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Potential Responses of Chinese Industry SMEs to New EU Legislative Market Requirements

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Outline

- 1.Role of SMEs and Foreign Trade dependence in China's Wood Industry
- 2.Potential Impacts of New EU timber Regulation on Chinese Wood SMEs
- 3. Potential Responses of Chinese Wood SMEs to New EU Regulation
- 4.Summary

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.1 Scale and Distribution of Wood Industry in China

- Wood processing wood bamboo rattan brown grass products industry: 2008

The major producing areas are Shangdong, Jiangsu, Henan, Zhejiang and Fujian.

	1、Quantity				2.Proportion of whole China				3.Averages per enterprise		
	A	B	C	D	A	B	C	D	B	C	D
		10000 person	Billion Yuan	Billion Yuan	%	%	%	%	person	10000 Yuan	10000 Yuan
China	61000	237.3	3732.0	5852.2	100.0	100.0	100.0	100.0	38.9	611.8	959.4
Henan	6361	20.3	130.5	510.6	10.4	8.6	3.5	8.7	31.9	205.1	802.7
Shandong	8690	31.1	423.7	959.2	14.2	13.1	11.4	16.4	35.8	487.6	1103.8
Jiangsu	7124	32.4	514.8	883.3	11.7	13.7	13.8	15.1	45.5	722.6	1239.8
Shanghai	1548	3.7	116.4	100.2	2.5	1.6	3.1	1.7	23.9	752.2	647.4
Zhejiang	3700	12.7	331.9	443.8	6.1	5.4	8.9	7.6	34.3	897.1	1199.5
Fujian	3400	15.9	204.4	319.1	5.6	6.7	5.5	5.5	46.7	601.3	938.5
Guangdong	2998	16.1	367.1	418.7	4.9	6.8	9.8	7.2	53.8	1224.4	1396.4
Total	33821	132.2	2088.8	3634.8	55.4	55.7	56.0	62.1	39.1	617.6	1074.7

A-Number of enterprises; B-Number of Employmees; C-Capital Asset; Annual sales value

Sources :Report on major data of the second national economic census.

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.1 Scale and Distribution of Wood Industry in China

- Furniture Manufacturing: 2008

The major producing areas are Guangdong, Shangdong, Henan, Shanhai and Zhejiang.

	1、Quantity				2.Proportion of whole China				3.Averages per enterprise		
	A	B	C	D	A	B	C	D	B	C	D
		10000 person	Billion Yuan	Billion Yuan	%	%	%	%	person	10000 Yuan	10000 Yuan
China	35000	157.5	2524.0	3621.4	100.0	100.0	100.0	100.0	45.0	721.1	1034.7
Henan	3246	9.1	33.2	232.6	9.3	5.8	1.3	6.4	28.0	102.4	716.4
Shandong	3623	14.4	250.8	452.6	10.4	9.1	9.9	12.5	39.7	692.2	1249.2
Jiangsu	2307	8.8	165.2	204.1	6.6	5.6	6.5	5.6	38.0	716.0	884.8
Shanghai	2686	8.7	171.4	223.0	7.7	5.5	6.8	6.2	32.4	637.9	830.1
Zhejiang	2600	19.8	457.5	462.5	7.4	12.5	18.1	12.8	76.0	1759.5	1778.7
Fujian	1100	7.9	124.0	172.3	3.1	5.0	4.9	4.8	71.5	1126.8	1566.4
Guangdong	5629	48.0	556.2	917.4	16.1	30.5	22.0	25.3	85.3	988.1	1629.8
Total	21191	116.6	1758.2	2664.4	60.5	74.0	69.7	73.6	55.0	829.7	1257.3

A-Number of enterprises; B-Number of Employmees; C-Capital Asset; Annual sales value

Sources :Report on major data of the second national economic census.

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.2 Role of SMEs in China's Wood Industry

- What are SMEs？

  Employees, General assets and Annual sales; (may be Production capacity)

- European Commission Definition

Enterprise Type	# of Employees	Annual Sales (Turnover)	（or） General Assets (Balance Sheet)
Medium sized	<250	≤50 million €	≤43 million €
Small	<50	≤10 million €	≤10 million €
Micro	<10	≤2 million €	≤2 million €

- China State Economic and Trade Commission Definition

SMEs：satisfying one of the following conditions:

employees less than 2000, (or) annual sales less than 300 million Yuan, or general assets less than 400 million Yuan

Medium enterprises：Are SMEs satisfying all the following conditions:

employees more than 300, (and) annual sales more than 30 million Yuan, and general assets more than 40 million Yuan

Sources :European Commission (2003), COMMISSION COMMENDATION concerning the definition of micro, small and medium-sized enterprises ;State Economic and Trade Commission(2003), Interim regulations on small and medium-sized enterprises categorizing criteria.

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.2 Role of SMEs in China's Wood Industry

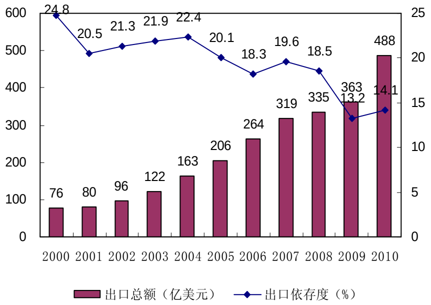
- Based on an assessment of their fixed capital, approximately 87 percent of the forestry enterprises in China are classified as small scale
- In 2003, the number of wood processing and wood, bamboo, rattan, palm, and straw product manufacturers amounted to 41818. Among them, there are 40 647 SMEs, accounting for 97.2 percent of the total amount.
- Most wood-processing enterprises in China are SMEs which contribute to 90 percent of total output value and 70 percent of employment for China's forest product industry.
- About 99.6 percent of wood processing enterprises are SMEs in Fujian Province, 2007
- There are 11176 wood processing enterprises in Guangdong Province. Among them, there are 24 large enterprises which have production capacity more than 0.1 million m3, accounting for 0.19 percent of the total number; 254 medium sized enterprises which have production capacity from 1 m3 to 10 m3, accounting for 2.27 percent of the total number; 10901 small sized enterprises which have production capacity less than 1 m3, accounting for 97.54 percent of total number.
- In 2003, the number of wood based panel product enterprises amounted 2017. Among them, there are 2005 SMEs, accounting for 99.4 percent of the total amount, 2005 enterprises which annual sales value is less than 5 million Yuan, accounting for 80.56 percent of total amount.

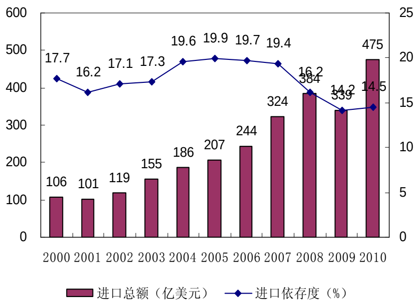
Source : Robert Kozak(2008); Xinjian luo and Jintao Xu(2011) ; Investigation report of wood processing industry in Guangdong provinve(2008); Yin Chang(2009)。

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.3 Foreign trade dependence in China's wood industry

●Import Value and Export Value of Forest Products in China: 2000-2010





Export value (billion $) Export dependence (%) **Import value (billion $) Import dependence (%)**

Source :State Forestry Administration. China Forestry Yearbook, China Forestry Publishing House.

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.3 Foreign trade dependence in China's wood industry

●Main import forest products in China:2005-2010

Product	Unit	2005	2006	2007	2008	2009	2010
Log	10000m^3	2936.8	3215.3	3713.3	2957.0	2805.9	3434.8
Sawnwood	10000m^3	605.4	615.3	655.8	718.2	993.5	1481.2
Particleboard	10000m^3	63.4	54.1	52.5	37.4	44.7	
Friberboard	10000m^3	113.7	92.4	70.3	50.5	45.3	
Plywood	10000m^3	58.9	41.3	30.4	29.4	17.9	21.4
Wood chip	10000ton	87.1	89.5	114.0	105.6	276.6	465.2
Wood pulp	10000ton	752.0	788.1	838.4	946.0	1357.8	1137.0
Waste paper	10000ton	1703.6	1962.3	2256.2	2420.6	2750.2	
Paper & paper product	10000ton	546.5	460.5	420.9	373.6	349.6	

➢ **Main imported forest products are log, swanwood, paper, paperboard and paper product, pulp, waste paper, hevea rubber and palm oil. The sum import value of these products is 391.1 billion dollar, accounting for 82.3 percent of the total forest product import value in 2010.**

Source :State Forestry Administration. China Forestry Yearbook, China Forestry Publishing House.

1.Role of SMEs and Foreign Trade dependence in China's Wood Industry

1.3 Foreign trade dependence in China's wood industry

●Main export forest products in China:2005-2010

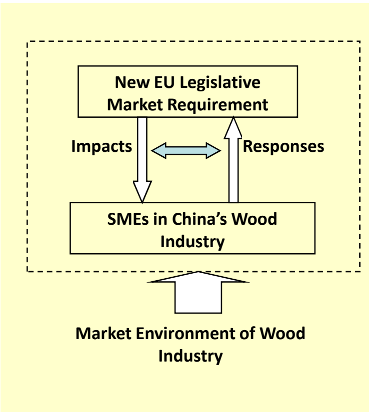
Product	Unit	2005	2006	2007	2008	2009	2010
Sawnwood	10000m^3	68.2	83.0	76.4	71.7	56.1	53.9
Particleboard	10000m^3	9.5	14.2	18.0	19.3	12.5	10.4
Friberboard	10000m^3	137.7	196.8	305.7	238.3	203.1	210.6
Plywood	10000m^3	558.4	830.4	871.6	718.5	563.5	754.7
Furniture	billion package	2.1	2.5	2.8	2.4	2.5	3.0
Wood product	10000ton	201.0	230.5	220.8	175.0	156.4	
Paper & paper product	10000ton	79.1	114.6	145.7	135.6	480.3	661.3

➢Main emported forest products are furniture, paper, paperboard and paper product, wood product, and plywood. The sum emport value of these products is 329.5 billion dollar, accounting for 67.5 percent of the total forest product export value in 2010.

Source :State Forestry Administration. China Forestry Yearbook, China Forestry Publishing House.

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.1Analytical framework of the potential impacts



●Impacts

➢**Finance impacts**

-Cost Change: variable costs, constant cost, risk cost
-Sale Value Change: price, market share

➢**Economic impacts**

-Impacts on Industry economy: scale distribution of enterprises, technological progress, impacts to related industries, Industrial Competitiveness
-Impacts on regional economy: regional economic development, local public finance

➢**Social impacts**

-Impacts on labour employment: number of employees, wage Level, labour conditions
-Impacts on social stability: income distribution, social inequality
-Impacts on social responsibility of enterprise

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.1Analytical framework of the potential impacts

- EU New Timber Regulation-1

- In October 2010 the EU adopted a new Timber Regulation to combat trade in illegally harvested timber, Regulation laying down the obligations of operators who place timber and timber products on the market' (EU (995/2010). The Regulation applicable from 3 March 2013
- The regulation counters the trade in illegally harvested timber and timber products through three key obligations:
  1) It prohibits the placing on the EU market of illegally harvested timber and products derived from such timber;
  2) It requires EU traders who place timber products on the EU market for the first time to exercise 'due diligence ';
  3) To allow for the traceability of timber products economic operators in this part of the supply chain (referred to as traders in the regulation) have an obligation to keep records of their suppliers and customers.
- The Regulation covers a broad range of timber products including solid wood products, flooring, plywood, pulp and paper. Not included are recycled products, as well as rattan, bamboo and printed papers such as books, magazines and newspapers. The product scope can be amended if necessary.The Regulation applies to both imported and domestically produced timber and timber products.

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.1Analytical framework of the potential impacts

- EU New Timber Regulation-2

- The core of the 'due diligence' notion is that operators have to undertake a risk management exercise so as to minimise the risk of placing illegally harvested timber, or timber products containing illegally harvested timber, on the EU market.
- The three key elements of the "due diligence system" are:
  ●Information: The operator must have access to information describing the timber and timber products, country of harvest, quantity, details of the supplier and information on compliance with national legislation.
  ● Risk assessment: The operator should assess the risk of illegal timber in his supply chain, based on the information identified above and taking into account criteria set out in the regulation.
  ● Risk mitigation: When the assessment shows that there is a risk of illegal timber in the supply chain that risk can be mitigated by requiring additional information and verification from his supplier.
- The European Commission will develop more detailed rules on the "due diligence system" by June 2012.

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.1Analytical framework of the potential impacts

- Characteristics of SMEs in China's wood industry
  - Business models of SMEs: Sources of raw material and Main product market

Sale \ raw material	Domestic market	Import
Domestic market	D-D type enterprise	I-D type enterprise
Export	D-E type enterprise	I-M type enterprise

  - Compared with big enterprise, Ability of SMEs to resist risk is relatively weak
- Market Environment of Wood Industry
  - International market: concern with the environment
  - China domestic market: rising labor cost

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.2 Potential Impacts on Wood Enterprises:

export enterprises (cost and benefit)

- Direct cost
  - Direct cost for export certification
  - Administrative cost for traceable supply chain
- Indirect cost
  - Purchase raw material: from uncertified to certified, from import to domestic, import from Russia, Southeast Asia to U. S. A., Canada
  - Product sale: from export to domestic, need new marketing channels
- Intangible cost
  - Unclear trade regulation rule may lower the trade predictability
  - Complex trade procedure may impact the trade convenience
- Benefit
  - Expansion of market share
  - Increase of product price

Reducing illegal logging is external economy. How many this external economy can reflected in the product price depend on the consumer's willingness to pay for environment.

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.2 Potential Impacts on Wood Enterprises:

domestic sale enterprises (indirect impacts)

- Impacts from the raw material market: cost may increase
  - Price of imported raw material will increase
  - Purchase cost of raw material will increase
- Impacts from the product market: Competition may exacerbate
  - Some of export enterprise will turn to domestic sales
  - high quality products will impacts low quality products sales

2.3 Potential Impacts on Wood Enterprises:

difference between SMEs and large enterprise

- Ability of data collection and analysis, the comprehensive judgment
- Investment ability for fixed assets which are needed for adjustment

2.Potential Impacts of New EU Timber Regulation on Chinese wood SMEs

2.3 Potential Impacts Differences among Enterprise Types

- D-D type SMEs: Domestic raw material-domestic sale
  - Indirect impacts such as increase of domestic raw material, intensification of domestic market competition--The impact is not big.
- D-E type SMEs: Domestic raw material-export
  - Direct impacts such as increase of legal insure cost of the domestic raw material, cost of export—The impact is relatively big.
- I-D type SMEs: Import raw material-domestic sale
  - Indirect impacts such as increase of import raw material, intensification of domestic market competition—The impact is moderate.
- I-E type SMEs: Import raw material-export
  - Direct impacts such as increase of legal insure cost of the import raw material and export cost—The impact is biggest.

3. Potential Responses of Chinese Wood SMEs to New EU Timber Regulation

3.1 Determinants of Potential Responses

- Decision Principle of Enterprise
  - Through the comparison of costs and benefits, realize the profit maximization
- Evaluation Ability of the Real Cost and Benefits
  - SMEs are less likely to have overseas market knowledge and are, therefore, less able to react quickly to new market opportunities.
- Ability of One-off Investment That are Required for Initial Compliance
  - SMEs are not as capable of spreading any additional costs of export across large output volumes and will more often find it uneconomic to export, relative to larger firms
- Balance of Long-term Benefits and Short-term Benefit
  - SMEs Entrepreneurs require strategic vision

3. Potential Responses of Chinese Wood SMEs to New EU Timber Regulation

3.2 Potential Responses of SMEs which Export to EU

- Continue to export EU and Take Measures
  - Legality certification of domestic timber
  - Legality guarantee of import timber
  - Forest Certification, FSC、COC
  - Enterprise wood the traceability system
- Give up continue to export EU
  - Turned to other foreign markets
  - Turned to Domestic market
  - Give up the timber industry

3. Potential Responses of Chinese Wood SMEs to New EU Timber Regulation

3.3 Economic Impacts of SMEs' Potential Responses

- Impacts on Industry Economy
  - Some of small enterprises will exit, the enterprise scale will increase
  - Rise in the cost of raw material will affect industry competitiveness
  - Speeding up the upgrade of technology, the technological level will increase
  - The business model will change, the dual structure (sale in domestic market and export) will appear
- Impacts on Regional Economy
  - Local economic development will be affected in the industry agglomeration region
  - Local public finance will be affected in the industry agglomeration region
  - Labour employee will be affected, Thus indirectly affect income

4. Summary

- Very important contribution of SMEs and quite high foreign trade dependence in China's wood industry suggest that we must pay attention to the potential impacts of new EU timber regulation on Chinese wood SMEs.
- The New EU Legislative Market Requirements will increase the direct costs, indirect costs and risk costs of the export enterprise, and one-off investment that are required for initial compliance has special meaning to SMEs.
- According to the business model type, the impact of import raw material-export SMEs is the biggest; the impact of domestic raw material-export SMEs is the relatively big; the impact of import raw material-domestic sale SMEs is the moderate; the impact of domestic raw material-domestic sale SMEs is the not big.
- The export SMEs may continue to export EU, also may give up continue to export EU, it will depends on comparison between the costs and benefits related the countermeasures, also depends on response ability of SMEs and entrepreneur's strategic vision.

Thank you for your time

Forests, Markets, Policy & Practice – Shanghai, 22 June 2011