INTRODUCTION

Scottish Development International (SDI) is pleased to submit this paper to the European and External Relations (EER) Committee as a combined submission on behalf of its joint venture partners: Scottish Government (SG), Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE).

The submission gives a brief outline of:

- The strategic context in which SDI deliver in China;
- the current economic environment, and in particular the economic growth in emergent markets;
- the priorities being pursued by SDI in China as an integral part of the China Plan; and
- delivery to date in pursuit of the priorities.

This submission focuses in particular on increasing international trade and investment with China, and how this is supported by SDI.

STRATEGIC CONTEXT

In developing SDI’s approach to increasing trade and investment it is important that this is pursued in a way which:

- fully reflects the Government’s Economic Strategy, i.e. exporting is not an end in itself it is a means to achieve sustainable economic growth, and
- delivers in a way that reflects the wider ambitions of Scotland articulated in the International Framework.

To ensure a further level of detail in the approach, these overarching areas are further refined through:

- Scotland’s Trade and Investment Strategy which sets out trade and investment priorities for Scotland.
- Country plans which set out the detailed priorities across the themes in the International Framework and how they relate to a particular country.

Government Economic Strategy

The Government Economic strategy has set an ambitious target to increase the value of international exports by 50% by 2017. The strategy recognises the enormous opportunity for Scotland of emergent markets “Improving our access to these emergent growth markets will open up Scottish exports to new consumers - 2.5 billion in India and China alone”\(^1\).

\(^1\) Page 41, Scottish Government Economic Strategy, September 2011.
International Framework
The International Framework is clear over both the importance of increased trade from Scotland and increased investment into Scotland and the role of SDI in working with partners to support these. It further provides the framework to ensure this activity is aligned with broader activity and gives a clear focus for international engagement in a rapidly changing world.
Scotland’s Trade and Investment Strategy 2011-15
The Government launched Scotland’s Trade and Investment Strategy in March 2011. This sets out the Government’s key objectives and priorities to increase Scotland’s international trade and investment performance as detailed below:

<table>
<thead>
<tr>
<th>Objective</th>
<th>Priorities</th>
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| Increasing International Trade| • More Scottish businesses trading internationally  
|                               | • Greater support for Growth businesses  
|                               | • International exploitation of Scotland’s education sector  |
| Attracting inward investment  | • Greater focus on strategic inward investment  
|                               | • Embedding companies, encouraging expansion and developing supplier links  
|                               | • Low carbon opportunities  |
| Promoting Scotland            | • Focus on growth opportunities in sectors  
|                               | • Ensuring a global footprint focused on opportunity  
|                               | • Emerging markets  |
| ‘Team Scotland’ delivery      | • Customer focused delivery  
|                               | • Aligning the work of the public and private sector  
|                               | • Wider promotion of Scotland  
|                               | • Influencing and providing business intelligence  
|                               | • Harnessing the potential of international networks  
|                               | • Integrated business planning  |

This sets the overall priorities for SDI to deliver against in partnership with the public and private sector.

Working with China – a Five Year Strategy for Engagement between Scotland and the People’s Republic of China

This high level strategy sets out the Scottish Government’s ambitions in developing Scotland’s relationship with China over the next five years. Since 2006 when Scotland’s first China Plan was published, Sino-Scottish relationships have gone from strength and strength, and the flows of trade and investment have fully contributed to this relationship.

One of the guiding principles in the China Plan is

‘Securing Sustainable Economic Growth- building Scotland’s prosperity by strengthening links with China, through increase trade and investment, and more developed links to education, research, culture and sport’

Trade and Investment has an important role to play in developing common interest between Scotland and China. It also has a role in supporting the other three guiding principles of ‘Respect for Human Rights and the Rule of Law’, ‘Understanding of culture’ and ‘Increasing Scotland’s Influence’.
SDI’s contribution will mainly be in supporting Priority Area 1 of the strategy, namely: ‘to increase trade opportunities for Scottish businesses in China and encourage more Chinese investment in Scottish industry and infrastructure’. However SDI also has an important role to play, with partners, in contributing to the other priorities in the Plan, namely: Priority Area 2 (education links); Priority Area 3 (increase collaboration in research and development) and Priority Area 4 (deeper cultural exchange including promoting Scotland’s Creative Industries sector).

**ECONOMIC CONTEXT**

**Overall**

Scotland’s export performance is dependent on a relatively small number of firms, in few sectors, exporting to economies which recently have experienced slow growth. Currently, only a small number of these firms export to the fast growing, emergent economies.

As the world economic map evolves, Scotland needs to take advantage of the shift in international economic activity towards these fast growing markets. In particular markets like China.

The diagram below shows the scale of current exports compared to the relative economic growth forecast in 2014. Exports to the Euro area and USA will continue to be significant. However, there is a need to diversify the export base to fast growing markets like China.
Recent Export performance to China
The latest Global Connections survey for 2011 estimates that Scottish exports to China are now £400m, an increase of 35% from 2010. However as the value is relatively small the estimates do fluctuate year to year. Over the least 5 years the value of exports has grown by 10%. China is ranked 14th overall in terms of exports from Scotland.

The HMRC regional statistics for 2012 (does not cover the export of services) shows overall export growth in Scotland as 0.1%. Although flat, it was the best performance of any part of the UK. However the geographic differences are fairly marked. There was a decline in EU exports by 6.7%, offset by an increase in exports to other markets. Notably the largest ‘value’ increase in exports was to China, with growth of 21% (+£89m). This ranks China as 8th export market (up from 11th in 2011).
Future demand
The latest Global Connections survey (2011 exports but survey carried out in 2012) also asked companies to assess future export markets.

China is ranked first as a future market (20% of respondents) this is similar to the year before where it overtook the US which has traditionally been the top future market.

Work with Industry Leadership Groups in 2012 also saw China identified as a priority across a range of growth sectors.

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<th>Top future export markets</th>
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<td>1 China</td>
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<td>2 USA</td>
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<td>5 Russia</td>
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### Sector/ Geography Priorities (top 5)

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<th>Chemical Sciences</th>
<th>Construction / Forest Tech</th>
<th>Creative Industries</th>
<th>Renewables</th>
<th>Financial &amp; Bus Services</th>
<th>Food &amp; Drink</th>
<th>Life Sciences</th>
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<th>Sustainable Tourism</th>
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TRADE AND INVESTMENT PRIORITIES IN CHINA

Increasing international trade

Working with China – Priority Area 1 (extract)²

There are already a considerable number of Scottish companies doing business in China with significant opportunities for more Scottish companies to grow their presence in a range of growth sectors where we have world class products and services and where there is known demand in China. Recent Scottish success stories in the export market include securing Geographical Indication of Origin status for Scotch whisky and an export health certificate allowing direct exports of Salmon to China, which has seen a significant rise in exports to China of both these quality Scottish products.

Scottish companies currently export to China through a variety of channels including the use of partners, agents and distributors and over 50 Scottish businesses currently have a physical presence in China in the form of representative offices, wholly owned subsidiaries or joint ventures.

Companies in Scotland with the products, services and desire to compete in China can be separated into two groups:

- Those companies that can provide technology, products and services to the China’s burgeoning oil and gas, renewable energy, life sciences, ICT, advanced engineering and financial services

- Those companies that can satisfy increasing consumer demand from an ever growing group of middle class consumers in China. These will be in the education, food and drink, textiles, financial services and tourism areas.

SDI and its partners will work with new market entrants as well as with more experienced exporters to ensure they understand all aspects of the Chinese opportunity and possess the best market access strategies. We will continue to build business networks and relationships in China to enable Scottish companies to quickly find partners and distribution channels for their products and services while also promoting Scotland’s overall reputation for invention, innovation and high quality products and services.

In increasing international trade to China, SDI will, in particular, focus on:

**Food & Drink:** The rise in the Chinese middle class has led to more demand for premium quality products and China will be the world’s largest importer of food by 2017. SDI will work with companies and industry partners in Scotland to help raise awareness of export opportunities in China and help Scottish businesses to build market access strategies. Building awareness of the provenance of Scottish Food &

² [http://www.scotland.gov.uk/Publications/2012/12/7734](http://www.scotland.gov.uk/Publications/2012/12/7734)
Drink in China will also be key component of increasing trade as will building an extensive network of premium importers and distributors in China.

**Energy:** It is estimated that by 2025 China will consume 25% of the world’s energy per annum. SDI will continue to position Scotland as Europe’s leading centre for energy related knowledge, innovation, R&D, especially in offshore wind, marine energy and Oil & Gas. Oil and Gas represents the largest trade opportunity in areas such as drilling, production and process management, subsea exploration, training and 3rd market co-development.

**Financial Services:** China’s growing wealth is being invested in assets and those assets need to be managed. Scotland has a world renowned expertise in asset management and SDI will continue to assist Scottish asset management companies to build their reputation and contacts with China’s largest financial institutions.

**ICT and Creative Industries:** These are pillar industries in the 12th Five-Year Plan in China. The Telecommunication industry offers great opportunities for related overseas suppliers and 4G is an emerging opportunity especially for R&D partnership. Other opportunities from China’s emerging industries include new display technology, next generation internet, smart grid, mobile intelligent information terminal, wireless communication, cloud computing, sensor technology, software development for gaming and animation, digital content, green/low carbon technologies.

**Life Sciences:** one of seven China’s national core industries and expected to become the third largest medical devices market in the world. Opportunities for Scotland are strong in medical devices and drug discovery. SDI will continue to promote Scotland as a world leading R&D centre and the most practical and efficient R&D collaboration partner in Europe. We focus on companies with the global development ambition and strong R&D investment and focus on regions/cities that have developed strong links with Scotland (e.g. Beijing, Shandong, Shenzhen), build relationship with the provincial governments and explore further collaboration opportunities.

SDI will also work to support companies in other sectors including; Education, Textiles and Tourism.

Mechanism’s to support and encourage more Scottish companies to actively seek business with China will cover the whole of the export journey from raising awareness, preparing an export strategy, to market entry and expansion. It will also include collective public-private sector initiatives to boost trade and investment, for example the Asia Food and Drink strategy which was launched in December 2011 in China. Key partners in this important activity will include UKTI, China-Britain Business Council, SCDI, Globalscots and local chambers of commerce in Chinese cities.

Scottish Government and SDI will continue to work with partners (e.g. the Scotch Whisky Association, DEFRA) on influencing wider trade policy and removing market access issues to support Scottish exports, recent successes include:

- Award of health certificate for Scottish Salmon, and
Geographical indicator status for whisky has seen exports of these products to China grown significantly.

**Attracting Strategic Inward Investment**

**Working with China – Priority Area 1 (extract)**

China’s Foreign Direct Investment has increased dramatically in recent years and has mainly involved the acquisition of mineral resources and energy. Whilst this mergers and acquisitions trend will continue, we expect more Chinese companies to become Global companies either through acquisition or by themselves through natural expansion.

To facilitate inward investment from such companies, we will position Scotland as the ideal European base for Chinese companies with a focus on our pro-innovation business environment.

Building close, early stage relationships with those Chinese companies who are most likely to globalise over the next 5 years will be a key element of our inward investment programme. We will use bespoke research together with our Asia provincial city outreach programmes to begin the process of identifying these potential inward investors and building relationships.

Particular strengths SDI’s will promote include:

- **Low Carbon:** Scotland is leading the way in low carbon offering and SDI is building relationships with leading Chinese companies working in the solar, wind and marine industries to encourage investment in Scotland’s low carbon infrastructure;

- **Innovation:** Scotland has some of the best research universities in the world and some of the world’s most innovative businesses. Innovation is a key theme in the 12th FYP and we will promote Scotland as a place where Chinese companies can find partners, to our mutual benefit.

- **Air routes:** the attraction of a direct route from China to Scotland will increase the attractiveness of Scotland for greater trade and investment to (and from) China. Team Scotland will work with Chinese airlines to build the commercial case for this.

- **Investment finance:** Scotland has, and will continue to have, a range of high quality investment opportunities suitable for funding from China. These vary from the low carbon sector to 5-star tourism destination developments. SDI will build relationships with Chinese investment companies and entrepreneurs to fully promote these and help create further investment opportunities in Scotland.

3 [http://www.scotland.gov.uk/Publications/2012/12/7734](http://www.scotland.gov.uk/Publications/2012/12/7734)
SDI DELIVERY – INCREASING TRADE TO CHINA

Overall approach
SDI is committed to supporting and working with any Scottish business that wants to trade internationally. In doing so it provides a range of products and services that can be accessed by businesses at all stages of growth, development and international ambition.

Growth companies are account managed by SE and HIE because of their potential to achieve growth and deliver economic impact. Account management starts with the preparation of a growth plan which sets out the milestones and objectives on the path to achieving growth. The support for companies is then tailored to the needs of the business in relation to this plan and in many cases includes expert international support through SDI.

SDI, along with partners, offers a range of services from awareness & ambition to market entry & expansion. This is delivered by SDI in conjunction with partners. The support available and how it integrates with wider business development support is shown below:

If market awareness and research identifies China as a market of interest to a company then work is conducted to prepare the company and subsequently support it in market. To support this SDI has three overseas offices in mainland China namely: Beijing, Shanghai, and Shenzhen as well as offices in Hong Kong and Taiwan.
**Rationale for Overseas Presence**
The key economic development rationale for the overseas presence is to address information asymmetries, establishing & maintaining networks and addressing institutional failures. In markets with significant cultural differences, like China, these barriers can be greater and therefore the need for public intervention is stronger.

To address these requires a sophisticated approach which combines in depth geographic and sectoral knowledge. The development of networks and relationships is a long term process involving significant technical and cultural competencies combined with high degrees of trust – SDI has invested significantly in developing these relationships and underpinning competencies. A key role for SDI is using its reputation, in particular for impartiality and trust, in developing these relationships and accessing senior private and public sector decision makers.

**Activities undertaken**
SDI's overseas trade and investment staff in China perform a wide range of work for businesses and for the wider promotion of Scotland, including:

- Specific work for individual trade and investment customers, ranging from market research to reaching senior decision-makers.
- Networking, contact-building and door-opening for business – up to and including the highest levels of business and key government contacts
- Building links to Scotland’s science and education base.
- Providing a platform for Scottish excellence and enhancing Scotland's reputation across the board through events and marketing activity

SDI works with partners such as China British Business Council (CBBC) and UK Trade & Investment and seeks the support of GlobalScot members to assist Scottish companies and promote Scotland's business interests in China. The pipeline of companies from Scotland showing an interest in the Chinese market is extremely healthy and there are many examples of Scottish companies doing business directly in China through partnerships, joint ventures and wholly owned foreign enterprises.

There are a considerable number of Scottish companies doing business in China. They cover a range of sectors (e.g. energy, financial services, ICT, food and drink and education). Many are conducting business from Scotland directly or via their appointed partners such as agents and distributors. While others own operations set up in China in the form of representative offices, wholly owned subsidiaries or joint ventures.

Around 50 Scottish companies have such a physical presence in China including: Aggreko, Clyde Blowers, Howden, SgurrEnergy, Weir Group, Standard Life, the Royal Bank of Scotland, Martin Currie, Aberdeen Asset Management, The Edrington Group, William Grant & Sons, Fresh Catch, Scottish Salmon Company, Kinloch Anderson, JD Wilkie, Edinburgh University, Glasgow University, Heriot Watt University, Dundee University, Napier University, Elmwood College, SQA.

There is clear evidence that our support helps to open doors and accelerates export success in harder to reach emerging markets like China. In 2011/12 we supported 169 Scottish companies export to China which represents a 69% increase on the previous year and we are on track to help a greater number of companies this year.
Recent Trade Visits, Missions and Exhibitions (two way), 2012

Detailed below are a selection of visits and missions to China in the last year alongside visits to Scotland from China.

- Nov 2012 Crawford Gillies, Scottish Enterprise Chairman (visit to Beijing)
- Nov 2012 Cabinet Secretary for Rural Affairs and the Environment visited Shanghai with the food and drink mission (14 – 17 Nov)
- Oct 2012 CITIC Group mission to Scotland
- Sep 2012 Scottish Oil & Gas mission to Dongying and Beijing
- Aug 2012 Scottish Oil & Gas mission to China
- July 2012 Scottish Gaming mission to China
- June 2012 Food & Drink promotion event in Shanghai
- June 2012 Huawei IP delegation visit to Scotland
- May 2012 Scottish Life Science Mission to ChinaBio partnering forum
- Mar 2012 Scottish Oil & Gas mission to Beijing
- Dec 2011 First Minister’s visit to China (Beijing, Shandong, Shenzhen and Hong Kong)
SDI DELIVERY – ATTRACTING INWARD INVESTMENT FROM CHINA

SDI’s Approach in China
While the majority of immediate opportunities, and therefore focus, is on the provision of support to Scottish companies, there are undoubtedly opportunities to attract Chinese knowledge and investment into Scotland. With the majority of Chinese companies focused on internal markets or international M&A strategies, this is seen as a long term agenda. SDI has established relationships with a large number of internationally aspiring companies and through this has developed a pipeline of investment opportunities with Chinese companies in priority sectors.

SDI also focuses on developing two way business between Chinese and Scottish companies in these priority sectors by proactively developing relationships with Chinese companies and facilitating collaborative opportunities that support the internationalisation plans of both parties. A number of high profile companies such as Huawei and Asiapharm have developed strong partnerships with Scottish companies and universities.

China’s investment profile
- China’s GDP continues to grow rapidly, current GDP growth is 8% slightly down from an average GDP growth of 10% for over a decade, it is still an emerging country in terms of its overseas direct investment (ODI).
- China has been the largest recipient of foreign direct investment (FDI) year on year for the last decade. Almost 60% of this is in manufacturing.
- The Chinese government has been actively encouraging its companies to go global and most recently to invest in R&D. However, it is widely recognised that Chinese companies are comparatively weak in these areas.
- China is now the holder of the largest stock of foreign currency. This provides a rich resource to support Chinese companies and key industries.

Main investment models from China
- **Mergers and Acquisitions (M&As):** this approach is often focused on acquiring natural resources and to a lesser extent brands and technology, like Lenovo’s acquisition of IBM. Scotland has previously been identified as a strategic ‘Worldsourcing’ location which is a significant step in demonstrating Scotland’s role in Lenovo’s expanding European presence – this recognises the local expertise and leadership of the Scottish operation, offering potential scope for expansion. Lenovo is seen as one of the few successful M&As from China.
- **Direct investment:** mainly in manufacturing. The set up of these are in developing and emerging countries.
- **Sales offices:** form a large number of inward investment projects from China and are seen as an ‘early’ investment.
- **Strategic alliances:** large Chinese companies in the financial services sector are acquiring a certain percentage of equities from overseas companies as a strategic partner e.g. China Development Bank’s share of 3% in Barclays.
- **R&D centres:** gradually a number of the bigger Chinese technology related companies are recognising the importance of overseas R&D facilities with countries chosen to try and take advantage of indigenous strengths and capabilities.
**Current Chinese Investors in Scotland**
At present Scotland has four major Chinese inward investors: Lenovo; Ningxia Zhongyin Cashmere Company (owners of Todd & Duncan); Cochran International Holdings Ltd (owner of Cochran Ltd) and the Bank of China.

There are also two joint ventures: Petrochina has entered Scotland through the setup of a joint venture with INEOS investing US$1.01 billion for a 50% of shares of INEOS’ European Refinery Business which includes the Grangemouth refinery, whilst Sinopec is acquiring a 49% share of Talisman’s UK North Sea business at a cost of US$ 1.5 billion.

**CASE STUDIES**

**Asia Food and Drink Plan**
Senior delegations such as SE chairman’s visit in late November and the recent ministerial trade mission led by Richard Lochhead also in November. Seventeen companies and five trade bodies supported to accelerate export growth in China. Companies attended Food and Hotel China which gave them access to over 30,000 buyers and we helped facilitate over 50 influential one to one meetings for the companies. There are a significant number of following up on enquiries and a live shellfish exporter has confirmed that opportunities identified from the one to one meetings.

**Food and Drink promotion**
Macallan and Johnie Walker whisky, salmon from the Scottish Salmon Company, shortbread from Walkers Shortbread, Campbells Shortbread and Reids of Caithness; plus a variety of produce from Baxters, Mackays and Mrs Bridges heavily promoted in 30 large Chinese supermarkets in a deal brokered by SDI

**Exploiting opportunity to quality dairy produce in China**
Graham's Dairies Managing Director Robert Graham said: “The demand in China for value-added milk products is simply enormous and the company we met today is very keen for Scottish producers to enter the market. Graham's are a family business and we have a reputation in the home market for producing high quality dairy goods, but until now we have never entered the export market. The meeting in China today was very positive and we are keen to explore the opportunities further.”

**Salmon – supported deal with the World Association of Chefs for Scottish Salmon producers to give Scottish produce global exposure across its 10 million members**

In January 2011, the Scottish and Chinese governments reached an agreement to allow salmon exports directly from Scotland to China which prompted a dramatic increase in Scottish salmon exports to China.

The value of Scottish Salmon exports to China in 2011 were up 103% year on year and by the end of July 2012, 86% of last year’s total tonnage had already been exported. We anticipate that total sales to these target markets will greatly exceed the 2011 total (Source: Scottish Salmon Producers Organisation)

China is now the 4th largest market for exports of Scottish salmon in the world (after USA, France and Poland)

Bakery
40 jobs have been secured at Stag Bakeries based in Stornoway after securing a lucrative order from China. The company plans to expand its workforce by 25% after clinching the deal to export the Far East. Pallets of Hebridean shortbread and water biscuits are being shipped out to Shanghai and regular orders are being placed.

Whisky
Exploiting opportunities to further boost export for whisky in China as a result of the rising population of middle class seeking luxury products like whisky – reception at Johnnie Walker House in Shanghai and new Johnnie Walker house in Beijing

Energy
we are working with Scottish Energy companies Scottish and Southern, Scottish Power, Sgurr Energy to help them do business with companies in Asia and introduced the European Marine Energy Centre to China’s Ocean University to support collaboration on a wave energy test centre in Shandong.

Over the next 10 years, over £40bn in investment opportunities exist within the Scottish low carbon sector and we are heavily promoting these opportunities to Chinese organisations to support investment and encourage greater Sino-Scot ventures for example Clyde Blowers subsidiary David Brown Gear Systems which has set up a JV with Jiangsu Shinri to manufacture systems for wind turbines and railways.

We are also seeing Chinese Investment into Scotland, including
- Sinopec which invested US$1.5b to acquire 49% of Talisman (UK) Ltd. Talisman operates in North Sea and out of Aberdeen.
- CNOOC completed its acquisition of Canada head-officed Nexen at US$15.1bn in Feb 2013. "Nexen is the second largest oil producer in the UK North Sea, thanks to the resource-rich Buzzard facility, which in 2012 generated about 160,300 barrels of oil equivalent per day (boe/d) (about 69,000 boe/d net to Nexen). We’ve more than doubled our proved reserves in the North Sea since 2004 and continue to actively explore in the region.” (from Nexen website)

8 http://www.hebrides-news.com/china_order_stornoway_bakery_131112.html
Textiles
SDI has organized the biggest ever Scotland textile delegation to China which consists of 16 companies. A Scottish manufacturer has secured a major new contract with a leading Chinese clothing firm in March 2013. The deal, which is worth £375k, will see Langham based Reid and Taylor supply 15,000 square metres of some of its highest quality fabric to Yeliya, based in Shandong Province, China.

The Carloway Mill on the Isle of Lewis has announced that after several months of discussion, a joint venture agreement has been concluded with one of the world’s largest, most innovative and progressive textile companies; the Shandong Ruyi Technological Group Ltd, whose HQ is in Jining in China. The joint venture will result in Shandong Ruyi becoming a shareholder in The Carloway Mill.
**R&D / Education**

University of Strathclyde (UoS) partnered with China Aerospace Science & Technology (CASC) through its China Academy of Launch Vehicle Technology (CALT) to create the new MSeSTech lab, located at UoS. With £1.5million worth of funding coming from China for the next five years.

The University of Dundee and spin-out company STAR-Dundee Ltd signed an agreement with the China Aerospace Science and Technology Corporation – Software Test & Evaluation Center on Tuesday February 8th. The agreement between the Dundee institutions and the CASC Software Test & Evaluation Center will establish links in software and system testing, training and research-related development activities in SpaceWire Technology.

**SUMMARY**

China is now the second largest economy in the world with a forecast annual growth rate of over 8%. China’s economy is gradually becoming more open and dynamic and Scotland’s ability to take advantage of this will be critical in developing Scotland’s long term sustainable economic growth.

China will continue to be one of the main sources for global growth and therefore it is vital that Scotland continues its efforts to increase trade and investment with China. Scottish businesses will continue to be provided with a full range of SDI export services such as China market research, strategic market entry planning, in-market consultation, introductions to Chinese business networks and missions and learning journeys to China.