Issue 190 • June 2020

CHINA BRIEFING

From Dezan Shira & Associates

Opportunities for Foreign Investors in China's Service Industries After COVID-19

Introduction

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Since COVID-19 was declared a pandemic on March 11, 2020, the world has been plunged into a cycle of tracking daily reports on the outbreak and its impact on societies, economies, and governments. At the level of business and industry, enterprises have had to accelerate all decision-making aimed at their survival and relevance.

Having suffered through the worst of the outbreak in the initial months of the year, China now offers the world a way to move forward. The immediate lessons from the almost overnight executive decisions are near unanimous. To survive a public health crisis of pandemic proportions, enterprises in China have had to digitize all contact-facing operations to the utmost extent possible, refit core company assets and redirect resources to manage sudden changes in market needs, salvage customer relationships by quickly adapting to new realities, and either expand the scope of business through technology solutions or withdraw to core operation strengths.

In this edition of China Briefing Magazine, we focus on how key industries in the services sector have entered into a new normal since the outbreak began. We also provide an overview of new opportunities for foreign investment that have emerged as a result of major disruption to the status quo. Finally, we spotlight two major industries impacted by COVID-19, healthcare and food and beverages, where new opportunities represent the larger trends towards technology mobilization, industrial upgrades, and online retail.

With offices located across China and more than 25 years of experience helping foreign enterprises set up operations in the country, Dezan Shira & Associates is well positioned to assist your company in the Chinese market. For more information, please email us at china@dezshira.com.

With kind regards,

Alberto Vettoretti

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Reference
China Briefing and related titles are produced by Asia Briefing Ltd., a wholly owned subsidiary of Dezan Shira Group.

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Credits
Publisher / Asia Briefing Media Ltd.
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This Issue's Topic

Opportunities for Foreign Investors in China's Service Industries After COVID-19

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Taking Advantage of China's New Normal

Author: Melissa Cyrill

China is emerging from a public health crisis of unprecedented proportions more resilient than ever before. Factories in the country have returned to pre-COVID-19 operation levels and internal movement has relaxed. Market trends show favorable growth prospects although consumer behavior may have permanently changed. Yet, six months into the year, the rest of the world is still navigating a myriad of nervous realities every day – extended home quarantines, social distancing in public spaces, travel curbs, constant monitoring of the health of families, friends, and neighbors, and anxiety over jobs and livelihoods.

The parallel experiences of China versus much of the rest of the world has put the country at a uniquely advantageous position. And, foreign investors who had seriously considered moving out of the country are now wondering whether China's recovery through rapid containment of the outbreak, and any new clusters that may appear, could propel it to lead the next phase of global economic growth.

Tapping into the new normal

Many foreign companies are now back to reassessing internal structuring plans – whether to shift their manufacturing base to lower tier cities to reduce costs or diversify to nearby countries while maintaining core operations in China? Foreign firms had seriously begun reconsidering their China exposure due to the US-China trade war, rising labor costs, greater compliance requirements, such as meeting environmental goals, and competition from domestic enterprises.

Yet, through the COVID-19 crisis, China has emerged as a reliable base for industries. Moreover, recent improvements in cultivating high-tech capacity in manufacturing and logistics have made it more viable for existing businesses to remain in China if they want to scale up newly developed products and service offerings in the post-pandemic economy. Investors are also well poised to roll-out new technological solutions as the expanding application of artificial intelligence (AI), cloud computing, and construction of 5G networks remain top priorities for Beijing.

From summoning key resources to survive the health crisis, enterprises in all sectors and industries in China have now moved into the next phase – strategizing how to grow their customer base, use digitized channels, and address gaps in the supply chain. Another interesting development is the focus on servicing local market demand to reduce global exposure. The world may depend on China for much of its manufacturing needs, but the country itself offers a vast market with rising purchasing power and an expanding middle class. Moreover, over the past five years, Beijing has continuously worked to shift its economic trajectory towards being consumption and services driven. That of course has meant that any crisis impacting local consumer spending patterns would impact national growth.

A solution to this has been the acceleration of market opening reforms to attract foreign capital, through the announcement of more free trade zones (FTZs), diversifying preferential incentives, and sector and region-based relaxation of entry norms. More importantly, through its handling of COVID-19, the world's second largest economy has shown that its central and provincial governments are more than capable of managing repercussions from unforeseen events and adapting to fast-changing scenarios.

At the same time, China has not withdrawn to focus on microeconomic policymaking alone. It has not abandoned the cross-regional Belt and Road Initiative, for example. Further, the Greater Bay Area scheme and the new Go West plan to develop the central and western regions of China, are key priorities for the government. Altogether, they seek to build critical regional infrastructure, augment trade routes with upgraded facilities to maximize logistics efficiencies, create the high-tech manufacturing and services capacity needed to attract more international business as well as address the uneven levels of industrial development in the country.

Overall, China's ongoing expansion of its FTZs and other incentive hubs as well as reduction of items on the prohibitive Negative List for FDI will facilitate the increased movement of goods, people, and capital – both to its market and as a base for increased exports.

China's support for businesses in the aftermath of COVID-19

China has extended several tax and preferential policies, unveiled last year, to the end of 2020. For example, from May 1, 2020 to December 31, 2020, small low-profit enterprises (referring to the enterprises that meet requirements set out in the State Taxation Administration's Announcement [2019] No.2) are allowed to defer payment of corporate income tax (CIT) until the first declaration period in 2021 after they make pre-payment declarations. Similarly, China has asked banks to allow for the extension of repayment deadlines for corporate borrowers. In addition, China's central and local governments have been rolling out a series of supporting policies to shore up the confidence of businesses and ease some of their compliance burdens.

Since February, policies have been released to enable businesses to resume production as well as access tax and fee reductions and exemptions, financial support, reduced social security compliance requirements, energy cost reductions, and incentives targeted at the medical supply chain. Further, several policies have been released to facilitate foreign trade.

Businesses in China, including foreign-invested enterprises, can leverage these special policies to overcome the short-term challenges due to the economic impact of the outbreak. Over the long-term, these will give way to a faster opening-up of multiple sectors as China seeks greater foreign investment to boost economic growth, create jobs, and move up the chain of value-added enterprise.

At this year's Two Sessions (Lianghui), held in late May after a two-month delay, China announced it would not set a GDP growth target this year as an economic goal – the first time since 1990 – but rather implement measures to support employment. (The Two Sessions are China's most important annual political meetings and signal major policy goals and government intentions for the year.)

Jobs growth will necessitate the faster opening-up of key sectors or relaxation of regulatory requirements that indirectly blocked market access for foreign investors.

What makes China a reliable investment destination

The coronavirus pandemic, or COVID-19, has shaken all parts of the global economy without exception. Some countries, however, have emerged more successful than others as they have adopted clear strategies, mobilized critical resources in a timely manner, and secured widespread community engagement and support. China is at the forefront of this recovery, having suffered through the worst of the crisis at the start of the year. Key lessons learnt while managing the outbreak have quickly converted into important policymaking that targets the strengthening of public health systems, financial well-being of businesses, market stabilization, and supply chain restoration, all of which have cumulatively aided China's faster than expected economic recovery.

Beijing has also accelerated planned market openings in various industries as it seeks to facilitate more foreign investors. At the end of this article, we provide information on the major types of preferential zones in China where foreign firms can locate their investment and take advantage of targeted incentive schemes. For quick reference, China has established multiple economic development zones (EDZs) since the 1970s. These are specific areas that provide preferential business policies, which differ from those governing the country as a whole. Since then China has evolved a diverse range of EDZs to attract foreign direct investment (FDI), depending on the industry and economic activity involved. Businesses operating in EDZs can expect, among other incentives, a higher level of autonomy over their operations, a variety of tax exemptions, land and building subsidies, and preferential employment and sourcing policies. Foreign entities looking to invest in China are advised to understand and compare the incentives available in the country's many economic development zones.

Future outlook

There is a clear trend enabling China's economic recovery and that is the accelerated application of technology across all sectors of industry and services. Given the country's pivot in recent years towards investing in high-tech innovation, the coronavirus outbreak has simply forwarded application timelines, as sheer urgency resulted in the almost immediate and widescale roll-out and use of tech solutions.

Whether these were software-based apps for tracking physical health and fitness parameters, surveillance of populations in lockdown, telemedicine, contactless devices, digital communication systems, e-commerce, or remote work management platforms – the speed with which new ideas, technologies, and operational changes were activated, customized, and normalized has permanently affected how companies will do business in China and with China, moving forward.

In the next three articles, we will identify the major disruptions and key opportunities in leading service sectors in the aftermath of the COVID-19 crisis. These will be of interest to foreign investors based in China as well as those looking to enter the market at a time when consumer needs may be rapidly changing.

Types of Economic Development Zones in China

Zone class	Zone	Central purpose	Major preferential policies
Zones for economic activities	Special economic zone (SEZ)	• Improve reform and opening-up in China • Improve manufacturing and exports • Located mainly in coastal cities and border areas	• Sound business environment • Tax exemptions for manufacturing and export firms
	Economic and technological development zone (ETDZ)	• Attract FDI • Serve as industrial agglomeration • Improve manufacturing and exports • Located mainly in coastal cities	• Tax exemptions for manufacturing firms • Faster export tax rebate process • Financial support for the provision of some facilities/services • Lower rental fees
Zones for commercializing high-tech research findings	High-tech industrial development zone (HIDZ)	• Take advantage of knowledge-intensive areas • Commercialize high-tech research	• Tax exemption for high-tech firms • Exemptions from local income tax and property tax • Faster export tax rebate process • Financial support for the provision of some facilities/services • Lower rental fees
Zones for trade/ export purposes	Free trade zone (FTZ)	• Attract FDI • Reduce storage cost of goods • Act as testing-ground for new policies	• Import duty exemptions and export tax rebates • Flexible tariff, approval, and management policies
	Bonded zone	• Increase exports	• Bonded warehouse
	Export Processing Zones (EPZ)	• Increase exports • Provide concessions for manufacturing firms	• Import duty exemptions and export tax rebates (bonded policy) • VAT and consumption tax exemptions
	Bonded port (BP)	• Increase exports • Serve as logistics hub • Located mostly around ports	• Import duty exemptions and export tax rebates (bonded policy) • VAT and consumption tax exemptions • Tax-free transfer within zones
	Bonded Logistics Park (BLP)	• Increase exports • Serve as logistics hub • Allows no advanced manufacturing	
	Comprehensive bonded zone (CBZ)	• Integrate functions of bonded zone, export processing zone, bonded port, bonded logistics park • Allow activities like international transit, distribution, procurement, intermediary trade, export processing, R&D, and product exhibition	• Import duty exemptions and export tax rebates (bonded policy) • VAT and consumption tax exemptions • Tax-free transfer within zones
	Cross-border e-commerce (CBEC) comprehensive pilot zone	• Boost cross-border e-commerce businesses • Increase exports and imports • Serve as entrepreneurship center and logistics hub	• VAT and consumption tax exemptions • New corporate income tax policy for in-zone enterprises • Preferential tax policies for SMEs
Zones to attract investment for specific purposes	National tourism resort zones; finance and trade zones	• Development tourism and finance industries	• Preferential tax and subsidy policies for specific industries
Zones for cooperation with certain countries or regions	4 different zone types depending on country	• Build cross-border business relationships • Incentives for partner country/region like Taiwan, Macau, ASEAN, Russia	• Preferential tax policies for companies from specific regions

Navigating Disruptions in the Service Sector: Leading Trends

Author: Alexander Chipman Koty

China's service sector is the main driver of the country's economic growth and the basis for the next stage in its development. Like other areas of China's economy, however, it was disrupted by the COVID-19 outbreak – with potentially long-ranging consequences for its future trajectory. From late January to mid-April, much of China's economy was shut down amid lockdown measures to combat the coronavirus. Service providers – whether lawyers, educators, or programmers – had to pivot to remote work arrangements, while consumption patterns of services themselves also witnessed sudden shifts. As China reopens its economy and returns to relative normalcy, some service industries may see permanent disruptions as consumption habits change and the push towards digitalization accelerates. In this article, we look at China's service sector and discuss some of the disruptions and opportunities induced by COVID-19.

China's service sector at a glance

China's unprecedented economic growth miracle over the past four decades was primarily driven by the manufacturing sector, which benefited from an enormous low-cost labor pool as the country opened to export markets. Now, as labor and land costs are growing and its workforce is increasingly well-educated, China is transitioning to a more sustainable post-industrial service and consumption-driven economy. While growth in China's manufacturing sector slowed over the past decade, the service sector grew at a faster pace – by 2019, it was responsible for 59.4 percent of total GDP growth.

Domestically, there is wide variation on the size of the service sector in China, based on the regional level of development. For example, in Beijing and Shanghai – two of China's most developed cities – the service sector was worth 83.1 percent and 72.7 percent of GDP, respectively, in 2019. In Wuhan and Qingdao – major but less developed cities – the tertiary sector was worth 53.3 percent and 55.4 percent of GDP, respectively, the same year. In some smaller cities reliant on industry, the share of the service sector is even smaller. In Foshan – a mid-sized city in Guangdong, China's manufacturing heartland – the services sector represented just 42.4 percent of GDP in 2019.

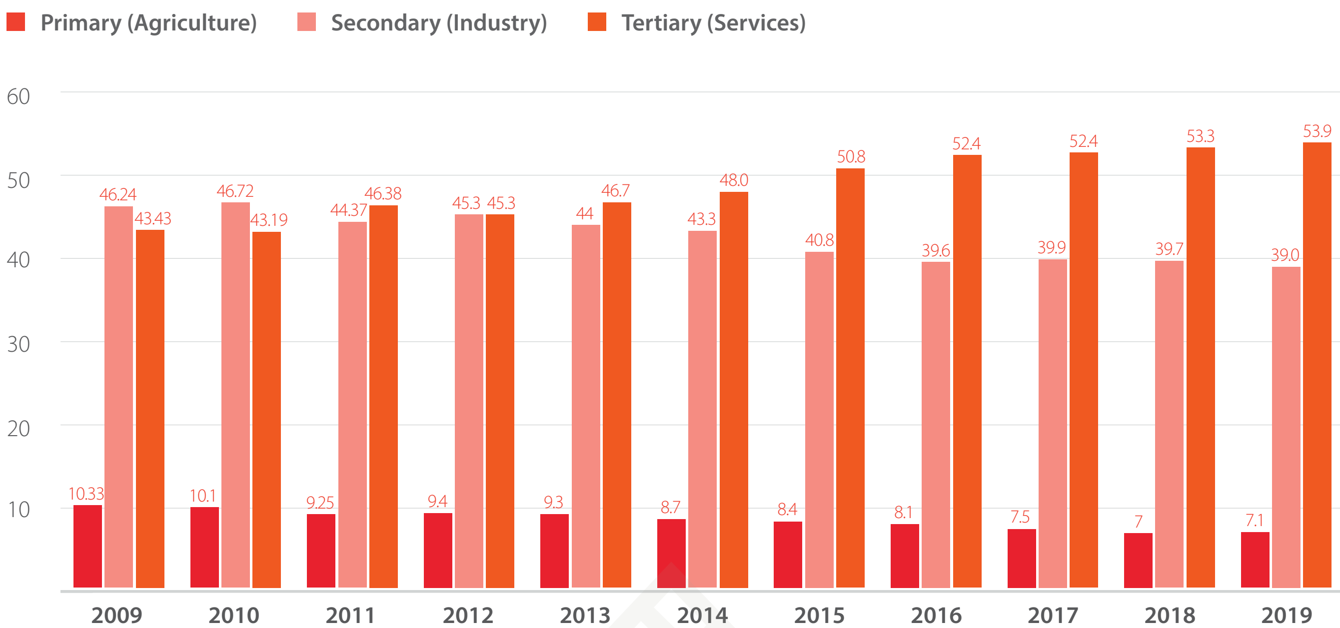
Put simply, wealthier regions tend to have stronger service sectors because these industries provide more value-added production than manufacturing and resource extraction. Service industries also need highly educated and specialized workers like lawyers, accountants, doctors, and researchers – who command higher wages than most laborers. Moreover, households with more disposable income have greater capacity to consume services locally, compared to manufacturers that are often reliant on overseas export markets. Thus, it is no surprise that service industries like finance, professional services, information technology, healthcare, and education are the most advanced in China's wealthiest cities.

Yet, while the service sector is strongest in first- and second-tier cities, lower tier ones (Shantou, Guangdong Province; Zhenjiang, Jiangsu Province; Mianyang, Sichuan Province; etc.) offer the biggest growth potential. Economic planners hope that, as lower tier cities gradually lose their manufacturing advantages to low-cost alternatives like Vietnam and India, they too will develop service-driven economies staffed by China's well-educated younger generations.

Opportunities after COVID-19

The COVID-19 outbreak dealt a significant blow to China's service sector amid the country's lockdown. With substantial parts of the economy shut down and hundreds of millions of people stuck at home while China curbed the spread of the virus, the service sector experienced a temporary but significant downturn. In February – the height of the lockdown in China – the Caixin/Markit services purchasing managers' index (PMI) fell to an all-time low of 26.5, where any figure below 50 represents a contraction. Since then, China's economy

China's GDP Composition (%)



has largely returned to normalcy. However, the outbreak and its lingering effects seem to have majorly disrupted some industries while changing the trajectory of others. In the next section, we look at how various subsectors in the service industries in China have been impacted.

Retail and e-commerce

COVID-19 has impacted both what consumers purchase and how e-commerce platforms distribute goods. Chinese consumers spent less during the lockdown, as they were confined to their homes and faced economic uncertainty. In January and February, for example, retail sales fell by 20.5 percent year-on-year. Despite this collapse, however, online sales of physical goods still managed to increase by three percent during the same period, as consumers overwhelmingly flocked to e-commerce platforms. The lockdown led to a huge increase in online grocery purchases, with sales of food products increasing 26.4 percent year-on-year in January and February. Partly as a result of COVID-19, the market research firm iiMedia Research projected that China's online grocery market will increase by 62.9 percent in 2020 to reach RMB 264 billion (US$37 billion) in revenue. Currently, Alibaba's Hema platform, JD.com's 7Fresh, and Pinduoduo dominate the online grocery market. In contrast, while groceries and other stay-at-home products like workout equipment soared, sales of discretionary products like apparel and makeup sharply declined – to say nothing of big-ticket items like automobiles. While lockdown measures have now largely ended, these trends may continue going forward, as Chinese consumers navigate an economic downturn and change their consumption habits accordingly.

To minimize spread of the virus, many apartment complexes now administer their own drop-off points for deliveries instead of having couriers deliver straight to the customer's apartment door. In some cases, local communities are banding together to place bulk orders for groceries. The surge in online groceries has put a strain on cold chain supply management, as operators struggle to handle supplies and distribution of fresh and perishable products.

In light of this challenge, e-commerce operators are turning to artificial intelligence (AI) to establish efficient distribution strategies as well as collaborating with local brick-and-mortar grocery stores to ensure that products are fresh and quickly deliverable. In a bid to spur consumption, in April this year, the Chinese government announced plans to establish 46 new cross-border e-commerce (CBEC) pilot zones – almost doubling the country's total from 59 pilot zones. Examples of the new CBEC zones are Xiong'an New Area, Hebei

Caixin/Markit Services Purchasing Manager's Index by Month

Note: Above 50 represents growth; below 50 represents contraction

Province; Jiangmen, Guangdong Province; Datong, Shanxi Province; Jilin city, Jilin Province; and Chongzuo, Guangxi Province, among others. Examples of the established CBEC zones are Hangzhou, Zhejiang Province; Guangzhou and Shenzhen, Guangdong Province; Zhengzhou, Henan Province; Chengdu, Sichuan Province; and Xiamen, Fujian Province, among others. Cross-border e-commerce pilot zones are special jurisdictions designed to encourage foreign trade via e-commerce platforms and offer preferential policies like exemptions on VAT and excise taxes as well as reduced corporate income tax rates. With over 100 of these zones in place, foreign businesses selling via cross-border e-commerce platforms will be better placed to fulfil timely deliveries on orders across the country, making their products more competitive vis-à-vis those offered on traditional e-commerce platforms.

Live streaming

Unable to go to malls and other physical stores to test products during lockdown, Chinese consumers turned to live streaming platforms for information on which products to purchase. The trend towards live stream sales was already strong before the outbreak – particularly in industries like fashion and makeup – but accelerated during lockdown, as viewers watched live streamers discuss their lives and exhibit products, often for hours at a time. According to China's Commerce Ministry, there were over four million e-commerce live streaming sessions in the first quarter of the year, many of which were held on platforms like Taobao, Kuaishou, and Pinduoduo. Taobao reported that the number of new merchants using the platform's live streaming feature increased by over eight times from January to February.

Most influential e-commerce live streams are hosted by internet influencers known as key opinion leaders (KOLs) or by celebrities paid by a company to showcase their products. During the COVID-19 outbreak, government officials from provinces like Hubei and Shandong even joined live streaming sessions to promote local products from their regions. Foreign businesses also got in on the act, such as the luxury company Louis Vuitton, which hosted its first live streaming event in March. In addition to showcasing and selling products, live streams became a popular way for users stuck at home during lockdown to stay active and social. Live streamers held activities as diverse as virtual workouts, musical performances, video game tournaments, and karaoke events, often incorporating social aspects to allow the audience to participate.

Industry analysts estimate that live stream-driven sales account for between two and 10 percent of total e-commerce sales. This is a large enough figure that businesses need to incorporate live streams into their broader e-commerce strategies, particularly as consumers increasingly flock towards creator-driven platforms instead of traditional mediums. Beyond direct sales, however, live streams are becoming influential platforms for determining how consumers view a given product more broadly, as views popularized through live streams diffuse into the wider consumer base. This means that live streams should not be seen only for converting direct sales, but also for building brand image. Foreign businesses opting for the live streaming strategy of marketing should establish partnerships with KOLs who are followed by the business' target demographics and represent the brand's values and lifestyle.

Online education

Online education in China has been booming in the last five years. Prior to the outbreak, market researchers projected China's online education and educational technology market would grow by 12.3 percent to reach RMB 435.8 billion (US$61.5 billion) in 2020. Much of this market consisted of supplementary education, such as exam preparation, tutoring, and foreign language instruction. The forced closure of schools and universities due to COVID-19, however, led to rapid growth in the online education market and put renewed emphasis on educational technology designed for institutional use. Schools and universities were forced to move online and use educational software to deliver lectures, manage class participation, and conduct online testing, among other functions.

With both educators and students growing familiar with online education during the pandemic, the use of educational technology (EduTech) will likely become more widespread going forward. Increasingly, EduTech will not just be used for distance learning and emergencies but will get integrated alongside traditional offline classrooms. Faced with the threat of another wave of the outbreak, educational institutions at all levels must now stay nimble and be prepared to pivot to online classes with little to no notice.

The market for online education in China is lucrative and rapidly growing but presents a complicated regulatory framework for foreign investors to navigate. Both education and online services are sensitive areas for the Chinese government, meaning its regulations for online education are particularly strict. Among the regulations governing the industry are the Opinions on the Orderly and Healthy Development of Educational Mobile Internet Applications, which nine ministries jointly released in 2019. Further, amid the COVID-19 outbreak, in February 2020 authorities released the Opinions on Deepening Reform of Educational Supervision and Guidance System and Mechanism in the New Era. Together, these regulations impose supervision of online education products, such as through the creation of a national database, as well as oversight to promote a minimum quality of education. Foreign investors entering China's online education market therefore must take measured steps to comply with the industry's complex regulations.

Accelerating digitalization

In some cases, the COVID-19 outbreak introduced impactful but likely temporary shocks to the service sector, such as in the case of declining cosmetic sales. In other areas, the virus is necessitating changes like the continued use of contactless delivery systems for e-commerce. In certain industries, however, the coronavirus may have introduced lasting change. It may have, for example, permanently changed how people buy their groceries and how universities deliver education. Overall, the coronavirus has simply accelerated the digitalization of the service industry. As China navigates its transition from manufacturing to services and consumption, foreign investors that are agile and can adapt to satisfy shifting trends will be best placed to capitalize on the country's new economic landscape.

Checking the Pulse of the Healthcare Services Industry

Author: Dorcas Wong

Over the past three months, China's healthcare system has been overwhelmed with efforts to treat, diagnose, and control the spread of COVID-19. During this time, the country's critical healthcare resources were stretched thin – exposing both the strengths and weaknesses of the system.

On one hand, the outbreak demonstrated the government's responsiveness to a crisis through the rapid deployment of emergency hospital beds and widespread testing. On the other hand, it revealed the uneven spread of healthcare resources, and wide disparities in the quality of healthcare available across regions.

Now, as China's healthcare industry starts to recover and rebuild from the aftermath of the crisis, the lessons learned from COVID-19 will underpin the direction of the transformation that will take place in this industry. Battling the pandemic has created a catalyst for change. It has also caused China to rethink its priorities within the healthcare system – pushing critical health infrastructure, digital services, and public health promotion much higher on the list than if the infectious outbreak had not occurred.

The state of the healthcare industry

China healthcare industry is currently ranked the second largest in the world behind the US. In 2019, the market reached RMB 7.82 trillion (US$1.1 trillion), an increase of 10 percent when compared to that from the previous year. The market has grown at a consistently rapid rate in the past five years, having increased by more than a third of its size, growing at an average 11 percent year-on-year.

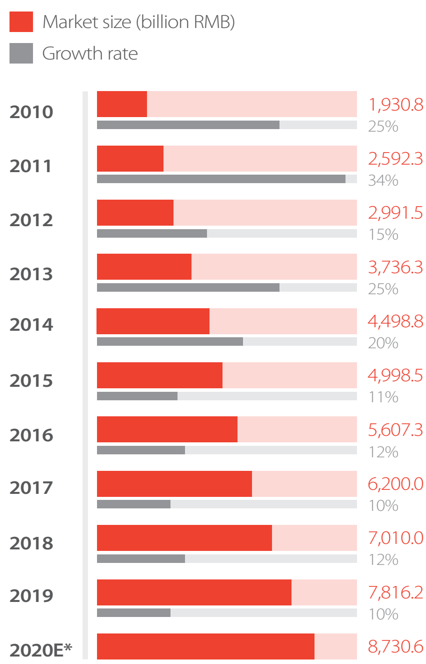
Despite this, the market remains relatively undeveloped and presents considerable opportunities for further growth. For instance, China's health expenditure accounted for only 6.57 percent of the total GDP in 2018, while the US reached 17.8 percent in the same year. In recent years, the Chinese government has laid out multiple initiatives to support long-term growth and innovation in healthcare delivery, but the policy landscape is in constant flux and needs ongoing monitoring.

Nevertheless, healthcare remains a positive area of for foreign investment with two new sectors added to the 2019 National Encouraged List just last year. New raw material for the production of vaccines as well as medical institutions are now an encouraged investment sector by the central government, unlocking opportunities for foreign investors to access preferential policies and tax rates.

It must be noted, that foreign investment in medical institutions is still limited to a joint venture structure and cooperation with a Chinese company, unless a special approval has been granted.

An exception, however, exists for Hong Kong entities, under the Mainland and Hong Kong Closer Economic Partnership Arrangement

China's Healthcare Market Size (2010-2020)



*Note: * Estimated figure for 2020 | Source: Open source reports*

(CEPA); eligible Hong Kong Service Suppliers can set up medical institutions in the form of a wholly-owned entity if the requisite conditions under CEPA are met.

In this article, we take a look at the initial indicators pointing towards a transformation of the medical care provider system in China, and the investment opportunities that are emerging as a result.

Healthcare Industries in China's 2019 Encouraged List

Telemedicine and digital healthcare

Prior to the outbreak, most Chinese consumers typically visited physical medical institutions for their healthcare needs. Though digital adoption was a much talked about concept, the actual digital penetration rate was relatively low. According to the survey completed by Bain & Company in 2019, only 24 percent of Chinese respondents had used telemedicine, which is the use of technology to provide remote clinical services.

However, as an inevitable consequence of COVID-19, there has been a rapid acceleration of the wide-spread adoption of digital technology in both the delivery of healthcare services (remote patient monitoring, online booking, and telemedicine) and the digitally assisted delivery in healthcare services (artificial intelligence or AI and machine learning for diagnostics and treatment, augmented reality or AR surgeon training, robotic and AI assistance).

In fact, during the COVID-19 outbreak, the country's National Health Commission (NHC) promoted the use of internet-based medical services to minimize population movements and reduce the risk of infection. This led to the exponential increase in the userbase and engagement of China's online medical platforms.

For example, Ping An Good Doctor – China's largest healthcare platform – experienced a 900 percent surge in new users, and 800 percent surge in online consultations during the period of December 2019 to January 2020.

Though the need for remote healthcare delivery was clear during the epidemic, there are fundamental reasons why this model is here to stay.

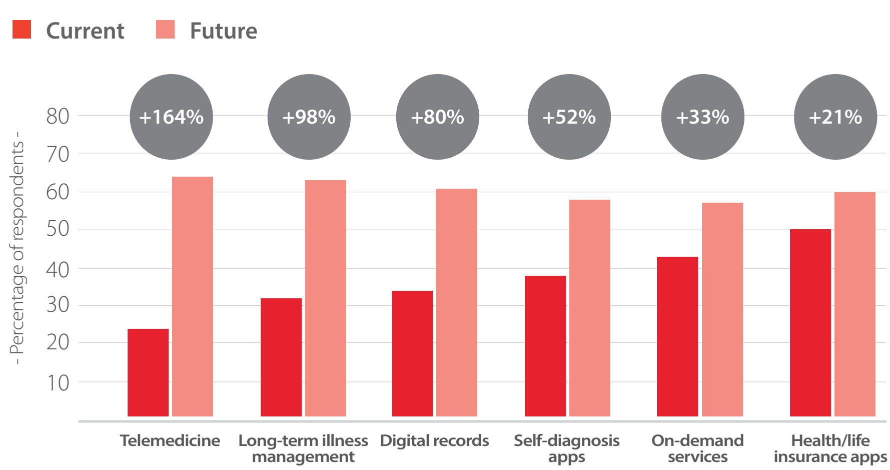
The pandemic exacerbated and shone light on the pervasive bottleneck within China's healthcare provider system, which has been a fundamental obstacle to consistently access quality healthcare services. China has a tiered healthcare system in which smaller community health centers (CHCs) and Class I institutions provide first-contact care, and larger Class II and III institutions provide specialist referral services. However, in practice, the provision of healthcare is extremely unbalanced with more than 2,300 top tier public hospitals running at capacity while the remaining low-tier hospitals, community health centers, and clinics struggle to attract patients. In response, online healthcare platforms are expected to continue to grow against the backdrop of a congested and unbalanced healthcare provider system to create a more patient-central engagement model.

By 2020, the digital healthcare market in China is expected to reach RMB 23.5 billion (US$3.29 billion). According to a survey conducted by Bain & Company, there will be an exponential growth in digital services among Chinese patients in the next five years – with telemedicine expected to take the lead, growing by more than 164 percent, and online long-term illness management services also expected to almost double in usage.

Renewed opportunities exist for digital health companies that wish to solidify their position in the Chinese market. Equally, medical technology (MedTech) companies and companies operating software as a service (SaaS), are well-positioned to partner with offline healthcare providers to transition into more innovative business-to-consumer (B2C) healthcare delivery models to provide a more holistic and comprehensive care.

Though telemedicine is not a new concept in China, the government has only recently started to adopt a more cohesive and regulated approach to this subsector. Most significantly, in 2019, the National Healthcare Security Administration (NHSA) launched an electronic medical insurance system. Starting from August, patients can get access to diagnosis

Chinese patients expect to use more digital services within the next five years



Source: Bain & Company

and prescription services from hospitals via WeChat and Alipay without bringing any medical insurance identity cards, thus promoting the widespread adoption of telemedicine. Also, notably in May 2020, the NHC encouraged provincial governments to establish their own online regulatory platforms to oversee and regulate individual online medical providers and to accelerate the market access of internet-based hospitals.

Medical devices

Driven by the need to support quality care at lower costs, the medical device sector is also likely to see continued entry of new players from all industries over the coming decade. In 2030, China is expected to have more than 25 percent share of the global medical device industry at over RMB 1.4 trillion (US$200 billion), second only to the US, according to a 2018 KPMG report.

China's market is already growing at twice the pace of the overall market, driven by healthcare reform, and overall rising demand for healthcare. Medical device players, particular domestic players, such as Shenzhen's Mindray Bio-Medical Electronics Co. Ltd have expanded significantly in the past five years and currently span all segments including – IVD, diagnostic imaging, cardiovascular, nephrology, orthopedics, hearing aids, and even wearables.

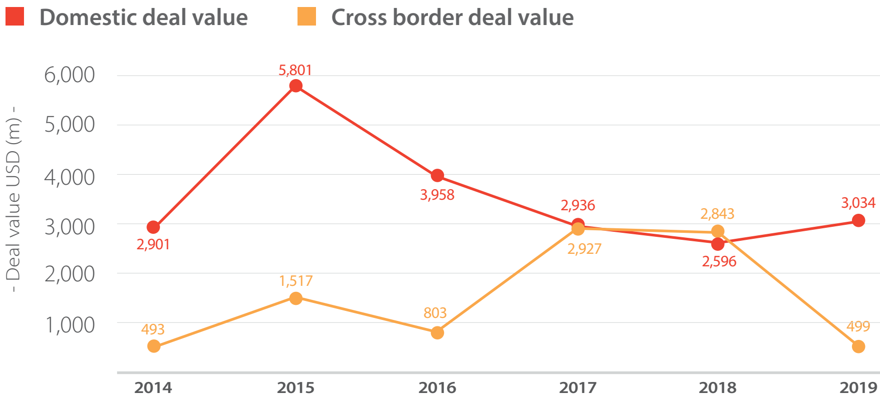
However, in 2019, China saw a decrease in overall deal values in the medical devices sector, mainly driven by the decline in number of cross border deal values, which saw a decline of 82 percent when compared to domestic deals, which only saw decrease of 17 percent in 2018.

Recent reforms, however, have reduced red tape and compliance costs to assist in the steady growth of the medical devices industry in China, while also allowing its market players to become more competitive internationally.

New regulatory requirements for import of medical devices

While in the past, the regulatory environment surrounding medical devices and equipment has grown more stringent, a general reversal of this trend is starting to emerge. There is now a gradual uptick of fast-track registration and ease in approval requirements, in part due to the shortages left behind by the outbreak but following on from a recent trend.

Medical Devices M&A Deal Value Trend (2014 to 2019)



Source: MergerMarket, Deloitte Research

For example, in February 2020, as a response to COVID-19, NMPA released a circular requiring the regulatory body and its local branches to adopt fast-track registration processes and grant registration certificates for certain critical protective gear and medical devices, with a one-year validity term.

Similarly, in December 2019, NMPA released a set of new regulations, which speed up the review and approval of medical devices needed in the treatment of severely life-threatening diseases by streamlining the pre-clinic, pre-market and post-market research stages of approval.

New management model for registration of medical devices

China has also made significant strides in removing obstacles surrounding the production and distribution of medical devices.

Most recently, the country has initiated a reform of its medical devices registration system – through its newly implemented Market Authorization Holder (MAH) system, which first came in 2015 and was expanded in 2017, and again in 2018 and 2019.

The Market Authorization Holder System refers to a management model that separates the authorization for market-entry from the authorization of the product. In this way, the market license holder can entrust a product to different manufacturers for production – giving them more flexibility in their business model to engage in new product research, and to avoid any manufacturing bottleneck issues. Applicants for medical device registration can be medical device manufacturers (including group companies), research and development institutions, scientific researchers, and doctors. This is a significant improvement on the current system, where the applicant must have an enterprise to be able to apply for registration in its name, which had restricted innovation in the industry.

Since 2019, the pilot areas of the Medical Device Holder Regime have extended from three cities to over twenty cities. These include Beijing, Tianjin, Hebei, Liaoning, Heilongjiang, Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Shandong, Henan, Hubei, Hunan, Guangdong, Guangxi, Hainan, Chongqing, Sichuan, Yunnan, and Shanxi. It is likely to be expanded to the whole country in the future.

A hard reset in 2020: Government signals future healthcare priorities

In 2020, China's healthcare industry has been forced to do a hard reset. While the 2003 SARS epidemic caused China to establish the necessary infrastructure to improve its disease surveillance, epidemic prevention, and healthcare accessibility, COVID-19 exposed the residual cracks in the system prompting improvements to the efficiency and quality of its services and supplies. As China is tasked with rebuilding and reorganizing its healthcare system, the government has started to signal its priorities for the next era of its healthcare transformation. In 2020, it is expected that the government will continue to reform its medical care provider system and relax red tape procedures in the medical devices industry to establish a more robust and cohesive digital health landscape.

Tapping into New Growth Opportunities in F&B

Author: Zoey Zhang

COVID-19 and its subsequent control measures significantly disrupted China's catering sector earlier this year. It also had a negative knock-on effect on the sales of beer, liquor, and condiments to restaurants. But these effects are expected to be short-lived. As the outbreak subsides, F&B demand, particularly for consumer necessities, is returning to normal. For foreign investors, it is worth noting that changes in Chinese consumer behavior since the outbreak has established a 'new normal' and is driving transformation in the industry, most visibly in the marketing and distribution channels of F&B products. Investors should note the changing trends in China's e-commerce, new retail, and food supply chain integration to seize the developing opportunities in one of the world's most dynamic markets.

An overview of China's F&B import market

As the world's largest food importer and consumer, China's net demand for imported F&B products shows no sign of waning. In 2019, China's food imports reached US$90.8 billion, showing a year-on-year growth of 23.4 percent. From 2014 to 2018, the value of China's imported food grew at a CAGR of 7.4 percent. At this rate, the country is expected to import more than US$100 billion worth of foods in 2021.

In 2018, out of 17 categories of China's imported food – aquatic products, meat, and dairy products were the three most popular food segments among Chinese consumers. Imports of aquatic products, meat, and dairy products reached US$12.2 billion, US$11.1 billion, and US$10.6 billion, respectively, and together accounted for about 46 percent of the total imported food. 185 countries and areas exported F&B products to China in 2018, up from 170 in 2017. New Zealand leapfrogged the US and Australia to become China's top import partner. Dairy products are New Zealand's main food export to China. Chile made it to China's top ten overseas food suppliers, with a year-on-year growth rate of 50.2 percent in 2018. What's more, thanks to favorable factors, such as free trade agreements and the Belt and Road Initiative (BRI), New Zealand, France, and Vietnam have significantly increased their export footprint in China.

New opportunities and leading trends in China's F&B market

Emergence of fresh food e-commerce

Virus-led city lockdowns and traffic restrictions damaged traditional offline food retail businesses in the affected areas but catalyzed the emergence of e-commerce and new retail for food supplies. During the extended Chinese Lunar New Year holiday in late January, fresh food e-commerce platforms with last-mile delivery services, such as Freshippo, experienced short-term spikes in orders, as home stayers were inclined to order food and groceries online. Daily new users of major fresh food e-commerce platforms increased by 50 to 200 percent, and year-on-year growth in transaction volume on these platforms rose by three to four times. Changed habits during this intense crisis period is certain to cultivate long-term preferences for online shopping. As supply chains improve, the future seems bright for fresh food e-commerce businesses.

Live streaming e-commerce, and KOLs

The popularity of live streaming and its relationship with e-commerce is evident in the influence it wields over Chinese consumers. In 2019, China's live streaming e-commerce market size reached RMB 434 billion (US$61.24 billion) with a year-on-year growth of 226 percent. E-commerce giants Taobao and JD.com and live streaming companies Kuaishou and Douyin have invested heavily in live streaming. To illustrate this – the live streaming company Kuaishou now allows its users to buy products from JD.com through the Kuaishou App. A new segment has also emerged, derived from the popular South Korean mukbang, which is "eating while live streaming," where the host eats food and entertains viewers. According to the 2019 Taobao Food Live Streaming Trend Report, fresh fruits, dietary supplements, pastries, dried meat, aquatic products, instant food, biscuit puffs, dried candies, nuts, and bird's nest supplements are the most popular foods in live shows in

China. More than 70 percent of the audience watching eating live shows are in their 20s and 40s, and 65 percent of them are women. F&B enterprises should review their marketing channels to assess whether they are successfully targeting the preferred age group. A shift to omni-channel strategies is essential if firms are to stay relevant given the intense market competition.

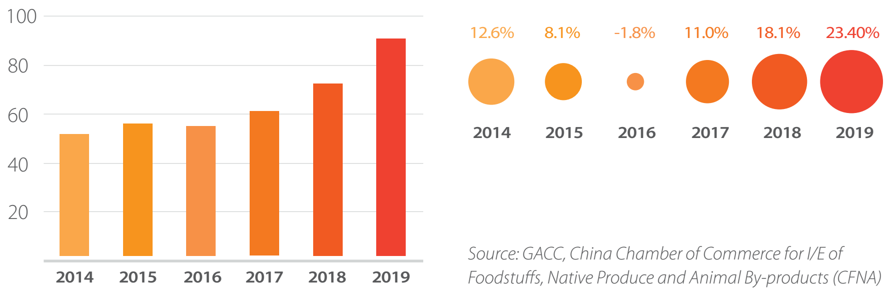
Food supply chain integration

Consumers are now more conscious of food hygiene and safety than before and growing more accustomed to online services. This means that the current state of China's complex and fragmented food supply chains, which can produce inferior products, are expected to be the target of major reforms. Stricter food safety regulations and innovative technologies will accelerate the integration, industrialization, and standardization of China's food supply chains, thereby also enabling food safety traceability. China's relatively less-developed cold-chain logistics system might also witness a shift toward how Europe has developed its cold-chain model. In the upstream segment of the food supply chain, leading companies engaged in breeding, slaughtering, and processing livestock are being encouraged by the government to extend the industry chain at provincial markets. F&B enterprises should fully understand, plan, and prepare for these changes in China's food supply chain. And, as the industry reforms, innovates, and upgrades, investors may find it more convenient to stabilize their market presence or navigate entry through merger and acquisitions (M&A).

Meatless meat and health food market

The intermittent break out of zoonotic diseases like bird flu, swine flu, SARS, and now COVID-19, have pushed consumers to rethink their diet structures. Consequently, plant-based meat producers and retailers are seeing bigger opportunities emerge over a relatively short period of time. In April this year, Starbucks and KFC began testing the market preference for plant-based meat with new menu offerings; in May, Nestle announced it was investing US$100 million to build a new plant-based food facility in China. Spurred by the COVID-19, the demand for dietary supplements, immune-boosting foods, and energy drinks are also expected to

China's F&B Imports 2014 – 2019



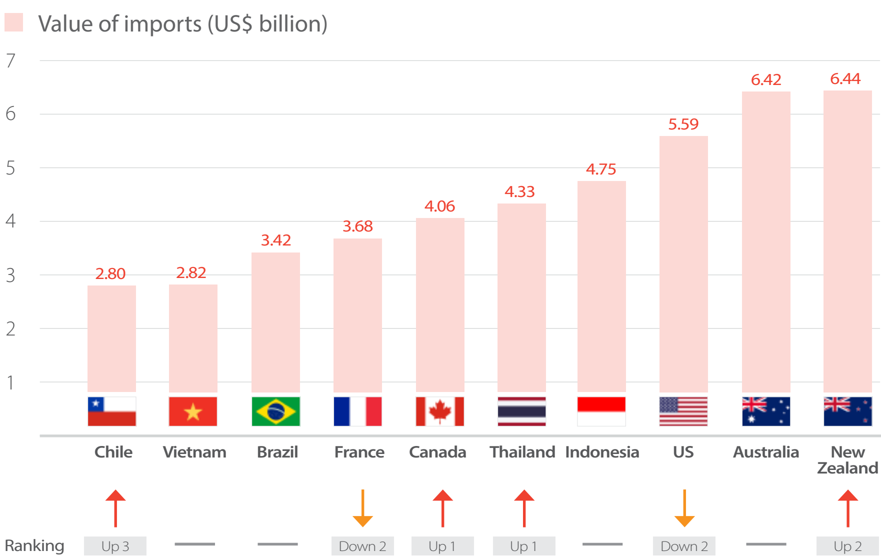
Source: GACC, China Chamber of Commerce for I/E of Foodstuffs, Native Produce and Animal By-products (CFNA)

China's F&B Imports by Category 2018

Category	Value (US$ billion)	Growth rate	Percentage
Aquatic products	12.2	42.87%	16.58%
Meat products	11.1	16.83%	15.08%
Dairy products	10.6	14.68%	14.35%
Fruit products	8.0	34.86%	10.88%
Grain products	7.4	-2.28%	10.02%
Vegetable oil	6.8	0.96%	9.26%
Wine	5.8	21.46%	7.84%
Others	10.6	-	15.99%

Source: CFNA

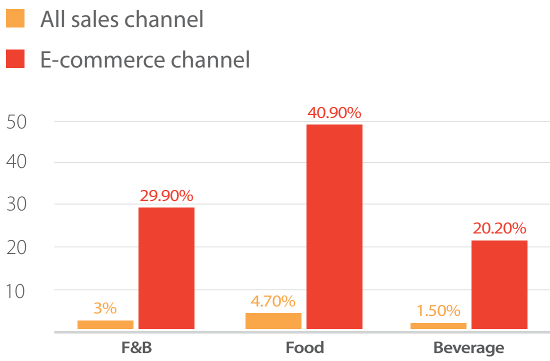
China's Top 10 Sources of Imported F&B 2018



Source: CFNA

China's F&B E-Commerce Market

F&B Market Growth by Sales Channel 2018



Source: Kantar Worldpanel, Household panel, 2018VS2017

Penetration Rate of Imported F&B Chinese Consumers Bought Online 2019

Source: iiMedia Research

climb. Health concerns, an aging population, and the expanding Chinese middle class cohort will continue to drive the future growth of the health food market.

China's F&B cross-border e-commerce

The development of cross-border e-commerce (CBEC) – activities of purchasing or selling products via online shopping across national borders – is gaining momentum despite COVID-19 and is opening China's F&B market wider for foreign exporters. According to iiMedia Research, in the first quarter of 2020, Chinese CBEC users were more likely to purchase F&B, toiletries, and healthcare products through CBEC platforms, partly because of the Chinese New Year holiday and the COVID-19 epidemic.

At present, China has 105 CBEC pilot zones. Further, under a new pilot scheme of CBEC retail import, in 86 cities and Hainan island, Chinese consumers can purchase goods on China's retail import list (also known as the "positive list") from overseas through a CBEC third-party platform through the bonded warehouse import mode (customs supervision code 1210). Listed retail goods can be regarded as goods imported for personal use and will not be subject to the license approval, registration, or filing requirements for first-time importation. Last year, China expanded the CBEC retail import list to allow more foreign F&B products to be retailed through CBEC. From January 1, 2020, China's List of CBEC Retail Imports (2019 Edition) officially took effect. Compared with the 2018 Edition, the new list added 92 items, including frozen seafood like frozen oysters, scallops, and octopus, and alcoholic drinks like gin and vodka.

These programs have lowered the entry threshold for international food brands in China. CBEC's overseas warehousing model is also helping small foreign brands – that cannot establish a physical presence – finally enter the Chinese market. Foreign F&B exporters and enterprises can make use of the CBEC channel to tap into China's market, establish a mechanism to obtain consumer and sales data from CBEC platforms, and develop market expansion strategies as well as explore offline channels.

China's Main E-Commerce Platforms for F&B Imports

E-commerce platform owned by e-commerce enterprises	Tmall Global, NetEase Kaola, JD Worldwide (Haitun Global), g.suning.com, yMatou.com, Little Red Book (Xiaohongshu)
E-commerce platform owned by express delivery enterprises	FengQu.com of SF Express, UDA of Yunda Express

Related Preferential Tariff Policies on F&B Imports

- Effective from November 1, 2018

Announcement of the State Council Tariff Commission on Lowering Import Tariffs for Certain Goods (Tariff Commission Announcement [2018] No. 9)

Involving tax cut for 21 food items, including 10 aquatic products, 6 types of beverage, and 5 miscellaneous foods.

- Effective from January 1, 2019

Notice of the Customs Tariff Commission of the State Council on the 2019 Plan for Adjustments to Provisional Import and Export Tariff Rates (Shui Wei Hui [2018] No.65)

Involving tax cut for 51 food items, including aquatic products, dried fruit and nuts, wine, staple food, dairy products, fruit, sugar, coco, and chocolates.

- Effective from April 1, 2019

Announcement of the State Taxation Administration on Matters Relating to Deepening the VAT Reform (STA Announcement [2019] No.14)

China's value-added tax (VAT) rate for most F&B items were reduced from 16 percent to 13 percent.

- Effective from January 1, 2020

Notice of the Customs Tariff Commission of the State Council on the Adjustment Scheme for Provisional Import Tariff Rates and Others in 2020 (Shui Wei Hui [2019] No.50)

The temporary import tariff rate of frozen pork, frozen avocado, non-frozen orange juice, among others, were added or reduced, which is expected to affect the domestic market of similar products and linkage products.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