China’s GDP grew by 7.5 percent for the second quarter of 2014, meeting the government’s target of 7.5 percent.

The Purchasing Managers Index (PMI) hit a six-month high in June reaching 51.0, while the Consumer Price Index (CPI) increased by 2.3 percent (versus the government’s 3.5 percent target).

ODI in the non-financial sector decreased by 5.0 percent year-on-year through the first half of the year, however the overall pace of ODI picked up in the second quarter, and should surpass the level seen in full year 2013.

FDI increased by 2.2 percent year-on-year through the first half of the year, anchored by China’s services sector investment growth and favorable FDI policy measures.
Second quarter growth reflects a moderate economic rebound

China’s GDP grew 7.5 percent in the second quarter of 2014, 0.1 percentage point higher than the first quarter and equal to the government’s annual target. Amid signs of a moderate economic rebound, it appears that under China’s targeted “mini-stimulus” adjustment policies, the economy has responded positively.

![GDP quarterly growth rate, year-on-year](chart)

Source: National Bureau of Statistics (NBS)

China’s official Purchasing Managers Index (PMI) also continued to strengthen, hitting a six-month high in June. The increase can be attributed to increased demand for industrial products, resulting from rising infrastructure investment and new export orders. In addition, industrial value-added exhibited higher growth of 9.2 percent and the Producer Price Index (PPI) decline narrowed to 1.1 percent in June, indicating that manufacturing enterprises are becoming more active.

![Monthly Purchasing Managers Index (PMI)](chart)

Source: National Bureau of Statistics (NBS)
Extended and detailed mini-stimulus policies

In early April, the government announced a number of “mini-stimulus” policies to support economic growth. A series of extended and detailed measures have since been released to facilitate the implementation of these policies, which have become the key drivers of the economic rebound in the second quarter.

- On 8 April, the Ministry of Finance (MoF) extended the scope of small- and micro- enterprises qualified to enjoy a 50 percent income tax deduction. On 18 June, the MoF announced that the original two value-added tax rates, 6 percent and 4 percent, would be reduced and merged into a single rate of 3 percent. This was a further action to reduce the tax burden on the service sector, after the replacement of sales tax with value-added tax was announced.

- On 22 April, China’s central bank cut the reserve deposit rate by 0.5 and 2 percentage points respectively for rural cooperative banks and rural commercial banks. On 9 June, it further reduced the reserve deposit rate by 0.5 percentage point for certain commercial banks, whose percentage of loans held by small- and micro-enterprises and the agriculture sector reached a minimum level.

- On 15 May, the State Council released measures to stabilize the growth of foreign trade, including detailed measures promoting trade in services.

- On 28 May, the MoF urged local governments to accelerate the payment of fiscal expenditure to ensure the economic growth target is achieved.

The service sector continues to be a primary central government policy objective for rebalancing the economy. The sector accounted for 46.6 percent of China’s economic output in the first six months, up 1.3 percentage points year-on-year, and outweighing the manufacturing sector by 0.6 percentage points.

In the second quarter, exports of commodities rose by 4.9 percent, due to a recovery in demand from overseas markets and the exclusion of arbitrage trading and other false index effects. The Consumer Price Index (CPI) rose by 2.2 percent, 0.1 percent lower than the previous quarter. The rise of per capita disposable income helped boost domestic demand, and total retail sales grew 12.3 percent.

Monthly inflation indices: CPI & PPI

Source: National Bureau of Statistics (NBS)

Over the first half of 2014, growth in infrastructure investment partly offset the negative effects caused by the cooling real estate market, and helped the monthly growth rate of accumulated fixed asset investment to reach 17.3 percent, the first rise since August 2013. Private investment grew 20.1 percent, and accounted for 65.1 percent of total fixed asset investment, a significant growth compared with 63.7 percent in the first half of last year.

Accumulated Fixed Asset Investment monthly growth rate, year-on-year

Source: National Bureau of Statistics (NBS)

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New economic drivers emerge; risks to future economic development remain

Along with the further implementation of policies to adjust China’s economic structure, the following factors are likely to strengthen as new economic drivers of China’s economy:

- The fast-growing service sector should boost domestic demand and services exports, while providing a large number of new jobs;
- More private capital will likely enter the real economy as we see further SOE reforms, opening up of monopoly industries, and more support measures targeting small- and micro-enterprises;
- Urbanization and development of high-value manufacturing will likely lead to increased investment in the infrastructure, real estate and manufacturing sectors.

On the other hand, there are still some risks that may threaten economic progress:

- The real estate sector as a whole remains in a cyclical period of decline, with the floor space of properties sold slumping 3.8 percent in the first quarter and 7.5 percent in the second quarter of 2014;
- The size of local government debt is quite substantial. In the second quarter, this debt burden has been aggravated by an increase of fiscal expenditure of 18.5 percent, and a slowdown in the fiscal revenue growth rate, from 9.3 percent in the first quarter to 8.4 percent;
- An economic slowdown increases the risk of default in the shadow banking system. Negative effects may spread to financial institutions, local governments, and enterprises.

To mitigate such risks, local governments have already adopted measures to support the real estate market, such as loosening restrictions on property purchases and down payments; in addition the central government has adjusted the fiscal revenue allocation system, and launched a trial program to allow some local governments to issue bonds. Finally, China’s central bank has strengthened management of the shadow banking sector, including implementing stronger operational regulations and greater institutional supervision.

It is expected that the central government will continue to ensure the implementation of the ‘mini-stimulus’ policies to stabilize economic growth, adjust the economic structure, and benefit the general public’s livelihood. KPMG’s Global China Practice (GCP) expects that China’s economic growth in the second half of 2014 will be higher than 7.5 percent, and that full-year GDP growth will achieve the government’s 2014 target of 7.5 percent.

Thomas Stanley
Chief Operating Officer, KPMG’s Global China Practice

“The recent economic data shows that the Chinese economy is continuing its steady evolution away from a ‘growth-above-all’ model – it is worth noting that the service sector is now larger than the manufacturing sector. Looking at the results of this year’s mini-stimulus, I expect that China should now be able to sustain this level of economic performance without a major course correction.”
Outward Direct Investment Analysis

<table>
<thead>
<tr>
<th>Outward Direct Investment (ODI) Summary</th>
<th>H1’2013</th>
<th>H1’2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-financial ODI (US$ billion)</td>
<td>45.6</td>
<td>43.3</td>
<td>-5.0</td>
</tr>
<tr>
<td>Overseas contracting project revenue (US$ billion)</td>
<td>57.8</td>
<td>61.6</td>
<td>6.5</td>
</tr>
</tbody>
</table>

Source: Ministry of Commerce accessed 15 July 2014, KPMG analysis

ODI policy updates, developments, and trends

China steps up outward investment through high-level leadership communications

In the second quarter of 2014, a number of high-level communications took place between China and Australia, the UK, Greece, Russia and some Central Asian countries, promoting closer trade and investment relationships. For example, Australia encourages Chinese investment in the natural resources sector, as well as emerging agribusiness sector due to China’s increasing demand for safe, high-quality food.

Based on the joint statement signed during Chinese Premier Li Keqiang’s recent visit to Britain, Chinese companies are expected to participate in constructing Britain’s high-speed railway, nuclear power stations, and other infrastructure projects. Meanwhile, the recovering UK property market has attracted interest from Chinese companies including Wanda Group, China Life Insurance and China Construction Bank.

China has signed several deals to fund and construct energy infrastructure with Russia, Kazakhstan and other countries along the ‘Silk Road’, in return for natural resources. The demand for construction materials driven by massive construction projects in the region will also create greenfield investment opportunities for Chinese companies. For example, CAMC Engineering and China Metallurgical Corp have recently announced decisions to build cement and steel plants in the region.

Chinese companies to enter developed infrastructure markets

An OECD report suggests that more than US$50 trillion will be needed to fund infrastructure projects around the world between now and 2030. However, governments alone will not be able to fund these projects: there is a significant opportunity for Chinese companies to invest in overseas infrastructure projects, with their robust financing capabilities, technology and experience.

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Chinese ODI in non-financial sectors

Source: Ministry of Commerce accessed 15 July 2014, KPMG Analysis

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2. The Silk Road refers to the land trade route opened when Zhang Qian was sent west on a diplomatic mission more than 2,000 years ago. Starting from the city known today as Xi’an, the ancient ‘Silk Road’ trade route ran from northwest China into Central and Western Asia and from there to the Mediterranean region.


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In particular, Chinese construction companies ‘partnering’ with local players and established international construction businesses can deliver benefits to all parties and achieve win-win situations. KPMG has already seen Chinese companies start to work with reputable partners as they enter developed markets. For example, China General Nuclear Power Group (CGN) and China National Nuclear Corporation (CNNC) have cooperated with French companies EDF and Areva to develop Hinkley Point in the UK; CNOOC has partnered with British Gas Group to commission the world’s first coal seam gas to LNG project in Australia.

Chinese companies are increasingly investing in overseas real estate markets

As European and North American economies stabilize and resume a growth trajectory, their respective real estate markets are also gaining ground. Chinese companies with strong cash flow and a desire for portfolio diversification are directing investment to this sector. Companies such as China Life Insurance, China Construction Bank, Wanxiang Group, Wanda Group and Fosun Group have all recently invested in overseas real estate.

The 2014 Fortune Global 500 list published on 8 July highlights the increasing number of global Chinese companies. This year, Chinese companies represent 20% of the top 500 companies (91 companies from China’s mainland, four from Hong Kong and five from Taiwan), an increase of five companies from the 2013 list. Chinese companies are clearly increasing their scale and top line revenues.

On the other hand, in terms of profitability Chinese companies underperformed the global average. This may help explain Chinese companies’ strategic rationale for globalization: they need to acquire high-end overseas assets and technologies to move up the value chain, and enhance their ability to provide more value-added services and generate higher returns.
Chinese outward M&As

<table>
<thead>
<tr>
<th></th>
<th>H1’2013</th>
<th>H1’2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deal value (US$ billion)</td>
<td>37.1</td>
<td>35.6</td>
<td>- 4.0</td>
</tr>
<tr>
<td>Number of deals</td>
<td>220</td>
<td>167</td>
<td>- 24.0</td>
</tr>
</tbody>
</table>

Source: Dealogic accessed 30 June 2014, KPMG analysis

M&A Summary

**Destinations:** During the first six months of 2014, several significant deals were completed in the natural resource sector in Australia, Canada, and Peru. In addition, there was also substantial Chinese investment directed toward the U.S., the UK, Netherlands, France, and Portugal, to acquire cutting-edge technologies, world-famous brands and sales channels to enhance the Chinese acquirers’ international competitiveness.

**Sectors:** The mining and energy sectors saw decreased activity in the first quarter, but bounced back in the second quarter. The agribusiness and food sectors continued to grow due to rising demand for high-end food in China. Real estate activity rose sharply in Q2, reflecting Chinese companies’ expectation for higher and more stable profits from overseas property markets amid domestic property market slump.

### Top sectors by number of deals in Q2’2014

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of deals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>10</td>
</tr>
<tr>
<td>Finance</td>
<td>8</td>
</tr>
<tr>
<td>Computers &amp; Electronics</td>
<td>7</td>
</tr>
<tr>
<td>Consumer Products</td>
<td>6</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>6</td>
</tr>
<tr>
<td>Agribusiness and food</td>
<td>5</td>
</tr>
<tr>
<td>Services</td>
<td>4</td>
</tr>
<tr>
<td>Retail</td>
<td>4</td>
</tr>
</tbody>
</table>

### Top sectors by deal value in Q2’2014

<table>
<thead>
<tr>
<th>Sector</th>
<th>Deal value (USD billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>8.30</td>
</tr>
<tr>
<td>Agribusiness and food</td>
<td>2.98</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>2.60</td>
</tr>
<tr>
<td>Real Estate</td>
<td>1.58</td>
</tr>
<tr>
<td>Retail</td>
<td>0.97</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>0.95</td>
</tr>
<tr>
<td>Automotive</td>
<td>0.64</td>
</tr>
<tr>
<td>Machinery</td>
<td>0.59</td>
</tr>
</tbody>
</table>

### Top ten outward M&A deals by deal value in Q2’2014

<table>
<thead>
<tr>
<th>No</th>
<th>Date</th>
<th>Acquirer</th>
<th>Target Country</th>
<th>Target</th>
<th>Target sector</th>
<th>Deal value (US$ bn)</th>
<th>Shares acquired (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2014.4</td>
<td>Consortium led by China Minmetals</td>
<td>Peru</td>
<td>Xstrata Las Bambas SA</td>
<td>Mining</td>
<td>5.86</td>
<td>99.9</td>
</tr>
<tr>
<td>2</td>
<td>2014.4</td>
<td>COFCO; Hopu Investment</td>
<td>Hong Kong</td>
<td>Noble Agri Ltd</td>
<td>Agriculture</td>
<td>1.50</td>
<td>51</td>
</tr>
<tr>
<td>3</td>
<td>2014.5</td>
<td>Bright Food</td>
<td>Israel</td>
<td>Truva Food Industries Ltd</td>
<td>Real estate</td>
<td>1.38</td>
<td>56</td>
</tr>
<tr>
<td>4</td>
<td>2014.6</td>
<td>China Life Insurance; Qatar Holdings</td>
<td>UK</td>
<td>Property in Canary Wharf, London</td>
<td>Retail</td>
<td>1.22</td>
<td>90</td>
</tr>
<tr>
<td>5</td>
<td>2014.4</td>
<td>China National Petroleum Corp</td>
<td>Canada</td>
<td>Oil &amp; Gas Assets (Dover Project)</td>
<td>Energy</td>
<td>1.20</td>
<td>100</td>
</tr>
<tr>
<td>6</td>
<td>2014.4</td>
<td>China Petroleum &amp; Chemical Corp</td>
<td>Kazakhstan</td>
<td>Caspian Investment Resources Ltd</td>
<td>Energy</td>
<td>1.20</td>
<td>50</td>
</tr>
<tr>
<td>7</td>
<td>2014.5</td>
<td>Guangdong Rising Assets Management</td>
<td>Australia</td>
<td>PanAust Ltd</td>
<td>Mining</td>
<td>1.16</td>
<td>77.2</td>
</tr>
<tr>
<td>8</td>
<td>2014.5</td>
<td>Baosteel Group Corp</td>
<td>Australia</td>
<td>Aquila Resources Ltd</td>
<td>Mining</td>
<td>1.06</td>
<td>80.3</td>
</tr>
<tr>
<td>9</td>
<td>2014.6</td>
<td>China Mobile</td>
<td>Thailand</td>
<td>True Corp</td>
<td>Telecom</td>
<td>0.88</td>
<td>18</td>
</tr>
<tr>
<td>10</td>
<td>2014.4</td>
<td>Sanpower Group</td>
<td>UK</td>
<td>House of Fraser Ltd</td>
<td>Retail</td>
<td>0.80</td>
<td>89</td>
</tr>
</tbody>
</table>

Source: Dealogic accessed 30 June 2014, KPMG analysis

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China’s service sector and manufacturing sector move in opposite directions, as FDI edges higher

For the first half of 2014, foreign direct investment (FDI) into China was US$63.33 billion, a 2.2 percent increase over the first half of 2013. FDI is currently on pace to hit the government desired target of US$120 billion, and break the FDI record of US$118 billion set last year. Following a year-on-year decrease of 7 percent in May, the June FDI number of over US$14 billion marked a sharp rebound and was the highest monthly FDI result in over 18 months. China continues to support further FDI measures and has adopted new systematic policies (see side bar) to help boost the approval process of FDI investments in the manufacturing and service sectors, providing more opportunities for foreign investors amidst its economic restructuring. 4

China’s service and manufacturing sectors are the primary contributors to FDI. While the manufacturing sector FDI dropped by 13.9 percent year-on-year through the second half of 2014, China’s service sector continued to see solid FDI growth increasing by 14.8 percent year-on-year. China’s Ministry of Finance spokesman Shen Danyang noted that “the manufacturing sector tends to attract a smaller share of total FDI, but hope that some sectors, including advanced manufacturing, will remain a magnet for foreign investment.” 5

Given the central government’s goal to ease foreign investment restrictions in China, China’s manufacturing sector may experience a slight rebound in future FDI, while FDI funds continue to be directed toward China’s service sector.

FDI to benefit from relaxed approval process

As of 17 June 2014, China has adopted a system of ‘limited approval’ and ‘general registration’ instead of the previous ‘all-round approval’ mechanism. Key attributes of the new approval process:

• All investment projects exempt from approval can go through the registration process with local authorities, and some projects previously needing National Development Reform Commission (NDRC) approval can now apply directly for approval from local authorities.

• The NDRC also simplified the procedures for approval and registration by scrapping the requirement to review market prospects, potential economic impacts, and product technology plans.

• The new regulations aim to shorten the FDI approval process, and to further encourage investment from foreign companies into China. 6


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Sharp drop in both value and volume of inbound M&A

There were 204 ‘announced’ or ‘completed’ inbound M&A deals through the first half of 2014, versus 280 through the first half of 2013, representing a 27 percent drop in year-on-year deal activity. Total deal value also shrank during the first half to US$10.8 billion, down 24 percent year-on-year. The drop in M&A deals through the first half of the year contrasts with overall FDI growth through the first six months of 2014.

Consumer goods and services led all other M&A sectors through the first half of 2014. Although consumer goods and services (CGS) slightly declined versus 2013, transactions of significant size continue to be prevalent in the diverse CGS sub-sectors:

- **Food and Beverage:** Belgian giant Anheuser Busch Inbev (AB Inbev) announced in late April that it wholly purchased the Chinese brewer Siping Ginsber. The acquisition was valued at around US$620 million and further expands AB Inbev’s footprint in China – the fastest growing (and largest) beer market in the world.

- **Retail Goods:** Canadian-based Dorel industries agreed to acquire Loredo Group, China’s largest toy manufacturer in a deal worth US$120 million. The deal allows Dorel direct supply chain access to China’s growing consumer goods and services, children’s toy market and further supports the notion of increased M&A activity in the Chinese consumer goods and services space.

Below we show the most active sectors for inbound M&A in the first half of 2014 and 2013:

**Top 5 sectors for inbound M&A H1’14 vs. H1’13**

<table>
<thead>
<tr>
<th>Sector</th>
<th>H1’2013</th>
<th>H1’2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deal value (US$ billions)</td>
<td>14.2</td>
<td>10.8</td>
<td>-24%</td>
</tr>
<tr>
<td>Number of deals</td>
<td>280</td>
<td>204</td>
<td>-27%</td>
</tr>
</tbody>
</table>

Source: Dealogic accessed 30 June 2014, KPMG analysis

"The consumer goods/services M&A trend will continue to be buoyant in China. It is anticipated that multinational companies, within the diverse consumer goods and services sector, will continue actively seeking acquisition targets that can expand or supplement their product offerings in order to reach out to a wider demographic and a geographically diversified consumer base."

Jessie Qian
Partner in charge,
Consumer Markets,
KPMG China

7. [www.atimes.com/atimes/China/FC03Ad06.html](http://www.atimes.com/atimes/China/FC03Ad06.html)
The materials sector noticeably bucked the downward trend of 2014 M&A deals: in the second quarter alone, three out of the top 10 transactions were in China’s materials industry, amounting to over US$1 billion in total M&A transactions:

1) Manhattan Resources Limited (MRL), a Singaporean shipping firm, announced that it will acquire a 70 percent stake in Urumqi Jinshi Huilong Mining Company for US$799 million. According to MRL’s CEO, “This transaction allows us an entry point into the lucrative mining market in China, and helps lay the path for our longer term goal to become a leading mineral resources group in the region.”

2) HB Fuller, a US chemicals firm, announced that it will acquire a 95 percent stake in Tonsan Adhesive for US$227 million. The acquisition adds strong customer relationships in the high-value, and fast-growing engineering adhesives (materials) markets. HB Fuller CEO Jim Owens commented, “With this acquisition, we enter the fast-growing and profitable engineering adhesives market and strengthen our business in China.”

3) Unifrax Asia-Pacific Holdings Ltd, a US-based specialty fiber products firm, announced that it will acquire 29 percent of Shandong Luyang Co. Ltd for US$116 million. Shandong Luyang is a China materials firm that has been a market leader for the past 30 years in developing, manufacturing and selling a variety of refractory and insulation materials used in China.

These materials deals point to China’s increasingly prominent role in the global materials sector. This was confirmed by Chinese State Councilor Wang Yong’s remarks on 27 June regarding foreign cooperation in the sector: “China welcomes foreign investment in mining and other materials and urges the international industry to pursue a stable and sustainable growth through innovation and resource conservation.”

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About KPMG’s Global China Practice (GCP)

KPMG’s Global China Practice (GCP) was established in September 2010 to assist Chinese businesses that plan to go global, and multinational companies that aim to enter or expand into the China market. The GCP team in Beijing comprises senior management and staff members responsible for business development, market services, and research and insights on foreign investment issues.

There are currently around 60 China Practices in key investment locations around the world, from Canada to Cambodia and from Poland to Peru. These China Practices comprise locally based Chinese-speakers and other professionals with strong cross-border China investment experience. They are familiar with Chinese and local culture and business practices, allowing them to effectively communicate between member firms’ Chinese clients and local businesses and government agencies.

The China Practices also assist investors with China entry and expansion plans, and on both inbound and outbound China investments provide assistance on matters across the investment life cycle, including market entry strategy, location studies, investment holding structuring, tax planning and compliance, supply chain management, M&A advisory and post-deal integration.

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