,72	-0,23	-0,51	-1,57	-2,79	-4,76	70,60

Source: World Trade Atlas 2000–2005. Data processing ICE Beijing

Italian quotas on the total imports of China

%

1999	2000	2001	2002	2003	2004	2005
1,63	1,38	1,56	1,46	1,23	1,15	1,05

Source: World Trade Atlas, China Edition 2004, 2005. Data processing ICE Beijing

Italian quotas on the total exports of China

%

1999	2000	2001	2002	2003	2004	2005
1,49	1,52	1,50	1,47	1,52	1,55	1,53

Source: World Trade Atlas, China Edition 2004, 2005. Data processing ICE Beijing



HOW WE SEE CHINA

The year 2006 has been designated as "The Year of Italy in China", an initiative launched by the Government in order to create a link between the two Countries. The Year of Italy in China focuses its attention not on the threat that China may represent, but on the opportunity of China, and more specifically on a potential market made up of 1 billion and a half purchasers and possible economic partners with the need of creating and/or improving new industrial sectors like the food farming, manufacturing and wine and food sectors.

The Chinese market represents a huge market that wishes to learn creativity and innovation, the "good-life", the "good-food", the "good taste", in other words it is a market where the desire/need to "learn" is emphasised and where the Italian enterprises could perform an important role as active "players": China is a wide market of training for two Countries with different but compatible requirements.

On one hand, China frightens the companies of the western countries, Italy included, because of its ability of producing at very low costs, the absence of strict laws on product standards, the facility of Chinese enterprises to reproduce exactly the same products of other companies. The markets are invaded from "made in China" products, which conquer more and more increasing shares of customers thanks to their extremely competitive prices.

A lot of discussions and considerations are made about China and special emphasis is given to the most evident phenomenon concerning the fakes, which anyway the Chinese Government has been committing to severely put down. In reality, China, with its low prices and strong competition, represents an high developing economy supported by huge public investments and fostered by the very low labour costs; the western economies have to work very hard in order to compete with this economic system.



HOW WE SEE CHINA

In the struggle against the counterfeiting both Chinese and Italian Governments share the same perseverance and responsibility, therefore it is necessary that both countries strengthen their co-operation relationships in order to defeat together the counterfeiting; in support of that, China and Italy have already started several good initiatives of collaboration, which turn out to be very fruitful.

China is also a big market which changes and grows progressively. In fact, several entrepreneurs and economists believe that China, with an economic growth that today and in the middle term is expected to have no comparisons in the world, will become a huge market with sufficient resources to consume even the "made in Italy" products, which are already considered from the Chinese as synonym of high quality and style. In fact, according to some surveys on how the Chinese enterprises see the Italian ones, the "made in Italy" is perceived very positively and the most frequently mentioned Italian products are food products (21%), clothing (18%), leather goods (15%), shoes (7%). These goods are on the top of the list of Chinese consumers' desires and contribute to make Italy, to the eyes of Chinese people, mainly a Country of fashion.

Nevertheless, we can't say that China doesn't imply an opportunity. As a matter of fact, the Italian enterprises can make profit from the low costs and the high productivity of the Chinese system, launching in loco an entrepreneurial activity. For these reasons, China is graded in the first place as far as the capability of attracting foreign capitals is concerned.

Several researches have pointed out that those Italian companies which have launched until now the most part of entrepreneurial initiatives in China are small and medium sized enterprises. The SMEs represent, indeed, more than 70% of the Italian presence in China.



HOW WE SEE CHINA

The mode of entering the Chinese market that has been till now more frequently chosen by the Italian enterprises is the start-up of a joint-venture with a local partner; this kind of entry has the advantage of getting an easier and quicker access into the market, but it doesn't ensure the company a complete protection of its own know-how. For this reason, about one third of enterprises has instead chosen to enter the Chinese market alone.

This modality, even if it safeguards the know-how of the enterprises from undesired intrusions, implies also a lot of risks and hidden dangers: the bureaucracy, the language and the local entrepreneurial culture are the main obstacles pointed out by these enterprises, among which some of them have not achieved great success or have even failed their own objectives, due exactly to these barriers, which arise very often from an inadequate attitude to face a market where rules so much different from the Italian ones are in force.



MAJOR ASSETS AND WEAKNESSES

The “Instrumental Mechanics” macro-sector, made up of many specialized branches, belongs to a wider statistical group named “Machines and Mechanical Devices”, and it represents the 41%, in terms of export value, of this larger group.

The whole group represents a central feature of the Italian economy, referring both to the entity of the turnover together with the number of employees and, above all, to the contribution that it gives to the trade balance. The sectors included in the Mechanics System turn out to be strongly dependent on the export, exceeding - in many cases - the quota of 70% in the exports/turnover ratio.

Nevertheless, the foreign demand, regardless the positive trend of some markets, is in a general difficult situation, in line with what is happening for all the “Made in Italy”, due to a series of factors, such as: a spread uncertainty in the global market (which doesn’t facilitate the replacement of machineries), an overestimation about the euro in comparison with the US dollar and other currencies, a strong competition on prices.

More than 40% of the exports of the mechanical sector is addressed to developing countries and newly industrialized countries, which are markets characterised by operational and logistic complexities that need a prompt acceleration in the internationalisation processes of the Italian enterprises.

The enterprises of the mechanical industry in Italy, as well as in all Europe, can count on competitiveness and technological innovation but need assistance in order to penetrate into the Chinese market, because of their small and medium size.

Highly qualified Italian enterprises may provide further impetus to the Chinese market development providing know how and advanced technologies towards China.