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A message from the Chairman and National President of the Australia China Business Council

It is with great pleasure that I present to you the 2014 Australia-China Trade Report.

Commissioned by the Australia China Business Council (ACBC), this report expands on the ACBC's "Benefits to Australian Households of Trade with China" report which, since 2009, has tracked the steady rise of benefits to ordinary Australian households from trade with China.

This year's report confirms the trend: two-way trade with China per household increased to AUD \$16,985 from \$14,480 reported in the 2013 ACBC report and has increased almost five-fold from \$3,400 in 2009.

The 2014 report provides exciting new insights into how the structural changes in the Australian and Chinese economies are set to increase the value to our respective economies and households, based on a more diversified trade and investment relationship and increased confidence in the early conclusion of a Free Trade Agreement (FTA) with China.

Thanks to major sponsorship from the National Australia Bank (NAB) and seed funding from the Australia China Council (ACC) of the Department of Foreign Affairs and Trade (DFAT), the 2014 report goes further this year by analysing the impact of Australia-China Trade across industry sectors, including Australia's integration with global value chains, and the flow-on effects for the Australian economy down to the household level.

This year the ACBC conducted an exclusive business survey of over 200 Australian firms engaged in Chinese business, predominantly from its membership. Supported by case studies from different industries and a new data source, the World Input-Output Database, this report demonstrates that as in the preceding years of the resources investment boom, Australian governments, firms and households have benefitted from Australia-China trade through GDP growth, tax revenue, employment and higher real wages.

This is now enhanced by new growth opportunities in industries such as agriculture, manufacturing, real estate, tourism, education, financial and professional services. Benefits of trade with China are thus more broadly based than generally assumed.

Australian businesses have developed a complex and sophisticated view of Chinese markets, although business understands

that China is a challenging market. Perhaps this is not surprising, since more than half the respondents to the survey have now been in business with China for over five years. Indeed, those Australian businesses that invest in China and export to China are more likely to be profitable than those that do not. Thus, critically, the report confirms that far from being detrimental to Australian households and businesses, the relationship in its growing complexity and diversity continues to benefit households and is helping make Australian businesses more competitive at home and in the international market.

As the premier business organisation dedicated to promoting business and trade between Australia and the People's Republic of China, the purpose of the ACBC's report is to provide a trusted source of data which can be used to contribute to an informed public debate and understanding of how fundamental the Australia-China Trade relationship has become to Australian prosperity. China is and will remain for the foreseeable future, our biggest trading partner.

The 2014 report could not be more timely. This year, Australia hosted the G20 Leaders' summit and a state visit by President Xi Jinping. The conclusion of an historic Australia-China FTA provides a baseline against which progress can be assessed. All of us engaged in the Australia-China business relationship can draw much inspiration from this report and for the future of this extraordinary economic partnership.

On behalf of the ACBC Board and our membership I would like to sincerely thank our sponsors, the NAB and the ACC for making this important report possible, and one which has now become a regular and respected reference for the bilateral relationships.



John Brumby
*Chairman of the Board
and National President*

A handwritten signature in black ink, appearing to read "John Brumby".





Executive Summary

New Perspectives on Australia-China Trade

The Australia-China Trade Report is the first close analysis of the impact of bilateral trade between Australia and China.

As Australia's bilateral relationship with China becomes more complex, so too does the way in which Australian businesses and households are benefitting from engagement with our biggest trading partner via diversifying trade, increasing investment, deepening integration into global value chains, and enhanced international competitiveness.

This Australia-China Trade Report breaks new ground by providing the first close analysis of the impact of bilateral trade between Australia and China on Australia's business and economic integration with global value chains. It also extends the findings of previous reports by evaluating the latest flow-on effects of Australia-China trade for the Australian economy right down to the household level.

Commissioned by the Australia China Business Council (ACBC), this report expands on prior versions of the "Benefits to Australian Households of Trade with China Report (Household Report)" which, since 2009, have tracked the benefits to ordinary Australian households from trade with China. Through data collection, analysis and illustrative Australian business case studies, these reports have consistently demonstrated that the benefits from two-way Australia-China trade to average Australians – as consumers, workers, investors, tax payers and small businesses – have been positive and increasing over time.

Based on an exclusive business survey of more than 200 Australian ACBC member firms (the ACBC Australian-China Business Survey), case studies from different industries, and a new data source, the World Input-Output Database, this report demonstrates that, as in the preceding years of the resources investment boom, Australian governments, firms and households continue to benefit significantly and increasingly from Australia-China trade through growth in Gross Domestic Product (GDP), tax revenue, employment and real wages.

Australian businesses have a complex and sophisticated view of Chinese markets and have been adept and innovative in doing business in these markets. As doing business with China becomes more diverse and demanding, Australian firms have demonstrated that they are ready to embrace those opportunities, while being prepared for the challenges. Global value chains are reshaping global economic activity as China emerges as one of three key global production hubs, along with the United States and Europe.

Our Global Value Chain analysis, the Australia-China Business Survey and accompanying case studies confirm that the China market is providing new opportunities in industries such as agriculture, manufacturing, real estate, tourism, education and financial and professional services.

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Engagement with China makes Australian companies more competitive and facilitates integration in global value chains.

Main findings at a glance

1. Two-way trade with China per Australian household grew 17 percent from 2013 to AUD \$16,985, and has increased almost five-fold since 2009.
2. Australia's trade with China as a share of total trade has risen from 8 percent in 2003 to 23 percent in 2013.
3. Direct trade with China has contributed 5.5 percent to Australian GDP – double that of agriculture, forestry and fisheries combined.
4. One in 58 Australian workplaces is involved in direct exports to China.
5. Nearly 200,000 Australian jobs are sustained by direct exports to China. The three largest sectors are mining (72,000), hotels and restaurants (38,000), and agriculture (18,000).
6. The engine of growth is shifting from resources to other sectors and industries. Australian non-resources exports to China are growing in agriculture, manufacture and services. Twenty percent of Australian non-resources exports go into Chinese final consumer markets.
7. Chinese demand for premium and high quality Australian food products, such as beef and meats, has increased dramatically in the last two years.
8. Chinese direct investment in Australia is creating employment and expanding opportunities for cooperation in sectors such as agriculture and real estate.
9. Far from being detrimental to Australian households and business, engagement with China makes Australian companies more competitive and facilitates integration in global value chains.
10. Australia-China trade is complementary: firms that do well in China have a higher tendency to stay in Australia and expand their Australian workforce.
11. Australia-China trade and investment present a range of strategic options for sustainable business engagement with China – from integrating more closely along value chains, targeting final consumer markets in China, to partnering with Chinese companies.
12. Australian businesses are generally positive about the opportunities offered by an FTA with China, while noting longer term challenges, such as the ability to deal in RMB and opening of industries for foreign participation.



**One in 58
Australian
workplaces was
sustained by
direct exports
to China in 2011.**

Benefits to Australian Households

Since the ACBC's first Household Report in 2009, the benefit to Australian households of trade with China has increased almost five-fold from \$3,400 in 2009 to \$16,985 in 2013.

After a year of subdued growth in 2012, Australia-China trade by household grew by 17 percent in 2013, lifting two-way trade with China per household to AUD \$16,985, up from \$14,480 reported in the 2013 ACBC Household Report. In comparison, the amount of Australia's two-way trade with Japan and USA, measured per household, declined to \$7,958 and \$6,149, representing a three percent and five percent decrease, respectively, from the previous year.

Most importantly for Australian households, the contribution of direct trade with China to Australian GDP surpassed 5.5 percent in 2011, reaching \$74,213.52 million. This means that trade with China contributed twice as much to Australian GDP as did agriculture, forestry and fishing combined. Nearly 200,000 Australian jobs were sustained by Australian exports to China. This translates to about one in 58 Australian workplaces being sustained by direct exports to China in 2011, double the figure for 2007 and four times that for 2001. Benefits to households of trade with China are larger than those of trade with any other major trading partner.

In order to make these benefits sustainable, Australian businesses must remain agile and adaptable in the increasingly competitive Chinese market.

Benefits to Australian Businesses

China is the largest importer of Australian agricultural products, the third largest buyer of Australian manufactured goods, and a strong and growing market for the Australian services sector. The Australia-China Business Survey, the first such study to focus on Australia-China business integration, provides unique insights on the opportunities available to Australian businesses in China, on contemporary issues that impact on the ability of Australian companies to do business with China, and on industry-perceived impediments and incentives.

The outlook of Australia-China Business Survey respondents on China business is markedly positive. Nearly 90 percent were optimistic about their business prospects with China. The survey also shows the complementarity of trade between Australia and China. Success in China plays an important role for economic survival in a globally competitive marketplace. Firms that do well in China have a higher tendency to stay in Australia and expand their Australian workforce.

“China is the largest importer of Australian agricultural products and the third largest buyer of Australian manufactured goods.”

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Further, the survey results reveal that Australian businesses have a complex and sophisticated view of Chinese markets and are integrated in Chinese value chains and through China in global value chains. Australian businesses see their domestic and international competitors gaining advantage from their business engagement with China and, in turn, are keen to use their own links with Chinese business partners to enhance their domestic (Australian) and global competitiveness. As such, as they strive to enhance their global competitiveness, Australian businesses are both pulled and pushed into cooperation with Chinese partners.

Most respondents across most industries agree that partnering with Chinese firms stands to benefit their business. The increasingly competitive environment in China requires Australian companies to search for new strategies in order to maintain competitiveness. One of the most common strategies embraced by Australian firms is to form partnerships with Chinese companies. Chinese partners provide Australian firms with networks of potential clients and suppliers, local knowledge, market access, and resources. Partnering with state-owned enterprises (SEOs) provides Australian businesses entry into restricted industries such as transport and can potentially help them to overcome local government restrictions and barriers and IP protection.

The results of the Australia-China Business Survey also reveal a range of structural benefits accruing to Australian businesses, the economy and society – from enhanced human capital capability in cross-cultural negotiations to more sophisticated approaches to international marketing, capital-raising and networking.

A New Era in Australia-China Trade and Investment

The past year has witnessed significant structural changes in the Australian and Chinese economies: changes with important implications for future business links. The Australian resources industry is at a tipping point, moving from an investment phase to a phase of increased output and declining investment. Resources exports will continue to rise in 2014, but as employment in the resources industry is now declining, growth in jobs will have to come from other industries. Accelerating change in the Chinese economy is affecting the way Australian businesses engage with China. China's economic rebalancing is generating greater demand for consumer goods, high-end manufacturing and services. Australian goods and services, such as clean food, high

“The scale and scope of bilateral business engagement is being transformed.”

value added manufactured goods, tourism and education, are increasingly within the reach of China's growing middle class. China is also the key link for numerous international value chains and, as such, is a significant avenue to global markets for Australian exporters.

As Australian businesses focus on Chinese demand in agribusiness, manufacturing and services, the scale and scope of bilateral business engagement is also being transformed. Australian firms are dealing in smaller volumes than the previously dominant multi-million dollar resources deals.



In 2013, for the first time, Chinese investment in Australia was not concentrated in the mining sector.

They are also dealing with larger numbers of business partners. Partnering and coordination with Chinese businesses enables Australian businesses to gain access to new value chains or to improve their position in existing value chains. Australian businesses are also increasingly able to rely on synergies with Chinese investors in Australia to expand into Chinese domestic and global markets.

A closer trade and investment nexus is emerging between Australia and China, with Chinese enterprises becoming more actively involved in the Australian domestic economy. Prospects for Chinese direct investment in Australia are positive as China is expanding its global outbound direct investment. China currently ranks sixth among countries investing in Australia.

Chinese enterprises are positioning themselves for investment in Australia outside the resources sector, including agribusiness and real estate. Chinese state-owned and private investors are diversifying into new industries and cooperating with smaller Australian firms.

“Chinese enterprises are more actively involved in the Australian domestic economy.”

Australia figures prominently as a main destination for Chinese investment. Up to 2012, Australia was the largest recipient country of Chinese investment globally. In 2013, Chinese investment in Australia for the first time was not concentrated in the mining sector. As investment and trade are increasingly intertwined, investment in Australia by Chinese firms will play a crucial role in the development of export industries and the removal of barriers to entering Chinese value chains.

Opportunities and Challenges in an Era of Trade Liberalisation

Australian businesses surveyed expressed strong confidence in the China market. Three quarters of survey respondents expected their business revenue from China to increase over the coming year. Australia-China trade is increasing competitiveness at home: firms that do well in China have a higher tendency to stay in Australia.

The fierce global competition in China's market has drawbacks and advantages. Australian companies face mounting competition from local Chinese and foreign competitors. In response, Australian firms are seeking to diversify away from China into alternative markets and closer integration with Chinese business partners.

Australian businesses have been successful in creating synergies through integration with Chinese partners. Through strategic use of relationships and nurturing of inter-organisational trust, Australian businesses are well placed to harness the networks of their Chinese partners to gain access to new markets and higher positions in Chinese value chains and extended global value chains.

Australian non-resource firms should continue to engage actively in establishing a niche along value chains, targeting final consumer markets where competition is more driven by product differentiation. Establishing foreign invested enterprises (FIEs) in China is one option. This brings firms closer to the consumer market. Another option is to form a partnership with Chinese companies, which affords Australian firms access to new markets and the ability to distribute goods and services to both the local and export market for China.

While the new opportunities associated with China require commercial responses along these lines, the Australian Government can also assist by opening new and additional avenues for trade and investment.

In particular, Australian businesses place high importance on the Free Trade Agreement (FTA) with China, although expectations vary from

Conclusion

This report highlights emerging trends in the Australia-China trade relationship. Starting from 2013/2014, the resources boom is shifting from its investment phase to a phase of increased output and declining investment. While resources trade with China may even increase in volume, its contribution to employment is declining. At the same time, Australian businesses in non-resource industries are using their trade links with China to become increasingly integrated in global value chains. Tapping into China's position as a global business hub to access new markets, Australian businesses in agribusiness, manufacturing and services have strengthened their competitiveness at home as well as internationally.

Creating synergies with Chinese trading partners and investors is increasingly becoming one of the ways to gain access to Chinese consumer markets and value chains.

“Australian businesses in non-resource industries are using their trade links with China to become increasingly integrated in global value chains.”

industry to industry. Tariffs are a major concern for agriculture and manufacturing, but less so for firms in other industries. Judging from international experience in other contexts, the benefits of free trade agreements only unfold over time. Businesses also recognise that there are longer-term challenges beyond the reach of the FTA, such as the ability to deal in RMB and the opening of industries for foreign participation.

Australian firms are deeply integrated in Chinese consumer markets and Chinese value chains. Most businesses see their own links with Chinese firms, and those of their competitors, as serving to enhance their competitiveness on home soil and in the international market. Far from being detrimental to Australian households and businesses, the relationship with China, in its growing complexity and diversity, is assisting Australian businesses to become more competitive globally.



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1.0 Households – the Benefits of Trade with China

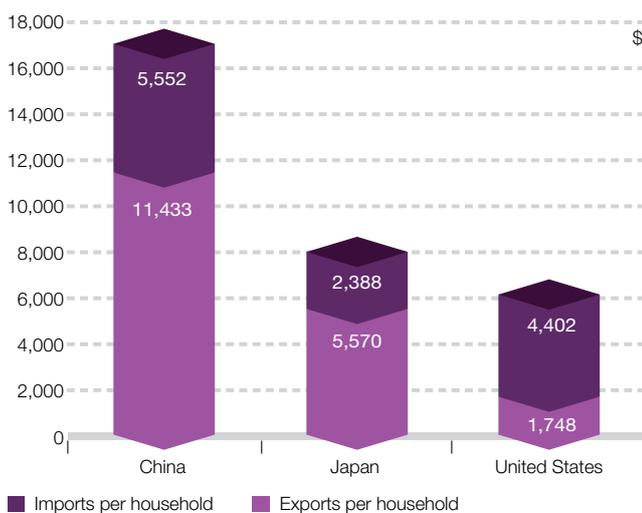
This shift in trade relations has delivered enormous benefits to Australian households.

Two-way Trade Per Household in 2013 Increased to \$16,985¹

Australia-China interdependency in trade and economic activities has never been as strong in history, surpassing Australia's other trading partners. This shift in trade relations has delivered enormous benefits to Australian households. As detailed below, Australian households have benefited from trade with China in a variety of ways, through Terms of Trade, contribution to Gross Domestic Product (GDP) and employment.

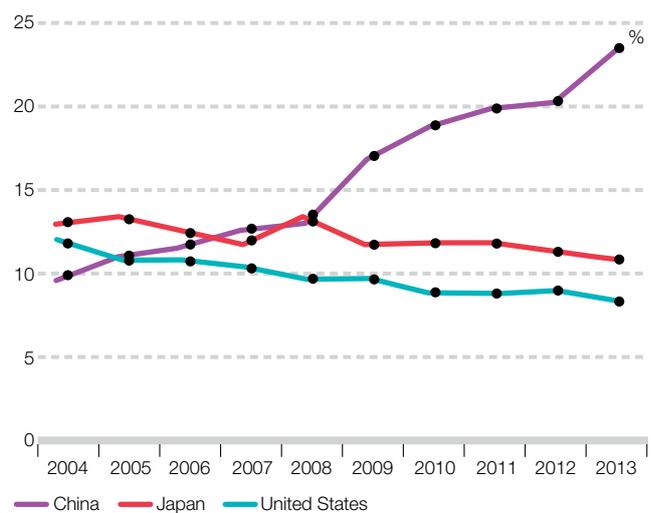
In 2013, two-way trade with China per household increased by 17 percent to \$16,985, up from \$14,480 in 2012.² By comparison, two-way trade per household with Japan and the United States, Australia's next largest trading partners, measured \$7,958 and \$6,149, reflecting a three percent and five percent drop from the previous year, respectively.

Figure 1.1 Australia's two-way trade with major partners per household in 2013



Source: The University of Sydney Business School's estimate, DFAT Publication 'Composition of Trade, Australia 2013'

Figure 1.2 Australia's major trading partners' share in Australian foreign trade



Source: DFAT Publication 'Composition of Trade, Australia 2013'

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1. Unless otherwise indicated, all currency references in this report are in Australian dollar.
 2. Australia China Business Council 2013, *The Benefits to Australian Households of Trade with China 2013*.

Since 2009, China has steadily consolidated its position as Australia's top trading partner and expanded its share of total Australian foreign trade from 17 percent in 2009 to 23 percent in 2013 (Figure 1.2). During the same period, the long-term position of Japan and the United States as the second and third largest trading partners of Australia has remained relatively stable. The growth of Australian foreign trade in recent years was largely driven by China's demand for Australian exports. Australia maintains a strong surplus in its trade with China.

The increase in two-way trade with China per household is attributable mainly to strong export growth in 2013. Exports of goods and services to China jumped 28 percent: from \$79 billion in 2012 to \$101 billion in 2013. The increase is most apparent across minerals including iron ore, coal, gold, and copper, and agricultural products including beef, oil seeds and oleaginous fruits and meat.

Imports from China grew by six percent in 2013. The major categories of imported goods from China were telecommunications equipment and parts, computers, clothing and furniture. Since 2009, China has moved to first position as Australia's major source of imports. In 2013, 15 percent of Australia's total imports in goods and services were sourced from China, ahead of the United States in second position with 13 percent.

Australia's high terms of trade are the result of increasing prices for export goods, in particular resources, and increased affordability of imported goods. Although Australia's current terms of trade have been in gradual decline since 2011, by historical standards, the terms of trade remain high (Figure 1.3). Imported Chinese consumer goods thus remain affordable and continue to offer Australian households variety and choice.

Main findings

Households – the Benefits of Trade with China:

- › Two-way trade with China has outstripped that with the US and Japan.
- › Australia-China trade per household grew by 17 percent in 2013, lifting two-way trade with China per household to AUD \$16,985, up from \$14,480 reported by the ACBC in 2012.
- › Trade volume per Australian household increased almost five-fold since 2009.
- › Increases in two-way trade with China per household are due mainly to strong export growth in 2013. Australia maintains a strong surplus with China.
- › Since 2009, China has contributed a higher proportion to Australian GDP than Japan or the United States.
- › The contribution of direct trade with China to Australian GDP surpassed 5.5 percent in 2011.
- › Trade with China now contributes twice as much value added to Australian GDP as agriculture, forestry and fishing.
- › Approximately one in 58 Australian jobs was sustained by direct export activities to China in 2011. This is double the figure for 2007 and four times that of 2001.
- › Employment attributable to trade with China is highest in mining, primary production and hospitality.
- › China trade in education and tourism produces positive spill-over effects for local communities.
- › Chinese direct investment in Australia contributes to Australian tax revenue and job creation.



Exports of goods and services to China jumped 28% from \$79b in 2012 to \$101b in 2013.

Direct Trade with China has Contributed 5.5 Percent to Australian GDP

Gross Domestic Product (GDP) is an important tool for gauging the economic performance of a country and for measuring the relative contribution of a specific economic activity to overall growth. An expanding GDP due to direct trade with China stands to benefit household income, create new employment, encourage capital investment and have a positive impact on business confidence. Moreover, higher GDP growth leads, at least potentially, to lower government borrowing and increased tax revenue for spending on social and physical infrastructure, such as local schools and hospitals, roads and public transport. GDP is also an indicator of the material wellbeing of a society. The level of per capita GDP is positively correlated with life expectancy and negatively correlated with infant mortality and inequality.

There have been various attempts to estimate the contribution of the China-driven resources boom to increasing Australian living standards and the volume of Australian output over the last ten years.³ The more optimistic estimates are that over time the resources boom was responsible for a 13 percent rise in real per capita household disposable income by 2013, a rise in wages of six percent and a reduction of unemployment by 1.25 percent.⁴

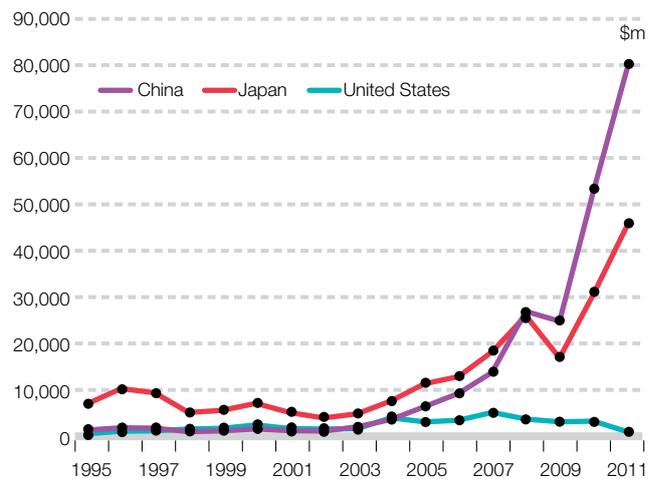
“Since 2009, China has also contributed a higher proportion to Australian GDP than Japan or the United States.”

Figure 1.3 Australian Terms of Trade, 2004 to 2014



Source: Australian Bureau of Statistics

Figure 1.4 Contribution of direct trade with China, the United States and Japan to Australian GDP, 1995 to 2011 (AUD million)



Source: The University of Sydney Business School's (USYD) estimate based on WIOD. Note: All WIOD based figures are in current year values.

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3. Downes, P., Hanslow, K., and Tulip, P. 2014, The Effect of the Mining Boom on the Australian Economy, Research Discussion Paper 2014-08; Barber, J. 2014, *The Mining Boom – the story so far*; Bureau of Resources and Energy Economics 2014, Resources and Energy Quarterly September Quarter 2014, p. 127 – 145; Minifie, J. 2013, *The Mining Boom: Impacts and Prospects*, Grattan Institute report.
 4. For lower estimates see Edwards, J. 2014, *Beyond the Boom: A Lowy Institute Paper*, 2014, Melbourne: Penguin Australia.

By using the World Input-Output Database (WIOD), we are for the first time able to calculate the contribution of overall China trade, including non-resource trade, to Australian GDP. During the period covered by WIOD data (1995 to 2011) the contribution of direct trade with China to Australian GDP has risen continuously (Figure 1.4) and surpassed 5.5 percent in 2011, amounting to \$79,150 million. By way of comparison, trade with China has contributed twice as much value added to Australian GDP as domestic agriculture, forestry and fishing.⁵

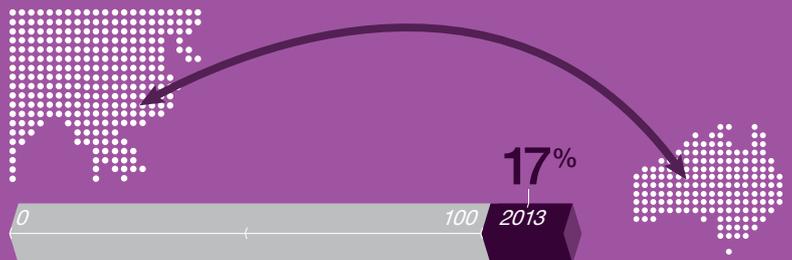
Since 2009, China has also contributed a higher proportion to Australian GDP than Japan or the United States. Figure 1.4 shows that China, the United States and Japan were at similar levels in their trade contribution to Australian GDP for the years from 2002 to about 2009 when China trade surpassed the volume of trade with Japan.

One in 58 Australian Workplaces is Involved In Direct Export to China

Direct trade stands to underwrite growth in employment as well as GDP. For example, the United States Commerce Department estimates that United States exports to China are responsible for 800,000 jobs.⁶ The corresponding 2009 figure for jobs sustained by China exports in the European Union is 1.1 million jobs.⁷

Analysis of the WIOD allows us to measure the employment effects for Australia of direct trade with China. In 2011, nearly 200,000 Australian jobs were sustained by exports to China. This was double the number of China export-related jobs that existed four years earlier. This translates to about one in 58 Australian workplaces being sustained by direct export to China in 2011, double the figure for 2007 and four times that for 2001 (see Figure 1.5).

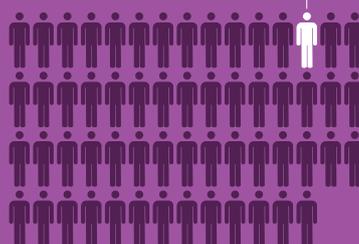
Australia China trade per household grew by 17 per cent in 2013



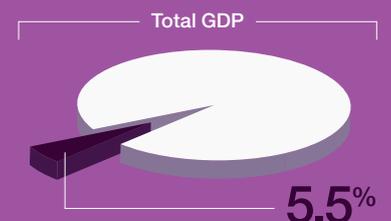
Since 2009 the benefit to the Australian household of trade with China has increased almost fivefold from \$3,400 to \$16,985 in 2013



Approximately one in 58 Australian jobs is sustained by direct export activities to China in 2011



Direct trade with China has contributed 5.5 per cent to Australian GDP, twice as much as agriculture, forestry and fishing



Almost 200,000 jobs were created via direct exports to China in labour intensive industries e.g. 71,000 mining, 18,000 agriculture and 37,000 tourism (hotels and restaurants)



5. World Input-Output Dataset (WIOD).

6. USCIB 2014, Participates in Greater China Business Forum, 13 October 2014, at <http://www.uscib.org/index.asp?documentID=4857>; Xinhuanet, 2014, Interview: Much can be done to improve U.S. Chinatrade ties – senior U.S. official, Washington 15 October 2014, downloadable at <http://www.uscib.org/index.asp?documentID=4857>

7. Gasiorek, M. and Lopez-Gonzalez, J. 2014, China EU global value chains: who creates value, how and where? – growing linkages and opportunities. p. 147.



Chinese investment in Australia creates benefits for firms and households through capital, expertise, export markets and technologies.

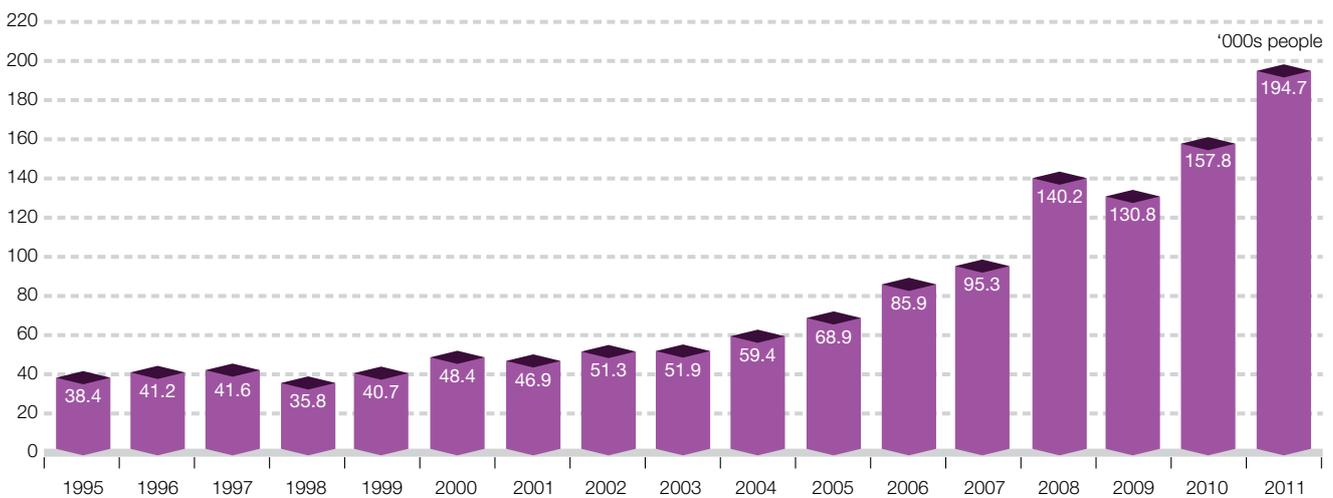
However, the job effect of direct export to China is not just a function of the overall trade volume. It also depends on industries and trade composition. By diversifying trade with China towards more labour-intensive industries, Australia stands to bring the job effects closer to other trading partners of China that depend less on resources exports. Looking at the distribution of job creation from China exports across Australian industries, mining, hotels/restaurants and agriculture/forestry/fishing are the three sectors with the largest levels of employment linked to China exports (Figure 1.6). In the resource sector, this accounts for 72,000 employees, in the hotels/restaurants sector 38,000 employees and in agriculture, forestry and fishing sector, 18,000 employees.

The above estimates only capture direct employment benefits of exporting to China. Indirect benefits from spill-over activities are likely to be large but are difficult to quantify. Take education export as an example. A case study in last year's ACBC report showed that the indirect benefits from local community accommodation and other goods and services purchased by international students were almost equals the volume of university fees they paid.⁸

Household and Community Benefits of Chinese Investment to Australia

Like trade with China, Chinese investment in Australia creates benefits for firms and households through capital, expertise, export markets and technologies. This assessment is supported by studies undertaken by KPMG and the University of Sydney.⁹ Chinese state-owned and private investors create tax revenue, local job opportunities and community benefits.

Figure 1.5 Total number of Australian jobs due to direct export to China, 1995 to 2011 (thousand people)



Source: USYD estimate based on WIOD

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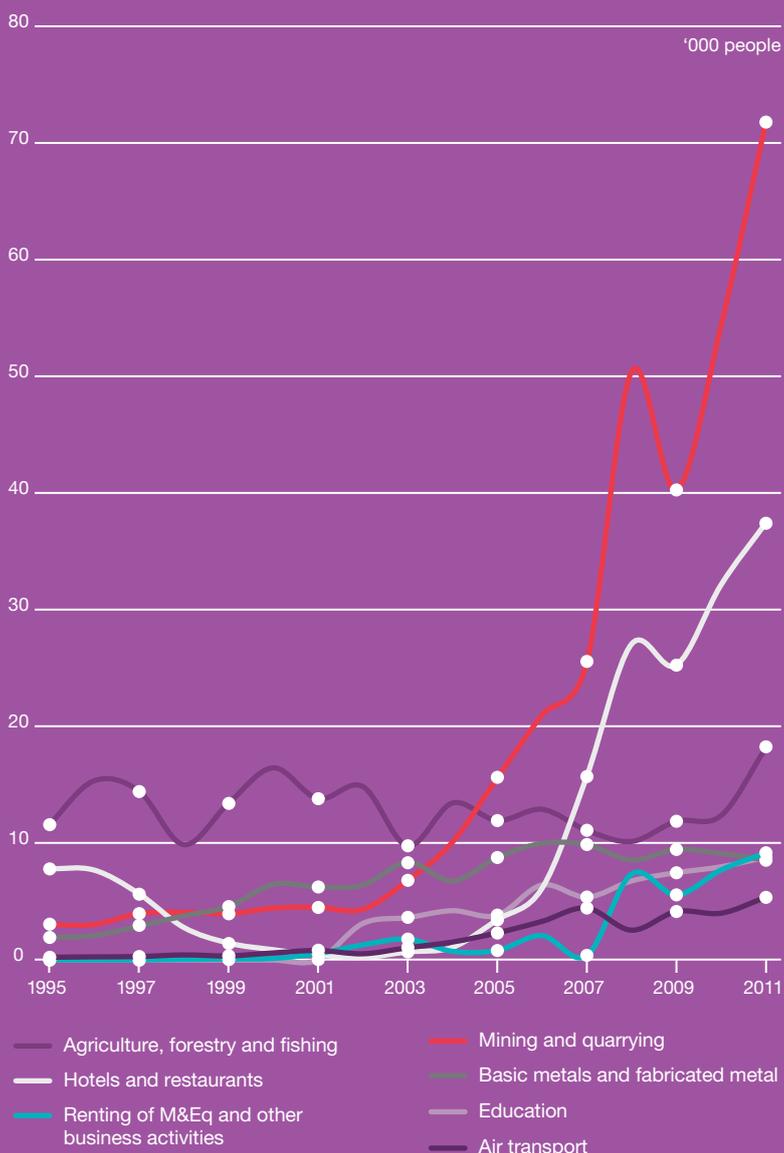
8. Australia China Business Council 2013, *The Benefits to Australian Households of Trade with China 2013*, p. 21.
9. See reports available at the Demystifying China Investment website at www.demystifyingchina.com.au

While the community benefits and job creation arising from Chinese direct investment in Australia have yet to be fully documented, anecdotal evidence suggests that the impact is positive and increasing. For instance, the attitude of Chinese investors towards local employment has been changing as Chinese investors become more experienced and start to appreciate the advantages of the Australian job market. A recent study of the integration of Chinese state-owned investors in Australia found that the composition of mixed Australian-Chinese management teams is changing towards empowering local Australian staff and shifting the balance towards a larger proportion of local employees and fewer expatriates from China.¹⁰

The same study estimates that 23 major Chinese investors sampled employ more than 5,000 full-time employees (FTEs) and contractors. For example, Bright Food (Manassen) employs 900 FTEs, Yancoal and MMG both 500 FTEs and contractors Zijin (Norton Goldfields) more than 300 FTEs plus contractors, COFCO (Tully Sugar) 200 to 300 people depending on the season, and the three established Chinese banks together employ approximately 500 FTEs.¹¹

Our case study of Goldwind Australia illustrates how a first-time Chinese investor has managed to integrate in the local Australian job market and benefit from the pool of talent available. It shows that employing local staff has become a major localisation strategy for Chinese firms that strive for successful investment in Australia.

Figure 1.6 Australians' employment by industry due to direct export to China, 1995 to 2011 (thousand people)



Source: USYD estimate based on WIOD

10. KPMG and the University of Sydney 2014, *Demystifying SOE Investment in Australia: A report prepared for the Business Council of Australia*, p. 21, downloadable at <http://www.demystifyingchina.com.au/reports/N12035MKT-Demystifying-SOE-Investment.pdf>

11. KPMG and the University of Sydney 2014, *Demystifying SOE Investment in Australia: A report prepared for the Business Council of Australia*, p. 21.





Permanent Magnet Direct
Drive 2.5MW Wind Turbine

Case Study: Goldwind Australia

Goldwind Australia Pty Ltd set up office in Sydney in 2009 and entered the Australian renewable energy market with its initial Mortons Lane wind turbine project in Victoria and the much larger Gullen Range project in New South Wales. From 2013, the Gullen Range Wind Farm near Goulburn with its 73 state-of-the-art wind turbines was supplying enough electricity for around 63,000 households. Gullen Range Wind Farm hosts the first 2.5MW gearless Permanent Magnet Direct Drive (PMDD) wind turbines in Australia.

Goldwind operates across the whole value chain of wind energy solutions, from installing wind turbines to selling and operating wind farms with business partners, including local wind project developers, international buyers of completed

Goldwind is a model for the integration of Chinese firms in Australia through its employment and governance practices.

projects and Australian and Chinese banks to provide long-term finance. In bringing technical expertise, capital and institutional experience to the Australian wind farm market, Goldwind operates like other globalising Chinese investors who rely on global technology, local business partners and local government and community support.

As Goldwind is a publicly listed company with some state ownership, all new investments have to be approved by FIRB. This is a routine process and has not impeded progress.

Goldwind prides itself on being a model for the integration of Chinese firms in Australia through its employment and governance practices and most recently through path-breaking syndicated project finance.

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Local Employment

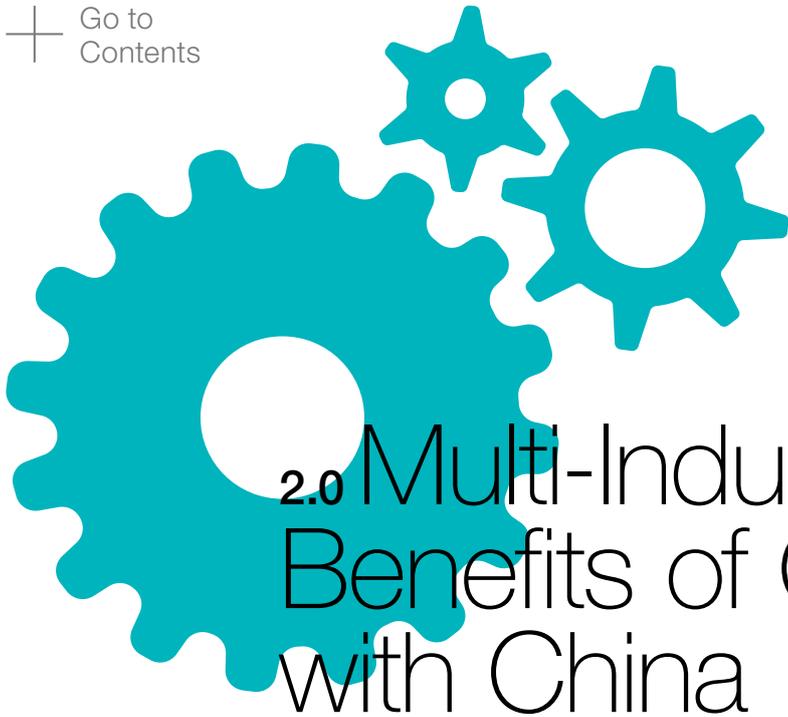
Goldwind employs 40 people in Australia, all of whom are locally hired. Some of the seven staff members in Accounting and Finance speak Mandarin. This is one of the demographic advantages of the Australian labour market from which Goldwind is benefiting, as bilingual staff members find it easier to communicate with headquarters in China.

Engineers and technical staff working at the wind farm sites are local people supported by technical specialists from China. This helps local employment along. The Gullen Range project employed 115 people during construction, 70 percent recruited from the local community. Gullen Range now employs nine maintenance staff. Mortons Lane, for which Goldwind has a 15 year maintenance contract, employs two local staff, and the Melbourne project employs five local people.



Gullen Range Wind Farm





2.0 Multi-Industry Benefits of Cooperation with China

China's economy is now dominated by the private sector.

Capitalising on China's Transition from Mass Production to Mass Consumption

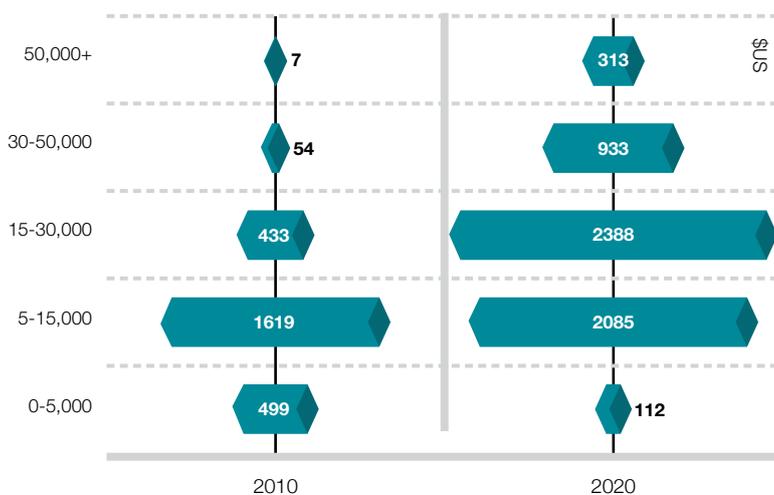
China's economic rebalancing, with emphasis on consumption, services and more sustainable, slower GDP growth rates has signalled to some of China's international trading partners that the 'golden age' of China business is over.¹² However, for Australian businesses, the change in drivers of overall economic growth in China offer new and long-term opportunities in sectors beyond mining and resources.

Projections by Oxford Economics show that China's middle class consumers are moving into higher income brackets (Figure 2.1).¹³ According to World Bank estimates, China's share of world GDP rose from two percent in 1990 to 11 percent in 2012 and is expected to rise further.¹⁴ Australian goods and services, such as clean food, tourism and education, are increasingly within the reach of China's growing middle class. Overall trade figures suggest that only five percent of Australian exports go into Chinese consumer markets, a ratio much lower than other comparable trading nations. However, if resources

exports are excluded, the ratio rises to 20 percent of Australian non-resources exports going directly into final consumption in the Chinese domestic market. Reaching these new Chinese consumers will require new approaches and deeper engagement with Chinese business partners and intermediaries.

China's economy is now dominated by the private sector¹⁵: a sector more influenced by markets than the state sector and a sector that demands more engagement and flexibility from domestic and international suppliers.

Figure 2.1 Forecast of China's total household income by income band



Source: Oxford Economics, *Emerging Markets Weekly Economic Briefing*, 11 May 2012

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12. The European Union Chamber of Commerce in China observed in their 2014/2015 position paper that China business is entering a long and sustainable 'silver age' with lower profits, more competition and European firms increasingly looking for alternative markets to China. European Union Chamber of Commerce in China, 2014, *European Business in China Position Paper 2014/2015*, downloadable at <http://www.europeanchamber.com.cn/en/publications-position-paper>
 13. Oxford Economics 2012, *Emerging Markets Weekly Economic Briefing*, 11 May 2012, www.oxfordeconomics.com/samples/emblog110512.PDF
 14. World Bank Data, <http://data.worldbank.org/>
 15. Lardy, N. 2014, *Market over Mao: The Rise of Private Business in China*, Institute for International Economics.

Australian manufacturing exports to China have been increasing since 2009.

Main findings

Multi-Industry Benefits of Cooperation with China:

- › Demand for Australian goods and services is driven by Chinese consumers and producers and benefits from the rebalancing Chinese economy. Australian non-resources exports benefit from a rebalancing Chinese economy.
- › Australian exporters in non-resources sectors have performed well during the resources boom and have potential to improve their future performance.
- › For Australian exporters, China is one of the entry points into global value chains.
- › China is the top purchaser of Australian agricultural products and education services, the third-largest buyer of Australian manufactured goods, and a crucial growth market for the Australian service industry.
- › Australian agribusiness exports have growth potential in consumer and producer markets.
- › Chinese demand for premium and high quality Australian food products has increased dramatically in the last two years. In 2013, Australian beef exports to China increased nearly four times, oil seeds five times, and meat exports doubled.
- › China is Australia's top dairy export market with exports to Greater China (China, Hong Kong, Taiwan) increasing 40 percent in 2013 alone.
- › Australian manufacturing exports to China have been increasing since 2009. China is the only one of the top three destinations of Australian manufacturing exports that has shown growth over recent years.
- › In services exports, Australian providers are well placed to take advantage of opportunities arising out of Chinese deregulation and reforms of the finance industry.
- › In-bound services exports in education and tourism rely on marketing of comparative advantages such as Australia's unique natural and social environment.



China is the top purchaser of Australian agricultural products and education services.

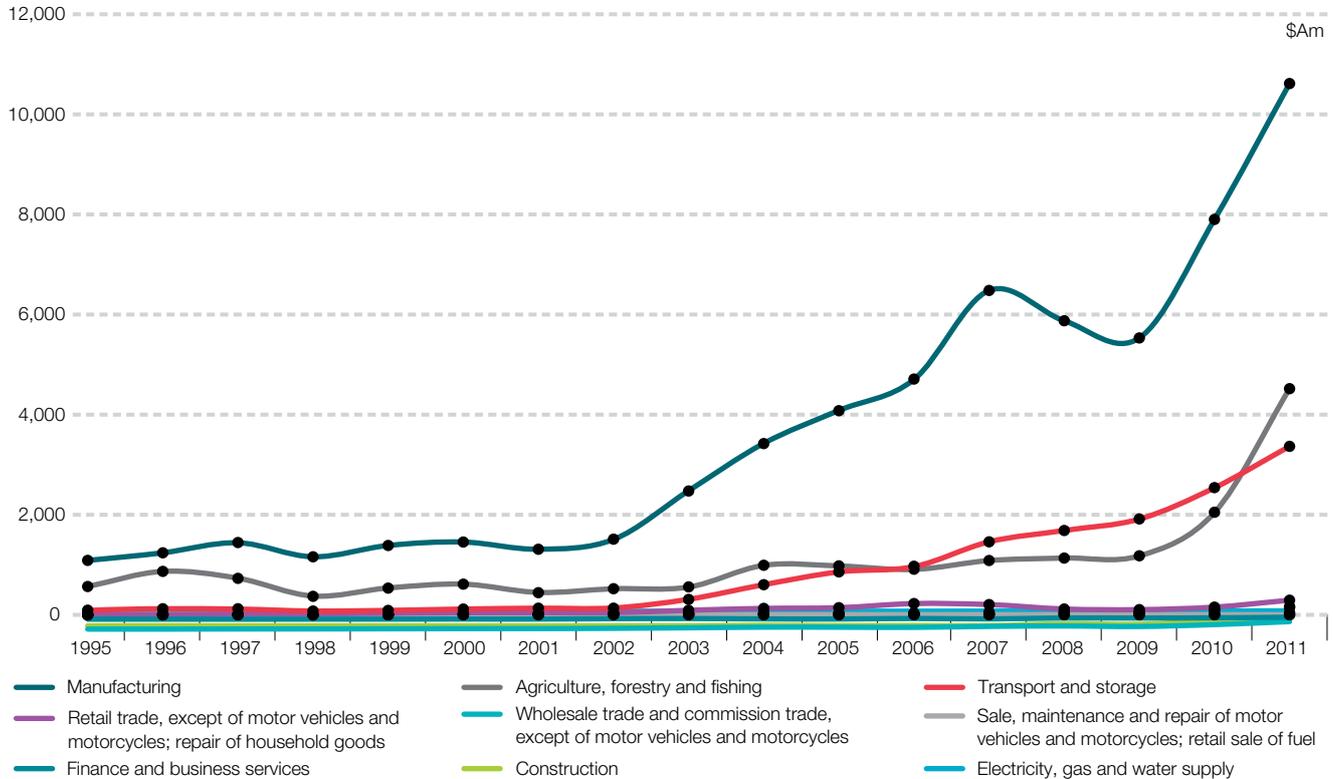
Australia’s reliance on its traditional comparative advantage in high volume resources will give way to a more diversified approach that targets markets and lower volume buyers. Senior government members are alert to this challenge¹⁶ as are the businesses surveyed and consulted for this study.

Australian resources exports in recent years have overshadowed the export potential and achievements by Australian exporters in other sectors. However, a closer examination of industry statistics reveals that all major sectors experienced strong export growth during the resources boom.

Increasingly, growth in exports to China is being driven by market forces. One of the key drivers is consumer demand. Another is growing demand driven by Chinese value chains (where a value chain is defined as ‘a set of production processes and services required to develop a product from its inception to its commercialisation’¹⁷). Intensifying competition and technological sophistication means that production lines are no longer necessarily co-located with designers or suppliers. The production line itself may be dispersed over many locations.¹⁸ This is relevant to Australian exporters because value chains create opportunities for specialised products and services.

China is also the key link for numerous international value chains. Research commissioned by the European Commission concludes that China, as the centre of the Asian production hub, provides access to markets in Europe as well as the United States:

Figure 2.2 Australian non-resources exports in value-added terms to China – by industry, 1995 – 2011 (AUD million)



Source: USYD estimate based on WIOD

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16. For instance, The Hon Malcolm Turnbull MP, Minister for Communications, in his speech at the NAB Australia-China Business Week in September 2014 remarked: “Not only will this result in more opportunities for Australian businesses, but it will result in a different type of engagement. Rather than the multi-billion dollar deals negotiated in the resources sector, transactions in the agriculture and services sectors, for example, involve many more parties and many smaller transactions. Even more so than resource companies, they will need to have a much keener sense of the Chinese market and a deeper affinity with Chinese culture and business practices”. Turnbull M. 2014, “More than a mine, more than a market – history, empathy, economics in the China relationship”, speech at NAB Australia-China Business Week, Sydney, 5 September.

17. Gasiorek, M. and Lopez-Gonzalez, J. 2014, China EU global value chains: who creates value, how and where? – growing linkages and opportunities. p. 89

18. Productivity Commission, 2014, *Relative Costs of Doing Business in Australia: Dairy Product Manufacturing*.

China has emerged as one of the most dynamic players in the Global Value Chain scene. Not only does it (China) play a central role in 'Factory Asia', it also truly embodies the 'global' part of value chains through its bridging role between 'Factory Europe' and 'Factory North America'.¹⁹

China is therefore one avenue to global markets for Australian exporters.

Australian non-resources exports have experienced strong growth during the final years of the resources boom and the World Input-Output Database (WIOD) allows us to trace the destination of these exports in the Chinese market. As shown in Figure 2.2, the growth in food industry exports was paralleled to a lesser degree in manufacturing sectors such as basic metals and fabricated metals, machinery, chemicals, electrical and optical equipment and transport equipment, as well as in services. As a result, China has also become Australia's most important export destination for industries other than resources.

Australian Exports and Chinese Value Chains

Along with the United States and Europe, China is one of three global production hubs that uses a large share of imported goods in producing final output for the Chinese domestic market as well as international markets. Research on global value chains has detailed flows and distribution of goods and services and pointed to the opportunities arising for niche market suppliers.²⁰ China is one of the entry points into global value chains for Australian businesses. The manufacturing capacity that has been developed in China will continue to attract further manufacturing activities.²¹ This fundamentally changes opportunities and the nature of competition for Australian businesses.

Table 2.1 Australian non-resources exports to Chinese industries 2011

Chinese industries	Share
Manufacturing	23.8%
Final Consumption	19.3%
Basic Metals and Fabricated Metal	9.4%
Food, Beverages and Tobacco	9.2%
Construction	7.6%
Agriculture, Forestry and Fishing	4.5%
Transport and Storage	3.9%
Financial and Business Services	3.2%
Real Estate	2.7%
Education	2.5%
Mining	1.4%
Tourism	1.4%
Health Services	0.9%
Electricity, Gas and Water Supply	0.7%
Other	9.4%
Total	100.00%

Source: USYD estimate based on WIOD

19. Gasiorrek, M. and Lopez-Gonzalez, J. 2014, China EU global value chains: who creates value, how and where? – growing linkages and opportunities. p. 147.

20. Taglioni, D. and Winkler, D. 2014, *Making Global Value Chains Work for Development*. World Bank Group; OECD, 2013, *Interconnected Economies: Benefiting from Global Value Chains – Synthesis Report*, downloadable at <http://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf>

21. Baldwin, R. 2012, *Global Supply Chains: Why They Emerged, Why They Matter, and Where They Are Going*, Working paper FGI-2012-1, Fung Global Institute, downloadable at <http://www.fungglobalinstitute.org/sites/default/files/u1913/Global%20Supply%20Chains%20Why%20They%20Emerg.pdf>



Chinese target industries absorb Australian goods and services into a global business environment.

Australian exporters are actively involved in Chinese value chains, with 80 percent of Australian exports going to a range of Chinese domestic industries as input into value chains. Table 2.1 shows the proportion of Australian non-resources exports going into different Chinese industry sectors as their first destination. Chinese target industries absorb Australian goods and services into a global business environment where business activities ranging from design, production, marketing, logistics, distribution and customer support are increasingly separable.

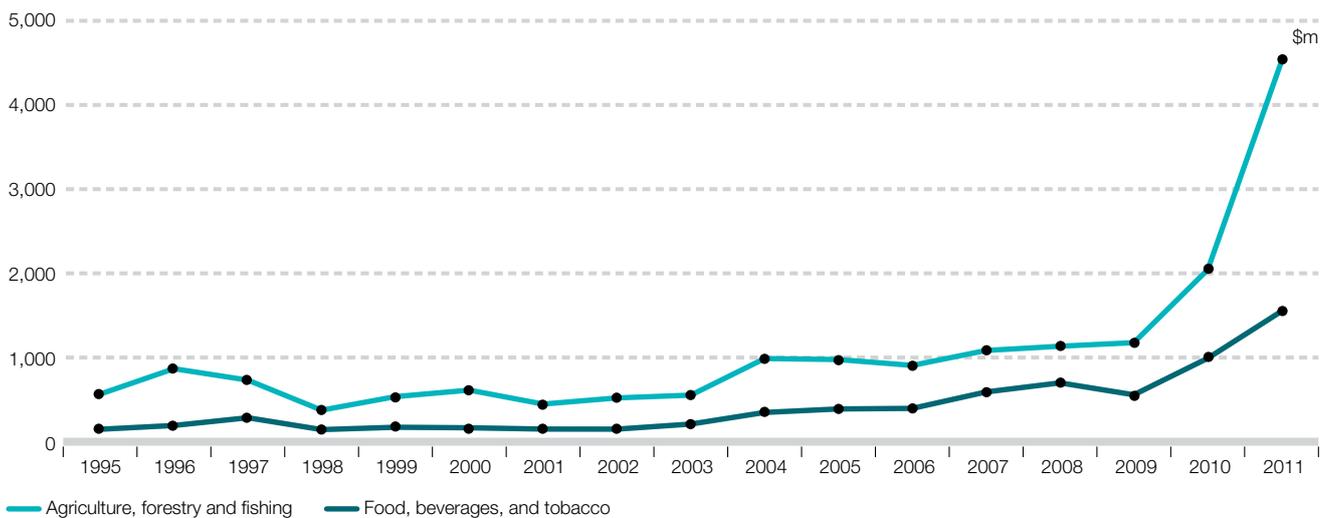
Whether targeting Chinese consumer markets or Chinese value chains, Australian exporters need to be familiar with Chinese business culture and the need to build relationships and inter-organisational trust. Case studies throughout this report will showcase the successful Australian experience.

Agribusiness

Export of agricultural and food products from Australia to China have risen dramatically since 2009 (Figure 2.3), with China now the largest market for Australian agricultural and food products.

Data on Australian major agricultural exports since 2011 confirm this positive trend (Table 2.2). Chinese demand for premium and high quality Australian food products, such as beef and other meat, has increased dramatically in the last two years. In 2013, Australian exports in beef to China increased nearly four times, oil seeds five times, and meat exports doubled year-on-year. In contrast, wool and cotton exports to China, while much higher in value, showed little growth. Plans drawn up by China's National Development and Reform Commission up to 2020 envisage strong growth in beef and lamb imports to cope with rising demand.

Figure 2.3 Australian agriculture exports to China



Source: USYD estimate based on WIOD

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The export market for Australian dairy products is also set for strong growth. China is Australia's top dairy export market with exports to Greater China (China, Hong Kong, Taiwan) increasing 40 percent in 2013 to 2.1 million tonnes.

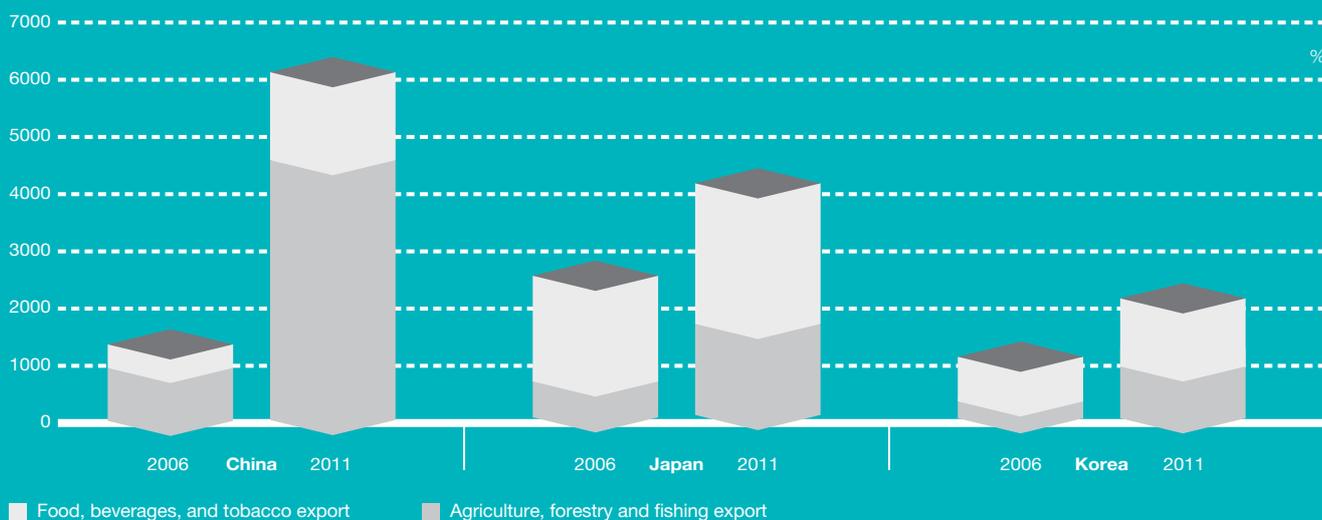
There is considerable growth potential for Australian agribusiness in processed food as Chinese income rises. Seventy-four percent of agribusiness exports to China are in the agriculture, forestry and fishing subsector compared to 26 percent in the food, beverage and tobacco subsector, reflecting Chinese demand for fresh Australian produce. In contrast, Australian exports to Japan and Korea are dominated by processed food while agriculture, forestry and fishing claim a smaller share of exports (Figure 2.4). Demand for Australian processed food is likely to increase as Chinese disposable income levels approach those in Japan and Korea.

Table 2.2 Major Australian agricultural exports, 2012 and 2013 (AUD million)

	2012	2013	Annual growth
Beef	149	722	383.7%
Oil-seeds & oleaginous fruits, soft	109	676	517.5%
Meat (excluding beef)	247	511	107.2%
Wool & other animal hair	1,877	1,944	3.6%
Cotton	1,788	1,734	-3.0%
Wheat	570	283	-50.3%

Source: DFAT, Composition of Trade 2013

Figure 2.4 Australian agricultural exports to China, Japan and Korea, 2006 and 2011 (AUD million)



Source: USYD estimate based on WIOD



There is considerable growth potential for Australian agribusiness in processed food as Chinese incomes rise.

Chinese Industry Destinations for Australian Agribusiness Exports

Exports from the agriculture, forestry and fishing sub-sectors are destined primarily for processing. Certain raw agricultural materials, such as cotton, go into the textile supply chain (11%) where products are sold both domestically and internationally. Australian premium quality beef products mainly go into China's hotel and restaurant supply chains before reaching end customers.

Exports from the food, beverages and tobacco sub-sectors usually go directly to the consumer market (62%), while smaller quantities go to hotels and restaurants (7%) and further processing (14%).

Comparison with New Zealand food exports shows that New Zealand has a better penetration of Chinese consumer markets (Table 2.3) and occupies a stronger position in the higher value consumption segment of the domestic Chinese market. Despite differences in agricultural industry structure, the strong position of New Zealand in the consumer segment points to untapped market opportunities for Australian exporters.

“Demand for Australian processed food is likely to increase.”

Table 2.3 Australian and New Zealand agricultural exports in Chinese markets

Australian and New Zealand exports		Chinese Industry Destinations				
		Agriculture, Forestry, Fishing	Food, Beverages, Tobacco	Textiles, Textile Products	Hotels, Restaurants	Final consumption
Agriculture, Forestry, Fishing	Australia	20%	45%	11%	3%	3%
	New Zealand	12%	25%	6%	2%	24%
Food, Beverages, Tobacco	Australia	8%	14%	1%	7%	62%
	New Zealand	3%	5%	0%	3%	79%

Source: USYD estimate based on WIOD

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25

MULTI-INDUSTRY
BENEFITS OF
COOPERATION
WITH CHINA

Outlook for Agribusiness

In view of its growing demand for clean and safe food, China is set to remain the top export destination for Australian agricultural exports. A growing middle class in China will boost demand for animal exports and exports for processed products in the food and beverage sector. Australian agricultural exporters face positive prospects in Chinese consumer and producer markets.

“China is set to remain the top destination for Australian agricultural exports.”

An encouraging development is Chinese plans to invest in the Australian agricultural sector, such as the recent announcement by the Beijing Agricultural Investment Fund to invest \$3 billion in an agribusiness supply chain stretching from Australian farms to Chinese consumers. This degree of transnational supply chain integration necessarily involves significant infrastructure investment at both ends of the chain, as well as major challenges in operations management.²²

The commitment of Chinese investors to building up infrastructure in Australia and the challenges they face is well illustrated by the Ord River Project by Shanghai real estate investor Shanghai Zhongfu. The challenge for Shanghai Zhongfu was to integrate off-take from its planned Australian operation into the long supply chain of China's domestic market.

20% of Australian non resources exports go to Chinese consumer markets



China is the top purchaser of Australian agricultural products and education services, the third-largest buyer of Australian manufactured goods, and a crucial growth market for the Australian service industry



In 2013, Australian exports in beef to China increased nearly four times, oil seeds five times, and other meat exports doubled

2012 | 2013

Beef exports



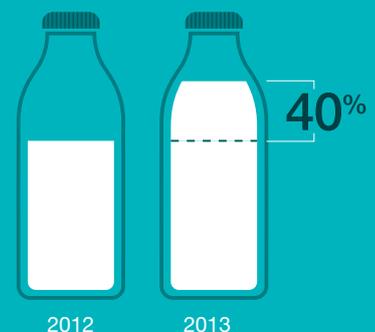
Oil seed exports



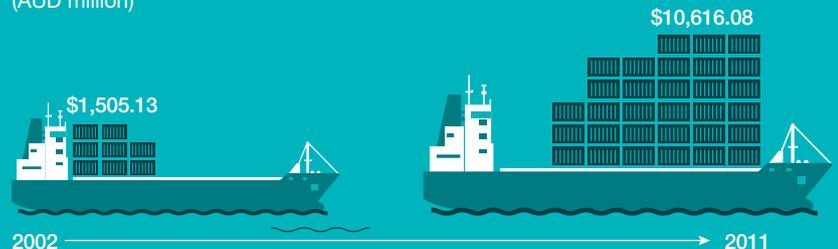
Other meat exports



China is Australia's top dairy export market with exports to Greater China (China, Hong Kong, Taiwan) increasing 40 per cent in 2013 alone



Australian manufacturing export to China has been increasing since 2002 (AUD million)



22. As KPMG's head of Asia Business, Doug Ferguson, has observed: "At least 50 percent is spent trying to improve China's own domestic infrastructure around cold storage, logistics and food safety. So it's not just investment into Australia or New Zealand or elsewhere. The (investors) are trying to solve the logistics and distribution issue back in China." Sarina Locke, Chinese interest in Australian farms is high but action is slow as China calls for reduced scrutiny from the Foreign Investment Review Board, ABC Rural, <http://mobile.abc.net.au/news/2014-10-28/monday-hold-nrn-chinese-investment/5839882?pfm=sm§ion=news>



Australia China Business Council
澳大利亚中国工商业委员会



Kununurra local Stephen Davies involved in the land clearing process

Case Study: Shanghai Zhongfu Group

Established in 1992, Shanghai Zhongfu Group is one of Shanghai's largest private real estate developers, with over 20 years' business experience. Over the years the Group has developed some well-known buildings in Shanghai such as Zhongfu Building and is responsible for several old city reconstruction projects in Pudong and Puxi districts. Recently, Shanghai Zhongfu Group has expanded into areas such as network communications and auctioneering.

In 2012, Shanghai Zhongfu won the right to lease and develop the second stage of the Ord River irrigation area with 13,400ha of land under its control

and projected investment of \$700 million in the local agriculture, processing and related infrastructure. Shanghai Zhongfu sees this project as its prime experiment in local integration.

Above all, the Ord River project is Shanghai Zhongfu's first overseas investment project. As a diversifying property developer in China, Shanghai Zhongfu came across the opportunity to invest in Western Australian agriculture by chance and was helped by Western Australian contacts and the state government, which convinced the chairman that an agricultural base in Australia was an opportunity for his company to tap into China's fast-growing demand for agricultural products.

The challenge for Shanghai Zhongfu was to integrate off-take from its planned Australian operation into the long supply chain of China's domestic market.

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Shanghai Zhongfu's familiarity with China's domestic market was crucial in making the investment decision. Originally Shanghai Zhongfu was planning to grow sugar cane, but then settled on sweet sorghum as a more suitable crop for the immediate future. Locally grown sorghum will first be processed in a sugar mill that Shanghai Zhongfu is building for AUD \$250 million. It will then be shipped to China for further processing into ethanol and bio-fuel. In addition, Shanghai Zhongfu is introducing the cultivation of chia seeds which have been approved for food consumption in China. The Ord River region is one of the places suitable for the cultivation of chia seeds. Demand in China for this type of health food is strong.

“Chinese plans to invest in the Australian agricultural sector are an encouraging development.”

More than a third of Zhongfu's investment in the Ord River project will be in infrastructure. This includes construction of thermal power plants, railways and port expansion. Poor infrastructure has restricted the growth of local businesses as local products cannot be exported because the lack of rail and port infrastructure. Building local infrastructure will benefit Zhongfu as well as the local economy.



Cleared farmland on the Goomig area north of Kununurra

Survey findings – Agribusiness

Findings from the Australia-China Business Survey provide a snapshot of the opportunities respondents see for Australian agribusiness in China.

- › 100% of respondents rank China as important in their company's near term global expansion plans.
- › 89% describe their two year business outlook with China as optimistic.
- › 67% feel that they would benefit from coordinated Australian branding.
- › 50% consider physical infrastructure as an impediment to their ability to deal with China.
- › 33% of total business sales are from China business.
- › Chinese administrative procedures, brand recognition and Chinese domestic market access are the three top barriers to doing business with China.
- › Personal networks and government agencies are the two main ways to find the right Chinese business partners.



Manufacturing is now the second largest Australian exporting sector to China behind the resources sector

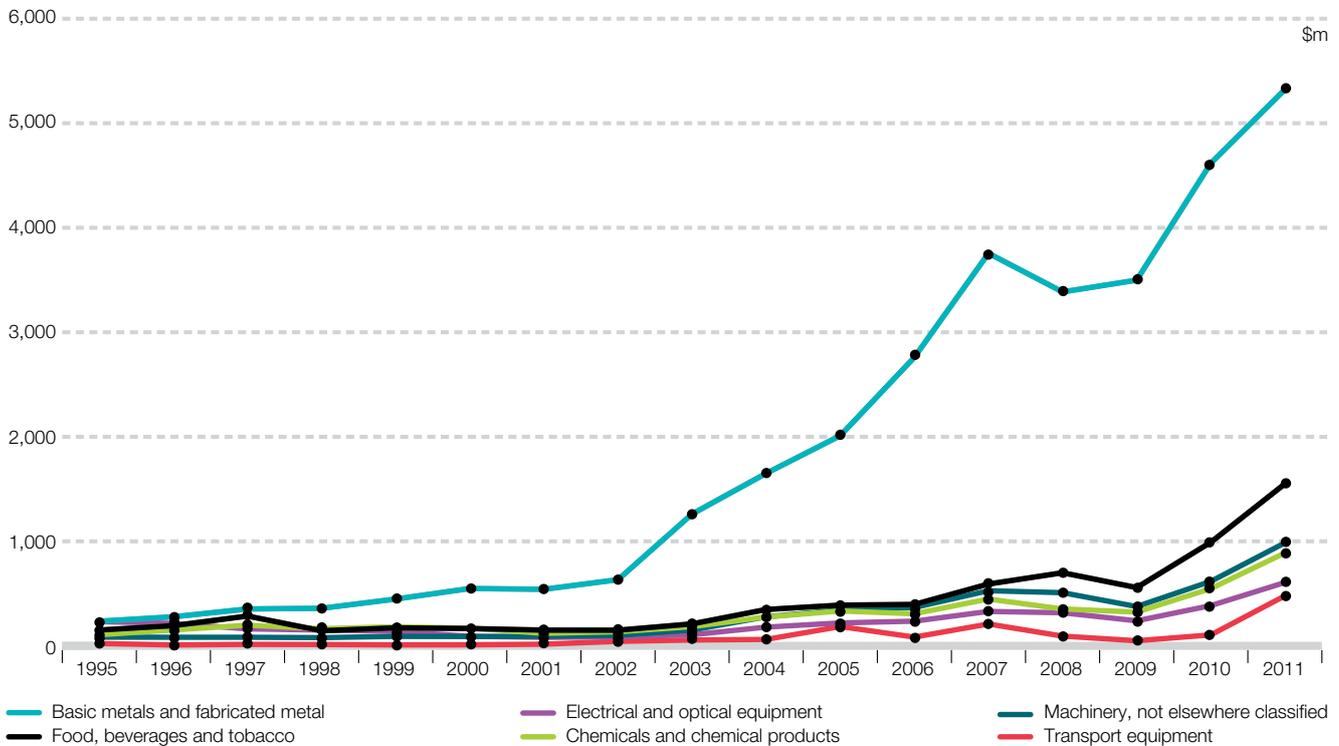
Manufacturing

The fact that China is a strong buyer of Australian manufactured goods is not widely known. Manufacturing is now the second largest Australian exporting sector to China behind the resource sector. In 2011, the export value of manufacturing was twice the size of agriculture, forestry and fishing. High value-added manufacturing exports complement Australian exports of metals and fabricated metals, which still dominate the sector.

Manufacturing exports to China have grown consistently since 2002. Since 2009, Australian manufacturers have been able to respond to the rise in Chinese consumer demand in a success story that has been overshadowed by the much steeper rise in resources exports. All manufacturing sub-sectors, with the exception of textiles and textile products, have shown growing export volumes to China in recent years (Figure 2.5).

Australian manufacturers depend increasingly on China as one of their three major export destinations in an overall slowing export market and at a time when domestic demand is shifting from manufactured goods to services. China has thus become a crucial growth market for Australian manufacturers (Table 2.4).

Figure 2.5 Australian manufacturing exports to China by subsector, 1995 – 2011



Source: USYD estimate based on WIOD

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Outlook for Manufacturing

The increase in manufactured exports to China is set to continue. Chinese producers are in-sourcing an increasing proportion of inputs from global markets. China will continue to need high value-added manufactured goods, including those that build upon Australian advantages such as specialised mining equipment and R&D intensive parts and components. The challenge for Australian exporters will be to identify niche markets and to safeguard intellectual property rights while working closely with Chinese partners. Australian manufacturers are concerned about the risks they are facing in this regard.

A firm that is directly addressing the problems and risks involved in finding niche markets and sourcing materials and components is South Australian engineering company, Mawson Global.

Survey findings – Manufacturing

Findings from the Australia-China Business Survey on the manufacturing sector highlight the positive outlook for Australian manufacturers doing business with China and the opportunities for Australian high value-added manufactured products, while acknowledging some of the constraints.

- › 82% of respondents describe their two-year business outlook with China as optimistic.
- › 80% claim that their China business is part of their global value chain.
- › 76% disagree that increasing operations in China means shrinking operations in Australia.
- › 23% of the total business sales are from China business.
- › Less than 30% state their major competitors are Chinese companies entering the Australian market.
- › Chinese administrative procedures, lack of intellectual property rights protection, and brand recognition are the three top barriers to doing business with China.

Table 2.4 Australian manufacturing exports (AUD billion)

Country	Rank	2010-11	2011-12	2012-13	Share of total exports	5 year trend
New Zealand	1	5.35	5.28	4.95	12.5%	-3.7%
United States	2	4.61	4.72	4.44	11.3%	-3.2%
China	3	3.65	4.00	4.04	10.2%	10.9%

Source: DFAT, Trade in Primary and Manufactured Products Australia 2012-2013





L-R: Peter Evans, Founder, Mawson Global,
Tony Capobianco, Owner, Nocelle Foods

Case Study: Mawson Global

Mawson Global is a textbook case of a company bridging gaps in increasingly fragmented production processes with their long value chain. Their two-step approach of first sourcing materials and then offering to source components facilitates the transition from localised to globalised production for clients.

Mawson Global is offering these services to Australian SME clients who otherwise would not be able to access global sourcing. Where clients possess competitive intellectual property rights, this might be the only way for them to keep production and R&D in Australia, while reducing the scope of their production activity to the sustainable minimum.

Bringing Australian companies in contact with Chinese suppliers can lead to flow-on business when access to products affords access to markets and new supply chains. Peter Evans, the

**Bringing
Australian
companies
in contact
with Chinese
suppliers can
lead to flow-on
business.**

founder of Mawson Global, observes that his company plugs Australian manufacturers into global supply chains. The reason for sourcing in China lies more in the access to supply chains and information than in cheap labour.

Among the success stories of Mawson Global is a South Australian engineering firm trying to source stainless steel products from China in order to reduce costs. After initial contacts with Chinese suppliers, the sourcing scope expanded to include components of machinery which enabled the manufacturer to resume the production of three types of machines which had been discontinued because they were no longer competitive due to high local production costs. With Chinese components reducing production costs, these machines are able to go back into export markets in North and South America.

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Services

Australian service exports to China have been increasing for more than ten years. Performance is strongest in areas where Australia has internationally recognised expertise or can bring its own unique comparative advantages to bear, for example in in-bound education and tourism.

In cross-border and in-country provision of services in China, Australian providers are subject to regulatory constraints and face the same hurdles as providers from other countries. When, in November 2013, China's new leadership released their 60-point decisions as the economic blue-print for the period until 2020, they included three commitments to opening up services to international competition. The first was to treat domestic and foreign service providers on the same basis; the second to establish the China (Shanghai) Free Trade Zone and the third, and most detailed, was a list of service sectors to be opened.²³

To date, the opening up of the Chinese service sector has been gradual, with reform being rolled out cautiously via pilot projects and coordination with stakeholders. This makes the progress and sequencing of these reforms difficult to predict, but at the same time creates incentives for Australian business to be involved at an early stage such as the big Australian banks or AMP have done.

Australian companies have achieved partial breakthroughs in insurance, banking and currency trading. At the same time, Australian financial and professional service providers are opening up two-way business opportunities for their Australian and Chinese clients. Australian companies operating in a market environment are doing well in other service sectors such as architecture and design.

“Australian financial and professional service providers are opening up two-way business opportunities for their Australian and Chinese clients.”

23. The list includes finance, education, culture, healthcare and other service sectors. Limits are also to be eased on access for foreign investment in childcare, care for the elderly, architectural design, accounting and auditing, trade and logistics, electronic commerce and other such service sectors, and further liberalize general manufacturing. Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, 2014, downloadable at http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602_7.htm





Representatives from Snowden and Chinese company ENFI at the signing of their cooperation agreement

Snowden initially worked with Chinese geologists, mining engineers and other experts to translate international mining codes into Chinese.

for investors. These reports protect investors from misleading information and are done against the respective codes by accredited competent persons.

Snowden Group discovered a market opportunity when Chinese mining companies started outbound investment and discovered that while possessing rich technical and industry know-how, they lacked crucial regulatory expertise in working with international mining codes which impacted on their ability to source external funding for their projects. Snowden identified a key design institute in Beijing as the best partner to offer consulting services in international mining codes to Chinese mining companies.

Snowden initially worked with Chinese geologists, mining engineers and other experts to translate the codes into Chinese and interpret them from a Chinese perspective. Over time this led to closer cooperation with Snowden giving presentations in Beijing and training Chinese mining engineers and geologists in Perth. Relationship building took the better part of three years. Once confidence was established, the negotiation of a cooperation agreement was completed within months. The cooperation agreement established a joint platform for the Design Institute and Snowden Group to offer their services to Chinese state-owned mining companies intending to invest overseas.

Case Study: Snowden Group

Snowden Mining is an Australian company utilising its standing in the mining sector to partner with an influential Chinese state-owned company, the Design Institute. Snowden Mining spent years in building a relationship and trust with their Chinese counterpart that eventually led to global expansion of their joint service.

Snowden Group achieved a breakthrough for the Australian service sector by cooperating with one of China's central technical design institutes for the mining sector. They jointly support Chinese global mining investments through their special expertise in international mining codes and their application. Codes, such as the Australian Joint Ore Reserves Committee Code (JORC Code), the Canadian National Instrument NI 43-101 and the South African Code for the Reporting of Mineral Resources and Mineral Reserves (SAMREC), regulate the publication of mineral exploration reports

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For example, Snowden was brought into a Chinese mining project in a Southeast Asian country where the Design Institute had already done feasibility studies and required Snowden to contribute specific technical expertise through working together with the Chinese team. In projects of this nature, Snowden has the international expertise and connections, while the Design Institute has the expertise required for the Chinese regulatory environment.

Turning to services provided to Chinese clients and consumers within Australia, education and tourism are the backbone of Australian-based service exports that produce huge community benefits. China is Australia's biggest market for international students. As of December 2013, 28 percent of international students studying in Australia came from China (Table 2.5). Growth in student numbers from China has stabilised in recent years. Between December 2012 and December 2013, the annual growth rate was only 0.2 percent, lower than the overall growth rate for international student enrollment. Chinese sources indicate that demand for overseas education is stabilising and that flat growth for Australia is the trend, while the United States and United Kingdom are performing slightly above trend.

Far-sighted educators in Australia have started considering how international students from China can be better integrated with local students in order to make educational export of Australian universities more sustainable. Caulfield Grammar School in Melbourne is an example of how a long-term engagement between Australian and Chinese students can be achieved outside of commercial constraints and with a view to creating intangible benefits for the long-term integration of Australian students in our region.

Table 2.5 Student enrolment in Australia

	December 2012	December 2013	Annual growth
China	149,758	150,116	0.2%
Total	515,853	526,932	2.1%

Source: Australian Education International, AEI International Student Enrolment Data



The signing of the cooperation between Snowden and ENFI





Caulfield Grammar students
cycling in Nanjing, China

**Annual
spending by
Chinese visitors
to Australia
could rise to
\$13 billion
by 2020.**

the capital of China during the Ming Dynasty. Nanjing has an active sister city relationship with Melbourne and is the capital of Jiangsu Province which has a sister province relationship with Victoria.

Caulfield Grammar and the high school affiliated with Nanjing Normal University jointly established a campus inside the grounds of Nanjing Middle School in a building designed by Caulfield's school architect. The partnership has given Caulfield Grammar a base in the heart of Nanjing. Currently, a team of 14 staff, most of whom are appointed from Australia, work with students in Nanjing.

Chinese language was first taught at Caulfield Grammar in 1989 and it has remained a core subject in primary year levels since 1994 and an elective subject throughout secondary level. The added stimulus of the China program has had a significant impact on encouraging large numbers of students to continue their language studies through to VCE.

Case Study: Caulfield Grammar School

Sixteen years ago, Melbourne's Caulfield Grammar School looked to China to give its Year 9 students an immersion experience as part of their normal academic program. Since its initiation, the program has gone from strength to strength with over five thousand students from Year 9 and about one thousand students from Year 11 participating in their China cultural program.

In 1994, Caulfield signed a memorandum of understanding with Nanjing Middle School. Caulfield had considered various Chinese cities and eventually settled for Nanjing, a city with a long history and

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Through the immersion experience in China at an early stage, Caulfield Grammar encourages its students to become aware of their future in a globalised world in close neighbourhood to Asia. Students build leadership skills and develop adaptability and resilience.

These skills and capabilities are increasingly important as Australia enters a new phase of deeper and broader engagement with the world around it.

While numbers in the education sector are stabilising, the number of Chinese tourists travelling to Australia is growing strongly overall with seasonal fluctuations (Figure 2.6).

China is now Australia's fastest growing inbound tourism market. Tourism Australia's latest projections suggest that annual spending by Chinese visitors to Australia could rise to \$13 billion by 2020, an increase of nearly 50 percent on the previous estimate of \$9 billion in 2011.²⁴ The potential for growth in in-bound tourism from China is illustrated by the family-owned Tangalooma Island Resort which receives 40,000 Chinese visitors a year. Tangalooma Island Resort built up a network of travel agents in China that enabled them to target more affluent customer groups and then match expectations with carefully selected services in the resort.

Figure 2.6 Number of short-term (less than one year) visitors arriving from China to Australia



Source: Australian Bureau of Statistics

24. Tourism Australia 2014, Chinese visitor spending projected to hit A\$13 billion by 2020, downloadable at <http://www.tourism.australia.com/news/media-releases/media-releases-chinese-visitor-2020.aspx>





Hand feeding wild dolphins at
Tangalooma Island Resort (Haitundao)

Case Study: Tangalooma Island Resort

Tangalooma Island Resort's David James began to travel to China in the 1990s to forge business links with Chinese partners in Beijing, Shanghai, Guangzhou and Shenzhen. Since 2000, these arrangements have expanded to other major cities such as Chongqing, Chengdu, Hangzhou, Suzhou and Tianjin. China is Tangalooma's fastest growing tourist market. Over a decade of cultivating relationships and building up the Tangalooma brand, the number of Chinese visitors has increased tenfold from 3,000 to 4,000 visitors per year in the early 2000s to 40,000 a year today, creating vast benefits to business, the local economy and the local community.

**The number of
Chinese visitors
has increased
tenfold.**

From the outset, Tangalooma concentrated its efforts in China on a small number of highly selected travel agencies and long-term relationships. Tangalooma's strategy is to work with a select group of key travel agencies, normally four to five wholesale agents and the same number of high volume retail agents in each major city, to avoid brand erosion and price competition. These agents hold a crucial role in providing information and resources to present the resort as a high quality holiday experience.

Tangalooma has built a strong and recognised Chinese brand name, Dolphin Island (海豚岛). The brand is targeting China's rising independent tourists who demand more unique and authentic experiences when they travel. These tourists, often referred as Free Independent Travellers (FIT), tend to be younger, more affluent and sophisticated than other tourists. A strong brand plays a key role in enhancing the overall image of Tangalooma and attracts the more affluent travellers.

Carefully nurtured, the brand caters for travellers who want an Australian experience but in a familiar Chinese environment. The resort has a Sichuan restaurant, Chinese speaking staff and special activities on annual Chinese festivals.

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Resort guest quad biking at Tangalooma Island Resort (Haitundao)

Tangalooma Island Resort (Haitundao),
Moreton Island QLD Australia

Outlook for Services

Australian service providers in China are making slow progress as they await regulatory change in service areas that are tied to reforms of China's domestic services, some of which are state-controlled or under state monopolies.

Services open to market supply and demand offer better opportunities and are expected to grow, driven by China's consumer and producer demand. For example, in the healthcare sector, Chinese companies such as Lancare Australia operate across both markets to combine health service provision in Australia and China.

For the Australian education sector, faced with stabilising Chinese student arrivals, the challenge is to generate higher added value by providing more differentiated products and improved or differentiated services, with an emphasis on high quality learning, work-integrated learning and strong graduate outcomes. Similarly, the future growth of the Australian tourism sector will depend on its ability to shift from organised travel tours to more high value-added free independent travellers.

Survey findings – Tourism

- › 96% describe their two year business outlook with China as optimistic.
- › Less than half of respondents believe that alternative markets to China are improving.
- › 28% of the total business sales are from China business.
- › Brand recognition, communications and administrative procedures are the top three impediments to doing business with China.
- › Increased competition from foreign businesses and deterioration that may occur in Australia-China relations are perceived risk factors.
- › Avoiding corruption or legally risky business practices is regarded as important for business relations.





3.0 Doing Business with China: Realised and Anticipated Benefits to Firms

**The outlook of
our respondents
on China
business is
markedly
positive.**

The main conclusion from our Australia-China Business Survey is that Australian business respondents have a complex and sophisticated view of Chinese markets and are integrated in Chinese value chains and through China in global value chains. They see their domestic and international competitors gaining advantage from their business engagement with China and in turn use their own links with Chinese business partners to enhance their domestic (Australian) and global competitiveness. Australian businesses are pulled and pushed into cooperation with Chinese partners as they strive to enhance their global competitiveness.

The outlook of our respondents on China business is markedly positive. Nearly 90 percent of all respondents were optimistic about their business prospects with China.

Survey Background

The Australia-China Business Survey commissioned by the ACBC is the first survey to focus on Australia-China business integration. It provides unique insights into the outlook of the China market from the perspective of mostly small and medium-sized Australian companies.

The aim of the Australia-China Business Survey, reported in detail below, is to contribute to an informed public debate about Australia-China business interactions with a view to improving Australia's international competitiveness. The objectives were to investigate current business issues that impact on the ability of Australian companies to do business with China, as well as perceived obstacles to, and incentives for, doing business with China.

The survey items consisted of multiple choice and scaling questions. The survey questions covered topical statements relating to Australia-China business interactions, experience and expectations on future business development and business operations in Australia. A total of 209 valid responses were recorded. These businesses, predominately large and small members of the ACBC, represented all states and industry sectors including agribusiness, manufacturing, financial and business services, mining and real estate.

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All had experience in cross-border trade and investment and all understand the business environment in China with an average length of five years in China business.

The detailed survey respondent demography is reported in Appendix 1.

Business Outlook for the China Market

Our survey results reveal that a positive outlook towards doing business in China prevails across all sectors with relatively little variation among industries. Respondents have positive expectations based on past performance and realistic evaluations of opportunities and risks. The survey results are broadly in-line with other surveys by China's major trading partners and reflect a realistic assessment of a competitive and maturing market.

Reported profitability is higher than average in the services and agribusiness sectors and for companies involved in investing in China. Companies that used their China activities to move higher up the value chains also report higher profitability. While respondents report positive business results, they are also looking beyond short-term profit to longer term strategic and competitive possibilities. A larger proportion of small businesses reported that their trade with China had made them globally more competitive. China engagement is actively pursued by businesses that see their domestic and global competitiveness increase as a result.

DevWest is an example of a West Australian real estate development company whose directors have developed a close rapport with Chinese clients over years of interaction and building up relationships with investors from mainly second and third tier cities in China.

Main findings

Doing Business with China: Realised and Anticipated Benefits to Firms:

- › The outlook of our respondents, mostly ACBC members, on China business is markedly positive. Nearly 90 percent of all respondents were optimistic about their business prospects with China.
- › The survey reveals little variation from industry to industry on the question of business outlook. A positive outlook prevails.
- › Small businesses feel that their China engagement improves their domestic and international competitiveness.
- › Business engagement with China makes Australian businesses more competitive globally, as the engagement facilitates integration of Australian businesses in global value chains. This works as a pull factor for China engagement.
- › Competitive pressure has a push effect when business see their competitors gaining advantages from cooperating with Chinese business partners.
- › Cooperation with Chinese partners enables Australian businesses to gain access to new value chains or to improve their position in existing value chains.
- › Australia-China trade is complementary: firms that do well in China have a higher tendency to stay in Australia and expand their Australian workforce.





Chinese capital played a key role in the financing of DevWest's commercial and residential project at 1 Richardson Street, South Perth. The project is under construction with completion expected in the fourth quarter.

DevWest's directors took less than five years to build a reputation with Chinese investors.

momentum until they had delivered several successful projects for Chinese investors. Initial trust needed to be followed by successful delivery.

The DevWest directors have built active client networks through personal contact with visiting delegations of investors, frequent presentations by its directors in China, meetings with migration agents, liaising with Chinese banks and their private clients as well as introductions to family and friends of existing investors.

DevWest has investors from second and third tier cities in Zhejiang Province such as Wenzhou, Ningbo and the provincial capital Hangzhou as well as from Shanghai and cities in the north including Beijing and Taiyuan. Because of the wide regional spread, DevWest decided against setting up a permanent office in China, but hired a Chinese staff member and set up a Chinese language web presence.

Case Study: DevWest

DevWest started as a residential real estate developer in Perth and is now one of Perth's most diversified developers, with an established presence in China and a major player in attracting Chinese real estate investment into multi-level retail, mixed use and residential development projects in Perth. A significant proportion of the equity that DevWest sources for its development projects now comes from China.

After an initial introduction from an Australian contact based in Beijing, DevWest's directors took less than five years to build a reputation with Chinese investors. At this time DevWest had a track record with local and Singaporean investors, but not with investors from China. The DevWest directors initially relied on introductions in Beijing. However, after a focused and sustained effort, which included trips to many different cities and plenty of pavement pounding, their network began to grow. Notwithstanding their efforts, they did not gain real

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DevWest is confident that its network-based business model will serve it well as competition from Sydney and Melbourne increases. Chinese competitors are also expanding their reach into Western Australia, but are currently hindered by lack of familiarity with local practices.

DevWest demonstrates how small Australian businesses can break into markets that are difficult to enter. DevWest's success shows that relationship building continues to be the most significant investment to attract Chinese clients.

Firms are also being drawn into China engagement when they have to respond to competitors who gain advantages over them through China exposure. Partnering with Chinese businesses then becomes an important business strategy. An overwhelming majority of our survey respondents from all business sectors and industries indicated that they would benefit from partnering, including joint ventures, with Chinese businesses. Three quarters of respondents partner with Chinese private firms. The one quarter of Australian firms partnering with Chinese state-owned enterprises are larger in size than the average respondents and are predominantly targeting Chinese industries where the state sector has remained strong.

“Firms are also being drawn into China engagement when they have to respond to competitors.”



The interior of a DevWest apartment in Subiaco, Western Australia



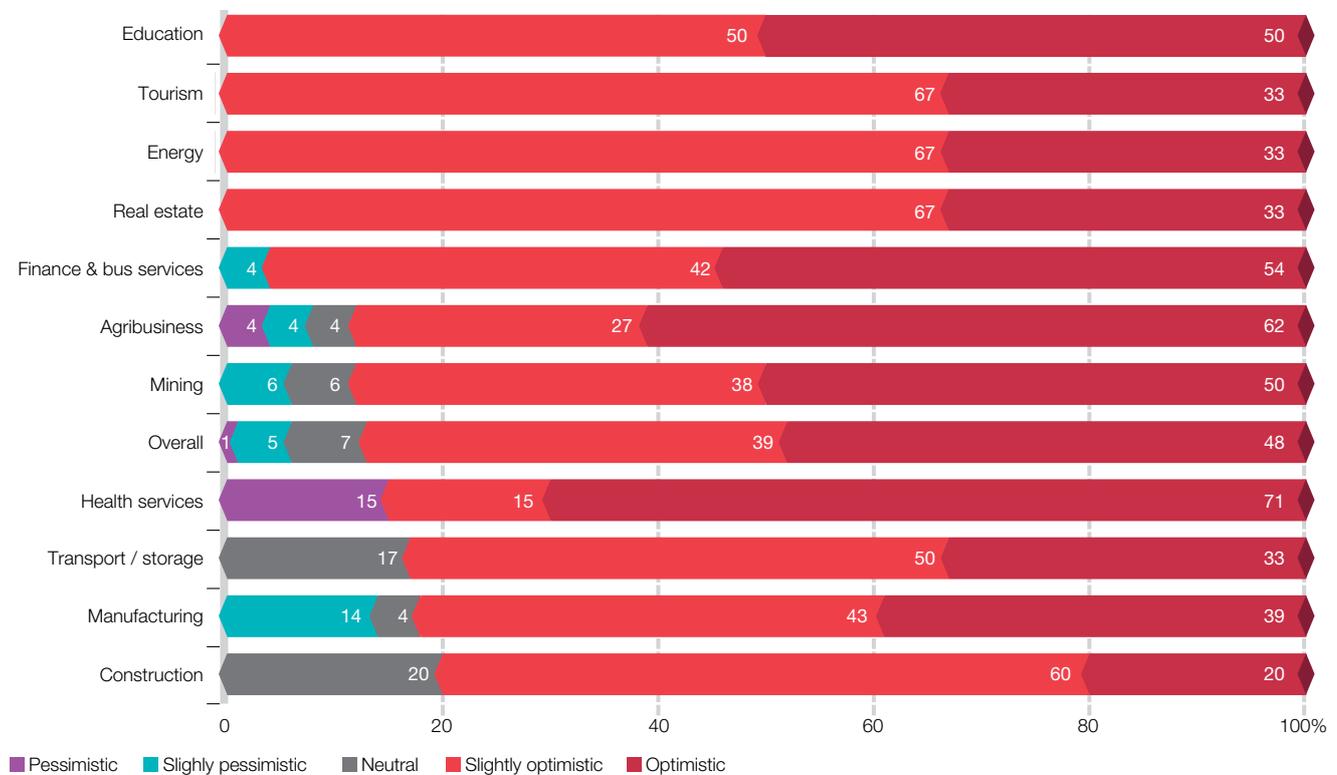
87% of respondents said they were either optimistic or slightly optimistic about their business with China.

High Confidence

The majority of respondents were positive about the outlook for their business with China. Eighty-seven percent of respondents said they were either optimistic or slightly optimistic about their business with China. Only six percent of respondents were pessimistic in outlook. Some 76 percent of respondents expected their revenue to either grow or grow significantly over the coming year. Almost 70 percent expected profits to be better or much better next year.

The survey results reveal little variation from industry to industry on the question of business outlook (Figure 3.1). Respondents from the education sector were most optimistic about the two-year business outlook with 50 percent of respondents saying they were optimistic and 50 percent slightly optimistic. One third of respondents from the tourism, energy, and real estate sectors expressed that they were optimistic and 67 percent slightly optimistic. The least optimistic views were expressed by respondents from the construction and manufacturing sector, though more than 80 percent of respondent companies from that sector also said that they were optimistic.

Figure 3.1 Two year business outlook – by industry



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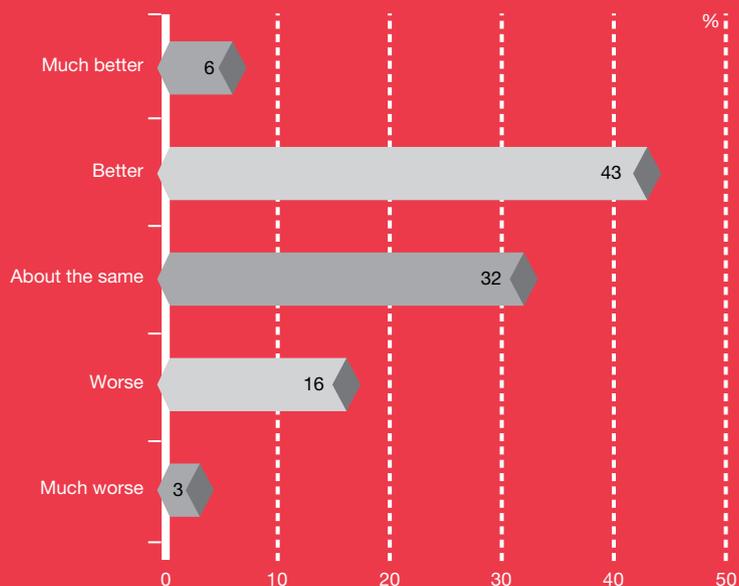
Past Performance

Half of our respondents (49 percent) increased their profits from China-related business activities during last year. One third of respondents (32 percent) reported that they maintained about the same level of profitability as the year before. (Figure 3.2). Over the last three years, 60 percent of respondents achieved growth in turnover and 25 percent had a constant turnover. Nineteen percent reported falling profits and 16 percent shrinking revenue.

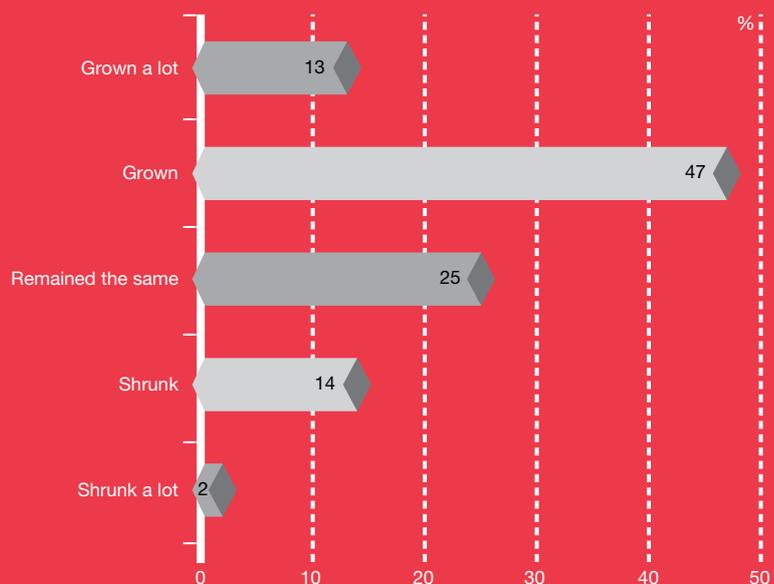
“Respondents from the education sector were most optimistic about the two-year business outlook.”

Figure 3.2 Previous revenue and profitability

Compared to last year, this year's profitability is:



Over the past 3 years, our revenue has:



A higher proportion of firms in the agribusiness, construction, health services, education and tourism, and real estate sectors said their profitability had increased in 2013.

Which Firms are Thriving?

Around 50 percent of the respondents indicated that this year's profits were either better or much better than last year's (see Figure 3.2 above). The survey responses indicate different criteria for successful China engagement such as industry sector, type of business activity and movement along the value chain.

A higher proportion of firms in the agribusiness, construction, health services, education and tourism, and real estate sectors said their profitability had increased in year 2013 (Figure 3.3).

More than 80 percent of firms in the real estate sector recorded positive growth. Health services, education and tourism continue to benefit from China's growing disposable income and Australian-developed services markets.

Businesses investing in China and those exporting to China reported higher profitability than those investing in Australia and importing from China (Figure 3.4). This indicates that despite entry barriers and risks, China offers considerable opportunities for profitable high growth.

Firms Working with Chinese Partners

Profitability is also linked to cooperation with Chinese partners and integration into value chains. Companies that had moved up the value chain through their China engagement reported higher profitability (Figure 3.5).

Figure 3.3 Sectors in which firms do well

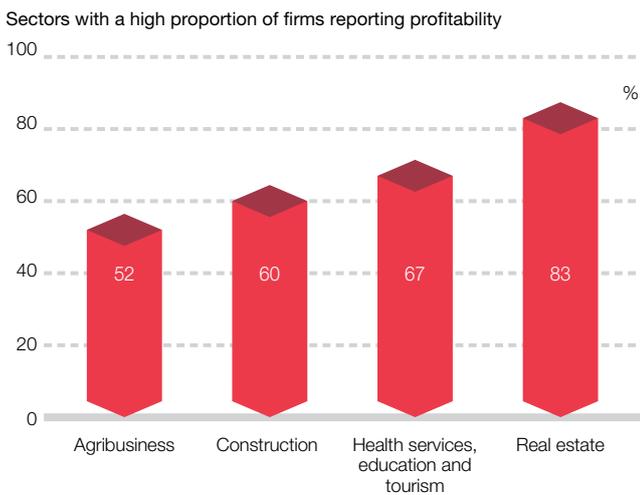
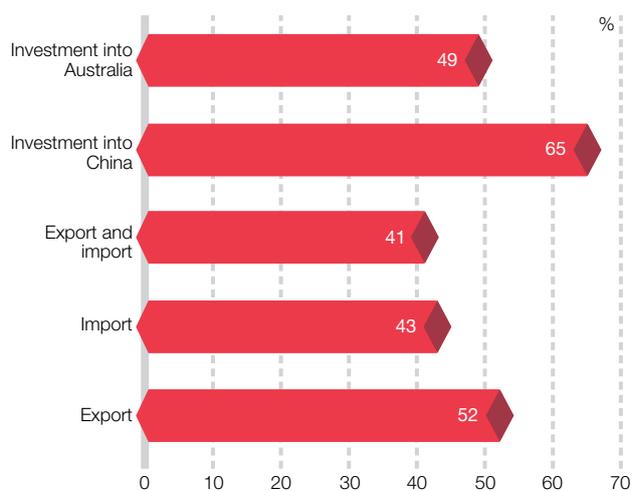


Figure 3.4 Type of business reporting profitability



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Small Businesses

In contrast to the general perception that small businesses are disadvantaged in the global economy, our survey results show that small business respondents view China as a market that can make them more competitive. If small businesses succeed in entering value chains, they are less hindered by their lack of ability to establish reliable supply chains. Instead, by joining global production networks through Chinese partners, small businesses expand their market from local to global and capitalise on larger markets with more efficient factors of production (Figure 3.6).

“Profitability is linked to cooperation and integration.”

Pull and Push Factors

The survey underscores our observation that trade with China is inherently global and not confined to bilateral exchange.

Trade with China influences domestic competition in Australia as well as global competition. Even companies not dealing with China are affected when their domestic and international competitors are dealing with Chinese business partners through the impact on markets and prices. In the survey, respondents agreed most strongly when asked if their international and domestic competitors were dealing with Chinese partners. More than 90 and 75 percent, respectively, answered in the affirmative.

Figure 3.5 Moving up the value chain

Our China operations enable us to move up the value chain

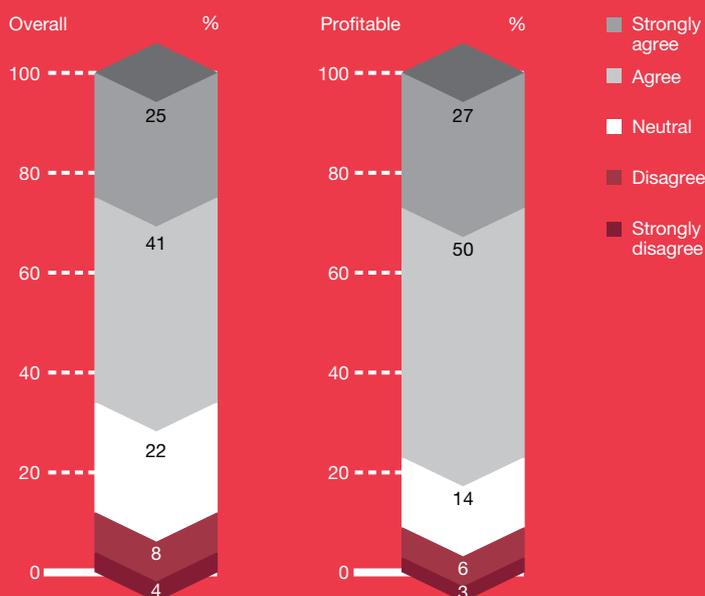
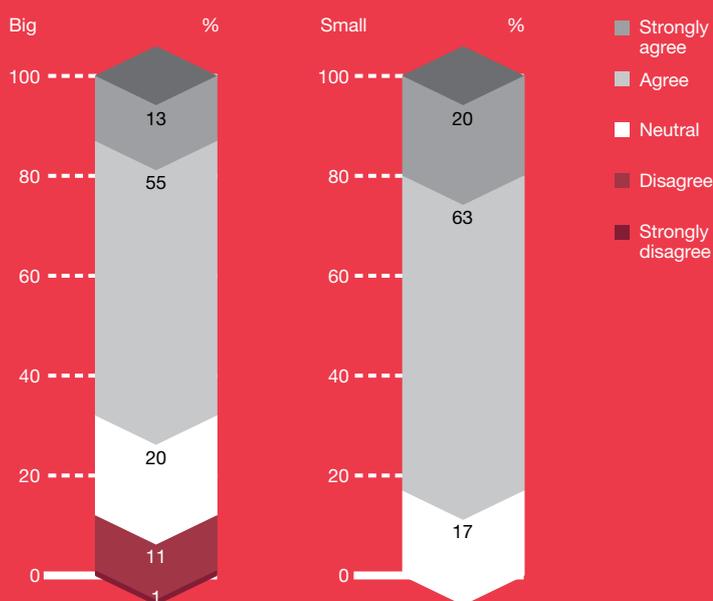


Figure 3.6 Trade with China and global competitiveness

Trade with China has made our company globally more competitive



For Australian businesses, links with China are part of their globalisation strategy.

Asked about their own businesses, two thirds of respondents stated that 'Trade with China has made our company globally more competitive', and more than half noted that 'Trade with China has made our company domestically more competitive'. This suggests that for Australian businesses, links with China are part of their globalisation strategies. They see their domestic and international competitors gaining advantage from engaging with Chinese business partners and use their China links to improve their own competitiveness.

There is a double motivation at work for businesses engaged with China. There is a pull factor and a push factor. The pull factor comes into play when Australian businesses see opportunities to improve their products or services by dealing with a Chinese business partner. The push factor operates when Australian business see that competitors gain advantage by linking up with Chinese business partners.

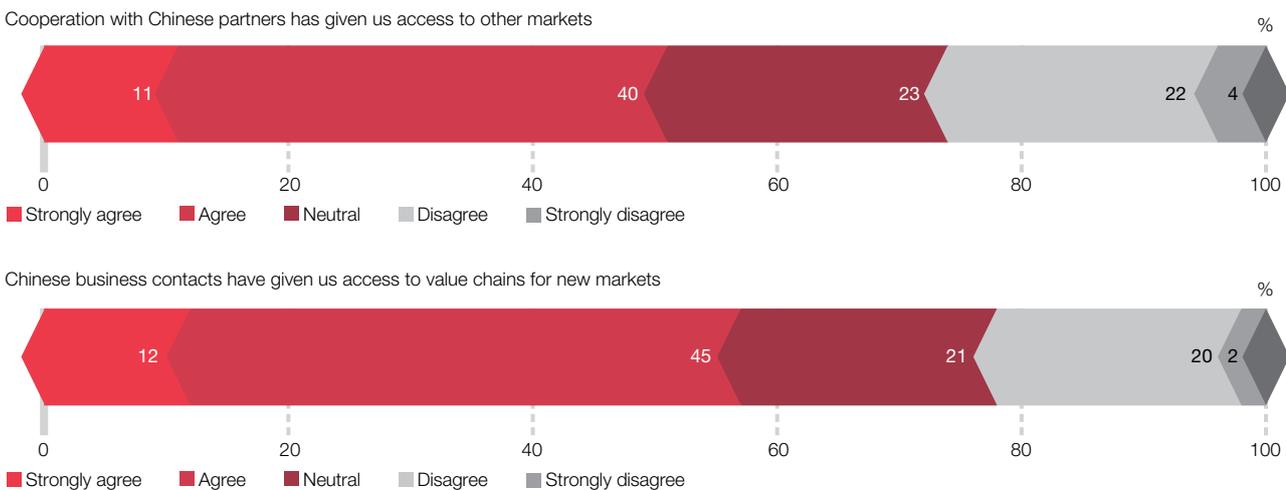
The Pull Factor

Profitability is only part of what makes cooperation with Chinese business partners attractive. The pull factor goes beyond profitability by improving the long-term position and opportunities for growth of a business. Linking up with Chinese partners provides access to new markets, economies of scale, advanced technology in the value chain and opportunities for clustering and innovation.

Cooperation with Chinese partners was closely related to expanding of or upgrading to higher positions in value chains. Fifty-seven percent said that their China business contacts had provided access to value chains for new markets. Half of the respondents (51 percent) stated that cooperation with Chinese partners had given them access to other markets (Figure 3.7).

The pull factor confirms that links to Chinese business partners have to be seen in a global context in the sense that Chinese partners do have a bridging function to other manufacturing centres and markets.

Figure 3.7 Integration in value chains



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The Push Factor

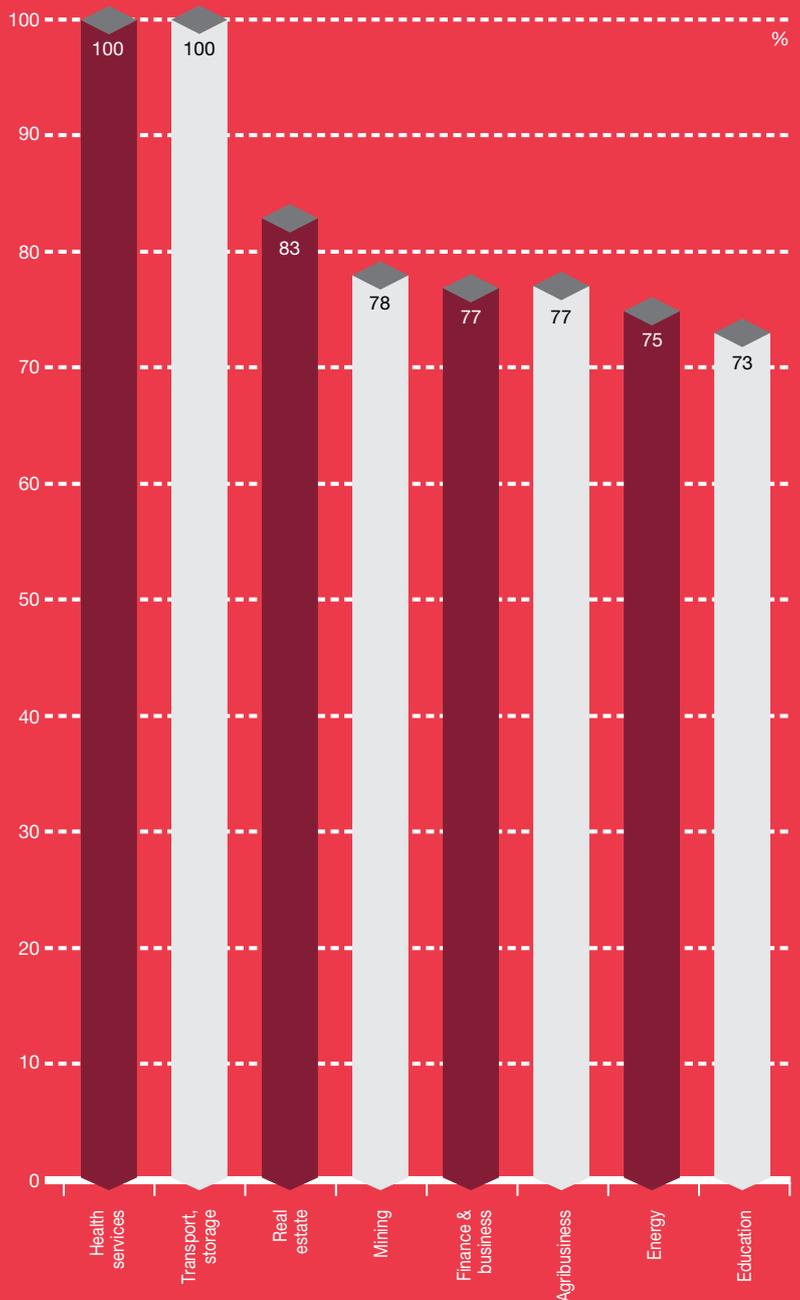
For many respondents, cooperation with China is not a matter of choice. There is a push factor at work when their local and international competitors are ahead of them in cooperating with China. The logic here is simple but inexorable: either emulate the competition or lose out to it.

Three quarters (73 percent) of Australia-China Business Survey respondents – all of whom are, by virtue of their membership of ACBC, China-engaged – indicated that their domestic competitors were working with Chinese partners and 90 percent said the same for their international competitors.

“Either emulate the competition or lose out to it.”

Figure 3.8 Partnering with Chinese companies

We would benefit from being able to joint venture with Chinese partners



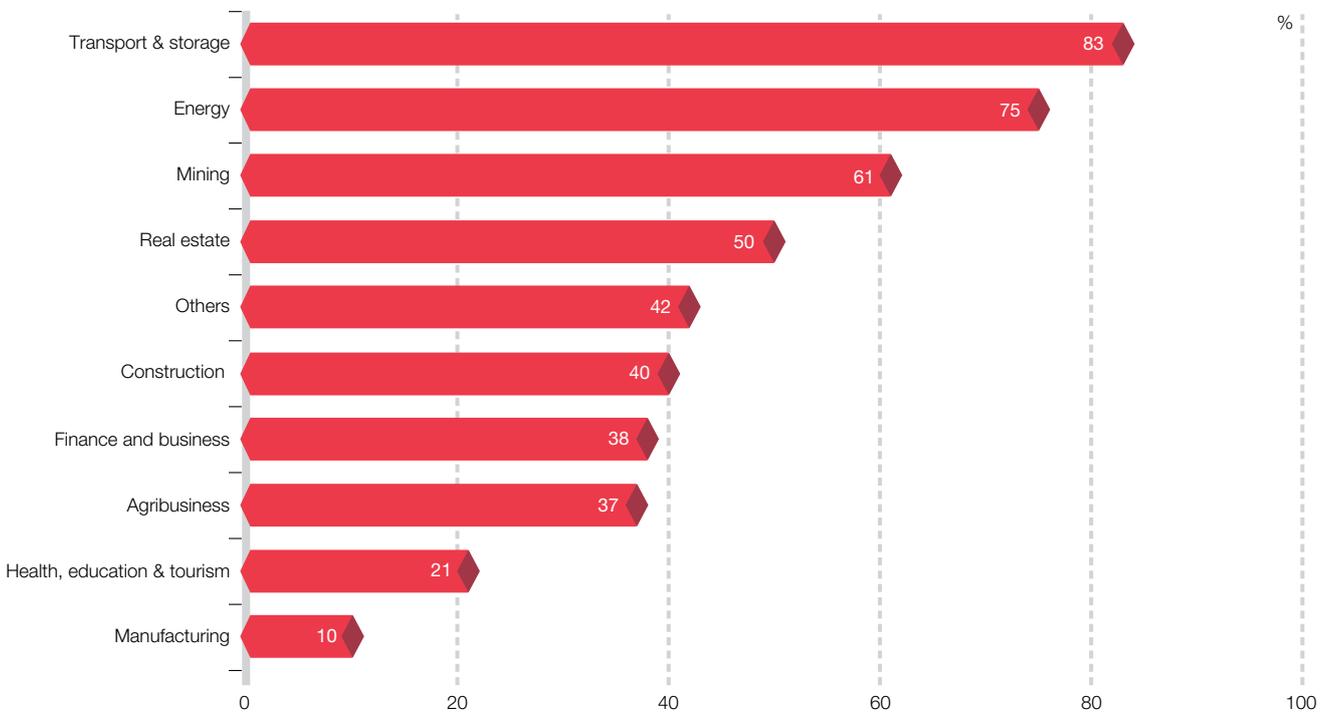
Chinese partners provide Australian firms with networks of potential clients and suppliers, local knowledge, market access, and resources.

Partnering with Chinese Companies

The increasingly competitive environment in China requires Australian companies to search for new strategies in order to maintain competitiveness. One of the most noted strategies by Australian firms is to form partnerships with Chinese companies. Chinese partners provide Australian firms with networks of potential clients and suppliers, local knowledge, market access, and resources. The survey shows a large majority of respondents across most industries agreeing that partnering with Chinese firms would benefit their business. The breakdown in industries shows the strength of support from health services, transport and storage, real estate, mining, finance and business, agribusiness, energy and education (Figure 3.8).

The survey shows that three quarters of respondents partner with Chinese private enterprises, which is an indication of the growing maturity of the Chinese market environment.

Figure 3.9 Proportion of firms with SOEs partners across industries



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Partnering with State Owned Enterprises (SOEs)

The reform of the state sector in China has resulted in State Owned Enterprises (SOEs) emerging as one of the main drivers of economic growth in China itself. It is chiefly the larger Australian businesses that partner with Chinese SOEs: nearly 50 percent of the businesses working with SOEs have a turnover of more than \$25 million and a higher percentage of firms in the energy, mining, and transport and storage sectors have an SOE as their main partner. The percentage is highest in the transport and storage sector with four out of five companies in these sectors partnering with SOEs that still monopolise the sector. The ratio of SOE partners is lowest in the manufacturing sectors.

“Cooperation with Chinese partners was closely related to expanding or upgrading to higher positions in value chains.”

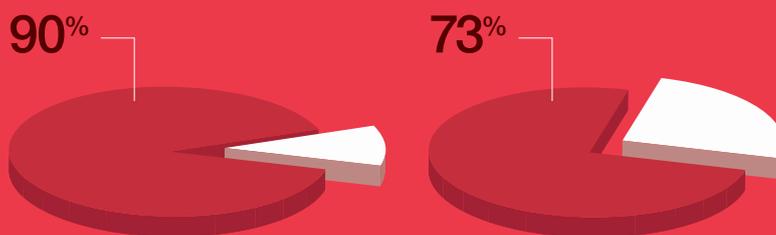
One of the main reasons that Australian firms chose this form of partnership is that SOEs provide entry into restricted industries such as transport.²⁵ Partnering with SOEs also helps firms to overcome local government restrictions and barriers and to qualify for preferential policy treatment. For overseas investment projects in energy, mining and the transport and storage sector, SOEs are still the dominant players (Figure 3.9).

Qenos is an example of an Australian-based advanced manufacturer successfully creating a space for itself in the value chain of a large Chinese SOE. This has led to the development of a new commercial business in the global value chain of the industry.

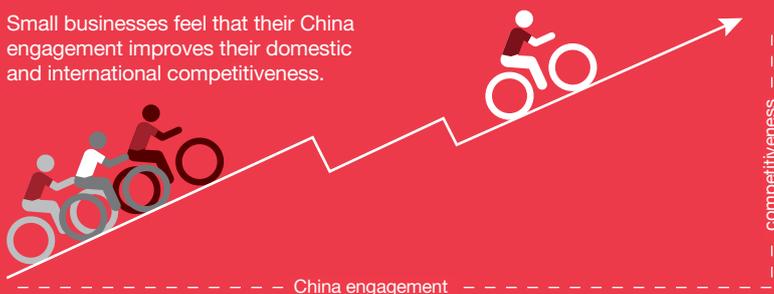
Business engagement with China makes Australian businesses more competitive globally, as they integrate in global value chains.



Competitive pressures are pushing businesses towards a China strategy. 90% of surveyed businesses have international competitors and 73% have domestic competitors dealing with Chinese partners.



Small businesses feel that their China engagement improves their domestic and international competitiveness.



Firms that do well in China have a higher tendency to stay in Australia and expand their Australian workforce.



Statements based on the responses from the exclusive ACBC business survey of 200+ businesses that are engaged with China

25. OECD, The Services Trade Restrictiveness Index (STRI).



Advanced manufacturer
Qenos - Olefins Plant,
Altona at dusk.



Case Study: Qenos

Qenos is Australia's sole manufacturer of polyethylene and leading supplier of world class polymers. It serves packaging, food and beverage, building and construction, home wares and leisure, mining and energy, agriculture, water conservation, waste management, and personal care industries in Australia and internationally. The company was incorporated in 1991 and is based in Altona, Victoria. As of September 30, 2008, Qenos Pty Ltd. has operated as a subsidiary of China National Bluestar (Group) Co Ltd – a joint venture between China National Chemical Corporation (ChemChina) and The Blackstone Group.

Qenos has a long history in managing hazardous processes safely and effectively. Its operational expertise and safety, health and environmental (SHE)

Qenos took the initiative to transfer safety expertise to China.

management practices were important factors in ChemChina's decision to acquire Qenos. Qenos took the initiative to transfer safety expertise to China, starting with a program of SHE knowledge exchange to the 22 Bluestar plants operating in China.

Initially, Chinese key personnel were brought out to Australia to shadow Qenos teams, but soon emphasis shifted to Qenos teams travelling to China for visits of one to two weeks to work with ChemChina plants.

Qenos helped the Chinese businesses develop and implement management processes and control and maintenance procedures for Chinese production facilities and their staff. Over time, these management systems were refined and a scorecard system based on diagnostic assessment was introduced to track improvements in operational practices and highlight areas where further support was required. This program has now been running continuously and with great success since 2007.

“Qenos helped Chinese businesses develop and implement management processes and control and maintenance procedures.”

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Helped by their local ownership links, Qenos teams were given access and information that enabled them to expand what had initially been technical advice into production management support able to improve asset performance.

Demand for Qenos expertise has reached a level that has seen seven teams sent to China in the first months of 2014 alone. In addition, Qenos is encountering demand from outside the group, for example from Chinese local governments keen to improve the performance and safety record of local chemical production facilities.

Faced with growing opportunities in China it was a logical step to consolidate these activities into a business platform. In 2013, with support from the Victorian State government, Qenos announced the establishment of a new business unit to export SHE and operational management expertise to hydrocarbon and chemical manufacturing companies in China.



Qenos Safety Health & Environment Training Representatives at Chengrand with Bluestar trainees.

Complementarity, Not Hollowing Out

There are concerns that Australian firms doing business in China will eventually outsource and migrate out of Australia to take advantage of lower production costs in China. However, this view is not supported by our survey results (Figure 3.10). The survey finds 79 percent of the respondents do not intend to shrink operations in Australia. Firms that do well in their China operations have a higher tendency to stay in Australia, indicating Australian operations in China complement rather than compete with domestic operations.

Figure 3.10 Complementarity

Increasing operations in China means shrinking operations in Australia

Overall

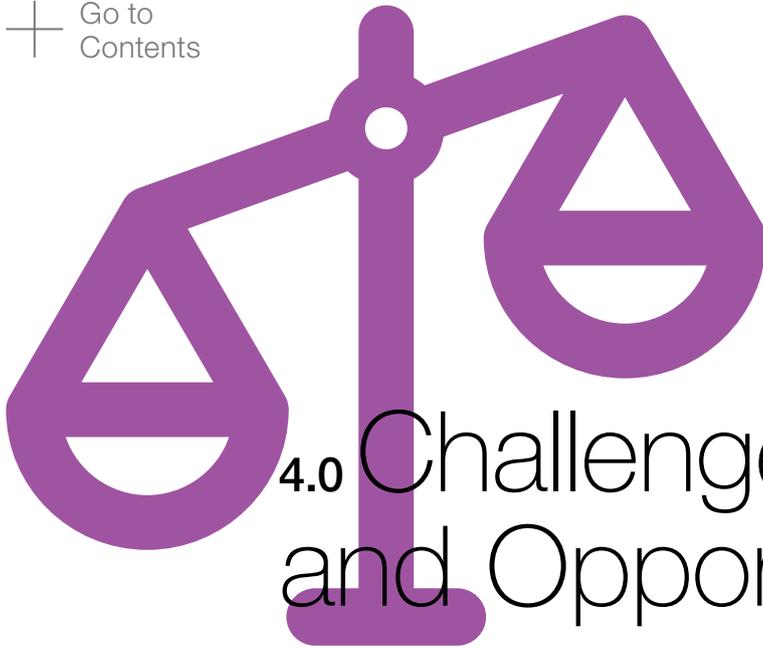


Profitable



Source: USYD estimate based on WIOD





4.0 Challenges and Opportunities

Two thirds of Australian firms see China as important for their global expansion.

China's Increasing Importance

China has long been a strategically important market for Australian resource companies. As China emerges as one of three major global production hubs and the expansive growth of the consumer middle class continues, China becomes an ever more crucial market for both resource and non-resource Australian companies.

China Ranks High in Global Expansion

For many Australian businesses, China is the driver of their global business. Of the more than 200 companies that participated in the Australia-China Business Survey, 88 percent stated that China is either 'very important' in their global expansion plans (66%) or 'important' (23%) (Figure 4.1).

Three key reasons are cited by respondent companies for China's increasing importance in their global expansion: first, building up an international brand name; second, access to the Chinese domestic market; and third, access to global markets.

Figure 4.1 The importance of China in global expansion plans

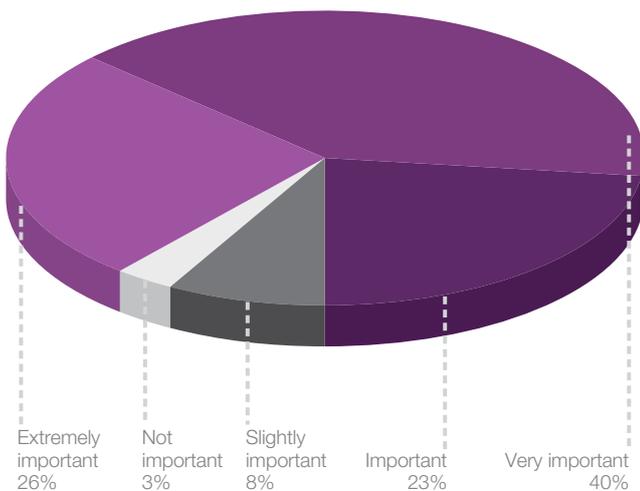
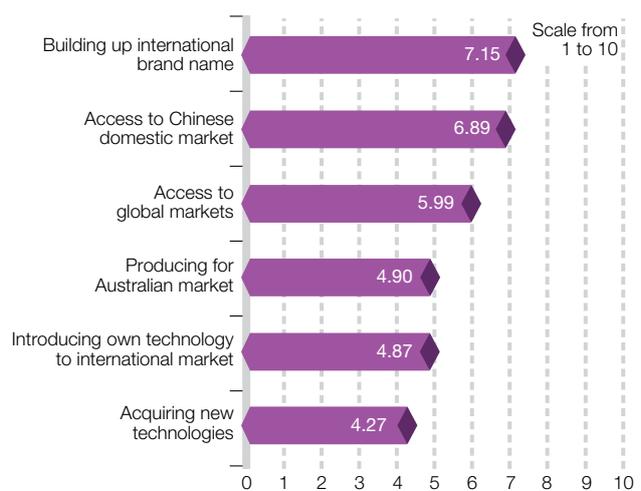


Figure 4.2 Motivations for business engagement with China



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The motivations for Australian companies to engage with China demonstrate the global importance of engaging with China. The highest ranking motivations refer to building international brand reputation and access to the Chinese as well as global markets (Figure 4.2).

“Competition from Chinese domestic and foreign competitors is seen as a major risk.”

Questions related to alternatives to the Chinese market indicated an awareness of the need to spread risk. Almost 60 percent of respondents said that alternative market opportunities to China were improving (Figure 4.3). On an industry basis, those reporting that they were dependent on China were most pronounced in energy and agribusiness, while industries with the lowest perceived dependence on China were construction, real estate and health services (Figure 4.4).

Main findings

- › Two thirds of Australian firms see China as being of high importance to their plans for global expansion.
- › Australian businesses are aware of the importance of China as part of a global market and access point to global value chains.
- › Australian businesses take a long-term strategic view of their China engagement.
- › The need to find alternative markets to China is recognised. For some industries this is easier than for others. Perceived dependence on China is greatest in energy and agribusiness and lowest in construction, real estate and health services.
- › Competition from Chinese domestic and foreign competitors is seen as a major risk in the Chinese market.
- › Australian companies doing business with China are concerned about regulatory and commercial barriers and unforeseen regulatory changes.
- › Support for a Free Trade Agreement between Australia and China is high across most all industries, with the strongest support in transport and storage, agribusiness, finance and business services, real estate, and mining.
- › Firms are evenly divided on the potential benefits of coordinated branding and aggregated marketing/ distribution channels as ways to help Australian businesses in China.
- › Relationship building with Chinese partners is the preferred strategic response to addressing the challenges of the Chinese market.



Australian companies are facing increasing competition from local Chinese firms and other multinationals.

Challenges

The Chinese market is maturing, especially in sectors where foreign and private enterprises are able to fully participate. Australian companies are facing increasing competition from local Chinese firms and other Multinational Corporations (MNCs). Australian companies are aware they must start implementing new strategies in order to maintain competitiveness, notably partnering with Chinese firms.

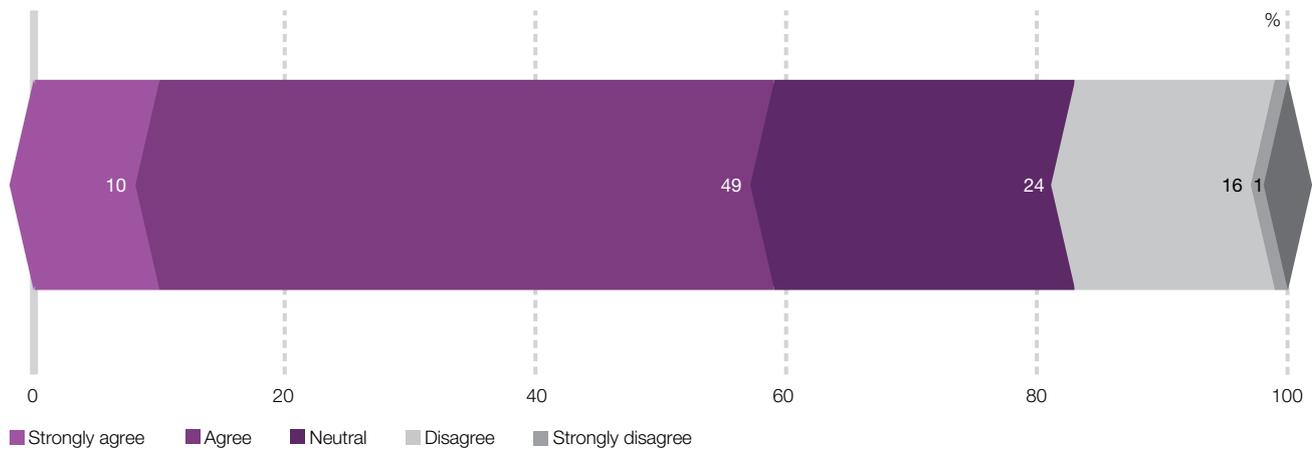
Competition

Increasing competitive pressure is regarded as a major risk for Australian companies. Increased competition from Chinese companies and other MNCs are ranked as a higher risk than other perceived market challenges such as currency risk, rising production cost and lack of skilled labour (Figure 4.5).

Like Australian companies, global MNCs are increasingly seeing China as an important market. A recent 2014 survey by the EU Chamber of Commerce, for example, shows that 59 percent of respondent companies believe that China is increasingly important in their company's overall global strategy compared to last year.²⁶ Many MNCs are already highly reliant on the Chinese marketplace for significant portions of their global revenues and will therefore continue to compete with Australian companies to maintain their positions.

Figure 4.3 Alternative markets to China

Overall, alternative markets to China are improving



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26. The European Union Chamber of Commerce in China 2014, Business Confidence Survey 2014, downloadable at <http://www.eurochamber.com.cn/en/publications-business-confidence-survey>

Many MNCs are already highly reliant on the Chinese marketplace for significant portions of their global revenues.

Figure 4.4 Perceived dependence on China market
In our business we have no alternative to dealing with China

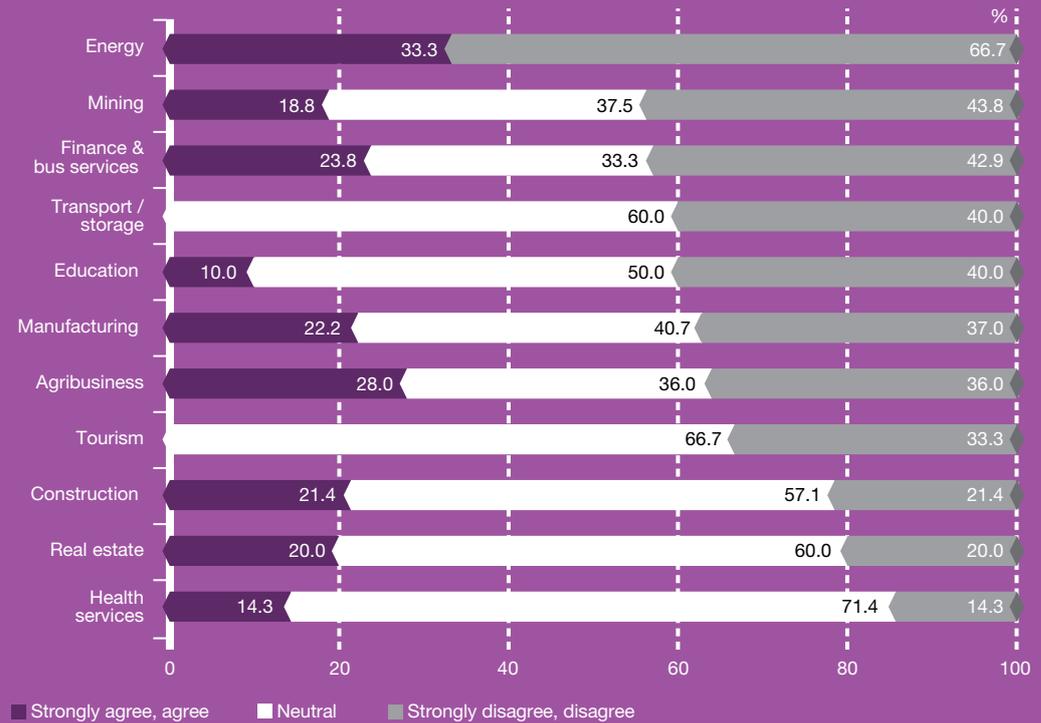
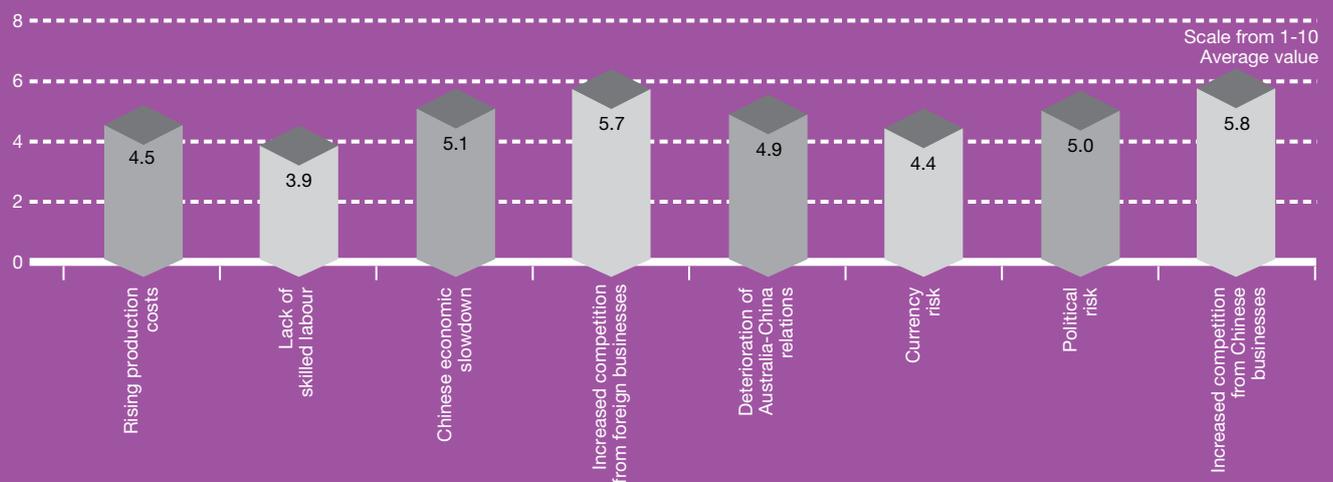


Figure 4.5 Challenges in the Chinese market



The FTA will help solve problems Australian businesses face in China.

Concerns

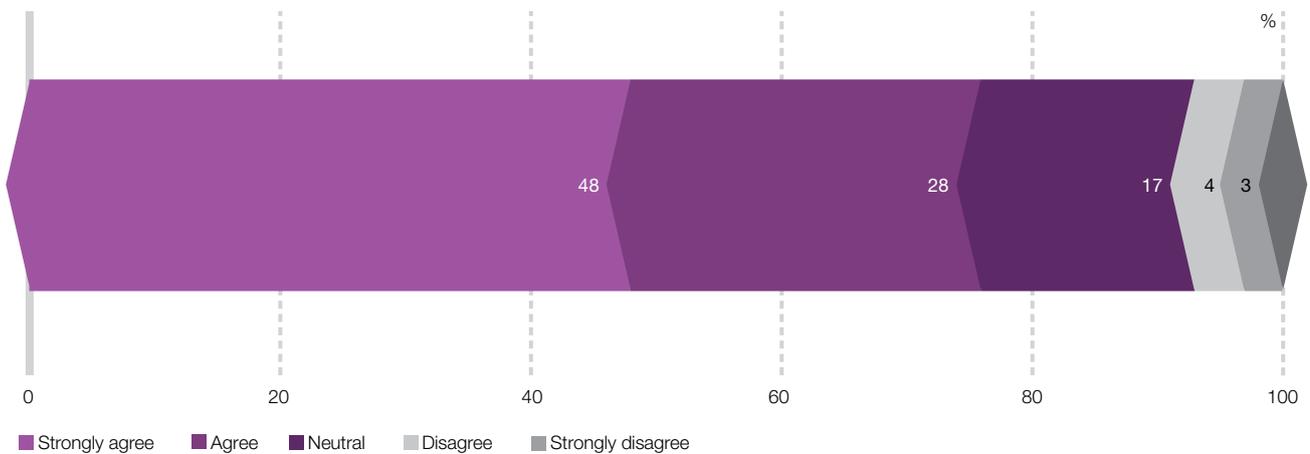
Despite the solid opportunities presented by engagement with China, Australian businesses harbour a range of concerns about some aspects of the relationship.²⁷

Asked about areas of concerns when doing business in China, our survey respondents mentioned regulatory and commercial barriers and unforeseen regulatory changes. Respondents identified the following top concerns for doing business with China.

- Regulatory changes ranked as the top concern for agribusiness, education, real estate, transport/storage, finance and business services, manufacturing, health services and mining.
- Chinese administrative procedures were among the top three concerns for agribusiness, manufacturing, mining, health services, transport/storage, finance and business services, education and real estate.
- Visa issues were among the top three concerns for construction, real estate, education and health services.
- Intellectual property rights protection ranked among the top three concerns for transport/storage, energy, manufacturing, mining and real estate.

Figure 4.6 Overall FTA expectations

A Free Trade Agreement (FTA) between Australia and China would help my company doing business



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27. John Lyndon, David Dyer and Chris Bradley, 2014, *Compete to Prosper: Improving Australia's global competitiveness*, McKinsey Australia.

Strategic Responses

Faced with global competition in the China market, one response is to draw on national comparative advantages such as Australia's natural endowments, proximity to China and a multicultural social environment. Respondents were strongly supportive of potential action in coordinating branding across Australian industries and coordinated marketing and distribution.

Free Trade Agreement

A highly anticipated FTA will help solve the problems Australian businesses face in China. Three quarters of respondents expected an FTA to help their business with China, while only seven percent hold the opposite view (Figure 4.6).

Support for an FTA between Australia and China is high among nearly all industries represented in the survey (Figure 4.7). The strongest support came from transport and storage, agribusiness, finance and business services, real estate and mining.

Figure 4.7 FTA expectations across industries



Finance and business services, tourism, mining, agribusiness, and education expect that their China operations will expand if and when they are able to deal in RMB.

RMB Convertibility

While the financial services industry stands to benefit most from an Australian RMB trading hub, the ability to deal in RMB received considerable support across industries, with 54 percent of respondents in favour. However, different industries had different views on RMB convertibility. In general, export-oriented sectors, including both goods and services, were more positive than import-oriented sectors. This is to be expected given that import tariffs are mostly very low already. Finance and business services, tourism, mining, agribusiness and education expect that their China operations will expand if and when they are able to deal in RMB (Figure 4.8).

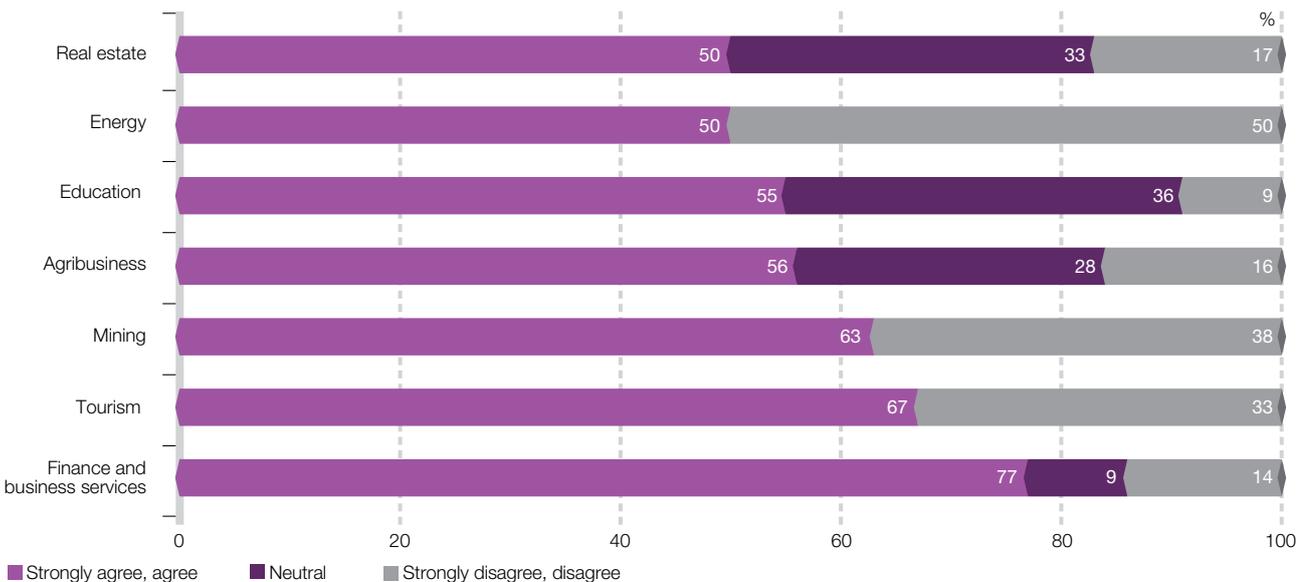
Coordination Among Australian Firms

Participants were asked for their views on ways to improve and deepen business engagement, including more coordinated Australian business activities to present a consistent message to Chinese business partners. In general, respondents have mixed views about a more coordinated approach to business engagement with China.

Views were similar on both coordinated branding and aggregated marketing/distribution channels as ways to help Australian businesses in China. In both cases, half the respondents (51 percent and 50 percent, respectively) agreed with the propositions that business would benefit from coordinated branding and aggregated marketing/distribution channels.

Figure 4.8 RMB convertibility – across industries

Our China operations would expand if we were able to deal in RMB.



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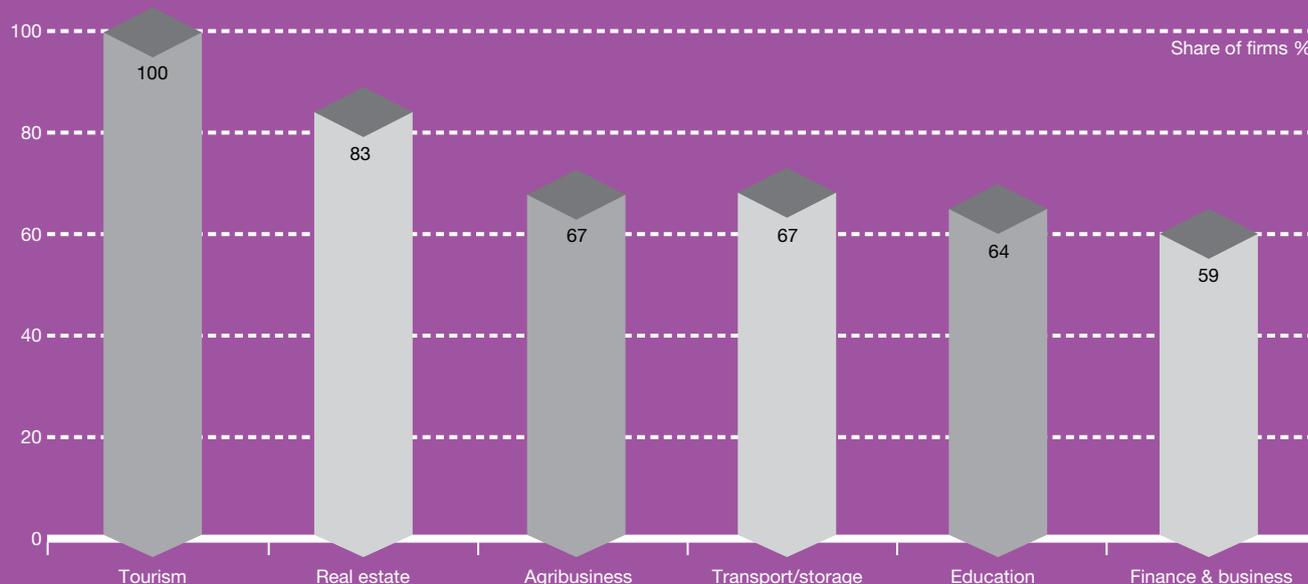
Views on coordinated branding differed from industry to industry. The industries targeting Chinese consumer markets tended to be more supportive of coordinated branding (Figure 4.9). For example, tourism, real estate, agribusiness, transport and storage, education, and finance and business services strongly supported coordinated branding.

Aggregated marketing and distribution channels were supported by tourism, energy, real estate, finance and business, manufacturing and mining (Figure 4.10).

“Respondents have mixed views about a more coordinated approach to business engagement with China.”

Figure 4.9 Coordinated branding – across industries

In our line of business we would benefit from coordinated branding



The dominance of relational strategies in working with Chinese business makes it imperative to locate Chinese partners.

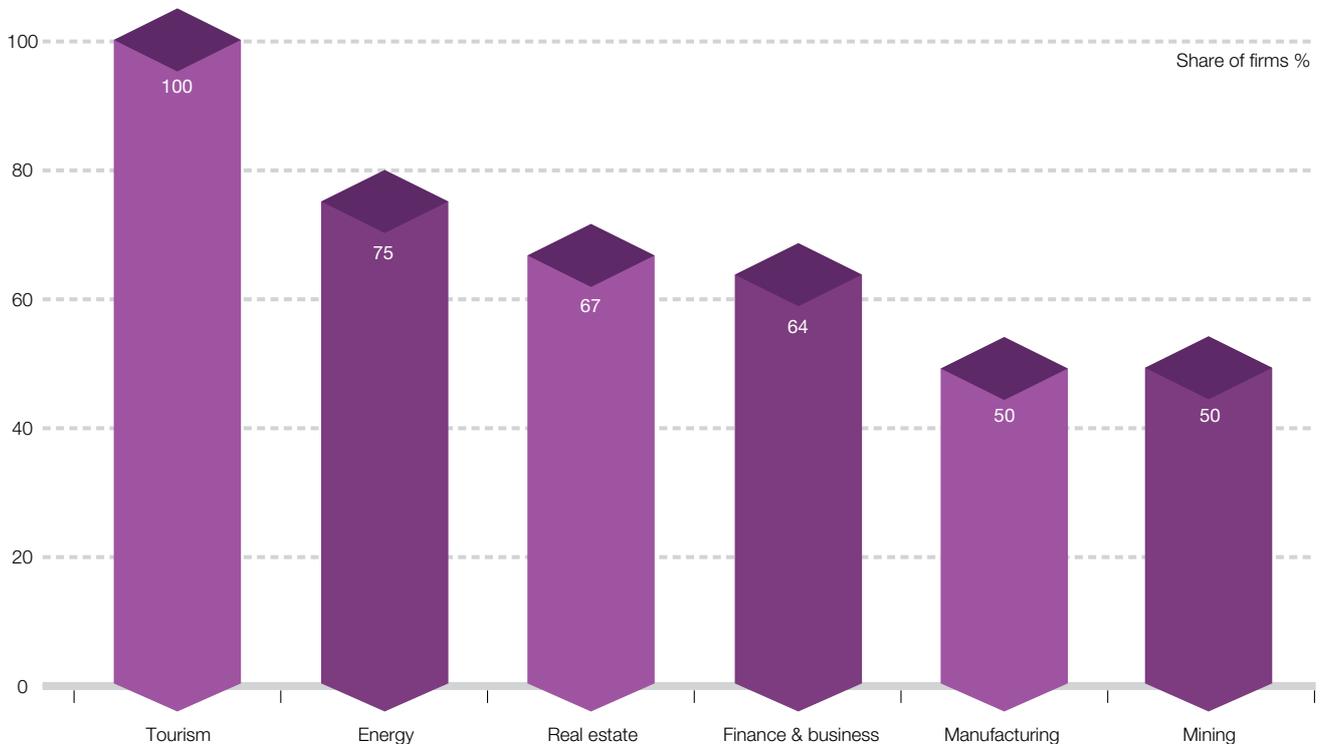
Relationship Building with Chinese Firms

Relationship building with Chinese partners is the preferred strategic response to addressing the challenges of the Chinese market. The dominance of relational strategies in working with Chinese business partners makes it imperative to locate Chinese partners, in parallel to addressing specific business issues and drawing on their market knowledge and contacts. The importance of relationship building with Chinese firms is common knowledge and not a specific theme for this report. However, our case studies show that relationship building is one of the areas where Australian firms have done well and been able to maintain market share against multinational competition.

From the case studies emerge three distinct strategies for engagement that are linked to specific corporate aims and preparedness to take risks. The first is a basic relational approach, the second a coordinated approach, and the third an integrated strategy.

Figure 4.10 Aggregate marketing and distribution – across industries

Our position in China would be stronger if we were able to aggregate marketing and distribution.



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The basic relational strategy refers to relationship building with Chinese partners with the purpose of creating interpersonal trust. This relational strategy does not commit either of the partners to adjust their corporate structure or business procedures, but requires demonstrated personal commitment to on-going performance that benefits both partners. Examples for this type of relationship are the DevWest and the Tangalooma case.

“Our case studies show that relationship building is one of the areas where Australian firms have done well.”

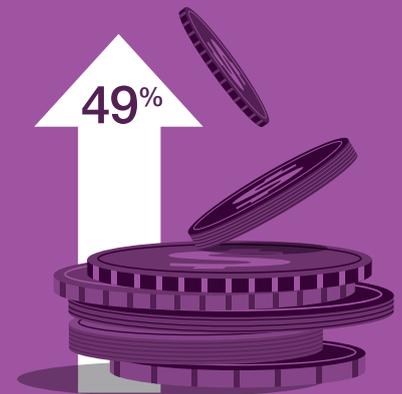
A transformational form of relationship develops when both partners pool some of their resources for the purpose of expanding existing cooperation. This relationship requires long-term commitment and inter-organisational trust between both organisations. An example is Ferngrove Winery.

The most advanced form of commitment we observe in our cases is when both parties contribute core know-how and resources in order to jointly establish new ventures at positions in the value chain that would have been beyond the reach of the individual partners. Examples in our case studies are Snowden Group and Qenos, both of which created specialised services for global clients after having spent years in preparation. Both new ventures are fully integrated in the Chinese value chains and can serve the global market through their unique combination of expertise.

Nearly 90% of all respondents were optimistic about their business prospects with China.



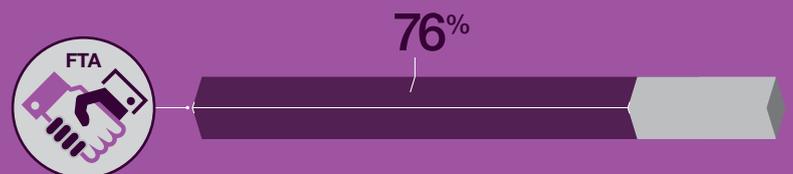
49% of our respondents increased their profits from China related business activities during last year.



Two thirds of Australian firms see China as being of high importance to their plans for global expansion.

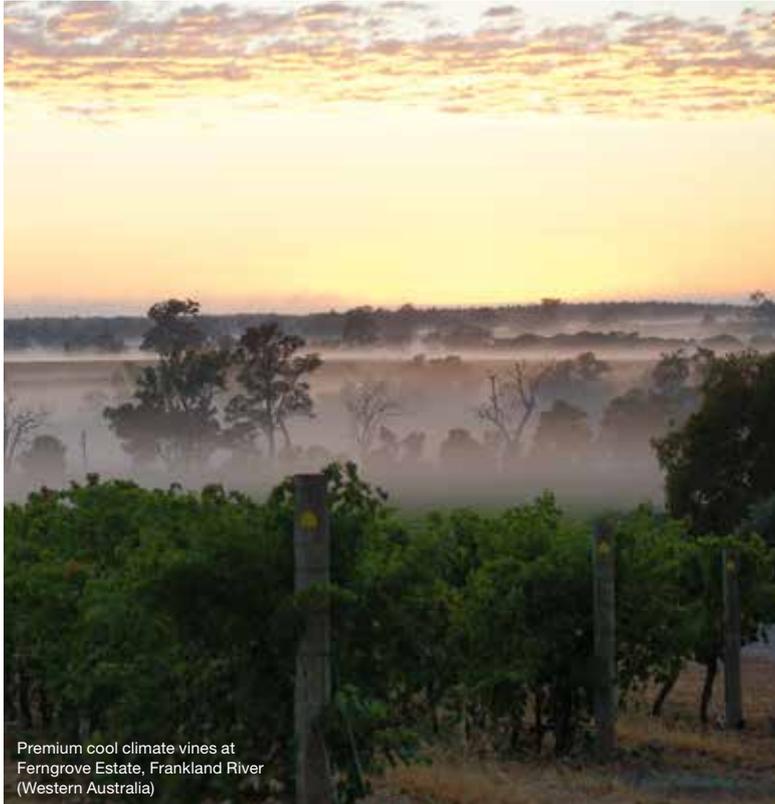


76% of respondents expected an FTA to help their business with China.



Statements based on the responses from the exclusive ACBC business survey of 200+ businesses that are engaged with China





Premium cool climate vines at
Ferngrove Estate, Frankland River
(Western Australia)

Case Study: Ferngrove

Ferngrove is an Australian winery based at Frankland River, in the Great Southern wine region of Western Australia. Established in 1997, Ferngrove is a well-reputed private company with high profile board members. Ferngrove produces premium Shiraz, Cabernet Sauvignon, Riesling, Chardonnay, Sauvignon Blanc, Semillon, Merlot, Malbec and Pinot grapes from 305ha of its own vineyards and 70ha of leased vineyards.

“Ferngrove Wines is an example of a successful Chinese investment in the Australian agribusiness sector.”

In 2010, Ferngrove Wines found itself short of capital and with sharply reduced revenue after the contract that delivered 60 percent of its produce to a major Australian winery came to an end.

The business strategy of the joint operation was to link up Chinese capital and access to Chinese consumer markets with Australian expertise.

Ferngrove received assistance from a well-connected Australian businessperson who arranged an introduction to a Chinese entrepreneur, Mr Ma from Hangzhou who had interests in metal processing and manufacturing.

In addition to investing in Ferngrove's Australian operations, Mr Ma opened more than 50 Ferngrove branded wine shops in China. These shops employ more than 100 staff and convey a specific Western Australian wine offering to wealthier Chinese consumers. In addition, Mr Ma has recently purchased a 12,000 tonne winery in South Australia. Expanding from his investment in wine, Mr Ma is now pursuing opportunities in other areas of Australian agribusiness and making use of the expertise of this Australian top management team.

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Ferngrove Wines is an example of a successful Chinese investment in the Australian agribusiness sector. It is a useful lesson in how cultural and business motives have to come together to make a successful business relationship. In the case of Ferngrove, personal trust was indispensable in convincing a Chinese investor who had limited experience in investing in agribusiness and in Australia to make a major commitment.

Once the personal relationship was established, the business strategy of the joint operation was to link up Chinese capital and access to Chinese consumer markets with Australian expertise in running the operation of the winery.

This initial strategy paid off as Ferngrove was able to continue expanding into global markets and expand production. Access to these new markets also enabled Ferngrove to introduce new branding and wine ranges specific to consumers within China.



L-R: Anthony Wilkes, Managing Director, and Kim Horton, Chief Winemaker, with Ferngrove sale staff at Fuzhou China National Sugar and Alcoholic Commodities Fair



Ferngrove's modern winery – the second largest solar-powered winery in Australia.



Conclusion

Australia's strong service industry will play a key role in transforming trade and investment patterns between China and Australia.

This report has shown that Australian exporters are integrated in Chinese value chains across a range of industries and at different positions in the value chains. The diversity and complexity in integration across sectors means a wider range of responses and strategies are required to sustain and expand trade with China. For resources products, Australia is traditionally stronger in the lower end of the value chain where goods feed into existing Chinese supply chains as intermediate products. This means resource companies are more reactive as they rely on coordination in the upper part of the value chains. In a competitive market, strategies tend to be low-cost oriented in order to either increase margins or lower prices.

For other non-resources products, Australian firms should actively engage in establishing a niche along value chains targeting final consumer markets where competition is more driven by product differentiation. Firms will require different strategies to ensure their goods meet the immediate needs of the consumer market. Establishing foreign invested enterprises (FIEs) in China is one option. This brings firms closer to the consumer market. Another option is to form a partnership with Chinese companies, which affords Australian firms access to new markets and distributes goods and services to both the local and export market for China.

“Governments are important stakeholders in the formation of global value chains.”

A deeper integration into the Chinese market means risk too. While our survey shows that Australian firms are less affected by the recent anti-corruption campaign in China, as Chinese and Australian markets intertwine and investments are made from Australia to China, Australian firms will face the challenges of operating in restricted sectors and business conditions.

Services are a critical but often overlooked part of the growing global value chain phenomenon. Australia has a strong service industry which will play a key role in transforming trade and investment patterns between China and Australia through enabling the development of value chains in goods and through the creation of value chains in their own right. In this context, partnerships with Chinese firms in areas such as technology R&D, design, advertising, marketing, data processing, financing, transport and insurance help Australian service firms create value in the Chinese market.

Understanding the diversity and complexity in value chain integration is particularly important because 2013/14 saw a qualitative change as the resources boom shifted from its investment phase to a production or harvesting phase. This means the dividends of resource boom will continue for a while, as iron ore and LNG exports reach full capacity in the next two to three years. Yet benefits of trading with China relying on resources trade will grow at a lower speed, as activities and employment driven by investment in resources decline. Increasingly firms in non-resource sectors are positioned in the front line and hold the key to broader-based growth between Australia and China.

International experience shows that governments are important stakeholders in the formation of global value chains as confirmed by the Joint Ministerial Statement of the 2014 APEC Ministerial Meeting in Beijing in November 2014.²⁸

Our report shows that there are areas where governments in Australia and China can play a key role in enabling global value chains by:

- › Improving physical infrastructure, such as roads, ports, airports and electricity supply.
- › Removing market barriers to enable the services sector to move up the value chain.
- › Integrating trade and investment policies to support cross-border partnership in value-added production.
- › Promoting partnerships between Australian and Chinese companies to leverage the skills and business networks of Chinese investors and of the Australian multicultural workforce.
- › Jointly developing policies to help SME integration in global value chains.

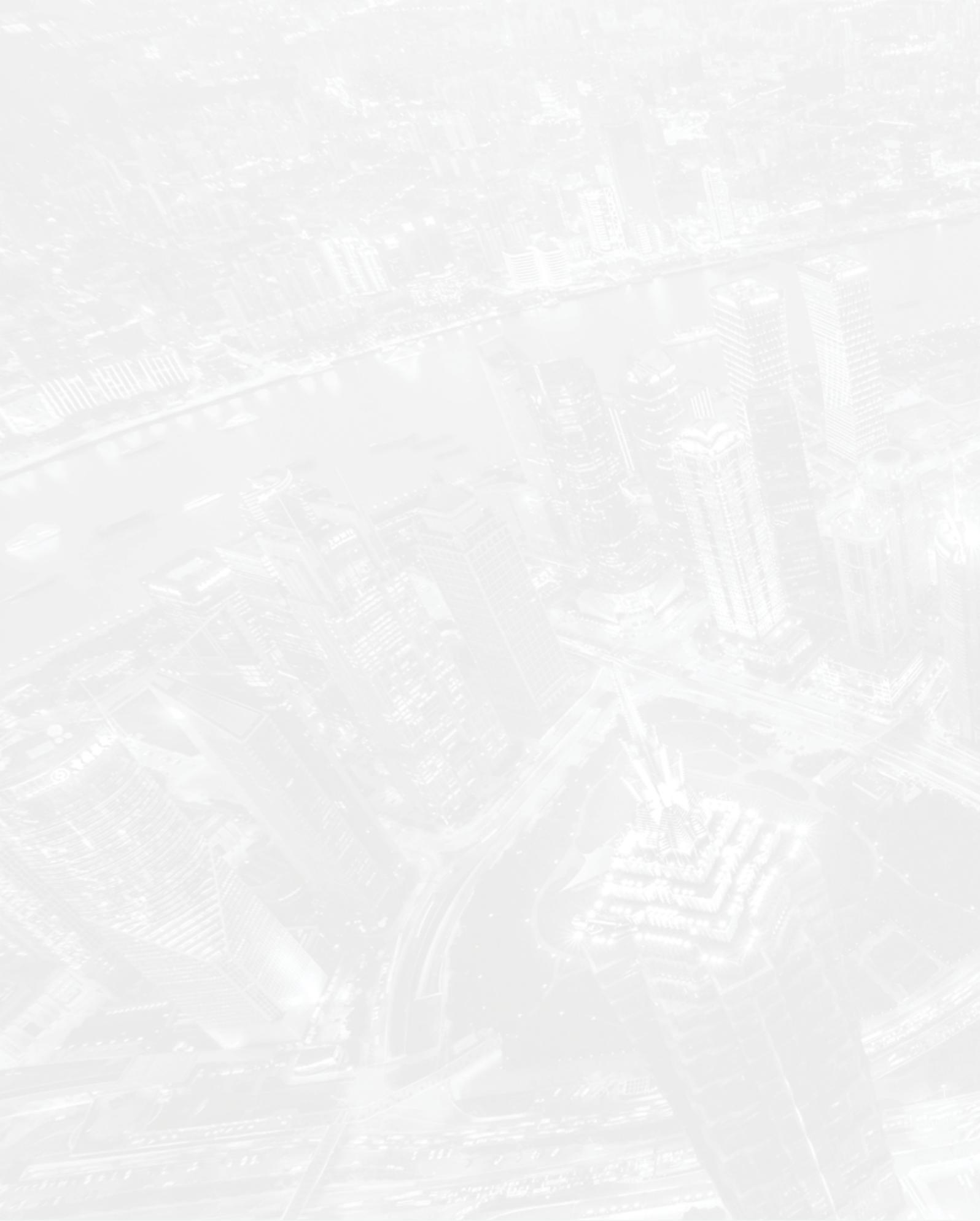
Main findings

Conclusion:

- › Australia-China business is changing as Australian firms become more deeply engaged with Chinese consumer markets and contribute to Chinese value chains.
- › Increasingly firms in non-resource sectors are positioned in the front line and hold the key to broader-based growth between China and Australia trade.
- › Australian exporters are integrated in Chinese value chains across a range of industries and at different positions in the value chains.
- › Partnerships with Chinese companies afford Australian agribusiness and manufacturing firms access to new markets and distribute goods to Chinese and global markets.
- › There are areas where governments in Australia and China can play a key role in enabling global value chains, such as improving physical infrastructure, removing market barriers, integrating trade and investment policies and promoting corporate partnerships.
- › Australian corporate strategy needs to look beyond bilateral trade to sustain and expand value-added trade with Chinese and global value chains.
- › Partnerships with Chinese firms in areas such as technology R&D, design, advertising, marketing, data processing, financing, transport and insurance are plausible options for Australian service firms in order to create value in the Chinese market.

28. 'Recognizing that Global Value Chains (GVCs) have become a dominant feature of the global economy involving economies at varying levels of development, we agree to take concrete actions to create an enabling environment for GVC development and cooperation while taking into account the different economic circumstances of APEC economies.' 2014 APEC Ministerial Meeting, Joint Ministerial Statement, 8 November 2014, downloadable at http://www.apec.org/Meeting-Papers/Ministerial-Statements/Annual/2014/2014_amm.aspx





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Appendix



Australia-China Business Survey

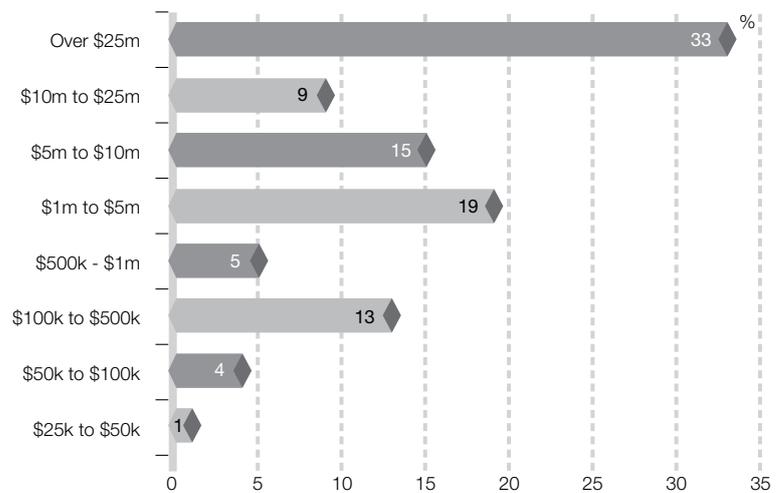
Survey Demographics

What sector best describes the business of your company?

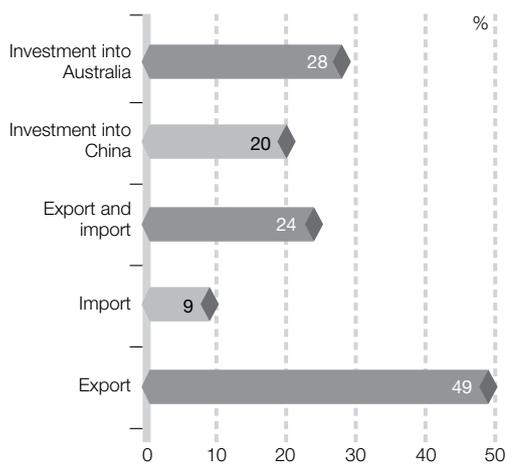
Manufacturing	19%
Others	20%
Agribusiness	17%
Finance and business services	15%
Health services, education and tourism	15%
Mining	12%
Construction	10%
Real estate	4%
Transport / Storage	4%
Energy	3%

Note: Businesses may choose more than one sector.

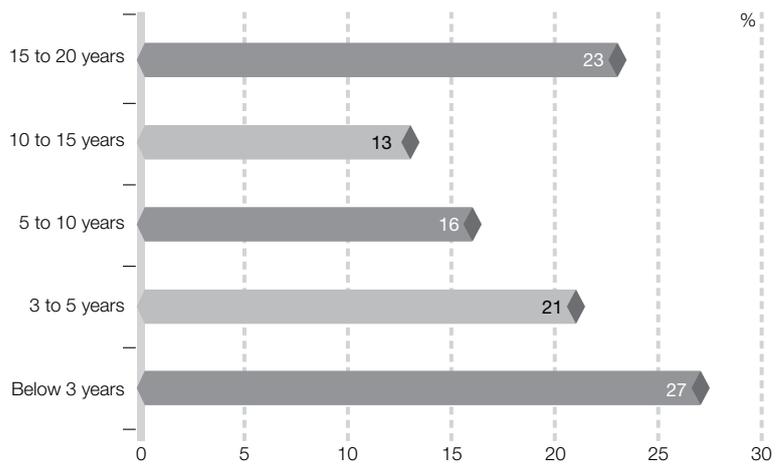
What is your current turnover?



What type of business are you engaged in China?



We have been operating in the Chinese market for:

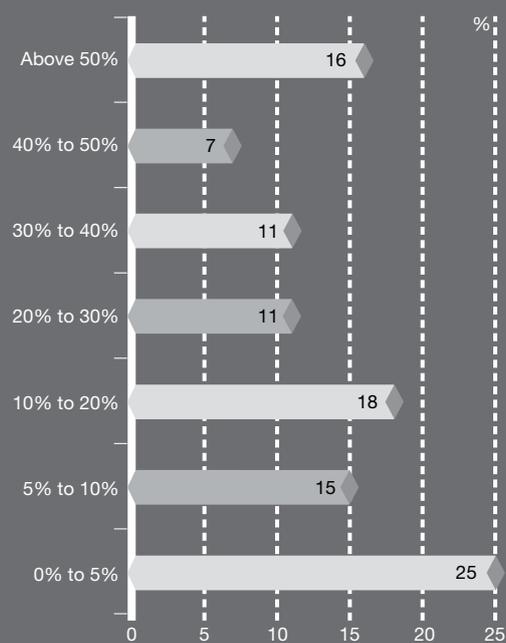


Average = 8.83 years

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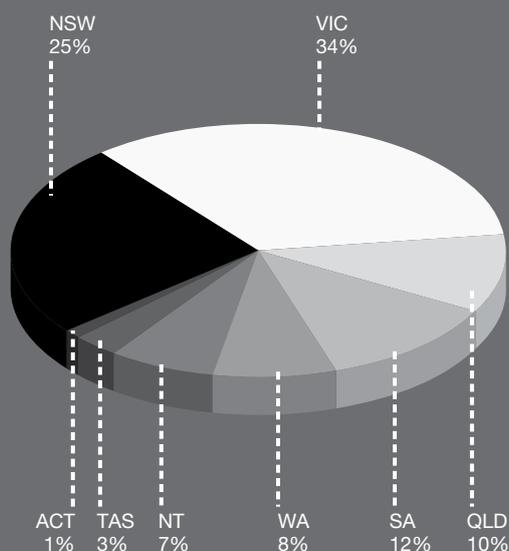


What percentage of your total business sales is from business with China?



Average = 28%

Headquarter in Australia



Where are your China operations mainly located?

Number of firms	
Shanghai	66
Beijing	59
Guangzhou / Shenzhen	46
Second tier cities Middle China and Yangzi Region (Hangzhou, Ningbo, Suzhou, Nanjing, Wuhan)	29
Second tier cities North China (Dalian, Tianjin, Hebei)	27
Western China (Chengdu, Chongqing)	17
Second tier cities South China (Dongguan, Hainan, Nanning)	5
Central China	4
Australia	61

What is the time horizon of your China engagement (years)

Min Value	Max Value	Average Value	Standard Deviation
0	10	5.6	3.8



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