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## GREENING CHINA

### OUTLOOK FOR EUROPEAN SMES



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*chinadialogue*



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*About chinadialogue:*

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# TABLE OF CONTENT

INTRODUCTION	4
CHINA'S 12 <sup>TH</sup> FIVE-YEAR PLAN	7
KEY FEATURES	9
INCLUSIVE GROWTH	9
STRATEGIC EMERGING INDUSTRIES	9
SECTOR CONSOLIDATION	10
ENVIRONMENTAL PROTECTION	10
REDUCING CARBON INTENSITY	11
ENERGY EFFICIENCY	11
POLLUTION AND WATER	12
A TOUGHER ENVIRONMENT FOR FOREIGN INVESTMENT	12
WHAT STAKEHOLDERS SAY	16
GREEN OPPORTUNITIES	16
COSTS, COMPETITION AND CONSOLIDATION	18
CASE STUDY	19
INTELLECTUAL PROPERTY RIGHTS	19
LEGAL AND ADMINISTRATIVE HURDLES	20
A MORE COHERENT EUROPEAN APPROACH TO CHINA	22
SME INTERNATIONALISATION AND THE EU SME CENTRE	23
IPR SME HELPDESK	24
EUROPEAN ENTERPRISE NETWORK	25
POLICY RECOMMENDATIONS	26
CONCLUSION	30
UNDERSTANDING CHINA	31
A SPECIAL THANKS TO	33

## INTRODUCTION

In 2011, China overtook Japan to become the world's second largest economy. The country has rebounded quickly from the global economic crisis: its economy grew at a rate of 9% in 2009 and an estimated 10% in 2010.

China's huge manufacturing capacity and a burgeoning internal market continue to provide opportunities for foreign enterprise. But the Chinese market also presents challenges, including: numerous formal and informal barriers to market entry; difficulties associated with retaining intellectual property; and fierce local competition.

This report highlights the opportunities and challenges facing European Small and Medium-sized Enterprises (SMEs) doing business in China's green sector. It is released to coincide with the ratification of the 12<sup>th</sup> Five-Year Plan (FYP) by the Chinese National People's Congress (NPC) in March 2011. The 12<sup>th</sup> FYP promises unprecedented investment in environmental protection and a transition towards greener economic growth. China is expected to accelerate an important rebalancing of its economy. This will include a move from:

- export-led growth towards domestic consumption
- low-value-added manufacturing to high-tech development
- high-carbon growth to green development

A strategic shift towards low-carbon growth and high-value, clean technologies should create important opportunities for foreign investors and partners. The European Union (EU) is China's biggest trading partner, the largest source of foreign direct investment (FDI) in China, as well as a source of important overall technological expertise and capacity. It has established a reputation as a global leader in clean-energy technologies and environmental services and European business could be well-placed to take advantage of the expansion of the green sector in China mandated by the 12<sup>th</sup> FYP. However, there are significant barriers to exploitation of these opportunities by foreign enterprises.

This briefing seeks to address the impact of China's new environmental and trade policies in the 12<sup>th</sup> FYP on EU SMEs operating in the green sector and

highlight where the plan creates openings and opportunities.<sup>1</sup> It draws special attention to the concerns of sectoral stakeholders and makes recommendations that are designed to complement and support European policy implementation. It addresses the new opportunities in China's green economy available to EU SMEs and the obstacles to their exploitation, and explores how existing EU services can be leveraged to help these SMEs prosper.

Wherever possible, this briefing highlights the concerns of key stakeholders in the sector, including representatives of SMEs and EU and member states' support services.<sup>2</sup> Interviews with these stakeholders were supplemented with the views and expert advice of the China Advisory Council, as well as research into EU and Chinese policy and consultation with *chinadialogue* expert advisors.

The world looks set to face increasing resource constraints and competition for raw materials, energy and water as China and other emerging economies continue to grow. China's success in shifting to a more sustainable, low-carbon model of development is of vital interest not only to China but also to its partners and competitors. It will also be critical to the global effort to mitigate climate change and move towards sustainable development.

If China's policies are successful, the country could become a proving ground for a wide variety of new technologies, including large-scale renewables, carbon capture and storage and innovative forms of transport. To execute this important change in direction, China will need to look beyond its domestic capabilities and draw on technology and expertise from abroad.

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1 Throughout this brief we make extensive reference to Small and Medium-sized Enterprises (SMEs) and the green sector. We use the European Commission definition of SMEs – enterprises with up to 250 employees and turnover of up to €50 million. When referring to the green sector, we use the definition supplied by the Organisation of Economic Cooperation and Development (OECD) and Eurostat: *"eco-industries are activities which produce goods and services to measure, prevent, limit, minimise or correct environmental damage to water, air and soil, as well as problems related to waste, noise and eco-systems. This includes technologies, products and services that reduce environmental risk and minimise pollution and resources such as waste and wastewater management, renewable-energy sources, environmental consulting, air pollution and control, eco-construction."*

2 We contacted over 50 stakeholders in China and Europe, both in person, by telephone and online. Stakeholders and SMEs were identified through directories provided by the EU Chamber of Commerce, the chambers of commerce of European Union member states and Chinese green-technology companies. We also solicited suggestions from China Advisory Council members, members of the *chinadialogue* network, including experts, editorial advisors and interviewees. Where these people were unable to commit to a full interview, we also offered the option of answering questions anonymously through an online questionnaire.



Investment in renewable energy in China was up to \$ 51,1 billion in 2010 – Bloomberg Energy Finance

## CHINA'S 12<sup>TH</sup> FIVE-YEAR PLAN

In October 2010, the Central Committee of the Communist Party of China (CPC) approved the guiding principles of China's 12<sup>th</sup> Five-Year Plan for National Economic and Social Development (FYP) (2011-2015). The plan went to the National People's Congress (NPC) for ratification in March 2011.<sup>3</sup>

The 12<sup>th</sup> FYP will attempt to move the Chinese economy from its current focus on the manufacturing sector towards services; it will also seek to raise domestic wages, increase internal consumption and drive innovation. The plan promises new targets for the use of renewable energy and promotion of energy efficiency and looks at targeted investment in key sectors of the economy, including environmental protection. It is shaped by China's ambition to become a global leader in the green sector, while also addressing concerns about energy and food security, as well as its vulnerability to climate change.

China's 12<sup>th</sup> FYP will drive unprecedented, consistent and sustained investment in the green sector and provide significant opportunities for European SMEs operating within China and exporting to the country. At the same time, aspects of China's new plan may create significant challenges, including:

- increased competition from Chinese green enterprises;
- lack of transparency;
- increased costs of doing business in China;
- procurement policies that favour Chinese enterprises; and
- an uneven subsidy regime.

China will also look to acquire foreign technologies in this sector, providing both opportunities and challenges for European enterprises.

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<sup>3</sup> This section provides a summary of those elements of the 12<sup>th</sup> Five-Year Plan and related policies that are likely to impact on EU SMEs operating in the green sector. This report was compiled prior to the National People's Congress. For further reading, please see: Chinese Challenge or Low Carbon Opportunity? *The implications of China's 12<sup>th</sup> Five-Year Plan for Europe* – Shin Wei Ng and Nick Mabey, February 2011.

Five-Year Plans remain a key policy instrument for the Chinese economy. The recently concluded 11<sup>th</sup> FYP set ambitious targets of 15% renewable energy by 2020, a 20% reduction in energy intensity (energy per unit of GDP) and a 10% reduction in pollutants over the life of the plan. While these targets proved challenging, the direction they set was clear.

These policies were generally successful. China's target for pollution reduction was achieved and investment in renewable energy in China was up to \$51.1 billion in 2010, according to Bloomberg New Energy Finance. This was the largest investment in 2010 by any country and China and Europe are now the two largest markets in the world for renewable energy. Installed renewable-energy capacity in China is predicted to increase by 64% to 427 gigawatts (GW) by 2015, compared with 320 GW in the EU by 2015.

China is the world's largest producer of solar panels and wind turbines, accounting for 22% of the world's installed wind capacity. In 2010, China increased wind-power installations by 62%, adding some 16,000 megawatts (MW) of windmill turbine power, to a total installation of 42,000 MW. China is also a leading investor in supercritical and ultra supercritical coal technology (highly efficient coal-fired power plants that emit less carbon-dioxide than regular plants).

Energy intensity decreased by an estimated 15% since 2009. However, there were reports that some provinces were taking drastic measures towards the end of the plan to achieve their targets, including temporarily shutting off power to some regions. Chinese experts, including Pan Jiahua of the Chinese Academy of Social Sciences, have expressed concern that it will be difficult to achieve similar efficiency gains in the future.

## KEY FEATURES

The 12<sup>th</sup> FYP will shape the opportunities and challenges faced by EU SMEs over the next five years. Key features of the plan include:

### INCLUSIVE GROWTH

The 12<sup>th</sup> FYP will increase the focus on “inclusive growth”: rebalancing the economy to spread the benefits of economic growth more equally, as well as alleviating social inequality and protecting the environment. This is expected to drive growth in Chinese consumption. Resource and environmental costs will be included as indicators of success – with targets for energy usage, carbon emissions and pollutants included as part of the plan.

### STRATEGIC EMERGING INDUSTRIES

The Chinese central government plans to use preferential tax, fiscal and procurement policies to develop seven “Strategic Emerging Industries” (SEIs). These are:

- biotechnology
- new energy
- high-end equipment manufacturing
- energy conservation and environmental protection
- clean-energy vehicles
- new materials
- next-generation information technologies

Planners hope that these industries will be the backbone of China’s economy in the decades ahead. China is likely to invest up to RMB 10 trillion (€1.1 trillion) over five years in these SEIs and anticipates that they will contribute 8% of GDP by 2015, up from approximately 5% now. The income tax rate for investors in these sectors is likely to be halved to 7.5%. To achieve the economic transformation mandated by the 12<sup>th</sup> FYP, China will encourage foreign investment in some strategic sectors at preferential tax rates.

It is believed that Chinese planners will target a GDP growth rate of at least 7% over the next five years; by comparison, China significantly exceeded the 7.5% target growth rate for the 11<sup>th</sup> FYP, growing more than 10% per annum on average over this period.<sup>4</sup>

## SECTOR CONSOLIDATION

Enforced sector consolidation, already a feature of the 11<sup>th</sup> FYP, will be extended to new industries, initially focusing on automotive, steel, cement, machinery, aluminum and rare earths. In the automotive industry, for example, the government aims to consolidate today's approximately 100 manufacturers down to a few dozen major producers within a decade. This will increase competition for EU enterprises, as some of their Chinese counterparts grow and gain access to new resources.

## ENVIRONMENTAL PROTECTION

The 12<sup>th</sup> FYP stresses pollution reduction, increased energy efficiency, large-scale recycling and a more reliable and cleaner energy supply. If rigorously applied, China's environmental policies will also significantly impact other industries.

The government has predicted investment in environmental protection in excess of RMB 3 trillion (€330 billion) over the 12<sup>th</sup> FYP period. A large percentage of this will be spent on pollution control, building on the RMB 1.5 trillion (€165 billion) spent during the 11<sup>th</sup> FYP. According to Wu Xiaoqing, Vice-Minister of Environmental Protection, the market should grow by 15% to 20% annually, making China one of the largest markets for the environmental-protection industry in the world.

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<sup>4</sup> According to a report by APCO Worldwide, a focus on a lower growth rate will allow the Chinese government time to put in place policies that target an increase in consumption, shifting the Chinese economy away from an over-reliance on exports – see: *China's 12<sup>th</sup> Five-Year Plan: How it actually works and what's in store for the next five years* – APCO Worldwide, December 2010. At the time of writing, the officially announced target is 7%. Private interviews revealed that some officials from government think-tanks believe that an 8% rate is the minimum level of growth necessary to provide enough employment, ensure social stability and allow for environmental protection.

## REDUCING CARBON INTENSITY

China has pledged to reduce carbon intensity (the amount of carbon dioxide emitted per unit of GDP) by 40% to 45% by 2020. A heterogeneous mix of policy measures is likely to be employed to meet China's carbon-intensity targets: China is likely to experiment with both a domestic carbon-trading scheme – possibly as early as 2015 – and carbon taxes. Complementary policy measures already launched include national low-carbon province and low-carbon city projects in Guangdong, Liaoning, Hubei, Shaanxi and Yunnan provinces and the municipalities of Tianjin, Chongqing, Shenzhen, Xiamen, Hangzhou, Nanchang, Guiyang and Baoding – areas with a combined population of more than 300 million inhabitants.

## NON-FOSSIL FUELS

The 12<sup>th</sup> FYP incorporates measures designed to achieve China's long-term target of generating 15% of energy from non-fossil fuels by 2020 (from 8.3% in 2009 to approximately 11% by 2015). The New Energy Industry Development Plan 2011-2020 commits the government to investing RMB 2 trillion to RMB 3 trillion (€220 billion to €330 billion) in renewable energy over 10 years, with RMB 1.5 trillion (€170 billion) earmarked for wind energy and RMB 0.2 trillion to RMB 0.3 trillion (€22 billion to €33 billion) for solar energy. This package is part of an overall investment of RMB 5 trillion (€550 billion) in non-fossil fuel energy that includes nuclear and hydropower.

## ENERGY EFFICIENCY

The 12<sup>th</sup> FYP will also continue the 11<sup>th</sup> FYP's focus on increasing energy efficiency. China will target a reduction in energy intensity of just over 16% in the 12<sup>th</sup> FYP, building on the 11<sup>th</sup> FYP's 20% reduction target. However, these targets should become increasingly challenging as relatively easy gains, such as the closing of inefficient power plants – 70 GW of capacity were closed during the 11<sup>th</sup> FYP period – are used up quickly.

*"During the 12<sup>th</sup> Five-Year Plan period, there will no longer be energy intensity gains as there were during the 11<sup>th</sup> Five-Year Plan. This is because, during the 11<sup>th</sup> Five-Year Plan, many small coal-fired power plants and steel furnaces were shut down and not many are left to be shut down during the 12<sup>th</sup> Five-Year Plan. Moreover, many Chinese enterprises are already approaching world standards for energy efficiency."*

Pan Jiahua, Executive Director of the Research Centre for Sustainable Development of the Chinese Academy of Social Sciences

In addition:

- China will target gains in energy efficiency and reductions in carbon intensity in heavy industry, construction and transportation.
- Management of energy supply and demand will be improved and national utility demand-side management (DSM) will be established.
- Chinese government agencies at all levels will preferentially purchase energy-saving products with "Energy Saving Labels".

## POLLUTION AND WATER

China will target reductions in a range of key pollutants: it aims to cut chemical oxygen demand (COD) (an indirect test of water quality) sulphur dioxide, ammonia nitrogen and nitrogen oxide by 1.5% per year to 2015.

The 12<sup>th</sup> FYP will also build on existing policies to manage water resources more effectively. Investments in water management and infrastructure construction will be doubled in the next 10 years and a cap has been placed on total annual water use of 670 billion cubic metres. A new tax will be levied on land sales and 10% of the proceeds – an estimated RMB 60 billion to RMB 80 billion (€6.66 billion to €8.88 billion) per year – will be used to strengthen water management in rural areas.

## A TOUGHER ENVIRONMENT FOR FOREIGN INVESTMENT

China's Ministry of Commerce has encouraged foreign investment in: clean energy production; renewable energy research and development; industries that protect the environment; and production of environmentally friendly

components for other manufacturers. Majority foreign ownership is often possible in these areas and deals can often be approved by local-government bodies. However, new barriers to investment have recently been introduced, specifically:

- The income tax rate for foreign investment enterprises (FIEs) has been increased from 15% to 25% under the new *Enterprise Income Tax Law*.
- Some tax benefits and preferential policies previously available to FIEs have either been restricted or abolished.
- Incentives are available for foreign investment in clean-technology – including a reduced income tax rate of 15% – but in order to qualify, investors must own core proprietary intellectual property, which many foreign investors are reluctant to hold in China because of perceived poor IPR protection.
- The *Catalogue for the Guidance of Foreign Investment Industries* restricts FDI in certain clean-tech sectors. FDI in biofuels, for instance, is difficult to achieve, as it requires provincial or even central-government approval. By contrast, FDI in wind power, solar energy, pollution control, waste disposal, recycling and environmental-protection equipment requires the approval of only local or provincial authorities.

Chinese policies that encourage so-called “indigenous innovation” are also likely to offer fresh-challenges for EU SMEs operating in China. Indigenous innovation refers to a series of interrelated industrial policies designed to promote the development of technologies within China. A question of particular concern for foreign enterprises is how these policies intertwine with Chinese government procurement procedures.

In 2009, three Chinese ministries jointly released the National Indigenous Innovation Products Accreditation Program, building on provisional measures released in 2006, which required all Chinese government agencies to purchase domestic goods and services. Products made with indigenous intellectual property qualified for priority status in government procurement. These procedures are now undergoing revisions in response to international pressure.<sup>5</sup> However, in practice, a “buy Chinese” attitude still shapes procurement policy.

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<sup>5</sup> Substantial further revisions will be necessary if China is to fulfil its commitment to join the World Trade Organisation’s Agreement on Government Procurement (GPA).

The effect of these policies and attitudes has been pronounced in the renewable-energy sector.<sup>6</sup> For example, in 2005, the National Development and Reform Commission issued a note requiring that wind farms in China use 70% locally-produced equipment. China's 2008 stimulus package also required that preference be accorded to Chinese companies.<sup>7</sup> This provided a significant boost to the Chinese industry, which is now both the world leader in installed wind capacity – accounting for 22% of the world's total capacity – and home to three of the world's leading wind-energy firms: Sinovel, Goldwind and Dongfang.<sup>8</sup>

The United States recently referred China to the World Trade Organisation, requesting dispute settlement consultations for perceived protectionism in the wind-energy sector. The U.S.-based United Steelworkers Union filed a petition claiming that China has used “hundreds of billions of dollars in subsidies, performance requirements, preferential practices and other trade-illegal activities to advance its domination of the sector”. Whatever the result of this particular dispute, and whether or not the EU follows suit,<sup>9</sup> it seems likely that increased Chinese investment in the green sector risks making it more difficult for EU SMEs to compete.

Navigating these barriers will be difficult even for the best-resourced European enterprises. For many SMEs, there is a risk that they will prove a real obstacle to market entry.

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6 For more on this issue, see *China's Promotion of the Renewable Electric Power Equipment Industry* – Dewey & LeBoeuf LLP for the National Foreign Trade Council (U.S.), March 2010.

7 The introduction of a government ‘feed-in tariff’ policy replaced these processes in 2009 for on-shore wind.

8 The effects of these policies have not been entirely positive – China now faces problems associated with the quality and reliability of some wind turbines.

9 The EU currently uses the Trade Policy Review of China in the WTO to raise concerns about China's trade policy.

Avoiding air pollution through reduced carbon intensity and energy efficiency is a key priority of China's 12<sup>th</sup> Five-Year Plan



## WHAT STAKEHOLDERS SAY<sup>10</sup>

The green market for EU SMEs is largely conditioned by the preferences and policies of the Chinese government. This presents challenges not only for SMEs, but also for the EU in its efforts to support them.

In this section, stakeholders in the green sector offer their analysis of the opportunities and challenges for EU SMEs. In particular, they highlight: the risks associated with market saturation and anti-competitive Chinese policies; the need for good relationships with Chinese government agencies; the challenges associated with preserving intellectual property; and the need for a more focused, coherent European approach to China.

These stakeholders also raised a number of additional issues that are not confined to the green sector but affect SMEs more generally. These include: the importance of building and maintaining networks of influence and good relationships, known as *guanxi*; the difficulties of establishing a presence in China; the need to overcome language barriers and cultural misunderstandings; and Chinese firms' preference for dealing with large companies.<sup>11</sup>

### GREEN OPPORTUNITIES

The 12<sup>th</sup> FYP should produce unprecedented growth in China's domestic demand for green products and services. The best opportunities for EU SMEs lie in those areas where China is not yet competitive. Without a product that is new or otherwise unavailable, SMEs in the green sector will find market entry challenging. Chris Cheung of the newly established EU SME Centre identified several opportunities, including the provision of services related to wind-energy; smart grids; waste-water treatment and energy saving devices. SMEs should

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10 This Policy Briefing was made possible thanks to interviews and input from various European and Chinese experts including members of the China Advisory Council. For a full list please refer to page 33 of this report.

11 These findings largely tallied with an extensive survey conducted by the EU as part of a 2008 European SME Centre feasibility study conducted by the Sociedade Portuguesa de Inovação, European Business and Innovation Centre Network and Application Européenne de Technologies et de Services, in which stakeholders identified legal barriers; IPR protection; lack of regulatory transparency; bureaucracy; cultural and linguistic differences; and lack of information on Chinese market opportunities as the main obstacles to furthering SME activities in China.

also deploy their knowledge of clean technologies, systems management and software.

*"Funds for SMEs in the West have dried up. Ample funds and policy in China provide perfect conditions [for low-carbon technology development]."*

Anonymous survey response.

Other opportunities include:

- New central-government targets for pollution reduction, energy efficiency and carbon intensity, which create a need for improved measurement of a variety of pollutants and resource use and provide opportunities for EU SMEs to offer innovative technologies and support.
- Chinese moves to increase energy and carbon efficiency, which should provide opportunities for European SMEs to capitalise on their expertise and experience of climate regulation and carbon markets in the EU.
- The probable introduction of carbon markets and carbon taxes, which should provide opportunities for the provision of consultancy services: Chinese local officials have reportedly faced problems with pilot schemes and would benefit from European expertise.
- Stricter targets for emissions of other pollutants and the use of natural resources, which could afford similar opportunities.

Greater domestic demand also means larger markets for EU SMEs with competitive products and good local-distribution channels. Having a new product can help counteract a "buy Chinese" attitude.

Cheung and the China Advisory Council of the Understanding China programme emphasised the benefits for SMEs of focusing on second- and third-tier cities,<sup>12</sup> where competition is likely to be less fierce, administrative hurdles lower and pathways towards government relationships easier to identify.

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<sup>12</sup> Provincial capitals and special administrative cities qualify as tier two. Any prefecture level or county-level capitals are generally classed as tier three.

## COSTS, COMPETITION AND CONSOLIDATION

The Chinese drive to create a more balanced economy may increase costs for foreign firms. Increases in the minimum wage, value-added tax, rising raw-material prices and new environmental taxes will significantly increase the cost of operating in China, particularly in more developed eastern cities.

European green SMEs are likely to face increased competition from Chinese enterprises as the government prioritises investment in the green sector. Chinese companies often have easier access to capital and subsidies and closer relationships with government. Alexander Boitin of BioEnergy Berlin GmbH, a biogas technology supplier, noted that EU SMEs face price competition from Chinese firms that have access to government subsidies, not necessarily available – or even visible – to EU SMEs.

*“Another problem in China is transparency. True, there are many government subsidies for the green industry, but these incentives are not transparent. In Germany, all the incentive information is out there, in terms of how much subsidy you can get. In China, it is all very unclear.”*

Magali Menant, Manager of the Shanghai Office of Econet China

European firms already find it difficult to compete in the wind and solar energy sectors, where Chinese companies enjoy both government support and lower labour costs. With the significant investment mandated by the 12th FYP, Chinese companies may soon enjoy similar advantages in other green industries. The likely expansion of sectoral consolidation policies may also increase competition for EU SMEs as Chinese companies grow.

Most SMEs had not experienced problems with so-called indigenous innovation policies, but Cheung of the EU SME Centre noted that the commercial sections of member-state embassies are wary of the uncertain future impacts of these regulations. It was also suggested that these policies “surely will [have an effect] in the near future if the rules are properly applied”.

## Case study

Scan Messtechnik GmbH is an Austrian supplier of wastewater-monitoring systems. The company employs around 50 people, four of whom are based in its representative office in Shanghai, which opened in 2006. It sells its product to local Chinese distributors, who then find clients, including government departments with responsibility for urban wastewater.

The company is a leader in its field and therefore does not face much local competition. Since its systems do not require an oil reagent to test water quality, there is no secondary water pollution and there are low maintenance costs. The company aims to supplement its sales with high-quality technical support.

Scan Messtechnik GmbH has a United Kingdom (UK) patent on the technology, but importantly the company also certified its logo and brand in China before market entry, in order to prevent local producers producing “pirate” versions of its products.

Quality of product, good guanxi, the trust of local clients, wide distribution channels and speed of delivery and service have all been crucial to its success in the Chinese market, according to the representative office.

A solid relationship with government at many different levels is crucial. Distributors maintain local relationships, while the company representative office maintains high-level relationships including with the Ministry of Environmental Protection and the Ministry of Water Resources. The company has not been negatively affected by Chinese government procurement regulations.

On entry into the Chinese market, Scan Messtechnik GmbH used the services offered by a number of European member states’ chambers of commerce and found them helpful in launching new products and technology. But these support structures became less relevant as the business grew and became more established in China.

## INTELLECTUAL PROPERTY RIGHTS

To stay ahead of Chinese competitors in this sector, many EU SMEs deploy technological innovations. IPR protection was the problem most often raised by green SMEs during stakeholder interviews. Many SME representatives stressed that registering IPR in China should be a priority when entering the market, but even then, problems can occur. One stakeholder, who offered accountancy and financial services to the sector, said “in some businesses we structured, and in which the clients insisted on having a joint-venture partner or a Chinese general manager, the technology inexplicably found its way into the hands of competitors who knew which clients to hit at what price point.”

IPR issues can be especially thorny when dealing with low-carbon technologies. At the international level, Chinese climate-change negotiators continue to request the transfer of low-carbon technologies to China, maintaining that developed nations have a historical responsibility to help green growth in the developing world. This adds additional layers of uncertainty for those deploying green technologies in China, although the transfer of technologies from private companies is not mandated by the Kyoto Protocol.

By contrast, Ralph Rogers of the China-Britain Business Council felt that Chinese protection of IPR has been “improving dramatically over the last few years”. He noted that more IPR courts are being set up across China. These courts are taking on more foreign cases and becoming more efficient in dealing with them. In 2009, Chinese courts concluded 6,262 cases, a 30% increase on 2008, and the average time to process a foreign-related lawsuit has been steadily decreasing, from 233 days in the period 2001-2005 to 172 days in 2006-2010.

## LEGAL AND ADMINISTRATIVE HURDLES

Identifying relevant environmental regulations and other necessary administrative and legal information proved challenging for many SMEs, though this was not a problem unique to the green sector. Problems frequently cited included: “complicated regulations and bureaucracy”; lack of “regulatory transparency”; and the “slow speed of bureaucracy”.

*"One common problem is that people cannot find the right people. By right people, I am not saying talent, I mean authority. China is just huge and there are so many different departments in government."*

Hermann Koller, Acting Managing Director of the International Solid Waste Association

Relationships with provincial governments can prove challenging. Magali Menant of Econet China said that policy implementation at a provincial level was not always "stringent". Many local-government targets for growth during the 12th FYP, for instance, vastly exceed those proposed by central government, which may make ecological goals more difficult to achieve. Clive Rigden of Eco-Solids International noted that it takes time for provincial governments to catch up with central-government policy and that this can present problems for SMEs. However, opportunities may be available as these governments look to meet targets and promote green growth.

In terms of navigating these hurdles, it is notable that SMEs setting up in China already face budgetary constraints. "There's no real platform or network to find those regulations, and spending resources to find out about those things means quite a big increase in costs," noted Jan Buiters of the China Advisory Council. Paid consultancy services were out of reach for many of the SMEs interviewed. The cheaper services provided by the EU and individual member states' institutions may be an alternative, but a number of interview subjects suggested that they would not have had the budget to pay for this.

## A MORE COHERENT EUROPEAN APPROACH TO CHINA

Stakeholders had mixed feelings about the effectiveness of EU policies related to China and SMEs. Magali Menant of Econet China asked for “better coordination among member states”. European states, she said, “need to have stronger visibility as a group” in order to compete with the United States, which is “promoting their business very aggressively”. She identified the large variety of green construction certification programmes across member states as one example of a weakness in comparison with the U.S., whose widely recognised Leadership in Energy and Environmental Design (LEED) programme brings business opportunities in this sector to U.S. companies. Several members of the China Advisory Council suggested that the EU should also look to actively shape and promote a “European identity” for green technology products. This would provide a European brand that could compete with the United States and others and would lend credibility to SMEs in the eyes of Chinese clients and partners.

In 2010, the EU and China strengthened bilateral relations in foreign affairs, security and global challenges including climate change and global economic recovery. Members of the China Advisory Council and many other stakeholders argue that the EU needs to take this opportunity to be more coherent in its engagement with China. Shared policy goals and commercial and environmental interdependence mean the green sector offers an ideal opportunity for Europe to speak with one voice at the international level. China and the U.S. are already moving ahead with high-level cooperation on the environment and clean energy. Without similar engagement, European business and consumers risk being left behind.

Most SME representatives interviewed for this report either did not use or were not aware of the support services offered by the EU in China.

*“It’s difficult for SMEs to get hold of information, and when you do, 9 out of 10 [times, the information] will be flawed.”*

Tristan Edmondson, Founding Partner of Mint Research

## SME INTERNATIONALISATION AND THE EU SME CENTRE

The 2008 Small Business Act codified the EU's support for SME internationalisation, committing the EU to establishing business centres in China and India. Other examples of internationalisation initiatives taken at EU level include the China IPR Helpdesk; the Enterprise Europe Network (EEN); bilateral and multilateral SME policy dialogues; the establishment of 30 Market Access Teams and a 2009 study mapping the internationalisation of European SMEs.

The EU SME Centre in Beijing aims to support European SMEs looking to do business in China. It offers a range of services, acting as both an information centre and a business support service provider.

Inaugurated on November 5, 2010, the EU SME Centre has a budget of €5 million for the period 2010-2013.<sup>13</sup> Up to €4 million is available should the EU extend the length or scope of this contract. The Centre is led by the China-Britain Business Council and includes a consortium of European chambers of commerce, such as the Benelux, French, German, Italian and Spanish Chambers, as well as the European Union Chamber of Commerce in China and EUROCHAMBRES (the Association of European Chambers of Commerce and Industry).

According to Chris Cheung, the Centre's business advisor:

"The Centre's core purpose will be to assist EU SMEs to establish, develop and maintain commercial activities in the Chinese market – through export and/or investment – by providing support through, inter alia, the provision of information, advice, matchmaking, networking events and training, as well as acting as a platform facilitating coordination amongst member states' services and private-sector service providers to EU SMEs, particularly at the crucial early stages of their market-penetration strategy."

Cooperation with business-support organisations based outside Beijing – including, for example, the European Enterprise Network (EEN) – has been identified by some China Advisory Council members as a priority for the Centre in order to facilitate entry into second- and third-tier cities. Many of the best opportunities in the green sector can be found beyond large eastern cities.

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<sup>13</sup> A 2008 SME Centre feasibility study recommended that the Centre operate for at least two five-year cycles

The Centre has also identified key areas where it can develop and provide specialist expertise and facilitate the sharing of knowledge, including on environmental technologies.

Examples of services the EU expects the Centre to provide include:

- Basic market entry services and legal advice, including information on Chinese technical regulations, standards and finance.
- “Hot-desking” with office-support services.
- Professional screening of available services and support structures, including referral to such services.
- Organisation of business “match-making” in well-targeted sectors between European SME exporters and potential Chinese clients, with follow-up to bring about concrete transactions from the EU to China.
- Provision of expertise to specific growth sectors, including environmental technologies, food-and-drink, communications and transport.

All of its services will be free, but during its second year, the Centre will “research its own sustainability and present options for the ongoing operation”, said Chris Cheung. These options could include providing paid support services to SMEs, depending also on whether the European Commission will continue supporting the Centre after the first three years or not. The European Commission is still evaluating this option, but according to the 2008 SME Centre feasibility study, SMEs are generally unwilling to pay for services the Centre might offer.

Given that the SME Centre has only recently opened, it is not surprising that most SME representatives had not heard of it. Tania Can Loon of 3E, a Belgian renewable energy services company, suggested that the Centre could make the most of its remit by developing its own “strengths, specialisation and focus”, including an emphasis on the green sector.

## IPR SME HELPDESK

The China IPR SME Helpdesk was launched in 2008 to provide intellectual property rights assistance to European SMEs in the Chinese market. It supplies free information, advice and training support by way of an online portal,

publications, background research, workshops and training sessions in Europe and China. Guidance is also offered in its offices by appointment, by email and over the telephone. It provides most publications in several European languages. The Helpdesk came into being following a number of Commission Communications which backed a pan-European IPR strategy, particularly to support SMEs.

Those who had used the China IPR SME Helpdesk considered it a useful service. 3E used a variety of services provided by the Helpdesk, including attending seminars and asking questions to Helpdesk experts. They found the services provided “incredibly useful”.

In January 2011, it was announced that the Helpdesk project had been extended for an additional three years. The contract will be carried out by Development Solutions (a European consultancy working internationally in the field of sustainable investments and sustainable development) and the European Union Chamber of Commerce in China, and will continue to provide free advice and services. The Helpdesk has an operating budget of €3 million for a three year period.

## ENTERPRISE EUROPE NETWORK

The Enterprise Europe Network (EEN) was launched in February 2008 by the European Commission Directorate General for Enterprise and Industry and is part of the EU’s Competitiveness and Innovation Framework Programme, which aims to encourage competitiveness in European businesses. It offers practical support and advice to more than two million European SMEs. The Enterprise Europe Network allows Chinese technology and business support organisations to link up with roughly 600 similar centres in Europe and other countries, in order to exchange information on business opportunities. It has opened 10 offices in China so far.

## POLICY RECOMMENDATIONS

Building on the advice and experience of stakeholders in the sector and the opportunities and challenges presented by the 12<sup>th</sup> FYP, we make the following recommendations:

**1. The development of a common, coherent and more robust EU approach to China should include an emphasis on fostering engagement and cooperation on environmental issues at all levels, with a special focus on developing economic cooperation in this sector.**

The EU has already recognised the need for a more coherent and engaged approach to China; the EU and China would both benefit from a more cooperative relationship. This is especially true in the green sector. There have been encouraging signs of action at recent high-level EU-China dialogues, where representatives on both sides sought to build on an initial recognition of the need to strengthen cooperation on climate change and low-carbon technologies. But to engage effectively on this issue, the EU will need to act coherently across different European Commission departments and coordinate the support and cooperation of member states.

For these positive outcomes to be achieved, fair incentives and adequate protection need to be established. SMEs, with smaller operating budgets and less liquidity, may be particularly vulnerable to anti-competitive practices and informal trade barriers. European enterprises should participate in helping China achieve its ambitious green targets and they should be fairly rewarded where these are realised.

If the relationship were strengthened further, it could create new opportunities in the green sector. Nick Mabey and Bernice Lee, of E3G and Chatham House respectively, have advocated a “historic partnership” between Europe and China with a specific focus on the green sector.<sup>14</sup> This partnership would be

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<sup>14</sup> Further details of these recommendations can be found in *An alliance worth striving for* - Nick Mabey and Bernice Lee, *chinadialogue*, October 2010. Lee and Mabey of Chatham House and E3G respectively led the EU-China Interdependencies on Energy and Climate Security project and are experts on EU-China low-carbon cooperation.

multi-tiered but could include policy innovations, such as a Low Carbon Technology Development and Diffusion Fund, designed to promote bilateral investment in SMEs and a joint EU-China Low Carbon Technology IPR Protection Service and Technology Trade Centre. Such a centre would be designed to “promote strategic IPR partnerships between government agencies and businesses from both sides”, write Mabey and Lee. It could also provide additional protection for SMEs.

But Europe should aim to be an equal partner with China; if not, it risks being left behind by China as it moves more quickly to a green economy. Recently, Europe’s commitment to its green goals has wavered in the face of economic recession. Fears of competition from China and other Asian countries in heavy-emitting industries have delayed plans to move to a 30% reduction target in greenhouse-gas emissions. Without this strong market signal, European SMEs in the green sector could suffer both in Europe and when exporting to China.

**2. The EU SME Centre – which has been tasked with provision of practical advice and guidance to SMEs – should build specialist expertise on the green sector in China.**

With the announcement of investment, new targets and complementary policies as part of the 12<sup>th</sup> FYP, there will be niche opportunities across the green sector for fast-moving, innovative EU SMEs.

The EU SME Centre should build specialist expertise on Chinese government policy in the green sector and provide specialist advice and information to SMEs. This expertise will be particularly valuable in helping EU SMEs navigate complex and often opaque regulations, trade barriers and subsidies implemented by the Chinese government as it pushes to meet the ambitious targets set out in the 12<sup>th</sup> FYP. The development of expertise related to this sector should complement the advice and services provided by existing member states’ institutions.

3. The development of a “blueprint” that explains various EU and member states’ support structures available to SMEs hoping to enter the Chinese market.

EU SMEs face a bewildering array of challenges upon entry into the Chinese market. It is therefore important that support services provided by the EU and member states are clearly delineated. The EU, wherever possible, should seek to fill gaps in the market by providing services previously unavailable or underdeveloped, such as expert advice on the green sector.

Members of the China Advisory Council suggested that for this process to be successful, cooperative relationships between new EU-financed initiatives, such as the EU SME Centre, and member states’ institutions, are needed. Member states’ institutions like chambers of commerce should be encouraged to work with the EU to create a blueprint for EU SMEs. This would describe the services provided by the EU and member states both prior to market entry and in China. Doing so will benefit SMEs by helping to avoid overlap and create synergies between institutions.

4. The EU should provide continuous funding for an extended period of time to those services that are deemed to be successful, allowing structures like the EU SME Centre and the IPR Helpdesk to grow, build their profile and retain expertise.

Members of the China Advisory Council repeatedly stressed that the communication of information about EU services needs to improve.

Successful initiatives like the IPR Helpdesk should be better marketed so that more SMEs are aware of the services they offer. Our stakeholder interviews revealed that a number of SMEs that might have benefited from the services provided by the Helpdesk did not know it existed.

Existing EU-funded structures should also be given time to build both a profile and their own unique areas of expertise. In the short term, new initiatives like the EU SME Centre should be guaranteed funding, provided they meet initial assessment criteria, for an extended period of time. This would allow initiatives to provide continuous service, retain staff and prioritise building specialist knowledge, all of which are essential to creating a unique, useful resource.

Of course, such structures may also want to explore how to generate revenue and become self-sustaining. However, for the immediate future their funding should not be contingent on generating revenue themselves. The better the quality of service, the easier it will be to market them. In the long term, this is much more likely to create the conditions under which financially pressed SMEs might be willing to pay for services.



The 12<sup>th</sup> Five-Year Plan has an impact on EU-China trade relations that are regularly discussed by Chinese Prime Minister Wen Jiabao and European Commission President José Manuel Barroso

## CONCLUSION

The 12<sup>th</sup> FYP should signal an important shift in China towards a more sustainable and inclusive form of growth. It should provide a range of opportunities in the green sector for European SMEs. But these firms may find it difficult to navigate the challenging Chinese marketplace. Green EU SMEs could therefore benefit from more coordinated support from the EU and member states at every level, including better coordination of existing EU and member-state support structures within China.

Europe must seek to engage and deepen ties with China. It has long enjoyed first-mover advantage in the green growth sectors but risks losing ground in the face of China's mammoth investments. Ultimately, engagement in the Chinese market must be matched by greater political will at home, including providing a clear signal to the market by moving to a 30% Europe-wide target for reducing carbon emissions and more actively supporting and promoting dynamic, innovative and entrepreneurial green organisations.

A combination of Chinese investment and manufacturing capacity, with European technological and entrepreneurial expertise in innovative low-carbon and environmental technologies, could be crucial in putting the world on a path towards sustainable development. EU SMEs can play an important role in facilitating this transition.

## UNDERSTANDING CHINA

The Understanding China programme is co-funded by the European Commission and implemented by EUROCHAMBRES, *Friends of Europe* and other partners.

A 3-year programme, it is planned to continue until mid-2012, and consists of the following initiatives:

1. One high-level Policy Summit per year
2. An annual training cycle
3. Eight SME Roundtables across Europe
4. An interactive website community
5. The China Advisory Council

The Understanding China programme features an annual high-level Policy Summit that is policy-oriented and focuses on economic and political cooperation between Europe and China. The Policy Summits provide a platform to communicate on political and economic challenges for both trading blocs.

The Understanding China training programme focuses on training 30 executives from business organisations each year, in order to better support their local enterprises in Chinese markets. By training the trainers, the Understanding China programme disseminates and multiplies knowledge on China across Europe. The third training cycle will begin on Monday, 6 June 2011.

Several SME workshops, organised with European SMEs, discuss what works and what does not in the context of Chinese markets, and provide feedback on what the EU can do to improve EU-China business relations.

The Understanding China website focuses on the needs of SMEs for practical information on the ground. The website serves as an intelligence hub for practical, business-related information on China. It is developing into a one-stop shop for SMEs and provides an online portal for exchange.

The China Advisory Council roundtable discussions welcome up to 30 high-level participants sharing experience on EU-China relations to provide the European Commission and European member states with policy recommendations and advice on the political and economic needs of business in China. The China Advisory Council reports these recommendations to the European Commission.

This Policy Briefing entitled 'Greening China: Outlook for European SMEs' provides a first input in the process of two China Advisory Council roundtable discussions that will take place in 2011. The roundtable meetings will be addressing two pertinent issues in EU-China relations:

- China's 12<sup>th</sup> Five-Year Plan and Europe 2020: Creating new EU-China synergies
- China and the EU in the next decade: Revival or stagnation?

The Policy Briefing and the roundtable discussions will be followed by another Policy Briefing highlighting the key issues that need to be addressed in EU-China relations.

## CONTACT THE UNDERSTANDING CHINA PROGRAMME

If you would like to find out more about the Understanding China programme, please do not hesitate to visit the website:

[www.understandingchina.eu](http://www.understandingchina.eu)

You can also find out more about other European Union initiatives like the China IPR-SME Helpdesk and the EU-SME Centre.

## THE CHINA IPR-SME HELPDESK

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