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Insights from MNCs Senior Executives in China:

Investment Opportunities in Central and Western China

Spring 2024

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Catalogue

Executive Summary

In January 2024, PwC China held its annual conference for senior executives from multinational corporations (MNCs) in Shanghai, during which over 100 business representatives shared their perspectives on investments in central and western China via an onsite survey.

Participants cited population/market size (67%), preferential foreign investment policies by local governments (47%), and labour and land cost advantage (43%) as the top three motivating factors for MNCs to invest in central and western China.

77% of respondents consider the central and western areas as a potential market for their products or services while 47% see them as a potential production base. A fifth of surveyed companies consider those regions as land connectors to South Asia and Central Asia (21%) and essential logistics hubs (20%).

MNCs' scope of investments in central and western China encompasses points of sale/distribution (44%), production facilities (31%), and backoffice support (31%). Foreign investors have also set up regional headquarters (20%), logistics facilities (17%), research and development facilities (14%), as well as procurement (11%) and data centres (6%) in those regions. Only 29% indicated that they have not invested there so far.

Among foreign investment policy incentives in central and western China, the majority of respondents consider preferential tax treatments (65%), financial subsidies (50%), simplified foreign exchange administrations (36%), and improvement of infrastructure (35%) as their preferred measures.

Over 70% of the surveyed MNCs have once considered exploring business opportunities in central and western China. It implies the region is now on the radar of most surveyed companies. Respondents have different opinions on the assessment of market opportunities: 30% believe that those regions present a "big opportunity" while 15% consider them as a game-changing opportunity.

17% of MNCs are planning to allocate over half of their investment in the central and western areas of China. Overall, the participants showed a positive outlook on the investment of inland markets and indicated their development plans: 52% of them would allocate a relatively small proportion of their investment in the central and western areas, and 17% would maintain their full investment in the coastal regions.

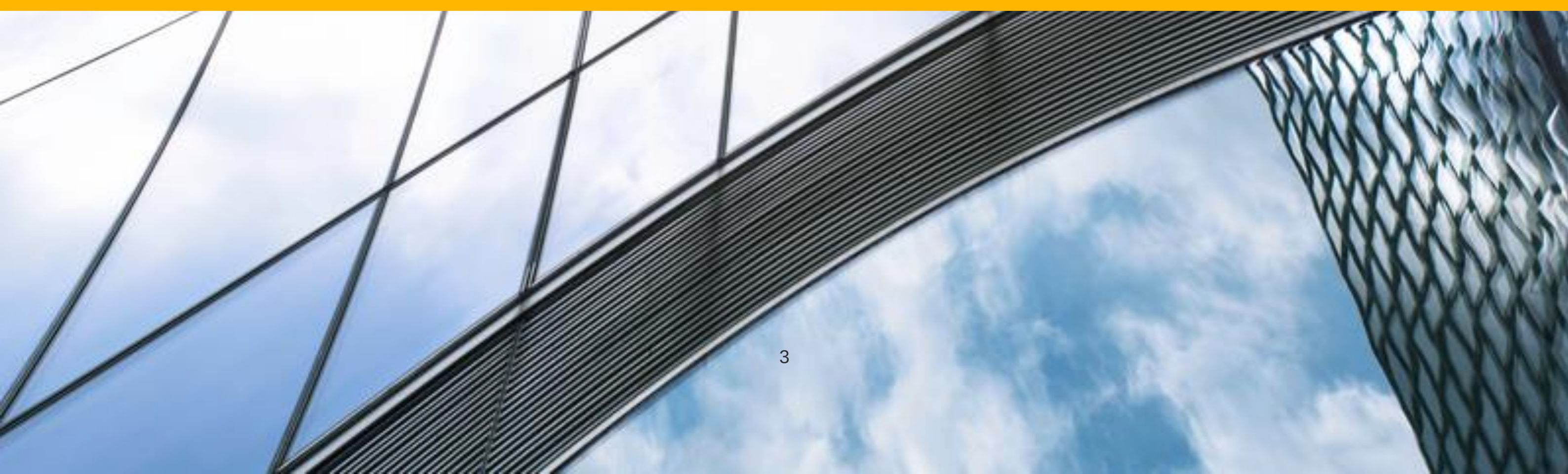
Introduction

Over the past four decades of economic opening, China has emerged as a significant global destination for foreign direct investment (FDI). In 2023, the country reported USD163.25 billion of actual use of foreign capital, the third highest in history, only shy of the 2021 and 2022 levels, according to China's Ministry of Commerce.

Historically, China's foreign investment has been predominantly centred around its coastal regions, but the ongoing development of regional economic clusters has made the central and western regions, including Sichuan, Chongqing, Hubei, Hunan, Shaanxi, and Shanxi, increasingly attractive to foreign investors. Central and western China is home to populous provinces like Henan and Sichuan, as well as education powerhouses like Hubei and Shaanxi. This implies that the regions have considerable development potential in becoming an ideal market and a strategic hub for research and production for MNCs. Through continuous efforts on the part of local governments, the central and western regions have seen a growing interest from foreign investors in recent years, driven by improvement in the business and infrastructure environment, as well as the support of subsidy measures.

In January 2024, PwC China hosted its annual conference for senior executives from multinational corporations in Shanghai, where over 100 representatives participated in an onsite survey to express their views on investing in inland China. Moderated by Mr. Chen Dongxiao, President of the Shanghai Institute of International Studies, the business leaders from renowned MNCs engaged in a roundtable discussion to exchange their business management experiences in central and western China. PwC partners also shed light on the opportunities and advantages of investing in those areas.

After gathering the survey results and recommendations from invited experts, PwC has summarised their insights and presented the key points in the following report.



Chapter 1:

Geographical distribution of foreign investment in China

According to the Statistical Bulletin of China's Foreign Direct Investment published by the Chinese Ministry of Commerce, the top ten FDI recipient Chinese provinces and municipalities collectively attracted USD 162.74 billion worth of actual utilised foreign capital in 2022, contributing to 86% of the national total, with all except Beijing located in coastal areas. Statistics from the past three years reveals that Jiangsu, Guangdong, Shanghai, Shandong, Zhejiang, and Beijing consistently maintain the top six positions, demonstrating their absolute advantage in attracting foreign investment.

Table 1: 2022 Top 10 FDI recipient provinces and municipalities in China

Rankings.	Province/municipality	Actual utilisation of foreign capital (USD billion)	Shares (%)
1	Jiangsu	30.50	16.1
2	Guangdong	27.89	14.7
3	Shanghai	23.96	12.7
4	Shandong	22.87	12.1
5	Zhejiang	19.30	10.2
6	Beijing	17.41	9.2
7	Liaoning	6.16	3.3
8	Tianjin	5.95	3.1
9	Fujian	4.99	2.6
10	Hainan	3.71	2.0
Sum of Top 10		162.74	86.0
Sum of all remaining areas across the country		26.41	14.0

Source: 2023 China Foreign Investment Statistical Bulletin

Overall, inland regions attract far less foreign investment than coastal areas, but in recent years, certain inland provinces have witnessed above-average growth rates in the actual utilisation of foreign capital. The 2023 Statistical Bulletin of China's Foreign Investment pointed to the significant growth of inland provinces and autonomous regions such as Hunan, Hubei, Shaanxi, Shanxi, Inner Mongolia, in terms of actual utilisation of foreign capital.

Table 2: Actual utilisation of foreign capital in inland provinces in 2020-2022 (USD billion)

	2020	2021	2022	Compound annual growth rate
Hunan	1.68	2.41	3.53	45.0%
Hubei	1.68	2.50	2.65	25.6%
Shaanxi	0.46	1.06	1.46	78.2%
Shanxi	0.21	0.24	0.83	98.8%
Inner Mongolia	0.30	0.32	0.54	34.2%

Source: 2023 China Foreign Investment Statistical Bulletin

Success stories of some well-known multinational enterprises investing in the central and western regions were widely reported by the media. In Hunan, South Korea's CJ Group invested about RMB 200 million in its movie theatre business in the cities of Changsha and Yueyang. Siemens has built their industry automation products manufacturing and development base in Chengdu. Eberher Group from Germany launched a new project involving the production of 500,000 sets of automotive exhaust systems in Xuchang, Henan.

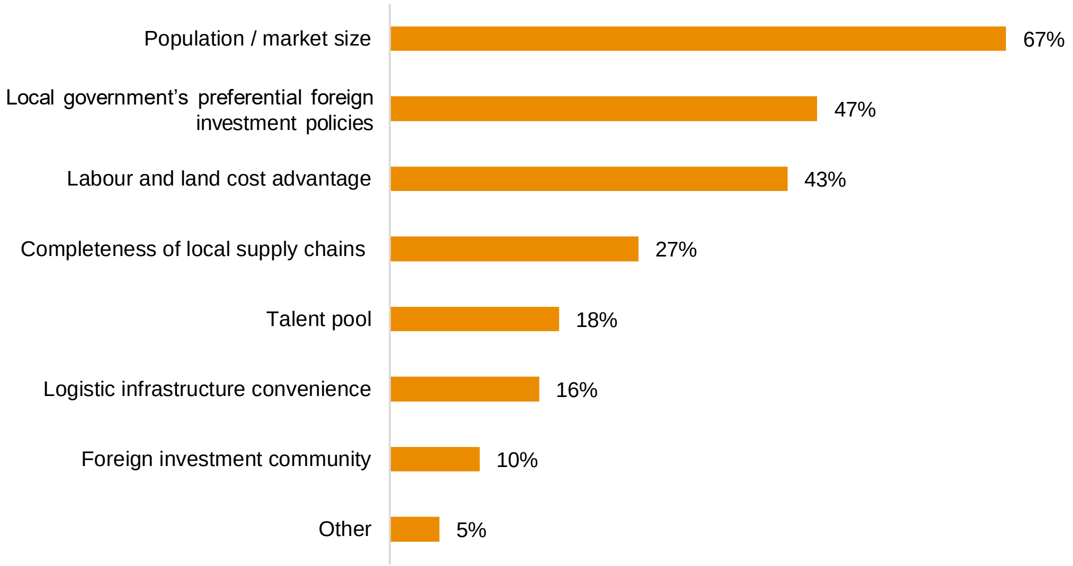
In 2023, despite a decline in the actual utilisation of foreign capital nationwide, the central and western regions achieved noticeable performance. Foreign direct investment in Sichuan reached RMB 24.52 billion, marking a 6.5% increase year-on-year; in Shaanxi, the actual utilisation of FDI amounted to RMB 9.99 billion, up 3.7% year-on-year.

Chapter 2:

Market and policy as crucial consideration for MNCs' investment in central and western regions

The surveyed companies consider population and market size (67%), local government's preferential foreign investment policies (47%), and the cost advantages of labour and land (43%) as key drivers for their investments in the central and western regions.

Figure 1: Top drivers for MNCs to invest in central and western China



According to China's National Bureau of Statistics, the top ten regions in China that draw the most foreign investment accounted for just about 30% of the country's overall population. The central and western regions are boasting untapped market opportunities from their large population bases. According to 2022 population data, Henan (98.72 million), Sichuan (83.74 million), Hunan (66.04 million), and Hubei (58.44 million) are the most populated provinces in central and west China.

A vast market is particularly advantageous for the consumer industry. For example, the beverage sector in central-western regions has higher upside in terms of market growth than the eastern coastal areas. In fact, Coca-Cola achieved an exceptional sales growth in Zhengzhou in 2023, according to Xinhua Finance. Sales revenue in February increased by almost 30%, marking the highest monthly sales in the 27 years of operating history. On the back of growing consumer demand, Coca-Cola is on track to further invest RMB 900 million in Henan for the development of a new manufacturing facility.

Lower labour costs in the central and western regions create a favourable environment for MNCs to better control their operational expenses. Data from the National Bureau of Statistics showed that the average wages of urban private sector employees in Shanghai and Zhejiang were RMB 104,560 and RMB 71,934 respectively, significantly higher than in Sichuan (RMB 59,121), Hubei (RMB 57,043), Hunan (RMB 55,780), and Henan (RMB 47,918), among other regions in 2022.

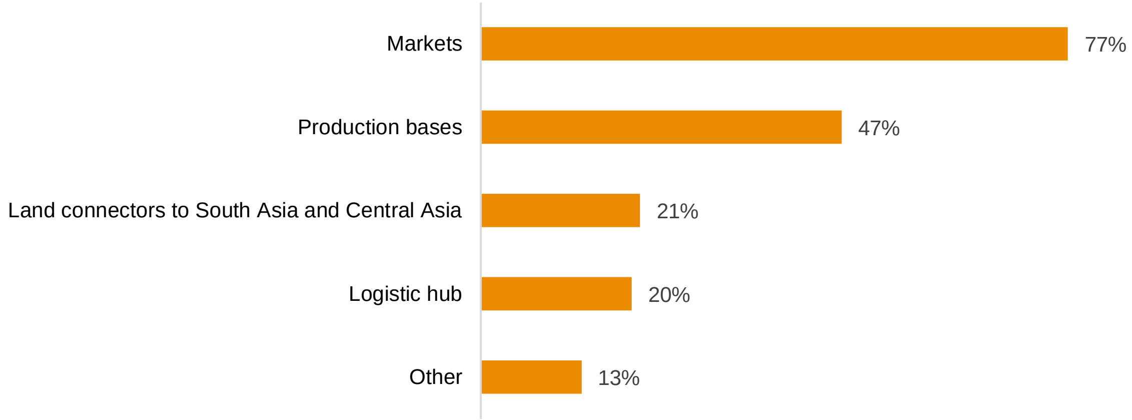
Talent is also a crucial consideration for MNCs investing in the central and western China. "Although our current activities are on a smaller scale, the primary factor behind the company's original decision to run an innovation and application centre in Xi'an is the presence of outstanding universities and talent in the local semiconductor industry", as disclosed by Mr Thomas Zimmerle, Senior Vice President & Chief Financial Officer of Infineon. He further explained that the growth of high-tech sector relies on a complete ecosystem run by a pool of skilled professionals. The advanced nature of local industry chains, workforce, and ecosystems makes it an attractive destination for foreign investment.

Chapter 3:

Central and western China positioned as target market and production hubs for MNCs

According to our survey, 77% of the interviewed companies consider the central and western regions as their target market for products or services. Meanwhile, 47% identify these regions as their primary production bases. 21% consider them as land connectors to South Asia and Central Asia, while 20% see them as logistics hubs.

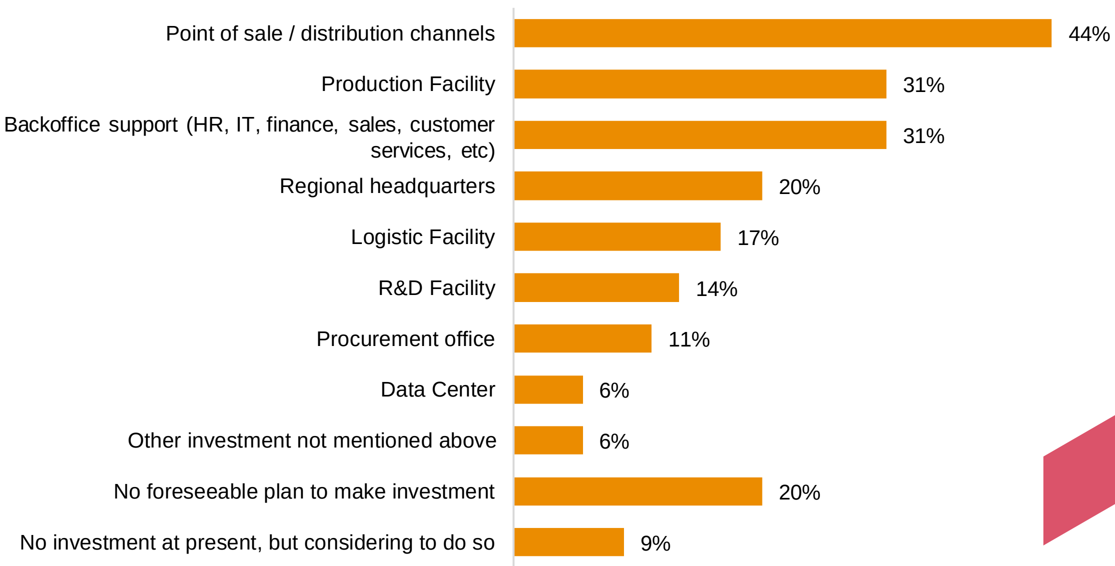
Figure 2 Strategic roles of central and west China to MNCs' development



Central and western China are home to several regional hubs that are strategically positioned to connect South Asia and Central Asia. The development of the Western Land-sea Corridor has brought significant advantages to central and western provinces like Chongqing, Guizhou, Sichuan, and Shaanxi. The number of intermodal trains operating on the new Western Land-Sea Corridor has increased from 178 in 2017 to the current 9,000. Furthermore, the construction of the China-Laos Railway and the China-Thailand Railway would further enhance the connectivity between China's inland areas and Southeast Asia. In merely two years of operation, over 24 million passengers have travelled on the China-Laos Railway.

The interviewed MNCs are investing in diverse ways in the central and western regions, from sales/wholesale outlets (44%), production facilities (31%), to backoffice support (31%). These types of investments are broadly in line with MNCs' strategic positioning in the central and western regions. Other key areas of investment include regional headquarters (20%), logistics facilities (17%), R&D facilities (14%), procurement offices (11%) and data centres (6%). 29% of respondents declared they did not make any investments in these regions yet.

Figure 3: Types of investments made by MNCs in central and western China

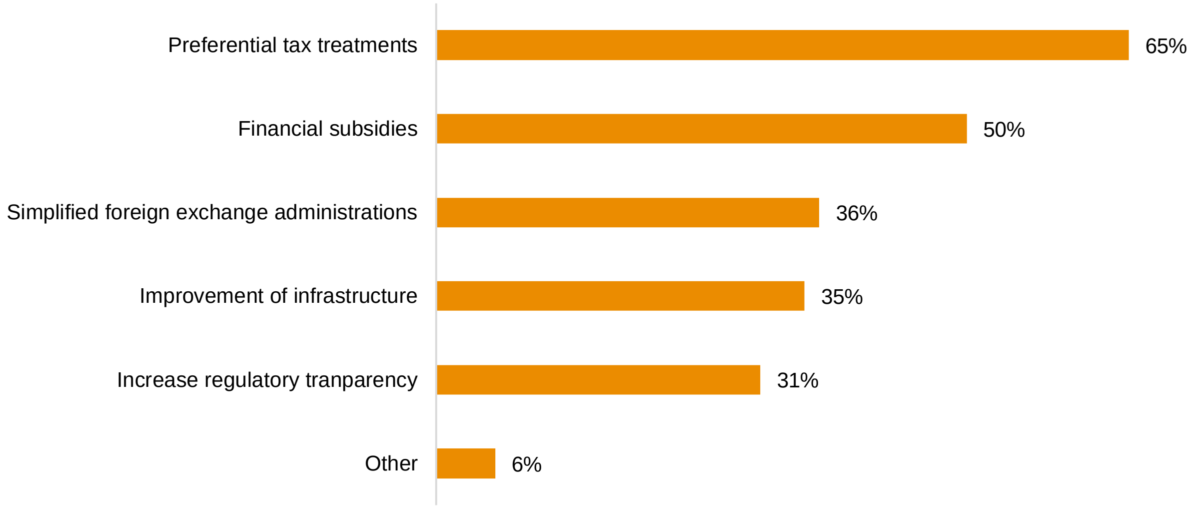


Chapter 4:

Policy expectations of MNCs investing in central and western areas

Tax incentives (65%) and financial subsidies (50%) are key policy factors that attract the surveyed MNCs to invest in the central and western regions. Simplifying foreign exchange management (36%) and improving infrastructure (35%) are also sought-after measures that would incentivise foreign investment. MNCs expect a comprehensive package of policy support, with nearly half of respondents choosing three options (up to maximum of three), and approximately 30% selecting two options.

Figure 4: Policy factors attracting MNCs' investment in central and western China



Subsidies serve as a vital policy tool for local governments in the central and western regions to attract foreign investment. Hubei offers an incentive of up to RMB 200 million for advanced manufacturing projects with a total investment amount of at least USD 100 million and an actual utilisation of foreign capital of RMB 30 million or above in the first year. Hunan offers a maximum reward of RMB 10 million for newly established Chinese regional headquarters of Fortune Global 500 companies with a registered capital of RMB 20 million or more. The scale and scope of these supportive policies speak highly of the significance the local governments of these regions place on MNCs.

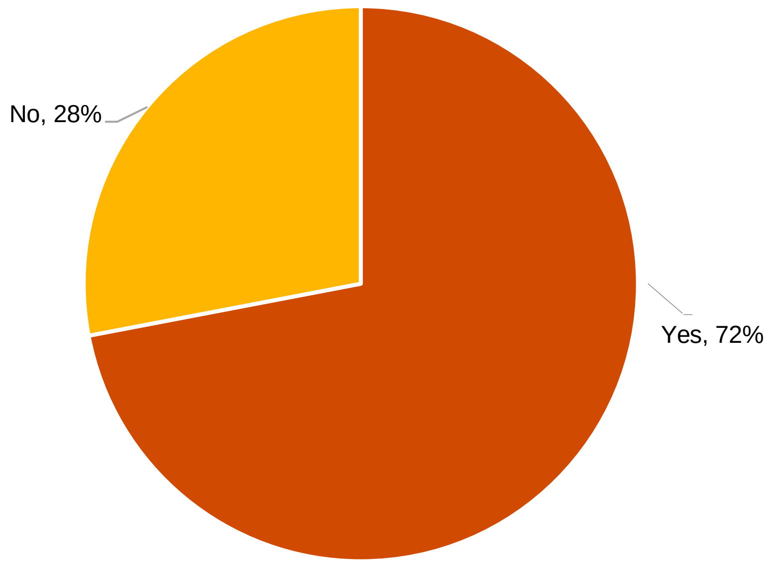
The relationship between enterprises and governments is a significant factor to consider. Amongst the Chinese provinces offering preferential policies and incentives to attract investment into specific sector, a reputable MNC has chosen to operate its business in a city in central and western regions, partly due to its long-standing good relationship cultivated with the local government, as revealed by the firm's senior executive attending the event.

Chapter 5:

MNCs' expansion endeavours in central and western markets

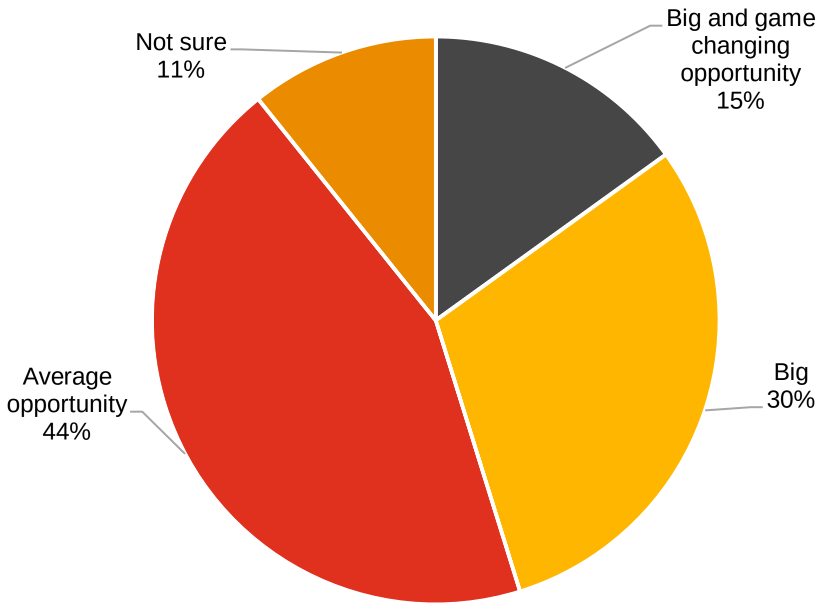
72% of the surveyed companies have once considered investing and expanding their business in the central and western regions, implying that foreign investors are now eyeing opportunities from emerging economic clusters in China.

Figure 5: Has your firm ever considered any investment plan in central and western China?



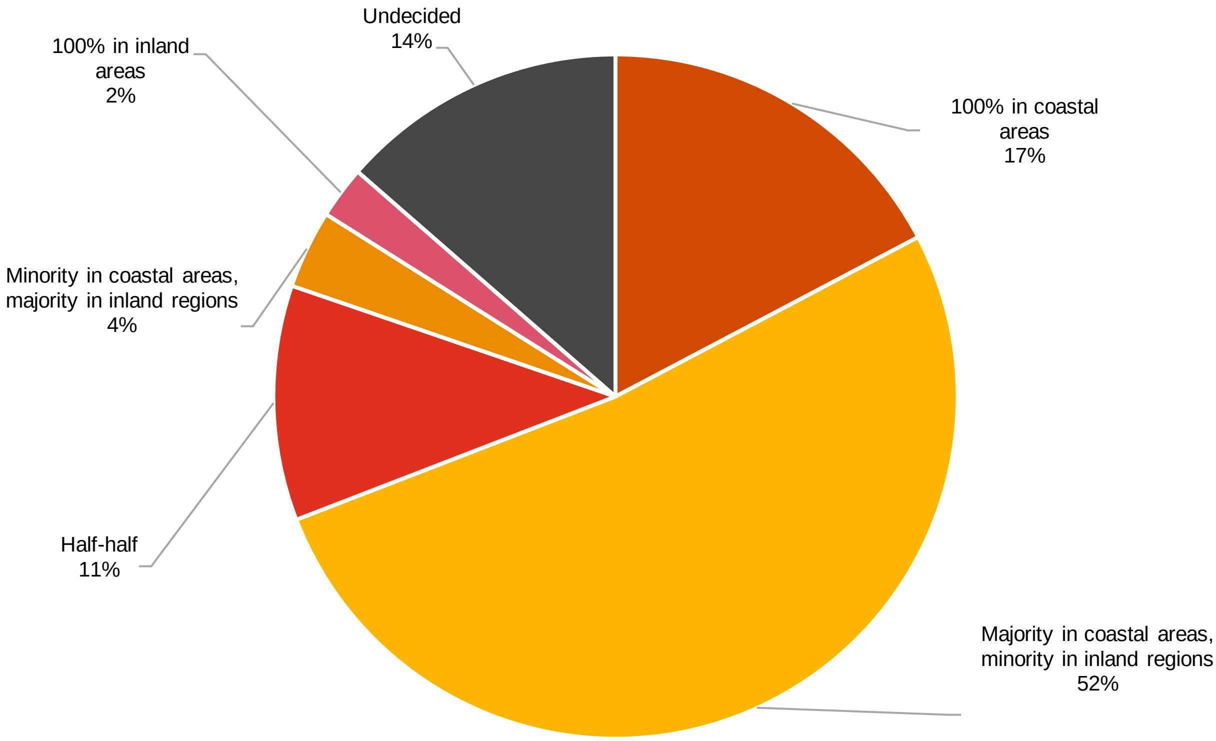
Yet, there is a noticeable divergence in perspectives of the surveyed companies regarding business opportunities in the central and western markets. 30% perceived these areas to represent a big opportunity while 15% believed that they represent a game-changing opportunity. On the other hand, 44% considered the opportunity from these regions to be average.

Figure 6: MNCs' assessment on the investment opportunities in central and western China



When it comes to pursuing investment opportunities in China, 17% of the surveyed MNCs allocate at least half of their investments to the central and western regions with respondents holding a favourable attitude towards investment in the central and western areas. In next 1-3 years, 52% indicated they would invest at least partially in inland regions while only 17% would stay exclusively committed to coastal regions.

Figure 7: Investment distribution of MNCs in China's coastal and central-western regions in next 1-3 years



Conclusion

In 2022, China's FDI stock-to-GDP ratio was 21.1%, which is far below that of major developed economies. China still holds significant potential for attracting foreign investment, and the central and western regions are expected to provide sustained momentum for the country's pursuit for high-quality growth.

Nowadays, the central and western regions are gaining greater significance for MNCs' business plans in China. Foreign investors, while seeing the central and western regions mostly as a promising market and production hub, are increasingly considering these regions as potential research and technology centres or even regional headquarters.

However, it is crucial for MNCs to address in their business expansion plans the unique characteristics of the central and western regions, as opposed to the coastal areas, in terms of infrastructure, business environment, talent supply, and industrial chain maturity.

MNCs investing in the central and western regions should pay attention to macro factors ranging from market potential, to investment policies and business environment. It is of great significance for foreign firms to adapt to unique local conditions and enhance the compatibility between one's own products and services and domestic customers. Establishing good relationships with local governments, employees, and upstream and downstream companies along the supply chain is equally essential.

For inland local governments seeking to attract foreign investment to promote economic development, it is imperative to continuously improve the local business environment in alignment with the direction of local industrial development and existing production resources. From a macro perspective, tailoring policy packages to better appeal to MNCs and effectively reducing their production and operational costs can pave the way for further economic prosperity.

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