BENCHAM
BENELUX CHAMBER OF COMMERCE IN CHINA

Succeed and Lead in China

Third Edition

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IN CHINA

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Third edition

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The first edition of this book was published in 2012 by Benelux Chamber of Commerce, Shanghai Chapter (BenCham Shanghai) in China under the title "BenCham Starter Kit China".
The second edition of this book was published in 2016 by BenCham Shanghai under the title "Succeed and Lead in China".

Order your copy of Succeed and Lead in China by sending an email to shanghai@BenCham.org

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Foreword

China, with its long history, expansive geography and large population, is fascinating to some while intimidating to others, and has always been hard for Westerners to figure out. Westerners have their own ideas about the country. Stereotypes and obsolete concepts abound, and most people are not aware of the vast differences within the mainland's borders. China's many facets make it a complex place, one difficult to comprehend. Huge differences between generations and various groups suggest that perhaps there are several Chinas, from a very modern one represented in glittering Shanghai to a China with provincial lifestyles which have not changed much in a hundred years.

For business people, China represents both opportunity and risk, and the question becomes not WHY things are as they are, but much more HOW to operate in China. *Succeed and Lead in China* will be your guide. It is written by BenCham members for fellow business people, and it consolidates knowledge from many experienced practitioners and presents it to those who are new to China or want to know more about China. Reading will help individuals and enterprises alike operate and achieve success swiftly, while avoiding many of the common pitfalls associated with doing business in China. Like the former Starter kit, published in 2012, and the second edition (Succeed in Lead in China – 2016), this new e-version of the *Succeed and Lead in China* guide collectively represents hundreds of years of Chinese business experience. Very few expert guides can beat this. With this tool, the reader will access invaluable knowledge to "ride the tiger" and focus on China's business opportunities, while circumventing the all too many roadblocks and potholes along the business landscape. Even those who consider themselves somewhat of a "China hand" will still find many useful tips inside this book's pages.

As Consuls General of the three Benelux countries of Belgium, the Netherlands and Luxembourg, we are extremely pleased to see that Sino-Benelux business relations have been strengthened by the success of so many Benelux entrepreneurs in the Middle Kingdom.

Combining our knowledge of the long history of Sino-Benelux business relations with the Succeed and Lead in China guide serves as an excellent tool to introduce entrepreneurs to opportunities in the Chinese market.

This BenCham guide is designed to support members of the Benelux business community in China in being successful, as doing business in China is more complex than often expected. It is thus with great pride that we welcome and would like to introduce the BenCham *Succeed and Lead in China* guide, as it fills a gap in the practical information available to the Benelux business community in a highly effective way. Kindly feel free to visit us in Shanghai, to discuss your plans and to ask for further information.

With our most sincere regards,

Paul Lambert Consul General of the Kingdom of Belgium	Remco van Wijngaarden Consul General of the Kingdom of the Netherlands	Luc Decker Consul General of the Grand Duchy of Luxembourg

Succeed and Lead in China with BenCham

Written exclusively by our members, "Succeed and Lead" is your expert handbook, containing the vast experience, insights and knowledge of BenCham's network.

The Benelux Chamber of Commerce (BenCham) is a business community with three chapters; Shanghai, Beijing, and Guangzhou.
It was established in 2001 from the Dutch Business Association and the Belgian-Luxembourg Business Association.

These strong ties and history collectively represent hundreds of years of Chinese business experience, which very few expert guides can beat. Even though it would take an entire library to contain every nuance of successfully doing business in China, "Succeed and Lead in China" contains the most concise and essential information. We don't intend it to provide an answer for every question, but rather to be, as our Community is, your first and central connection point to business here in China.

Our members, whether they are entrepreneurs, SME's or large multinational companies, have been, through their failures and successes, able to thrive on the demanding and fast paced market that China is. With this guide, together, they are sharing a step-by-step and detailed approach so that others can follow in their footprints and develop their own winning strategy.

After the releases of our first and second editions of Succeed and Lead, in 2012 and 2016, business in China has continued to evolve. We have seen many changes in law and business practices, and we hope that this third edition of "Succeed and Lead in China" will serve to set your business foundations and pique your curiosity at what is possible in China.

We are looking forward to support you to succeed and lead in China!

Karel Eloot
Chairman BenCham Shanghai

Bas Kreukniet
President BenCham Shanghai

Virginie De Jongh
General Manager BenCham Shanghai

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CHAPTER 1
GENERAL OVERVIEW OF CHINA

1. General Overview of China

This chapter compares China to Europe, economically and geographically.

- China at a Glance
- Brief Economic Overview

1.1 China at a Glance

From the 1970s until now, China has risen from an underdeveloped country to becoming the world's second economy, fast gaining ground on the US.

China is more than twice the size of Europe and has over 2.7 times its population, with more than 1.3 trillion citizens in 2017. In terms of GDP, China has about 71 percent of EU's GDP, in terms of current US$. However, it has 26 percent of EU GDP per Capita (current US$) (World bank, 2017). The purchasing income of the average Chinese is about 41percent of that of the average European, slowly closing the gap. Although the average Chinese is still looking at a rise in net income of more than 6 percent per annum for the near future, this growth rate has steadily been declining over the last years as the economy is maturing. Signs of this are also visible in the GDP figures.

Since the end of the 70s, the Middle Kingdom's GDP has increased with an average annual growth rate of 9.9 per cent until 2010. Although the growth rate has since slightly decreased, it is, with an average of 6.9 per cent annually, still much higher than Europe's growth rate and with an upcoming middle and upper class definitely an interesting market for entrepreneurs.

Nonetheless, these numbers help to understand why selling to customers in China takes such a considerable amount of time, and why Chinese buyers often spend more time on bargaining prices over what may seem like pennies. China's relatively low rate of arable land (23 per cent) and its many years of civil war – which only ended in 1949 – make it very obvious for many Chinese why hard work is esteemed so highly. Many generations have grown up hearing stories of hardships, and thus are fully aware of the need to distance themselves from the tough life their elders experienced in the past.

However, with the 'golden generation' now entering the workforce, the work ethic and consumer market has changed. Where most people over 50 years of age know what it feels like to go without enough food, this 'golden generation' has grown more comfortable with Western culture and higher levels of wealth created by the rise of the country. Also, they have been given more opportunities than the generations before them, inspiring more independence, brand-consciousness and quality focus.

**Europe is referred to European Union, including the follow x amount countries (Austria, Belgium, Bulgaria, Croatia, Cyprus , Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain , Sweden, and United Kingdom)*
All data is extracted from the World bank database, 2017.

Comparison of the size of Europe and China

Source: https://travel2chinablog.wordpress.com/2012/10/01/chine-compare-size-europe/

China has more highspeed railways than any other country in the world. By the end of 2017, the national railway mileage reached 127,000 kilometers, of which 25,000 km are high-speed rail, accounted for 66% of the world's total high-speed. It also has more highways, which are rapidly being extended further. In the past, many villages (which in China can have thousands of inhabitants) were isolated, utterly poor and full of hungry and dejected residents. But once a road or a railway line is opened nearby, changes can become visible within weeks.
With the upgrading of the national infrastructure, the rural population as share of total population has halved to 42 percent. The expansion of China's cities will represent a huge challenge for local and national leaders. Of the slightly more than 350 million people that China will add to its urban population by 2025, more than 60 per cent will be migrants. This growth will imply major pressure points for many cities including the challenge of

managing these expanding populations, securing sufficient public funding for the provision of social services, and dealing with demand and supply pressures on land, energy, water, and the environment.

Every five years a government plan is set up for all policies implemented. The latest was the 13th one and was adopted in March 2016. It emphasized continued economic reforms and the need to increase domestic consumption in order to make the economy less dependent in the future on fixed investments, exports and heavy industry. So far, the goals have only been achieved partly but President XI Jinping’s government showed a greater willingness to undertake reforms that focus on China's long-term economic health in which the market will have a more decisive role in allocating resources.

The 14th Five Year plan will be announced in March 2020. The expected highlights are:…

The rapid income growth and lack of skilled labour have made China no longer the best location for low value products, which require low-cost labour. Nonetheless, the scale of China’s infrastructure, the size of its growing market and the presence of extensive industrial clusters in specialized areas (electronics, machinery, fashion clothing, etc.) enable China to be the second country in the world for foreign investment.

Provinces of China

Source: Shutterstock

1.2 Brief Economic Overview

Economic comparison between Europe and China 2019

	Europe	China
Capitalcity	Brussels	Beijing
Currency	Euro (€)	Renminbi (¥)
Totalarea	4.324.782km²	9.640.821km²
Population	511million	1.35billion
Density	116/km²	145/km²
GDP per capita	US$35.849	US$12893.43
GDP (nominal)	US$18.398,67 billion	US$10.355,35 billion
Growth 2018/2017	1.3%	7,4%
GDP global rank	1st-	3rd
Labourforce	229million	798million
Unemployment	10.5%	4.1%
Export of goods	US$2.173trillion	US$2.049trillion
Import of goods	US$2.312trillion	US$1.818trillion

Source: BenCham analysis on data from the World bank 2017, IMF 2017

In 2014 China exceeded the USA in purchasing power GDP and is expected to surpass the USA in 2018 on nominal GDP. High unemployment exists amongst recent university graduates, as more than seven million students graduate every year. Six months after graduating officially 15% of them still did not find a job. Unofficially numbers of 30% are mentioned. Those without an engineering or accounting qualification have a hard time finding a job.

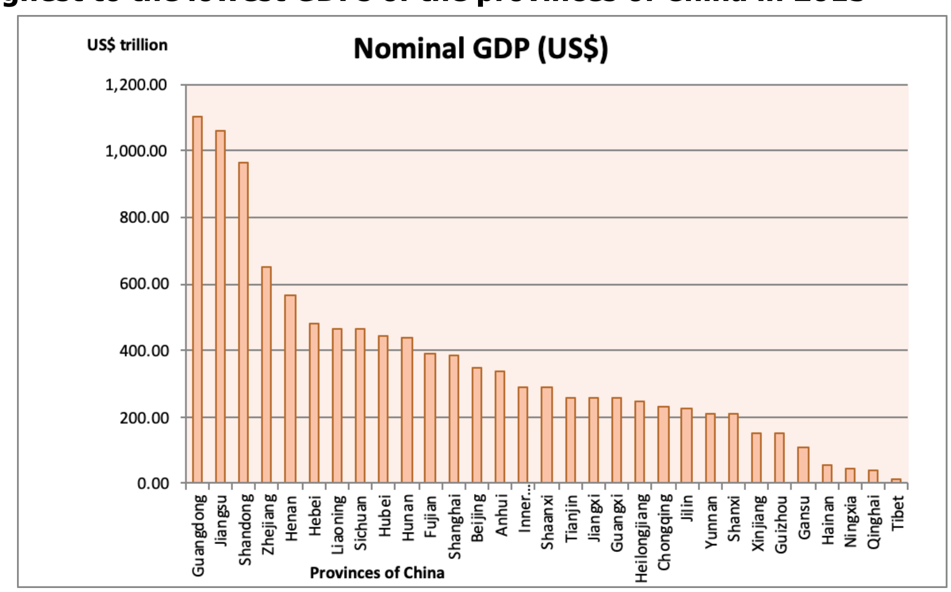
China planned to transform from a manufacturing economy to a knowledge-driven innovation economy by 2020.Getting more Chinese into universities was meant to help build the innovation-led knowledge economy. However, China's transition to a services-led economy is not implemented enough yet to offer all graduates a position up to their level.

At the same time, each year an average of thirty million students graduate from vocational schools, but this number is still too low to satisfy the need for skilled laborers in the market. The government made plans to increase this number to almost 40 million by 2020. The current shortage explains why foreign companies will often employ overqualified staff for a job, and why the same companies will then suffer from a high turnover rate of their employees, unless good retention schemes are in place.

Nevertheless, China still has a huge pool of engineers, which powers Chinese industry and makes the swift continuous growth possible.

The income levels of the largest developed cities of Shanghai, Beijing and Guangzhou and the smaller provincial capitals are seen below.

The highest to the lowest GDPs of the provinces of China in 2015



Source: IMF – WEO April 2015

2.Business Culture in China

2.1 How Tradition Defines China's Modern Business **Culture**

At the beginning of the 21st century, the Peoples Republic of China finds itself in the midst of social, economic and cultural transition. China is now the second biggest economy in the world and a superpower on the rise. China seems to grow more confident by the day. The Chinese government is steadfastly a policy of internal economic consolidation and international engagement. More liberal, though sometimes unclear policies were instituted by Mao Ze Dong 's great reforming successor, Deng Xiaoping, and subsequent regimes have continued building on them.

Of course, the Communist Party is still in power and continues its seemingly paradoxical economic model - rampant capitalism in the midst of a communist country. One often-quoted phrase probably explains this pragmatic view best: 'It doesn't matter whether a cat is black or white so long as it catches mice'. Thus, in this new order, what business rules apply? How do you re-invent a business culture in a country where commerce was outlawed for over thirty years? Where does a country find the rules by which to play? The answer is, partly, to fall back on traditional cultural drivers. In China, that means a return to Confucian values.

This chapter discusses the dynamic mixture of traditional values and modern views, technology and approaches that characterizes contemporary Chinese business practices.

- The Background of Chinese Business Culture
- Major traditional Elements in Chinese Business Culture
- Advice on Business

2.2 The Background of Chinese Business Culture

Understanding Chinese business culture requires familiarity with the historical context that shaped it. In addition, your knowledge of this background will demonstrate to Chinese counterparts your sincerity towards doing business in China.

The Historical Background

Three pillars of Chinese culture: Confucianism, Taoism and Buddhism

Chinese culture is unique and consistent, molded by a tradition of four thousand years of history, including more than two thousand years of uninterrupted influence of Confucianism, Taoism and Buddhism.

Confucianism, Taoism and Buddhism

Confucianism was undisputedly the dominating force in influencing Chinese culture. Confucianism is the behavioural or moral doctrine regarding human relationships, social structures, virtuous behaviour and work ethics. The main foundations of Confucianism stress duty, sincerity, loyalty, honour, filial piety, respect for age and seniority. The most prominent legacies of the Confucian doctrine are the high-power distance and hierarchical relationships in Chinese society. In China, rank and seniority are extremely important in business relationships, and must be kept in mind. In Taoism Wu Wei, or 'not act' – letting things take their own course - is an important concept, Wu Wei does not mean that people should be lazy or passive. It requires people to be able to observe fundamental principles while adapting to change only when it is necessary. In business management, a manager leads strategically by not micro-managing his or her employees, allows them do their work, and does not interrupt what they do naturally. Buddhism, originating in India, emphasizes that the elimination of suffering can be achieved by the extinguishing of desires through abstention and wisdom. Two important concepts of Buddhism related to business are 'Wu' and 'Yuan.' The concept of 'Wu 'can be literally translated into 'comprehend'. It refers to the ability to understand an issue from its core. Chinese use it in a business sense to imply a very deep understanding of people and the situation. The concept of 'Yuan' originates from Karma (the meta-ethical principle or law of cause-and-effect) in Buddhism. Nowadays it denotes predetermined relations between individuals that are far beyond one's control. The Chinese consider the chance to associate with another to be a very precious opportunity. They thus attribute close relationships (e.g. marriage) or good business relations to Yuan.

The Influence of Political Ideology and Western Values

Despite the relatively stable and persistent traditional cultural characteristics are, outside influence has caused changes also, most notably communist ideology and, more recently Western values. Political ideologies have shaped Chinese society since 1949: Maoism and then Deng's theory. During the Maoist era, many traditional Chinese cultural values were largely suppressed. When the 'open-door' policy started, Deng Xiaoping implemented more pragmatic methods that could help China's economic development. However as economic pragmatism became the only focus, materialism and various unethical business activities emerged as a normal business standard. Therefore from 2007, the Chinese government started to re-emphasize the values of traditional culture, such as the concept of a harmonious society. Second, a direct consequence of China's 'open-door' policy since 1978 is a Chinese society that is now in direct contact with foreign concepts, cultures and lifestyles. Although the Chinese culture is vastly different from the West, Chinese business practices such as professional competences, starting to align with international standards.

2.3 Major Traditional Elements in Chinese Business Culture

Saving face

The first aspect of Chinese business culture, still very much alive and dominant, is that saving face is important in all relationships. The best way to make sense of the abstract concept of face (miànzi) is to think about how others see you, rather than how your see yourself. Blame and criticism are thus rarely directly given in public because the loss of face could disrupt group harmony, which is more important than who is right or wrong. Usually, if there is a problem that you must call attention to, rather than being direct, you should cite external issues (he/she was tired and unable to focus, or the rules were unclear) and avoid putting a co-worker in the spotlight.

Face-saving sometimes can result in awkward situations. For instance, the Chinese rarely give definitively negative answers equivalent to 'no'. Instead of saying 'no' blatantly to a request, Chinese often use such expressions as ´bu fangbian' (inconvenient) or 'you xie kun nan' (there are some difficulties). If you ask, 'why is it inconvenient?' or 'what difficulty do you have?' you could be driving the conversation in an awkward direction. So how can one solve problems and at the same time avoid people ´losing face´? Very important here is to build trust among the Chinese staff. Chinese people tend to be much more direct and talk more business in private situations than in public, so you might find getting done much more done and understanding much more if you talk to your co-workers on the side.

Relationships are king - Guanxi

China is a high-context culture in which the rules of the game are based on personal relations, or "guanxi", Chinese relationships are long-term, which affects everything in the business world. Chinese people like to work with people with whom they have face-to-face contact and build up trust over time. Small talk and pleasantries are good ways to make people slowly warm up to you. If you rush things, you may actually end up spending more time trying to get things done because it could arouse mistrust in those who could help you. It is also important to understand that Chinese society is still very low-trust – it is often assumed that one can only trust close relationships. That largely explains why, in the past, contracts sometimes used to be of minor importance. After all, who needs a contract if there is deep trust between business partners? Nowadays, although it is common to use cold calls or direct contacts, the Chinese still tend to look for Guanxi-connected relationships as it may save a lot of time when securing business opportunities. Chinese people are also masters at maintaining these relationships: every Chinese individual has a web of relations spread over the whole of China.

Harmony and Big families

Chinese business culture's emphasis on group harmony goes back to the Confucian roots of Chinese civilization. While capitalism is relatively new, Chinese business practices are a lot older than you would think, and many companies both small and large were built on family or clan-based ties. The power structure in Chinese companies is quite vertical, resembling the traditional Confucian patriarchal family structure. Hierarchy is clearly defined within the company so that everyone can easily recognize his or her place and little conflict occurs. Accordingly, you will want to familiarize yourself with the company hierarchy.

Communication

To Westerners, the word 'yes' suggests agreement and affirmation, but to Chinese a 'yes' might not be a definite ´yes´, just as a ´no´ might not be a definite ´no´ either. To communicate effectively with Chinese, Westerners have to learn that the Chinese way of communication focuses on different elements, including implicit, context-based, listening-centered, and face-oriented methods. Also different from the Western communication pattern, Chinese prefer to use an implicit language pattern - meaning something is often implied or must be inferred. It is therefore not surprising for Chinese to use restraint and control in speaking. In addition, Chinese tend to engage in honest and truthful conversations with insiders while being reluctant to disclose information to outsiders.

Modesty

Chinese people value modesty and humbleness. Growing up in China, one learns not to be boastful in any situation. Self-effacing/other-enhancing is common rule in the Chinese socialization process. When receiving a compliment such as 'your son is an excellent boy', a Chinese would automatically say the phrase 'Na Li, Na Li', which literally means 'where, where' but its true meaning is 'not really'. In Chinese culture, blatantly accepting a compliment is considered impolite. However, in the workplace, the understatement of one's ability, expertise, strength, or competence driven by modesty may lead to misunderstandings and misconceptions. Westerners may believe that the employee is incapable of doing something or the business counterpart is 'weak'. Therefore, you should put into effort to find out the difference between modesty and honesty.

Traditional collectivism mixed with modern individualism

China is a traditionally collectivistic country which you can see clearly when looking at the Chinese way of dining: share dishes. Chinese people traditionally don´t focus on celebrating individual ambitions and goals, but more on achieving a collective effort and sense of pride all pointed towards a certain goal. The group is important, protects and helps organize a person's life where possible. In return, the individual has duties towards the group and is expected to follow its rules. In general, in-group personal relationships prevail over task and company. It is still common for a senior manager to take the complete team with him to the new employer. The western world on the other hand focuses on individualism, combined with liberal values. The pursuit of one's individual dreams has become a synonym for being successful and effective. In China the generation born after 1980 is much more individualistic than their parents. In addition to the changing family dynamics due to the 'single-child' policy, the radical economic development, and the exposure to Western cultures, younger generations in China enjoy much more freedom than their parents. The result is that in modern China collectivism and individualism are being blended more and more with the idea that collectivism should allow for individualism, because each individual is different and thinks in his/her own way.

2.4 Advice on Business Practices

Best business practices in China have evolved dramatically in recent years. I have been living and working in China for fifteen years, and what worked in the past doesn´t necessarily work now. That being said, some elements like focus on networking, a different way communication and a long-term view remain unchanged. What has changed, however, is how innovation and technology, the use of the internet, and the increasing focus on rule of law are quickly becoming crucial elements in doing business in China.

Take the long view and respect the Chinese view

The expression that ´in China everything is possible, but nothing is easy' is very much true today. China is surely still a country that offers tremendous opportunities to foreign companies. However, don´t expect to reap the benefits in the short term. This is because it takes a while to understand the culture, build the right network, find the right partner or distributor, or adapt products and services to the local market. The pace of change in China's rapidly developing economy is misleading, and China is really a place where slow and steady wins the race. Equally important is to respect the Chinese view of the world. Chinese people have intrinsic different values than westerners. That means you need to respect this influence and understand that your Chinese partners and customers may not define value the same way you do. Equally important is to show a healthy respect for China´s history and culture.

It´s all about speed and execution

In daily life and work speed is a crucial element for success. Chinese companies often complain about the lack of speed of western companies. The reason they think so is directly related to the fast evolutions in their home market. In China domestic competition is simply brutal. That means that staying ahead of the competition is important to be or remain successful. Speed is thus a crucial element. Fast execution is everything. Western companies need to adapt to this which is somehow opposed to the habit of western companies to work more detailed. Therefore, western companies should strive to find a balance of speed, while at the same time ensuring quality to be successful in China.

The network always wins

It´s common for Chinese people to mix personal and business life together, while Westerners like to keep them more separate. Unlike in the West, dinners (or in smaller cities often still karaoke sessions) in China are used to get to know each other and for networking purposes - to build up guanxi. In a food culture like China many Chinese managers and businessmen cultivate their network at dinners. The success of many endeavors in China depends on a close personal relationship with partners or customers, so spending time and money on these relationships is an investment that definitely pays off. At dinners although less common then before, drinking is a normal way to build up personal relationships.

Be pragmatic & flexible

Chinese people are very business and result orientated. The way to get to a good result is less important than the result itself. This in turn promotes very pragmatic and flexible behavior. While the cultural barriers to success in China seem high, Chinese companies are very business-oriented at the end of the day. So, as long as you find common ground to do business, everything can be worked out.

Leadership and group duty

There are also cultural differences between China and the West in the way followers view their leaders, what they expect from their leaders, and what leaders can expect from their team members. The leadership must have a "cultural fit" between leaders and subordinates from diverse backgrounds. Chinese leadership style is heavily influenced by Confucian values. The paternalistic leadership in China consists of three key elements: authoritarianism, benevolence and morality. It is a father-like leadership style in which clear and strong authority is combined with concern and considerateness and elements of moral leadership. By contrast, some Western leaders' valuable attributes, such as being non-autocratic, are not well accepted by Chinese subordinates. The same applies to some leadership practices. For instances, employee empowerment is taken for granted in the West, but not so easily accomplished in a hierarchical culture like China, where people prefer directive leaders. But, as everything else in China, existing practices are changing fast. Chinese employees increasingly prefer to be part of the decision-making process, or at least want to be heard. Comfortable work environments with respect for employees are becoming the norm.

The Chinese emphasize group duty. This can especially be seen at negotiations. At important negotiations it´s not unusual to encounter a large Chinese negotiating team. However, only the senior members will speak. The rest of the team are only present to collect information. The final decision is not made immediately either but made in their internal meetings between the negotiations. Also, due to the holistic way of thinking, the Chinese tend to consider all terms simultaneously in the bargaining process. The agenda of negotiation usually becomes a jumping off point for discussions. This is quite frustrating for Westerners, who are used to a linear way of thinking and sequential bargaining. Therefore, patience is an indispensable quality for foreign negotiators hoping to be successful in China.

Think technology and innovation

China is changing rapidly from ´Made in China´ to ´Designed in China´. That means China is focusing strongly on innovation and technology. Innovation however should not be understood in the western sense of the word. Although China is now the top country in the world in terms of patent applications, and the second biggest global spender on R&D, innovation is not only about R&D or new product development. But in China innovation takes many forms and shapes. It´s often about launching new business models or understanding exactly what Chinese customers prefer. Innovation in China is all about trying to solve particular needs and expectations. How to innovate in China is also very different than in the western world. Bold experimentation and rapid iteration are valued. Business models are quickly implemented and quickly discarded if wrong. Failure is not a problem, but a ladder to success. Innovation happens also through creative adaptation: Chinese innovators are bold enough to challenge former business models, merging different choices and creating new ones.

WeChat rules

As expanding one's network is a continuous task, networking is key. Business cards are still being exchanged, but that often has become nothing more than a brief, formal introduction. Often the real communication now happens on WeChat, by far the most important digital communication tool. China has become a very digital society, which is reflected in the success of WeChat, which with its one billion users is used extensively throughout China. Therefore, after exchanging business cards, Chinese people almost immediately exchange WeChat accounts to get connected. As WeChat is being used to make appointments, have business conversations, organize group calls, and much more, the tool is vital to modern day China business. One result is that emails are being used less and less. This of course provides problems for companies as it leads to IT security issues and often an interference with corporate IT guidelines. And as Chinese people mix personal and business, don't be surprised to see personal pictures of family and friends, or holiday pictures on WeChat.

Digitization is a must

Business and daily life in China are in many aspects very much digitalized. This can be less apparent in business processes, but when dealing with Chinese consumers, one can immediately feel the impact of the internet. With 800 million people online, China has the world's largest internet population. Not only is modern China heavily digitalized, it centers on smartphones rather than laptops or desktop computers. Often the best way to reach your customers is digitally. Companies must have at least an account on WeChat to communicate with is customers. The Chinese internet is also hugely different than that of the western world. The so-called Great Firewall -built by the Chinese government in order to supervise all incoming internet traffic- resulted in Google, Facebook and Twitter among other being blocked. That in turn means that western companies need to turn to Chinese tools to promote online. Furthermore, companies using non cloud-based CRM-systems, working on servers outside China, can face problems with accessibility. This all means that often IT infrastructure also needs to be localized.

Adapt your business to China

Adaptation to China is crucial, as the other way simply won´t work. China evolves fast and is now comfortably the second largest consumer market in the world. This also means that a lot of western products have found their way into China. which results in the fact that Chinese customers know very well what is available, and where to get it. And as annually 140 million Chinese tourists travel abroad, they are very knowledgeable about the world outside China. Result is that nowadays Chinese consumers and companies have often strong demands in terms of quality, design, colors, immediate availability, etc. That means that in order to be successful western companies need to launch a business proposition fit for the Chinese market. Just copying a western success formula for China rarely works. The expression ´You don´t change China, but China changes you´ is very much applicable in this context.

Rule of law and compliance are increasingly important

When Xi Jinping came to power as the new president of China, he made anti-corruption his central theme of government. A lot of social-economic problems like pollution or food scandals are directly related to corruption and greed, which is the reason why the Chinese government wants to put a hold to this. The effects of these policies can be seen at all levels of society and must not be underestimated. It is no longer acceptable to give exclusive dinners to appease an official or smooth a deal with the government. Also giving expensive gifts is no longer accepted. At the same is complete compliance with the regulations increasingly important

2.5 Conclusion

China still offers abundant economic opportunity for foreigners that come with an open mind to new cultural experiences. Paying on the one hand attention to the culture and understanding on the other hand modern business practices, are both crucial aspects for success in China. In my experience the willingness and openness to absorb the business culture, have patience when it comes to getting results, and the ability to look at things from a Chinese perspective are vital. If one understands the Chinese cultural perspective and communicate accordingly, China can be a place where anything is possible for your business ideas. Although it is an investment of time and patience, cross-cultural communication will open your mind up to different ways of thinking and appreciating life. And business success will follow eventually.

2.6 Business Case Study by China Access

Chinese business practices explained against cultural backdrop

In this article, we want to focus on ***three main themes****: the origins of* ***communication*** *discrepancies, ways to reach a more* ***transparent work environment*** *and the path to* ***solving problems*** *amicably and vigorously. These areas always ignite much ado during our trainings. Fortunately, it is possible to understand where cultural differences stem from –and how to anticipate and deal with them in your own work environment and working relationships. For the sake of clarity, this article looks at the typical cultural features that mark China's national character - it does not address the endless nuances that exist between Northerners and Southerners, old and young, city dwellers and rural farmers, and so on.*

Please meet Mr. Hogendijkand Mr. Liang

Mr. Hogendijk is a procurement manager of a well-known Dutch retail store in household utilities. His English is fluent thanks to a previous sourcing job in the US. In the last two years, he has travelled to China approximately four times per annum to visit Mr. Liang, his sourcing agent, working for a renowned big Chinese trading company. Mr. Liang is a reputable, well-seasoned agent, with lots of international experience. These visits mainly focus on purchasing new items for the coming season, including tailored design products and discussing problems that occurred in deliveries of the previous season.

I. Communication

Getting your message across effectively, indeed knowing it is understood, and interpreting your Chinese counterparts' message correctly at the same time, is often not simple in a Sino-Benelux work environment. First, there is the **language barrier.** Usually, English being the lingua franca, it is the mother tongue of neither nationality, and confusion and misunderstanding lurk around the corner easily. Even the use of an interpreter as a go-between may cause dents in the lines of communication.
Much of this is due to different communication styles in terms of **context**. The Dutch, for example, prefer a straightforward explicit manner, whereas the Chinese are more comfortable with delivering words in a more implicit way, using tone and leaving things out. Often it is the underlying message that needs to be heard, rather than what is exactly being said.
The **drivers** for messaging also differ. People from the Benelux are encouraged to reason based on facts, as objectively as possible and less in presenting a point that may cover up a blemish or may hurt someone's feelings. In fact, owning up for a mistake or saying one is sorry can rely on a measure of sympathy. After all, telling the truth is considered a virtue. In that light, people from the Benelux are alright with receiving and giving criticism and opinions openly (even though 'how one says it' is enormously important), whereas the Chinese always consider the other's feelings and face, and tend to take criticism personally, as disapproval. Chinese criticism is therefore wrapped in many guises and does not seek to provoke or generate an open debate about someone's wrongdoing. Therefore, Chinese do not like to say "No" to you and prefer to nod their heads and say "Yes".
Where reporting **lines of communication** are quite flat in a Dutch work environment, yet more hierarchical in Belgian and Luxemburg business settings, Chinese, as a rule of thumb, accept leadership from the top and expect bosses to lead the way, with clear working levels and leaders at every level. Knowing one's position and mandate is important to Chinese workers.

Mr. Hogendijk gets lost in translation

Mr. Hogendijk needs to discuss the deliveries of the last season with his agent in China, Mr. Liang. Unfortunately, these deliveries did not meet any of the mandatory compliance requirements. Three weeks before his next trip to China, Mr. Hogendijk puts together an agenda and mails this to Mr. Liang. It is a memo with short, bullet-marked matters to be discussed. One bullet however jumps out! It mentions the delivery of substandard goods that did not meet the requirements asked for. He describes the delivered goods in detail and includes copies of some of the fierce complaints made by the store's shoppers. Mr. Liang responds and says he will try his best to prepare accordingly. During their first meeting, Mr. Liang gives an extensive report on his company's business performance of the last season, stating impressive figures, supported by a nice presentation and a list of international clients that boast award winning designs in the field of fashionable household goods, but not a word about Mr. Hogendijk's complaints. Equally, no input on the requested new purchase items. Despite various efforts, Mr. Hogendijk fails to obtain the response he needs so desperately. He asks Mr. Liang to speak to the CEO, but also this request is not granted, even though Mr Liang said he would arrange this. Mr. Hogendijk feels frustrated and wishes to go back to his hotel.

What went wrong here?

- **Language**
  Mr Hogendijk's English was probably too advanced for Mr Liang to understand. Mr. Hogendijk should have used simple vocabulary and short clear sentences. Better yet, he should call Mr. Liang to reconfirm whether he understood his message.

- **Context**
  Mr. Hogendijk unwisely reckoned that the extensive report made by Mr. Liang was beside the point. By describing the business of the last season in detail Mr. Liang indirectly shared all kinds of information which explained the mishap deliveries. Raw material prices were under pressure, new players came into the market, and Mr. Liang's company won a new account; a world-famous mart in the US is now Mr. Liang's biggest customer. Mr Liang may have wanted to test the waters to see whether products designed by the American firm could possibly meet Mr. Hogendijk's wishes.

- **Drivers**
  Mr. Hogendijk put forward the complaints in a too confronting manner. Mr. Liang feels little at ease with all the criticism he is reading and prefers to set the matter aside and discuss it at a later stage in person. Had Mr. Hogendijk addressed this more implicitly, by first making compliments on the things that did go smoothly, like the timely delivery and the attractive pricing, then he would have given Mr. Liang room to respond without losing much face. More importantly, his harsh words probably damaged any form of trust that may have existed. He says to agree to arrange a meeting for Mr. Hogendijk with his Chinese boss but doesn't do this because it will cause embarrassment to himself and is not opportune under these strained circumstances.

- **Lines of communication**
  Mr. Hogendijk probably overestimated Mr. Liang's decision power, he was not authorised to respond to offer compensation for the substandard goods. The Chinese CEO could have been the ideal person to sort this out with, but he will not talk to a subordinate level procurement manager. Would Mr. Hogendijk have involved his own CEO, then the Chinese CEO would most probably have helped to solve matters at their level.

II. Transparency

Everyone who works in China, knows that the key to reaching workable levels of openness is first and foremost to build relationships in which trust, reciprocity and respect are warranted. Chinese people tend to be franker when they feel protected by the **relationship** based on these criteria. Indeed, the more people reside in the inner circle of their network, the more comfortable people will be to speak out and hence be more transparent on issues.

Benelux nationals are raised to think along linear A-to-B lines. Being logical thinkers, they carefully analyse cause and effect throughout the entire **process**, coming to painstakingly developed, integrated working propositions. To curb surprises, improvements, changes and timekeeping need to be as transparent as possible. The Chinese, being holistic thinkers, prefer to do things more empirically, to learn and shape the process as it unfolds. Instead of wanting to control the full process, they seek to focus on the issue at hand, thereby creating a more focused transparency in the present. But it may also mean that previous decisions or views need to be reconsidered.

In the Benelux, the view is that a pro-active **attitude** at work will help to develop levels of transparency, because the 'hands-on' exchange of ideas between departments, different levels of seniority and people can influence the outcome of plans and processes. Education in the Benelux aims at developing independent and self-confident people, who take the initiative. The Chinese educational system is based on taking on board knowledge by listening to the teachers and studying theory for exams. It requires less initiative but creates people with strong factual knowledge and flexible, responsive skills. A serious oversight not to value this pragmatic attitude in a market that constantly demands rapid answers to new situations.

Time is another concept influencing transparency. Linear thinking comes with strict scheduling and adhering to deadlines, making Benelux nationals quite predictable in their time management. For Chinese, time is more fluid and needs to be prioritised constantly. Time keeping is situational, also depending on relational priorities. Chinese managers do not plan future steps in detail as they cannot judge or foresee the situation in the long term. Planning so far ahead of time is simply deemed a waste of time!

Mr. Hogendijk loses grip on his business

After a quiet summer, with hardly any contact between Mr. Hogendijk and Mr. Liang, the Christmas season is approaching rapidly, which is bound to bring increased turnovers for the company of Mr. Hogendijk. He has ordered larger amounts of stock with Mr. Liang, including some special luxury items that will smartly complement the look and feel of the regular range of products. These luxury items are to be tailor-made and must be ready for market well before the Christmas season. But, when the standard products arrive on time in Holland, the luxury items are not among the shipped goods as per the agreement made with Mr Liang. Mr. Hogendijk immediately sets up a skype call with Mr. Liang. The latter explains that the factory where he ordered the items closed down, due to changed city planning. He is in the process of ordering elsewhere and reassures Mr. Hogendijk he need not worry; the beautiful articles will arrive just in time for Christmas. Mr. Hogendijk has no other way than to accept this and hope for the best.

What went wrong here?

- **Relationship**
  Possibly, Mr. Hogendijk was not on top of Mr. Liang's mind. Due to the slow summer season, there was hardly any contact between them, which may have resulted in an (unintentional) cooling down of the relationship. Probably, a new US customer gets most of his attention. Simple small WeChat messages from time to time and warming up for the high season could have maintained the relationship. Mr.Hogendijk now needs to strengthen the relationship again, by intensifying the contact and arranging frequent WeChat video calls.

- **Process integration**
  Mr. Hogendijkhad carefully built up his Christmas collection, where all items, both standard and tailor-made luxury items, nicely matched each other. Mr. Liang appeared to be little aware of the need to interlink the Christmas collection. When his trusted supplier closed down, he then started ordering through other channels that maintained different delivery schedules. Mr. Hogendijk should have kept a close watch to ensure all items were brought together in the same style. By constantly checking and asking for examples, pictures etc. he could have exerted

a measure of control. He shouldn't have sat back and waited for the container to arrive.

- **Active attitude**
Mr. Liang was probably not inclined to tell about the delivery problems, because he may have thought to deal with the problem in due course, and maybe also as it could mean loss of face. It should have been up to Mr. Hogendijk to check whether they are both still on the same page. Mr. Hogendijk must now stay in close friendly contact with Mr. Liang, assuring that the prompt delivery of his goods gets priority. Had Mr. Liang been in a more solid and open relationship with Mr. Hogendijk, he would probably have acted more pro-actively to settle the matter.

- **Time**
Being Chinese, Mr. Liang is almost certainly a last-minute planner, used to sudden changes and surprises, but with the nous to come up with instant solutions. Mr. Hogendijk must build up his confidence to allow Mr. Liang to do his utmost to deliver in time. Had he micro-managed the process from the order date onward, Mr. Hogendijk would in all probability, have discovered sooner rather than later that the deadline was difficult to meet. In the current situation, he must now frequently ask for the transport status, but in a manner, that demonstrates he trusts in the good outcome that Mr. Liang will bring.

III. Problem Solving

How to deal with problems as they arise in your office or factory? To know what is at the heart of any difficulty, to get to the root cause as it were, is an inborn reaction to almost any Benelux national. Solving difficulties is a Chinese setting may take a different **direction** though. Here, people will look at a problem empirically, dissect it as much as possible, repair it and make the customer or boss happy, but maybe also leave the problem for what it is. Much depends on the nature of the obstruction, who has caused it, what is involved and if it requires immediate attention.

Chinese national stake a more circumventing **approach**, which means that it is not deemed necessary to always share a hindrance with another. Either because it is being dealt with, or it is waiting to be dealt with, or in the bigger picture of things, it is not a priority, or it is the most important issue to be dealt with. Benelux nationals see this differently, because they like to address any glitch immediately, grabbing the bull by the horns.

Benelux managers may like to solve problems by calling everyone together to **get feedback** in a brainstorm type of session to obtain different views and perspectives, and to allow for the admission of mistakes so that lessons can be learned. Chinese employees, new to a Benelux work environment, may seem reticent at first to give feedback; as expressing a thought or opinion, not knowing how it will be received, may be daunting at first.

Clients in China expect to be treated with respect by their suppliers. The Chinese supplier constantly takes into consideration the **position** and face of his Chinese client. In Benelux countries, clients and suppliers see each other as complementing entities. Hence, face is all important as it can be lost when being put on the spot without having an 'exit route' or when one's rank and status are not met with the right amount of deference – face is personal and commensurate with one's social status. Better to give face and allow the other to shine and hold off on critical remarks until the effects are any assessment are carefully estimated beforehand. Western firms tend to put together a proposal without carefully deducing the exact needs of the client. They may assume that because they are a well-established and reputable Western business, the Chinese side will bow to their suggestions and advice. They are most likely to find out the hard way, that this is not the case.

Mr. Hogendijk finds partners in misfortune

Mr. Hogendijk is back in China and visits one of the BenCham organised events. He is always keen to talk to people about their experience of working in China. When he arrives at the venue, he gets talking to a few expats with a factory close to Shanghai named Poultry Solutions Ltd (PS)., a Benelux subsidiary. They are a globally operating firm and manufacture agricultural feeding systems for poultry farms. Their clients are local farming units, consisting of local government and rural farmers. Even though PS delivers the machinery according to contract the Chinese keep on changing the scope of the agreed sale and service, reigniting many of the points already discussed or dismissed. Subsequently, time parameters are getting compromised. On top of that, the Chinese seem little inclined to take on board the expertise of the multinational. Since providing the best advice is at the core of their business being, PS feel they are not getting the appropriate esteem they are used to receiving when advising clients in other parts of the world. After all, they are the experts! Mr Hogendijk discovers he doesn't understand either. What may have happened?

What went wrong here?

- **Direction**
  The Chinese probably have been learning on the go – as ideas and advice were presented to them, they were also given food for thought which they mulled over behind the scenes. Be prepared to go back and forth and provide offers in a tiered approach.

- **Approach**
  Poultry Solutions thought they understood fully the client's requirements but quickly discovered that certain obstacles weren't highlighted, not at the early stages during the negotiations, nor are new hindrances addressed during the process. PS should have listened more carefully or asked different questions to fully understand why and what the Chinese client wanted to change and achieve. Also, the interpretation of what obstacles are, may also have differed.

- **Positioning**
  Poultry Solutions should accept that the Chinese client is always king, their wishes should not be considered a problem. Even though being the industrial expert, it is not becoming for the firm to manifest itself as the equal, or worse still, position itself as being senior to the Chinese client. The relationship is one that is not based on equality and the Chinese client, especially if it concerns a government entity, must be treated with respect. This means it may be necessary to change the content of any offer more than once.

- **Feedback**
  Probably, the multinational firm had made little work of getting to know the deeper needs of the Chinese client. Had they done so, they might have learned that it would have been expedient to get to know the client better to prevent any time delays and misunderstandings later in the process. Building a strong relationship must be at the heart of any beginning partnership or client supplier relationship.

To end with

This overview of a few prominent cultural hurdles that Benelux business people experience in China, should not stand in the way of reaching out and developing new and exciting partnerships with Chinese customers and suppliers alike. Despite the differences, Benelux nationals often blend in quite beautifully in Chinese business life. Both cultures share some important similarities – its people being pragmatic, result-driven and ambitious.

Still, key to this success is to become aware of the root causes of culture gaps in order to aptly navigate the unfamiliar shores of Chinese business customs and to gradually grow into a culturally sensitive actor who can bring both mind-sets together.

This article has tackled simply the most common complications, explaining matters only to a certain level. In business practice, many other problems are culturally-laden too. Finding solutions can sometimes be difficult and may involve dealing with a more complex set of factors. But remember, that much of what happens in Chinese business society can be brought back to China's history, both ancient and contemporary, its philosophical foundations and its own world view. It is therefore necessary to prepare for China's reality by digging deeper, learning and understanding. where and why the Chinese mind set is programmed the way it is. This article just showed the tip of the cultural iceberg, we welcome anyone who is keen to become a bridge builder!

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Too much time is often wasted on matters concerning misunderstandings in communication, especially in a Sino-Western working environment.
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3. Enter and launch your product in the Chinese market

China has faced dramatic industrial and economic change, just about every 10 years since its opening in 1978. As a consequence, foreign companies cannot enter China today same way they could a mere decade ago. This chapter will serve to guide you through the preparation and implementation of your project in China, as well as the overall supervision of your China market presence. You should also remain aware that successful businesses in China require significant time and financial investments as well as a dose of flexibility, to efficiently adapt your product or service to the local market. Due to increasing competition and other challenges in the Chinese market, all three of these phases are integral and should not be neglected.

In short:

1. Understand the Chinese market, which also means understand your foreign and Chinese competitors, and define what you can bring to the market. Often, European businesses' assets lie in high quality products, know-how, safety (especially regarding food and pharmaceuticals), expertise and technology (in very specific fields).

2. Devise a clear, realistic strategy with regard to the market and your company. Determine which product, at what price, which service, which distribution channel, which partnership, which structure, which investment, for which result. Define your goal in China precisely - your implementation strategy will depend on it.

3. Plan for the necessary time and financial investment. In the long-term, you will need to create a legal entity (a Wholly Foreign Owned Enterprise or a Joint-Venture). However, in the meantime, they are many other options (contract partnership, cross-border e-commerce, representative office, merger and acquisition). You need to find the best option for you with respect to the in-time reality of the Chinese market, the strength of your local network and local team, and your clients' needs.

3.1 Get prepared: strategic diagnosis

A strategic diagnosis serves to understand the local situation of your expansion target, in order to then enunciate precisely your objectives and motivations for this market. The Chinese situation is particularly complex because of its size, development and social history. Consumer habits vary greatly according to geographical location (city's tier) and age (difference between generations). These aspects shall be further developed in the chapter about marketing. Indeed, they have a decisive impact on the definition of the pool of consumers, the decision to enter China's market or not, and the design of the marketing strategy.

Validate the country's potential

What potential lies for you in China? Its 1.4 billion consumers are surely attractive, yet they are not your products' consumer pool. Who will buy your products or services? Are they already buying similar products? Is it the right time to enter the market? This last question is crucial: a timely entry will increase your likelihood of success and help you save time and energy.

In 2007, a company had developed a packaging for vaccines that guarantees a specified temperature with a tolerance of+/-10°C in an environment that can change from -20°C to 45°C, which maintains the efficacy of the vaccines. Since China has had several scandals due to ineffective vaccines, in theory, there would be a high demand for this packaging technology. Looking at the situation, though, we realized that the responsibility for a break in the cold-chain was not clearly established along the pyramidal distribution of pharmaceuticals in China, and that a "temperature control device" in the packaging was not at that time required. As such, none of the actors involved had sufficient incentive to pay a higher price for the company's packaging: there was no market in China.

Regulation study

The Chinese government regulates in an empirical way: they try out a regulation, look at the effect, and then decide whether to maintain it or modify it. As a result, Chinese regulations are under development in almost all sectors of the economy where realities are fast-moving. Furthermore, regulations are made at a national level. At that level, they shape a general framework, leaving much room for more or less strict interpretations at the provincial level. In the midst of this temporal and geographic uncertainty, knowing the legislation is not enough: one needs to understand how this works in practice and the inherent regulatory risk. Referring to professionals established in China might be useful for this part. Another tip: take a look at competitors already present in China and how they work within the legislative framework.

Until 2014, one could import food supplements as food products; the only requirements at the time were that the supplement had a label in Chinese and that the ingredients were declared for customs clearance. In 2014, food supplements were re-categorized as pharmaceutical products, a type of good which requires costly and lengthy tests before being cleared for import. As a result, companies already importing food supplements turned to cross-border e-commerce (special e-commerce platforms for Chinese consumers to buy international goods directly from abroad, with exception measures: goods do not go through normal customs and are thus cheaper; certain licenses might not be required). Cross-border e-commerce is detailed in the chapter on e-commerce.

Study the competitors

There is no better way than to look at your competitors who are already in the market to find out its real size. You will also be able to gather some information on best practices: which products are sold, at what volume, using which business model, for example. In other words, learn what works, what does not, and why from the experience of others.

A European cosmetics company was looking to enter into the Chinese market, on the basis that they had an innovative and high-quality product. After a first attempt which lasted two years, they had no result and opted for professional advice.

At the end of a thorough competitor study, they had at their disposal key elements to design their selling strategy: which competitors were importing? Which ones were producing locally? Which ones were using a partner or a distributor? Which distribution channel was the most effective? Which e-commerce platform was the best adapted?... For instance, they realized that T-Mall was not appropriated for their product. As a result, they reached EUR 1million of benefits in China.

Internal analysis

Once you get the 'big picture' in China, it is time to think of what you can do with your company and your product. An internal analysis will also serve to identify the impact entering China will have on your own company (finance, HR, etc).

At this point of the project, the decision of hiring a person often comes up, and is very illustrative of the challenges that might arise at this step. In a recruiting process, the employers should precisely know why they are recruiting, and what position will that person take in the company: both in the Chinese organization to come and in the current international structure. Lastly, especially when the newly recruited person is to be integrated in an already existing structure, it is of the utmost importance to include all stakeholders in the recruitment process.

A Sino-European Joint-Venture specialized in mechanical engineering was looking for a plant's director. Yet, thanks to discussion with all stakeholders, we found that the European side was looking for a European manager, with experience in managing operations and with a solid financial knowledge in order to overlook the financial management that was on the Chinese responsibility. Meanwhile, the Chinese top management wanted a Chinese manager, who could speak their language for reporting needs, with experience in managing the operations and with no financial background.

As the five-legged sheep does not exist, two solutions arise: either hiring two different persons, or finding a compromise on the job description. Having an exact view on the needs of the company and of the top management was crucial here in deciding in favor of the first option: the opening of two distinct positions.

Define the commercial strategy

A commercial strategy is the conclusion of these external and internal studies, and it is the preliminary to your business plan: it explains to you with what to enter China, how, with whom, and when. Marketing strategy should be defined later, together with your local partner or local team. It is also the appropriate time to think about a strategy to protect your intellectual property rights (IPR). After you have entered China, it is often too late. For more information on how to protect your IPR, refer to the chapter on the topic.

Marketing is especially important when determining when one's product is sold online and when the brand awareness needs to be built. As such, the main reason for a premium food company not selling in China, despites their product being rather well-adapted to the market, was that their marketing was not adapted to the peculiarities of the Chinese market.

Yet, they had actors on the ground who could get this information. Building up a real coordination between the local partners (who have the information) and the mother company (who ensure unicity in the brand image) was key in designing a sound development strategy in China.

3.2 Go: implementation of your strategy

It is now time to decide on the form with which you will enter. This will depend on your turnover, your industry and sector, and your goals in China (precisely defined at the previous step). Overall, there are five big steps in a company's commercial development in China:

- To start selling in China, some companies make direct sales to European or Chinese customers (the latter buy directly from them), without specific studies nor specific work. However, we always advice to structure the approach, analyse the potential of the market and set up the necessary organisation to develop it in a secured and sustainable way.

As soon as you confirm that there is a market for your product in China, two solutions are available to you: using a distributor or integrating the sales.

Cross-border e-commerce is an option to test the Chinese market; it is a channel not a solution. This can be handled by a "trading company" based in Europe, a Chinese partner based in China or by your own team. It will be important to consider things such as import taxes that are then sold on various e-commerce platforms (T-Mall Global, JD Worldwide). Also, although Chinese consumers go on these platforms to buy foreign goods (European mother and infants' products, pharmaceuticals, clothing, and cosmetics are very popular), competition between brands remain high, brand visibility low and overall brands might suffer from information asymmetry regarding the platforms.

- Once you are selling a certain amount in China, it might be interesting to get closer to the market, control better one's sales, and build up your clients' brand loyalty. At that point, a local sales force is needed for three main reasons: being aware of the changing reality of China and being able to adapt to it; building up a relation with your clients thanks to a local team who share their language and understand their culture; and optimizing your service by reducing the distance with your clients. This local presence can be, at first, either a commercial or an agent
- Following the same logic, with the sales growing, it is recommended hiring local employees to develop your activity. Opening a representative office is one way to do it. Be aware: representative offices do allow for a quick local set-up (2-3 months), without heavy financial investment. Yet, they are no definitive solution for a long-term representation. Indeed, a representative office allows your company to employ in China, it does not allow for local billing. Furthermore, representative offices are under further restrictions regarding the number of foreign employees it may hire (only 4 allowed), the use of its bank account, taxation on spending... As a consequence, representative offices are used as transitory structures but are not sufficient for a sustainable development in China.

- When you already have an established market for your product, you can think about setting up a partnership in order to produce locally, for the Chinese or Asian market. As mentioned in the previous chapter, you should protect your intellectual property (brand, technology) before even entering China. Yet, as you are about to open your production to somebody external to your company, this is the time to be particularly careful with this question. A strategic thinking on what to disclose and what not to is necessary. In all events, the best way to ensure protection of your intellectual property is to have somebody locally or to be present on a regular basis in China.

- The final step will be to set up your own organization, either through a WFOE or through a Joint-Venture. Opting for one or the other will depend on various factors regarding your internal organization, your goal in China, your industry, etc.… For instance, WFOEs are better adapted for implementation in industrialized areas of China where it is less difficult for foreign companies to have access to local customers. Regarding Joint-Ventures, what you should bear in mind is that the Chinese vision of a Joint-Venture is quite different from the European one, which entails different views on its capital allocation, its working, its evolution and its length. In China, a Joint-Venture is often seen as a temporary step in one's development, in order to accelerate this development by acquiring capitals and know-how.

For further details on the legal forms of these implementation modes, please refer to chapter on the creation of legal entities in China.
About partnerships*: When the market is ready, finding a distributor, an agent, or an industrial partner in China is usually not an issue. On the contrary, hundreds of companies will be willing to work with you. Thus, it is of the utmost importance to select the dependable local partner that is both adapted to your company (in terms of size, specificities, products/services range, cultural proximity, etc.) and competent in your field in the Chinese market.*
You should be sure of the motivation of your partner regarding your project in the mid- and long-terms. In addition, it remains indispensable to think of a strategy to protect your IP in this relationship.

3.3 An example of a successful entry in China

A European cars seller is looking to enter the Chinese market. Their business involves buying new cars from dealers in Europe and selling them in non-specialized networks in other countries. Their turnover at the beginning of the project is around 100 million euros.
Once the country's potential is validated, the strategic diagnosis serves to determine which cars are in high demand, at which price, who are the actors, which regulations apply, and figure out what internal organization is needed to be successful in China.
Looking at the flux of the market – and excluding the car dealers' sales – it appears that the car market has a great potential for this type of commerce.
Yet, it is a complex market in terms of regulation: one must face various restrictions or conditions on car importations that are even stricter when one is not a car dealer. As the regulation is changing, interviewing experts on the topic is necessary to understand the trends in the evolution of the law and, above all, to understand how the regulations work in practice. Thus, we see that the application of the law varies greatly depending on the cities: there are legal gray areas in Tianjin, while the legislative framework is quite clear in Shanghai.
Geographical diversity in terms of law and business environment is a reality in China: it is important to carefully choose the province where you will start your business. It is also important to understand the evolution of the law, as regulations affecting some aspects of your business might be subject to sudden changes.
For example, since the sales margins are thin in the automotive industry, prices are likely to be significantly impacted by changes in tax policy.
Additionally, a look at the competitors shows that the market is changing fast. It also tells us what the real prices and the models sold on the market are, as well as other customers' preferences. Moreover, all parties tend to be very sensitive and wary.
Because of these specificities, quick, responsive communication between the client who wants a car and the company who makes the purchase in Europe is of primary importance.
From the analysis of the company's own organization and their competitors in China, we are able to come up with the right catalog for the Chinese market, and with the right prices. We can also then plan for other business, stock, and payment related issues.
With a precisely-defined strategy, the European company goes on to the implementation phase: finding buyers in China, as well as a local actor to maintain good relationships with them.
From there, we identify and visit the 20 largest importers. We manage to sign many contracts because of two points: we have the catalog that already corresponds to their needs and we are able to guarantee that cars will not be blocked at customs.

Since those aspects are decisive in the market, as the strategic diagnosis has shown, it is possible not only to sign right away, but also to include in the contracts reassuring conditions for the European company.
Lastly, such a business requires a local partner or a local employee responsible for customer relations. Although there are many actors in China, it is crucial to find a serious one; the monetary amounts involved in each transaction are high and customers are very demanding.
Finding someone with good internal (with the European company) and external (to the clients) communication skills is a must.
Today, this company has successfully developed their business model: they were able to expand, diversify and attract a sustainable client network in China, reaching over 20 million USD in sales per year


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CHAPTER 4
CREATING A LEGAL ENTITY

4. Creating a Legal Entity

In today's global economy, the opportunity and necessity to do business in China presents a major challenge for every global business. Comprehending how to access the opportunities that exist in China can be confusing and deciding on the right market entry vehicle is one of the most important decisions to make for businesses exploring China.

The chosen entry approach will always depend on a number of factors including: the landscape of the industry, the nature of the market, long-term strategy, whether to produce domestically or import, and the level of local support required to meet the needs of customers. Hence, choosing the most suitable entity to enter the market requires careful deliberation.

This chapter guides you through the following considerations:

• Open and Closed Industries for Foreign Investors in China
• Choosing a Corporate Entity
• Registration and incorporation of a corporate entity
• Common mistakes investors make when forming a WFOE
• Entering China through an Acquisition
• Due Diligence for an Equity Acquisition
• Pros and Cons of Setting up a Company in HK
• Renting an office

4.1 Open and Closed Industries for Foreign Investors

Although China's entry to the World Trade Organization in 2001 helped liberalize its trading environment, many industries remain heavily regulated. There are both opportunities and restrictions for foreign investors in different industries in China. These are described in the Catalogue for the Guidance for Foreign-invested industries ("Catalogue"). This Catalogue addresses foreign investment in the following four broad ways:

1.) *Encouraged: priority industries,* less strict administrative requirements, preferential tax treatment
2.) *Permitted*: industries not listed in the three basic categories of 'encouraged, restricted and prohibited are considered permitted, they have no particular restrictive or favourable treatment
3.) *Restricted*: industries where the government controls foreign investment is subject to high levels of scrutiny and strict administrative requirements
4.) *Prohibited*: the industries that are prohibited from foreign investment

As an example, the Chinese government encourages investment in hi-tech, environmental protection and new energy industries. Yet it severely restricts foreign companies' involvement in the field of petrochemicals, energy and telecommunications sectors. Consequently, any foreign company looking to do business in China should first make themselves aware of which category their desired investment projects fall under.

Restricted industries mainly include agriculture, forestry, animal husbandry and fishery, energy mining, special natural resources, transportation, financial investment, education, medical treatment, film and television entertainment, among others. Prohibited industries mainly include Industries related to China's unique animal and plant resources, especially rare natural resources, sensitive medicine, compulsory education, legal affairs consultation, geological survey, among others.

The Catalogue has been updated regularly based on the five-year plans and economic developments, with the latest version being published in July 2017. The Catalogue contains a so-called Negative List (which was updated again in July 2018 and is now applicable nationwide) as part of the new Foreign Investment Law (FIL), of which a draft version was published for public consultation in January 2015 and put into 2018 legislative plan of Chinese State Council. The draft FIL eases entry requirements for foreign investments as it unifies foreign and domestic regulations. It also eliminates existing grey areas that have allowed the participation of foreign investments in otherwise restricted industries.

Pursuant to the draft Foreign Investment Law, only foreign investments in industries set out in the Negative List will require prior approval and all other foreign investments will only be subject to reporting obligations. This negative list approach is already being applied in Free Trade Zones. The draft FIL, which is almost ready for implementation, will also require that all companies in China comply with the same set of laws and regulations. Foreign Invested Entities (FIEs) will no longer be treated differently from local companies purely for being foreign invested.

Pilot Free Trade Zones

At present, China has established 12 free trade zones (Shanghai, Guangdong, Tianjin, Fujian, Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan, Shaanxi and Hainan), and has signed free trade agreements with 24 countries or regions. This means that in the above 12 free trade zones, FIEs need to abide by the negative list system of free trade zones and trade agreements with relevant countries.

Among other things, incorporating corporate entities in the zones takes less time and effort than in other parts of China as the fiscal and legal requirements are more flexible compared with the rest of the country. This is especially the case for foreign e-commerce companies which can particularly benefit from these FTZs.

As indicated above, the FTZs adopt a Negative List approach towards foreign investment management, which lists the sectors in which foreign investment is still restricted or prohibited. Foreign Investment projects on the Negative list are required to go through pre-approval procedures while foreign investment into sectors not on the list will require record-filing procedures.

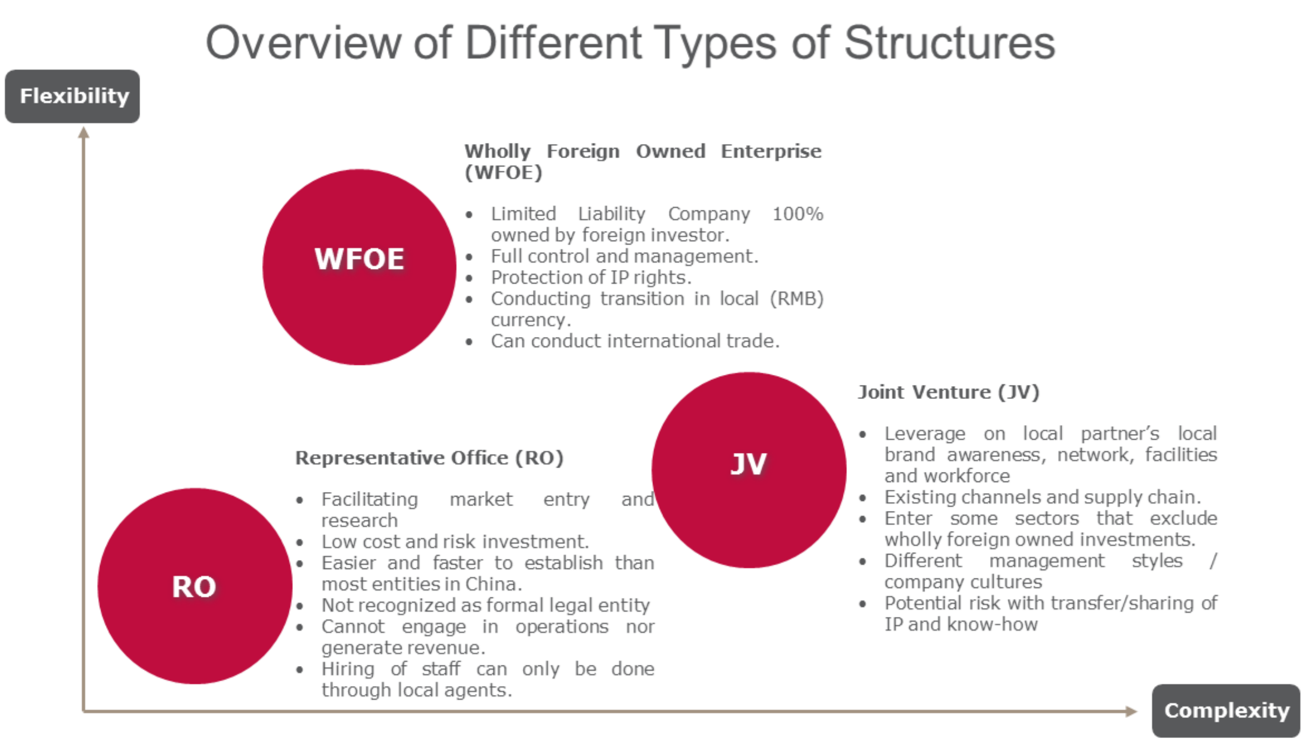
The latest edition of the negative list related to FTZs contains 32 major industries and 45 specific measures. It is worth mentioning that, compared with the "negative list of the Catalogue" above, many specific measures in FTZs have been significantly relaxed with more exceptions. For example, in the financial industry, investment is no longer prohibited, but restricted, and it is indicated that restrictions on the share of foreign capital will be abolished in 2021.

4.2 Choosing a Corporate Entity

Several different types of entities exist which can be used to enter the Chinese market. The different types of corporate entities will be discussed in this chapter. It is to be noted that mergers and acquisitions can also be used to tap into the Chinese market. For mergers and acquisitions, please refer to sections 4.5 and 4.6.

Types of entities

- *Wholly Foreign Owned Enterprise (WFOE)* – owned solely by a foreign investor (s)
- *Domestically Invested Enterprise (DIE)*– owned solely by mainland Chinese investor (s)
- *Joint Venture (JV)* – owned between a foreign investor and a mainland Chinese investor
- *Foreign Invested Partnerships (FIPSs)* – A Foreign invested partnership is an enterprise, where foreign companies and individuals are permitted amongst themselves or in partnership with China domestic individuals or entities to directly establish foreign invested partnerships (FIP) in China.
- *Representative Office (RO)*- a liaison office which is tied to its parent company (i.e. a shareholder which is overseas and must be a corporate entity – not individual).



Representative offices versus limited liability companies (a WFOE, for example) – a detailed comparison

The two most basic options for incorporating in China are:

1. a Limited Liability Company (LLC)

   or

2. a Representative Office (RO)

LLCs are independent PRC legal entities that are considered legally responsible for all their activities. LLCs are invested by a shareholder who can be an overseas company, domestic company or even an individual. There are no requirements in regard to the status of the shareholder.

ROs are not independent PRC legal entities, but rather liaison offices with a limited range of authorized activities. ROs can only be invested by an overseas corporate entity that has existed for more than two years. The RO's parent company is legally responsible for its activities.

In this section, we highlight the differences between LLCs and ROs with respect to:

- regulations
- business scope
- capital requirement
- corporate structuring
- employment of staff
- accounting requirements
- taxes
- annual maintenance obligations

Regulations

Changes in Representative Office (RO) regulations have altered the operational and financial effectiveness of using ROs in China. In China, over 50 percent of all foreign investors use the vehicle of ROs, but in light of the new regulations, many have been forced to close down and operate as Limited Liability Companies.
In addition, it can be seen that in the future, ROs, being formerly an inexpensive way to set up in China, are going to be phased out. In summary, the changes may include an increased tax burden which cannot be offset in the PRC, restrictions on activities, restrictions on employees and more government maintenance procedures on an annual basis.

Business Scope

LLCs may conduct business activities within the business scope of their business license as approved by the foreign investment approval authority and registered with the Administration of Industry and Commerce (AIC). It concerns most types of business and services, described in the Catalogue.

A Representative Office (RO) is prohibited from engaging in directly operational business activities. The limited activities permissible under new regulations are:

- Market research, product display and publicity activities relating to the foreign company's products or services, and
- Liaison activities relating to the sale of products or provision of services, and local procurement or investments, by the foreign company.

Capital requirement

In principal, unless they are operating in a restricted industry, LLCs and ROs are no longer under strict capital requirements.

ROs are only required to be funded by the parent company.

LLCs need enough capital to realize the company's operations, while their registered capital is the equity registered with the local authorities. Limited liability is recognized by the amount of registered capital injected into the LLC. These vary from industry to industry and also on a regional basis. Wherever the LLC is sited however, basic investment criteria remain the same; the government will look at the general viability of the project and take a reasonable cash requirement for a particular type of investment in consideration. It should also be noted that Registered Capital is additional to the amount that is required by the business to operate until it can break even.

In the past, LLCs were required to hold 30% of their registered capital in cash on hand. This requirement has been removed. The inference is that shareholders are now allowed to provide registered capital entirely through non-cash assets such as intellectual property, land use rights, etc., unless such assets for capital contribution is expressly prohibited by law. Nonetheless, different foreign investment laws still require foreign investors to pay certain amounts of registered capital in cash and set various deadlines for capital contribution. Therefore, although rules are no longer written in stone, it is still advisable to cap non-cash assets at 70% of the total registered capital.

Of course, there remains a great deal of confusion over the term 'Minimum Registered Capital'. Please keep in mind that the term is used by local governments as a guideline only. The government will require a numeric percentage expressed in the feasibility report and in the Articles of Associations.

The ratio requirement between total investment and registered capital is indicated by the authorities (see table) and must be specified in the LLC's Articles of Association and Feasibility Study Report, if applicable.

Total Investment (in USD)	**Registered Capital: Total Investment**
Up to 3 million (including 3 million)	At least 7:10
3-10 million (including 10 million)	At least 1:2
10-30 million (including 30 million)	At least 2:5
Over 30 million	At least 1:3

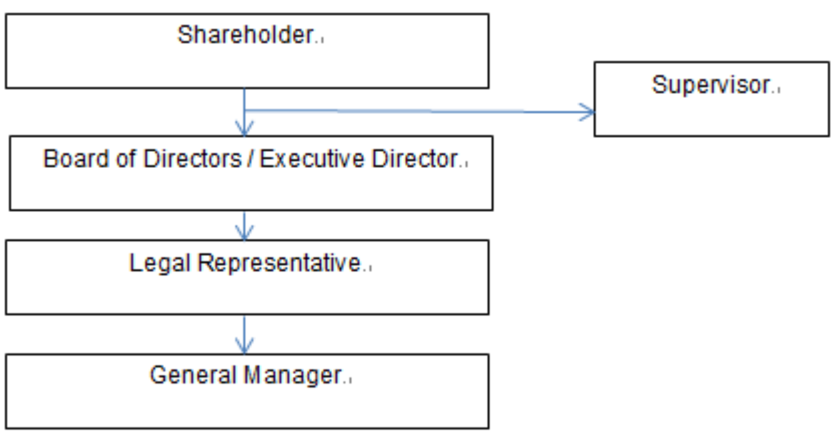
It is important to recognize Registered Capital amounts (your investment) should be measured against the businesses cash flow needs and not against minimum qualified amounts issued as guideline.

LLC Corporate structuring

The shareholder has the highest level of authority, subject to the Articles of Association. Aside from the Shareholder, people must be appointed to a number of key organizational positions, as follows:

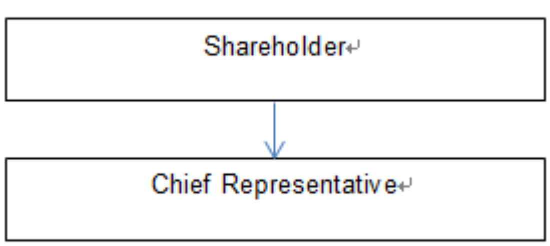
- The shareholder appoints the Board of Directors (minimum of 3 people) or Executive Director (if 1 person only). The role of the Board of Directors or Executive Director is to set the agenda of the company's operations according to the shareholders decisions.
- The shareholder also appoints the Legal Representative who is authorized to engage and represent the entity and who will be held accountable for any issues that arise within the China entity.
- The Board of Directors or Executive Director appoint(s) the General Manager. The role of the General Manager is to perform the day-to-day operations of the China entity.
- The shareholder appoints the Supervisor. The role of this position is to supervise the execution of company duties by the directors and senior personal management. To ensure there is no conflict of interest, a supervisor cannot concurrently hold the position of a Board of Directors / Executive Director, Legal Representative or General Manager.

The legal representative must hold the position of Chairman/Member of the Board and/or General Manager.



RO Structuring

For Representative Offices, a Chief Representative must be appointed by the parent company. The responsibilities of the Chief Representative are identical to those of Legal Representatives of LLCs.



Employment of foreign, Hong Kong, Taiwanese and Macanese nationals

LLCs may directly employ foreign nationals through employment contracts. While there is no rule explicitly limiting the number of foreign nationals who may be hired by LLCs, in practice, authorities do tend to enforce informal limits. Foreign employees of LLCs are not required to be registered with the Administration of Industry and Commerce.

ROs are statutorily limited to four foreign employees, who must also be registered with the Administration of Industry and Commerce

Employment of Mainland Chinese

LLCs are permitted to employ mainland Chinese nationals directly. The company can also handle social insurance activities directly. For temporary, auxiliary or substitute positions, LLCs can use staffing agencies, but for permanent positions they must hire directly.

On the other hand, ROs are not permitted to hire mainland Chinese nationals directly. They must be hired through third-party employment agencies, which become the Chinese employees' formal employers.

Accounting Requirements

Both LLCs and ROs are now required to produce all financial management reports. One significant accounting difference between the entities is that LLCs can offset expenses against revenues, while ROs must actually treat expenses as profit.

Tax Obligations

Both for LLC and RO Enterprise Income Tax, Value Added Tax, Surtax and Stamp tax apply. For their employees Individual Income Tax applies. All these are discussed in detail in chapter 7.

Annual Maintenance Obligations

Annual Audit Requirements: A LLC and a Representative Office must both perform end-of-year audit reports – a financial report. The report must be issued no later than May 31th of each year

Annual Individual Income Tax (IIT): All employees with following situations of a LLC or a Representative Office must submit an annual income tax declaration form by March 31st of each year.

Annual Profits Tax: A LLC and a Representative Office must submit the annual profits tax analysis and declaration form by May 31st of each year.

Annual Report: A LLC must perform a statistical analysis in the form of an annual inspection which must be submitted to the AIC before June 30th of each year. All application documents can be prepared independently.

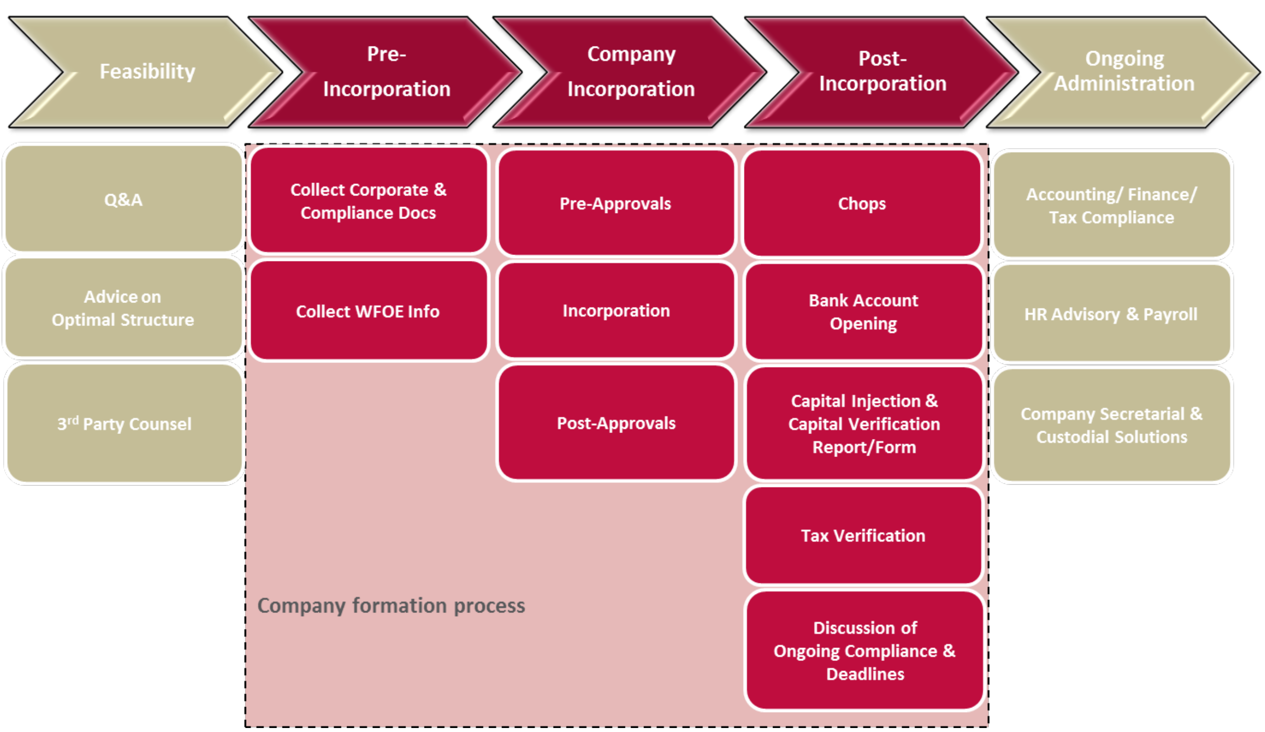
A Representative Office (RO) must perform a "RO Inspection" which is also an analysis of the activities performed by the RO. The parent company's documents must be notarized and submitted to the Administration of Industry and Commerce prior to June 30th of each year.

Conclusion: Why use a LLC versus a Representative Office (ROs)?

1. China is enforcing further restrictions on ROs and is investigating them more intensely. If the foreign investor is not 100% within his legal parameters of operating a RO, it would be highly recommended to avoid such a structure.
2. As you can see from the comparison above between LLC requirements and RO requirements, the activities which need to be performed are almost identical, implying that ROs are no longer a cheap and easy form of entering the market.
3. LLC offer greater flexibility in terms of business scope, employment of foreign and mainland Chinese staff and tax optimization solutions compared to ROs.
4. LLC means it is a fully registered legal entity in China and is capable of handling all activities legitimately. Companies who have a difficulty to choose between a RO or a LLC, are advised to go straight to the LLC structure. Should the business become viable, the company can avoid the costs of closing down the RO and establishing the LLC as a brand-new entity, which can be a rather complicated, costly and time-consuming process.
5. If you are not looking to have a "real" operational LLC, but only to handle the same functions that a RO would handle, then the LLC can be structured to a certain extent as a cost centre as well. Ask a consultancy firm for advice.

4.3 Registration and Incorporation of a Corporate Entity

It is complex to establish a company in China, because it involves approvals of various government authorities, such as MOFCOM, Administration for Industry and Commerce (AIC), Tax Bureau etc. It is also very time-consuming to complete the whole registration process, taking about 1 to 2 months. In order to make things go smoothly and efficiently, foreign investors coming to China are advised to always choose an agent to assist. In this paragraph we will only give a brief overview of the steps.



Pre-Incorporation
The pre-incorporation phase involves the collection of relevant information and documents required for the incorporation of a corporate entity. Different documents are required for different types of entities. This following table lists out the general documents necessary for the incorporation of WFOEs and ROs.

Company Incorporation

The incorporation phase is the most important and tedious phase. It contains 3 steps: Pre-Approvals, Incorporation and Post-Approvals. Each step requires the submission of relevant documents to obtain licenses specific to the industry. These steps will be explained in greater detail below:

<table>
<tr><th>WFOE</th><th>RO</th></tr>
<tr><td>Parent Company:
Background of Parent Company
Bank Reference Letter of Parent Company</td><td>Foreign Enterprise:
Bank Reference Letter of Foreign Enterprise
Background of Foreign Enterprise. i.e. Company Summary
Articles of Association for the Foreign Enterprise
Certificate of Good Standing and the relevant Registration Documents of the Foreign Enterprise (Documents should show that the Foreign Enterprise is a live company and has an operating history of 2 or more years and state its registered address)
A power of attorney on who will sign all necessary documents for RO</td></tr>
<tr><td>WFOE Information Checklist:
Preferred Company Name
Business Scope
Feasibility report (or Business Plan)
Registered Address
Authorized Representative
Organizational Structure</td><td>Registered Address of RO:
Details of Property including the Lease Agreement and other relevant documents provided by the landlord</td></tr>
<tr><td>2 Sets of Notarized Documents:
Certificate of Company Registration Documents, including Articles of Association that shows the updated detailed information of the Holding company
Certificate of Incorporation of Holding Company (Certified photocopy)
Business Registration Certificate of Parent Company (Certified photocopy)</td><td>2 Sets of Notarized Documents:
Bank Reference Letter of Foreign Enterprise
Articles of Association for the Foreign Enterprise
Certificate of Good Standing and the relevant Registration Documents of the Foreign Enterprise (Documents should show that the Foreign Enterprise is a live company and has an operating history of 2 or more</td></tr>
</table>

• Report Form of Annual Return • A power of attorney on Authorized Representative who will sign all necessary documents for the Holding Company	years and state its registered address) • The appointment document & ID/passport of the chief representative and other representatives • A power of attorney on Authorized Representative who will sign all necessary documents for RO
Authorized Representative: • Identity Certificate (Certified photocopy) • Passport of Authorized Representative (Certified photocopy)	*Authorized Representative:* • Identity Certificate of the Authorized Representative of the Foreign Enterprise (Certified photocopy)
Relevant Documents of the Registered Address of WFOE: • Lease Agreement (Original copy) • Other Lease-Related Documents	
Identity Verification of WFOE's Key Personnel: • Passport of Legal Representative (Certified photocopy or original) • Passport of Director(s) (photocopy) • Passport of General Manager (photocopy) • Passport of Supervisor(s) (photocopy)	*Chief Representative:* • Appointment Letter for the Chief Representative signed and endorsed by the Authorized Representative of Foreign Enterprise • The Passports (Photocopies, including the signature page) of the Chief Representative

Pre-approval and post-approval licenses

Depending on the category to which the foreign invested company belongs: encouraged, permitted, restricted or prohibited (see paragraph 4.1) specific licenses are required. The most recent revision of the Foreign Investment Catalogue (June 28, 2017) reflects China's current emphasis on advanced technology and materials by encouraging increased research and development activities and the adoption of new technologies, methods, materials and equipment. A handful of industries have been added to the "encouraged" category, which includes, among others, industrial design, construction design, garment design and development/application of the Internet of Things (IOT).

While some licenses need to be obtained before the responsible authority can issue a business license (pre-approval licenses), others can only be applied for after the business license is issued (post-approval licenses).

Industries with specific licenses include construction and architecture, medical and pharmaceuticals, education, banks and securities and many others. It is vital that foreign investors include all the regulatory requirements in their business operations in a timely manner.

Sector-specific licenses

Prior to entering the Chinese market, foreign investors need to be well informed about the licenses needed to operate their specific businesses, in addition to the normal business licenses. We will describe the licenses needed for a manufacturing WFOE in China and some other examples. However, the licenses are sector specific so please consult an experienced agent for the specific licenses you need.

Example: Incorporation of a manufacturing WFOE in China

For setting up a manufacturing WFOE there are some additional steps and procedures before incorporation can be initiated. We list them here very briefly.

- *Signing-off a Letter of Intent with an Industrial Park*

Manufacturing companies are usually clustered in an Industrial Park. Prior to the incorporation, a Letter of Intent covering the investment shall be signed between the investor and the Administrative Committee of the Industrial Park.

- *Environmental impact assessments*

Environmental Impact Assessments (EIAs) are required for all projects in China involving any construction. Anyone building (or modifying or renovating) a warehouse, an R&D facility, commercial office space, a manufacturing facility, a restaurant, or a new housing development needs to prepare an EIA.

The EIA is one of the first items prepared in the extensive list of documents and forms that must be submitted to obtain approval for a project in China. The EIA Report and EIA Approval constitute a part of the Project Application Report ("PAR"), which must be filed with and approved by the National Development and Reform Commission (or its local bureaus) before any foreign invested project can be undertaken.

EIA Reports (and EIA Forms) must be completed by qualified EIA consultants. There are two qualification levels for consultants, "A" (the highest) and "B" licenses, that are based on the prior experience and size of the consultant. Those holding B licenses may complete EIA Reports which can be approved by provincial level (or below) Environmental Protection Bureau (EPB) authorities. A consultant holding an A license is required if the EIA needs to be approved at the national level by the Ministry of Environment and Protection (MEP)

- *Land issues*

Prior to building a factory, the investor shall ascertain the classification of the land and the land ownership. There is state-owned land and collectively owned land. The latter cannot be used for purposes of manufacturing incorporation. The investor can purchase the land-use right from the state for a specified number of years. Only this kind of land can be used for incorporation. Due diligence on the classification of the land and the land ownership shall be conducted by a qualified legal company.

- *Construction-related permits*

Even if the land use rights have been acquired, a request must be made for the approval of the construction. Before the construction begins, the building company (or investor) shall apply for the Planning Permit of Using Land for Construction Purposes from the Municipal Commission of Urban Planning, which evaluates the project's impact on city planning and ensures that planned construction complies with city regulations.

Further to the approval of the Land-use Planning Permit, the building company (or investor) also needs to request and obtain the Construction Project Planning and Construction Project Working Permit from the Competent Department of Urban Planning and the Municipal Construction Commission respectively. Without these permits, the building company cannot initiate any construction work.

- *Safety assessment*

All project construction companies must obtain the certificate of safety operation. To obtain it, the building Company must file the annual building plan and the construction's planning permit with the Safety and Quality Supervision Office of the Municipal Construction Commission.

- *Certificate of completion*

Before the Certificate of Completion is issued by the Municipal Construction Commission, the below requirements must be completed:

- ✓ Inspection of completed fire-fighting equipment by the Fire Protection Bureau
- ✓ Register construction drawings at the People's Civil Defence office
- ✓ Request Opinion on inspection and acceptance of a lightning-proof construction project from the Weather Bureau
- ✓ Review of construction drawings by local City Appearance and Environmental Sanitation Administration Bureau
- ✓ Inspection of completed construction from the environmental protection department
- ✓ Receive on-site inspection by the Construction Commission
- ✓ Inspection of water and sewage connections

- *Registering the building with the real estate registry*

The factory considered here should fall into the category of non-residential real property, in which case the registry procedure will take 20 days from receipt of the application. The cost is calculated according to the actual property value.

- *Business scope*

On the grounds that the construction period might be time-consuming, even lasting more than two to three years in some cases, the Business Scope under the Business License granted by the authority will include a note that "Operations are forbidden in the construction period." With such scope, the company is only able to conduct a pilot run, but no actual business activities, manufacturing or transactions can be performed. Once the construction is completed, the investor shall apply for a change in the business scope and then delete the foregoing note in the Business Scope section at the local Administration Bureau of Industrial and Commerce.

Example: setting up a restaurant

A Belgian investor would like to set up a restaurant in Shanghai. In addition to catering services, he also wants to supply beverages containing alcohol such as French wines and German beers. To ensure that the flavours in his inventory are genuine and traditional, food and beverages will be imported on a regular basis. His restaurant will order certain specialties and sell these as pre-packaged foods to customers.

In terms of his business activities, specific licenses need to be applied for before he can start operating his restaurant.

Business Activities	Licenses Requirement	Pre/Post Approval License	Government Department in Charge
Catering /Kitchen Services	Opinion Letter on Environmental	Post -Approval	Environmental Protection Bureau
	License of Catering Services	Post -Approval	Food and Drug Administration Bureau (FDA)
Import of Foods and Alcoholic Beverages	Food Circulation Permit	Post-Approval	Food and Drug Administration Bureau (FDA)
	Import & Export Permit	Post-approval	Entry-Exit Inspection and Quarantine Bureau, SAFE, Customs, Bureau of Commerce
	Filing Procedures for Import Food	Post-Approval	Entry-Exit Inspection and Quarantine Bureau
	Import and Export Food Label Verification Certificate	Post-Approval	General Administration of Quality Supervision, Inspection and Quarantine

Example: Lamb business

A Dutch client plans to import lamb from Australia and sell it in Chinese supermarkets. Aside from the normal incorporation licenses, what special licenses are necessary in order to sell food? Similar to the restaurant, there are some food industry licenses that should be obtained. Particularly, meat has a special classification among food items and all imports are subject to animal quarantine requirements.

Business Activities	Licenses Requirement	Pre/Post Approva	Government Department in Charge
Wholesale of Pre-packaged Food or Bulk Food	Food Circulation Permit	Post - Approval	Food and Drug Administration Bureau (FDA)
Imports of Foods	Import & Export Permit	Post-Approval	Entry-Exit Inspection and Quarantine Bureau, SAFE, Customs, Bureau of Commerce
	Filing Procedures for Import	Post-Approval	Entry-Exit Inspection and Quarantine Bureau
	Import and Export Food Label Verification Certificate	Post-Approval	General Administration of Quality Supervision, Inspection and Quarantine
Imports of Meat	Meat can be shipped from approved countries and producers in accordance with the PRC Meat Admittance List	Post-Approval	General Administration of Quality Supervision, Inspection and Quarantine
	Filing Consignee of Imports of Meat	Post-Approval	General Administration of Quality Supervision, Inspection and
Annual Import Quota of Meat	Entry Animal and Plant Quarantine Permit	Post-Approval	General Administration of Quality Supervision, Inspection and Quarantine
	Quotas will be granted on an annual basis in accordance with the bilateral treaty between China and the country of origin. The accumulated import volume should not exceed the annual quota granted by	Post-Approval	General Administration of Quality Supervision, Inspection and Quarantine

Incorporation

The process of actual incorporation of the Chinese entity includes the following steps:

1. *Company Name*
   A name availability check has to be done with the State Administration of Industry and Commerce (SAIC). It is advisable to prepare up to 4-5 preferred Chinese company names in advance in case the preferred one is unavailable. Reservation of the Chinese company name can be made upon availability check.
2. *Approval Certificate/Filing at* Local Bureau of the Ministry of Commerce
   In the past, an approval certificate had to be obtained from the Local Bureau of the Ministry of Commerce. This certificate granted foreign investors the approval

to set up a company in China, and documents prepared at the Pre-Incorporation stage will be required at this stage. However, since late 2016, the approval system has been changed to filing system: The establishment of foreign-invested enterprises that does not involve the implementation of special administrative measures on entry (negative list) as prescribed by the state is changed from examination and approval to filing management. The establishment filing of a foreign-invested enterprise may be made not only before the issuance of the business license, but also within 30 days after the issuance of the business license.

3. *Business License*

   The Business License signifies the official establishment of a legal entity under the PRC law. It is issued by the local Bureau of the State Administration of Industry and Commerce (SAIC) and requires the submission of relevant documents prepared at the Pre-Incorporation stage. Please note since late 2015, there has been a big change in Business License: five certificates are integrated into one business license, including Business License, Organization Code Certificate, Tax Registration Certificate, Social Insurance Registration Certificate and Statistics Registration Certificate. It simplifies the establishment process and shortens the official processing time for the whole process.

4. *Foreign Exchange Registration*

   Previously, companies need obtain the Foreign Exchange Registration Certificate from the State Administration of Foreign Exchange (SAFE). The certificate permits the company to open a foreign capital account for the purpose of capital injection. Currently, SAFE has granted banks to apply for this permit on behalf of the companies. It means companies don't need apply to SAFE directly but entrust the bank where they want to open their accounts to do this application for them.

Post-Incorporation

Bank Accounts

At least 2 bank accounts will have to be set up after the incorporation of the legal entity. These are namely the RMB basic account and foreign capital account. The procedures, costs and required documents vary for different banks.

Capital Injection

After the set-up of the required bank accounts, the company can proceed to inject capital from the foreign investor's overseas bank account.

Company Chops

Every company in China has to obtain 4 chops, namely the Company Chop, Legal/Chief Representative Chop, Finance Chop and Invoice Chop. The Company Chop is used as contract seals, the Legal/Chief Representative Chop represents the approval of the legal/chief representative, and the Finance Chop endorses the bank transactions while the Invoice chop is required for all invoices issued to be effective.

Tax Verification

Tax verification is still required after Business License is issued. But about the time requirement, it depends on the local tax bureau.

Ongoing Compliance

Foreign investors should not undermine the importance of the legal entity's ongoing compliance. Ongoing compliance could be more complex and demanding than the incorporation process if foreign investors are unfamiliar with the procedures and deadlines which they have to comply with under the PRC law and regulations. For example, tax filings are done periodically, and the employment of human resources requires certain administrative work. In this regard, foreign companies which are unfamiliar with these procedures should seek advice from well-established firms which provide advisory services.

4.4 Common Mistakes Investors Make when Forming a WFOE

Only the basics of setting up a WFOE were discussed in this chapter, as it is a very detailed process. Although mistakes are difficult to avoid in this process, we want to mention some common mistakes.

Establishing a local company by using the name of a local staff member
Setting up a local company by using a local proxy's name is prohibited or restricted in a variety of sectors and incurs high risks. The local company then belongs to the proxy, regardless of what may be stipulated in the contract; as such an arrangement is in contravention of the law. Furthermore, dividends from such a local company cannot be transferred outside China, as there is no legal foreign shareholder.

Capital injection and currency
RMB is the currency of ideal choice, to avoid the need for more cash injections due to a fluctuating exchange rate. However, it is difficult and more time-consuming to open a RMB capital account and it is more complex to settle money from RMB capital account to RMB basic account. So, before you decide to open a RMB capital account, please consult with the bank. When transferring the RC, bank charges should not be deducted, or the amount of capital may be below the RC and constitute cause for an additional separate transfer.

For some banks, the amount transferred should not exceed one percent of the RC, otherwise the injection may be rejected and returned.

Although it is not a mandatory to issue capital verification report after RC is injected, some business activities may require such report. For example, bidding, financing. Therefore, it is suggested to think carefully whether you need ask a CPA to issue the verification report as soon as possible after the capital is contributed.

Difficulties with decreasing registered capital
The registered capital is at least equal to the amount that is required by the business to operate until it can break even. However, how can the investors withdraw this capital or apply for a capital reduction after the break-even point?

The Chinese Company Act stipulates that the shareholder is entitled to ask for a decrease in capital. Nevertheless, the Chinese authorities do not welcome the idea of a company cutting down on its investment. Such approval will take a considerable amount of time and may lead to additional inspections.

IP rights contribution

- A qualified assets appraisal company will be required to issue an appraisal report on the value of the IP rights, and this price will be used to calculate the size of the contribution.

- When the contribution is made in IP rights, the ownership of IP needs to be transferred to the proposed WFOE.

Inappropriate premises and ownership certificate

The qualifications and certifications of the landlord and the office need to be verified, in order for the lease contract to be accepted by the authorities for incorporating the company. Some key points need to be checked before signing the lease contract. This list includes, but is not limited to:

- Any potential disputes relating to property rights or property rights restrictions
- An integrated premise which has been divided without registration
- Whether the landlord or owner has been involved in illegal construction
- Safety standards not met
- Consent of the mortgager
- Appropriate classification: Commercial, industrial, residential or retail.

Relocation

Relocation of an office involves a new application procedure. Relocation within the same district needs to update all the certificates and licenses. In the case of relocation across districts, the whole process is deregister all the certificates and licenses in the previous district and register new ones in the new district, and the most complex step is a tax clearance needs to be approved before the relocation. The original tax bureau will review all the tax filing records of the company before approval for moving to the new district is issued. The tax clearance usually takes at least three months and requires close monitoring.

Business Case: Moving to the other side of the river

A Dutch company decided to relocate from Pudong New Area to Huangpu district. The relocation process was very exhaustive. The tax clearances took almost one year because the tax officer needed to review all the tax filing records, including the corporate and individual tax records. During the tax clearance, the company needed to return all the original VAT invoices, which severely influenced their normal trading business.

Start-up funds before issuing the business license

A WFOE is incorporated when the business license is received. Foreign investors may be eager to start operations but need to cover start-up costs such as the rent deposit, decorations, IT network, computers and other equipment. It is worth noting that in practice, such start-up funds will be difficult to get approval from the State Administration Bureau of Foreign Exchange (“SAFE”) to be paid back to the investor.

4.5 Entering China through an Acquisition

As an alternative to a greenfield investment, an acquisition can provide efficiencies for start-up ventures by reducing the timeline and associated costs related to setting-up operations and facilities, locating suppliers and trade partners, and hiring and training employees. In practice, however, due to differences in management styles, cultural differences (both company culture and Chinese culture) and unfamiliarity with the overall Chinese business environment and practices, operation of the existing Chinese business after the acquisition may be challenging, especially if the business will have to be integrated into the business of the new shareholder.

Before considering an acquisition of a Chinese company, a foreign investor will still have to check whether there are any restrictions on foreign investment in the specific industry in which the Chinese company is active. See chapter 4.1 for details.

Types of acquisition

Once a target has been identified, foreign investors have the choice of purchasing an equity interest in the Chinese company (an equity acquisition), or only (certain) assets (an asset acquisition). Each option has certain benefits and disadvantages. This section does not discuss the acquisition of a listed company.

Equity acquisition
An equity acquisition is usually favoured by the seller, is generally more tax-efficient and may be easier and quicker to execute because it only requires the transfer of the equity interest instead of separate transfers of the assets, contracts, permits, licenses and employees. The disadvantage of an equity acquisition is that all liabilities of the company will be taken over, including liabilities which may not be discovered during the due diligence investigation. In China equity acquisitions are far more popular than asset acquisitions.

Depending on the details of a specific transaction, a transfer of an equity interest in a Chinese company to a foreign investor can be subject to regulatory restrictions and approvals, for example because the company is active in a regulated industry (see 4.[1] above). After completion of the relevant approval process, the transfer of the equity interest will need to be registered with the Administration of Industry and Commerce (AIC) followed by other registration formalities to reflect the change in ownership of the equity interest.

In an equity acquisition, the counterparty to a contract of the target company may obtain certain rights as a result of the equity interest transfer in case the contract contains a so-called "change of control" provision. Careful attention will have to be paid to such provisions in the due diligence investigation and mitigation of negative consequences will have to be discussed with the seller.

Asset acquisition
An asset acquisition may be a suitable option if the buyer does not want to take over certain liabilities of the existing company. Generally speaking, any existing obligations, liabilities or restrictions of the company that are not assumed by the acquiring party will remain the sole responsibility of the company. In addition, asset acquisitions may be exempted from approvals of PRC authorities, especially if a foreign investor can structure the asset acquisition through one or more of its existing Chinese subsidiaries. However, asset acquisitions will generally result in a higher tax burden, such as payment

of value added tax, business tax, income tax, stamp duty and deed tax for transfer of real estate.

In case the buyer first needs to establish a new legal entity in China which will acquire the assets, it will need to obtain the relevant approvals from the Chinese authorities for such establishment followed by administrative registrations and filings (see section 4.[2] and 4.3[3] above). Also transfer of operational permits or obtaining new permits will require approval from the relevant governmental authorities, which may take a considerable amount of time.

Acquisition of state-owned enterprise

As a remnant of its planned economy history, China has a large number of state-owned enterprises ("SOEs") or companies with state-owned interests. There are differences in the characteristics and process of the transaction when acquiring a privately-owned enterprise or an SOE. In practice it can be difficult to determine which approval and registration procedures will apply to an acquisition of a certain SOE. The exact requirements can only be determined on a case-by-case basis depending on the supervision structure of the relevant SOE.

Main differences between negotiating deals in China and the Benelux

Deal flow and the quality of acquisition targets, as well as the size of the deals – due to very fragmented markets in almost all industries (except those restricted for foreign investors) - make the Chinese deal environment different from that of the home market.

In addition, valuations on expectations by Chinese sellers tend to be higher than with similar transactions in the home market and may not always be in line with the underlying performance and future business potential of the acquisition target. The valuation gap may result in lengthy discussions during a deal process which already tends to take longer than in the Benelux.

The following points may be good to keep in mind when negotiating an acquisition with a Chinese party:

- Cultural differences should not be underestimated.
- Personal contact and mutual trust are of central importance.
- Regulatory approvals are much more extensive in Chinese M&A transactions (all transactions need approval at a certain level).
- Chinese rules and regulations are not always clear and can be contradictory. In addition, rules and regulations are not always applied consistently and authorities in different cities may adopt different practices. The Chinese counterparty may therefore from time to time find it difficult to clearly explain certain legal requirements.
- The Chinese party should not have the feeling that it is getting the short end of the stick.
- The process is one of negotiating and re-negotiating until both parties are satisfied. Certain points of discussion may be ”agreed” upon several times before reaching the final agreement.

- Points which appeared to be agreed upon by the persons present at the negotiations table may actually be subject to sign-off by higher placed personnel.

Involving a legal advisor with experience negotiating acquisitions in China is a good idea to navigate the many legal and cultural pitfalls.

4.6 Due Diligence for an Acquisition

Due diligence is a critical part of any acquisition, but in China it is of greater importance than in the Benelux in enabling you to understand the underlying financial performance of the business as well as any hidden details which may impact your valuation.

Due diligence in China mostly focuses on the following categories:

- Financial and Tax due diligence;
- Legal and Regulatory due diligence;
- Operational and HR due diligence;
- Technical and Environmental due diligence.

More and more Western companies are first performing market due diligence and commercial due diligence before deciding whether to access the Chinese market. In any market due diligence, the political agenda and reforms following from such agenda will be an important consideration.

For many aspects of due diligence, it is crucial to choose competent advisors who are familiar with the unique characteristics of doing business in China and are familiar with specific issues, such as:

- Lack of (reliable) publicly available information.
- Financial fraud: it is not uncommon for a Chinese company to have more than one set of accounts.
- Compliance with anti-bribery laws: in China compliance with anti-bribery laws should always be part of the due diligence; the scope of the compliance due diligence depends on the type of business of the target and the third parties involved (government, distributors, etc.).
- HR compliance: Chinese companies often underpay social security, housing funds, overtime pay, etc.
- Employee retention and integration: you should agree with the seller which employees are crucial for the business and agree with these individuals the terms under which they can be retained after the transaction.
- Reliance on related party transactions or funds flowing from one related entity to another: this may result in a different financial performance when these flows are terminated after the transaction to the new owner.
- Licenses for specific businesses: the target company may not have proper licenses / permits for its specific businesses.
- Land use rights: different types of land use rights have different implications on what a company is allowed to do with the land and whether you can mortgage

it for borrowing. Verifying how the target company has obtained the land use rights is important.

- Tax avoidance: Chinese companies typically underpay taxes.
- Preferential tax treatments and other benefits may not continue to be applicable after the transaction or may be clawed back if there was no legal basis for such benefits.
- Unrecorded commitments and liabilities: although accounting standards have changed, it is still common practice for many Chinese companies to follow the cash basis of accounting. Hence, the accounting records may not reflect all liabilities, and the payment of taxes may have been delayed.
- Environmental claims: nowadays environmental laws are more strictly enforced, and fines may be very high.

Preliminary preparations

Due diligence team
Organizing a due diligence team experienced in doing due diligence in China will be important for an efficient and meaningful due diligence investigation. The team should consist of in-house financial, business and legal persons (preferably with M&A experience) and other expert personnel depending on the type of business to be investigated, complemented with external advisors. Since most documentation will be in Chinese, sufficient Chinese language capabilities should be added to the team. It is always a good idea to appoint a designated due diligence team leader to ensure all the team members will receive the information needed to perform the investigation and to meet the agreed timeline.

Gathering information
In sales processes in the Benelux the seller may have already organized a data room itself containing documents it believes to be relevant for a potential buyer. In China this is not always the case. If the seller has not yet established a data room, it is common practice for the potential buyer to prepare a due diligence questionnaire to request the information it deems relevant for its due diligence. The scope of the questionnaire may vary significantly depending on the nature of the transaction (e.g. majority or minority stake), the business activities of the target and the requirements of a particular buyer.

The collection of data for conducting a comprehensive due diligence can be cumbersome and time-consuming in China. Chinese parties can be less experienced in setting up a data room and can be reluctant to disclose information to outsiders. Even if Chinese parties are willing to cooperate, particular sets of information or documents may simply not be available due to a lack of proper filing and book-keeping. Publicly available information on the other hand may not be accurate and reliable. For these reasons, an on-site inspection by the due diligence team to go through the books and records of the target company may be helpful. Also interviews with the management of the target company and selected key customers and suppliers can provide valuable information.

Non-disclosure agreement
Before a seller will allow access to due diligence documents, it will usually require the potential buyer to enter into a non-disclosure agreement ("NDA"). An NDA contains the obligation for the potential buyer to keep all information it will be provided with during the due diligence process confidential and to ensure that all employees and advisors who have access to the information will adhere to the confidentiality obligation.

Outcome of due diligence

The goal of a due diligence is to gather sufficient information about the target company to be able to make a go / no go decision. If the decision is made to proceed with the acquisition, seller and buyer will negotiate about allocation of known and unknown liabilities in relation to the target company. The outcome of such negotiations will be reflected in the sale and purchase agreement. Chinese parties may not have experience in negotiating transaction documentation and M&A concepts which may be standard in transactions in the Benelux may therefore not be known to Chinese sellers.

Some examples of how due diligence findings may be reflected in the sale and purchase agreement are the following:

- the target company is involved in litigation: the buyer may seek to obtain a specific indemnity from the seller to cover for the costs of litigation and any damages in case the target company will lose the case;
- a permit which is required to operate the business of the target company is not in place: the buyer may request the seller to first obtain this permit before it will proceed to close the transaction
- a contract with a key customer contains a so-called "change of control clause": the buyer may request the seller to seek confirmation from this key customer that it will continue its contract with the target company after the buyer has become the new owner of the target company.

4.7 Pros and Cons of Setting up a Company in Hong Kong

Companies must first decide on the best investment structure by weighing the pros and cons of each business vehicle against their own business goals. One of the common strategies is to include an off shore vehicle as the investor of the Chinese entity. Due to Hong Kong's special relation with China, Hong Kong is the commonly used jurisdiction for this type of structures.

Double Tax Agreement
One of the most used arguments for having a Hong Kong company as the owner of a Chinese entity is the tax advantages. It is correct that in some circumstances the Hong Kong structure may reduce tax burdens in China. However, it has become more and more difficult to enjoy these fiscal advantages.

Based on the Double Taxation Agreement between China and Hong Kong, a Hong Kong company can benefit from a lower tax rate (5% instead of 10%) for the dividend that it will receive from its Chinese subsidiary. However, China has made it more difficult over the years to apply this lower rate. Currently the requirements are as follows:

- the overseas recipient (the Hong Kong company) of the dividend must be the beneficial owner of the dividend. This requirement can be met if the Hong Kong company has substance in Hong Kong meaning that if the Hong Kong company is only a holding with no actual office and/or local employees, it cannot enjoy the tax reduction. This requirement is to avoid that offshore vehicles were just created and used for the enjoyment of the tax benefit while the real dividend recipient (the investor of the Hong Kong company) is located in a jurisdiction without a China-treaty and,
- the Hong Kong company has to hold at least 25% of the capital of the Chinese entity.

It should be noted that the first requirement (i.e. examining the beneficial ownership of the dividend) applies equally to other jurisdictions. For example, if the Chinese entity is held through a UK holding company, who wishes to enjoy the China-UK tax treaty, the business substance of the UK entity would be called into question.

Another fiscal issue which relates to having a dedicated holding company in an offshore jurisdiction like Hong Kong relates to the transfer of shares. Under certain conditions, the Chinese authorities may adopt the view that a transfer of shares on the holding level should be viewed as an indirect transfer of shares on the China level and should be subject to Chinese capital gains tax (which may be withheld on the China level). Although enforcement of this circular across China is not uniform, investors should be aware of this regulation.

The fiscal climate in Hong Kong is very clear: corporate profits are taxed at 16.5%, while profits gained from offshore trade, outside of Hong Kong, are exempted. Hong Kong relieves its companies from the financial burdens of other taxes such as capital gains, withholding tax, business tax and value added taxes (VAT). Hong Kong also has tax treaties with multiple countries (i.e. all the Benelux countries) which could result in tax relief.

Based on the above, we would not base the choice of a Hong Kong company structure (or any offshore holding structure) on tax considerations alone. There should be a mix of general benefits.

Other benefits

Other benefits of the Hong Kong – China structure are:

- Shareholder's arrangements related to the Chinese business can be implemented in the Hong Kong company. This gives more flexibility compared to having the shareholder's arrangements on the China level: exit-mechanisms such as put and call option arrangements are not common in China, Chinese authorities do not always approve them, and Chinese courts do no always know how to apply them. The same applies for structure changes: it is less complicated and time consuming to transfer shares, appoint or deregister directors or change the Articles of Association of a Hong Kong company while in

China, all those changes require approvals from different government departments and may also be rejected.

- Hong Kong companies and businesses are allowed, if it meets certain requirements, to be active in certain industries on mainland China that are restricted or more strictly regulated for companies and businesses originating from other locations.
- CEPA is a free trade agreement concluded by the Mainland and Hong Kong. CEPA covers three areas: trade in goods, trade in services, trade and investment facilitation. CEPA has strengthened the trade relationship in goods and services, and fostered trade and investment facilitation between the two places and are conducive to accelerating the economic integration and enhancing the long term economic and trade development of both places.

Hong Kong company

Most small to medium-sized firms in Hong Kong are set up as limited liability companies. A private limited liability company must have at least one founding member taking at least one share, at least one natural person as director, (company) secretary and registered address in Hong Kong. The liability of the shareholders is limited to the amount of their respective shareholdings/investment. There is no minimum capital investment requirement. The shareholders declare the contribution of the capital but are not required to pay money to the company.

It is relatively simple to incorporate a Hong Kong company and incorporation can be finalized in approximately 2 weeks.

Due to more strict internal due diligence and compliance policies it is more complicated to open a bank account in Hong Kong these days. However, if the company succeeds to open a bank account, it will benefit from the facilities such as having bank accounts in multiple currencies, the use of internet banking, and easy international transfers while using the banks' global network.

Hong Kong functions under the common law system adopted when it was still a British colony and Hong Kong is one of the two "Special Administrative Regions" of China (the other being Macau). Under the "One Country, Two Systems" policy, Hong Kong enjoys greater commercial, political and personal freedom. It has an advanced and stable bilingual legal system with independent courts, international arbitration centers and professional attorneys.

Other considerations

Maintenance of a Hong Kong vehicle can be costly in comparison with jurisdictions such as BVI or Seychelles due to the audit requirements. The company is obliged to prepare annual audited accounts and to file tax returns.

Another cost aspect is that a Hong Kong company has to appoint a company secretary who will also deal with corporate matters and the company also needs to be domiciled in Hong Kong which means that a fee for the registration address needs to be paid. If the company wants to have an active office in Hong Kong, it should take into account that costs of living, salaries and real estate prices are relatively high.

Conclusion
A vibrant and fast changing business environment such as China creates many opportunities. Using a Hong Kong limited company strategy for your mainland China investment may generate more flexibility and provide an extra layer of protection to lower your long-term risks. Nevertheless, cautious planning is essential in order to execute a successful business structure.

4.8 Renting an Office

Office leasing: Procedures and common practices in China
The leasing processes for setting up a new office for the first time, renewing the current lease, or relocating to other premises are relatively similar. This leasing overview will describe the basic framework and standard procedures of a typical new office letting, taking into account market practices and common pitfalls. This overview does not cover pre-lease (e.g. business registration) or post-lease considerations (e.g. design and construction). The procedures outlined are for an office of maximum 500 square meters. For larger offices more steps will be required. When an organisation begins to look at its real estate requirements, it needs to follow this process in order to arrive at a decision that will account for all business concerns and explore all potential scenarios.

Phase I: Confirmation of facilities requirements
The first and most important step for any real estate transaction is developing a list of business requirements. This list will help start the project, and the use of a real estate agent to assist is highly recommended. Agent costs are mainly for the lessor, i.e. the landlord.

The agent will:

- Understand the business goals and objectives in order to incorporate that knowledge into a complete real estate proposal.
- Structure a timeline for each scenario that specifies all milestones and assigns responsibilities to the project stakeholders.
- Create a detailed "Statement of Requirements" based on the needs associated with the transaction, such as:

    - Timing
    - Space projections
    - Parking requirements
    - Location criteria
    - Budget
    - Expansion/Contraction capability
    - Renewal options and caps
    - Subletting
    - Required amenities

    - Technical requirements and base-building specifications
    - If landlord can issue fapiao accordingly and if any extra tax rate should be paid

Phase II: Market research and analysis
Companies need to be aware of recent transaction data in the market in their preferred commercial district, so as to have an estimation of the costs.

A good real estate agent will put together the following:

- An overview of the real estate market, including:
    - Leasing practices
    - Current market conditions, vacancy rates, take-up rate, etc.
    - Projections of future market conditions
- A survey identifying all options available that meets the Statement of Requirements.
- An analysis of the available options based on the likely financial terms at each location and the degree to which each complies with the Statement of Requirements.
- A schedule for site visits to each location.
- A shortlist of properties based on the initial analysis and site visits.

Phase III: Request for proposal
Once all relevant market information has been gathered and a list of potential relocations options has been identified, tenants are ready to begin the negotiation process with respective landlords. The first step in this process is the Request for Proposal (RFP), whereby the agent makes a list of wants and needs for the tenant's approval. This list will be incorporated into a formal document, the RFP, which will be submitted to the landlord for a response. Further negotiation by the agent on the tenant's behalf will lead to an executed Letter of Intent (LOI), which forms the basis for the formal Tenancy Agreement.

During this process the tenant may:

- Develop a comprehensive RFP for submission to each of the short-listed options.
- Meet with each of the prospective landlords or developers to ensure that there is a clear understanding of the objectives and timing of each project.
- Tell the agent to issue the RFP.

When an agent issues an RFP to a landlord on behalf of the tenant, it can take up to ten working days to receive a formal response.

Phase IV: Proposal analysis and business term negotiation
Upon receipt of the initial offers, the real estate agent may assess the financial and non-financial terms with the tenant. This includes:

- Completing a detailed qualitative and quantitative analysis based on the responses to the RFP.
- Making a financial analysis comparing the total cash and discounted costs of each option.

The goal of this exercise is to enable the tenant to make the most fully informed decision based on this data. For the sake of convenience, the LOI and Tenancy negotiation stage may be conducted in English. However, the official Tenancy Agreement will be written in Chinese, with an English translation prepared for reference. The Chinese agreement is the one that applies in cases of dispute. For a small office, the agent's legal advice on the LOI and the Tenancy agreement may be sufficient, but for a larger office the services of a legal advisor with extensive China experience are highly recommended.

Phase V: Approval documentation and lease negotiation

Once the tenant and landlord have agreed to all the principal commercial terms (LOI execution), the Tenancy Agreement must be negotiated. Upon signing of the LOI, the tenant is required to pay the first part of the deposit, generally equivalent to one month's gross rent and property management fee. During this time, the landlord and tenant will have the opportunity to finalise the wording of the Tenancy Agreement and make any last adjustments prior to the final signing.

In order to arrive at this stage, the real estate agent will:

- Assist with the preparation of all approval documentation required by the tenant.
- Complete an initial review to confirm that all financial and business terms agreed in negotiations and documented in the LOI have been accurately incorporated into the draft lease.
- Assist in the review by the tenant.
- Participate in the negotiation of the lease documentation with the landlord.

Once the Tenancy Agreement has been signed by both parties, the balance of the deposit must be paid, amounting to a total of two months' gross rent and property management fee. Before the handing over of space, the tenant is generally required to pay one month's (or several months' according to Tenancy Agreement) advanced rent and management fee. Upon payment, the landlord will hand the keys to the tenant to begin the fit-out and decoration of the office.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DeBund was awarded "IP Litigation Law Firm of the Year 2014 in China" by the "Acquisition International Journal" and was awarded "2012 Deals of the year" by the "China Business Law Journal". In 2018, one DeBund senior partner was included in the "Foreign-related Legal Services Talent Pool" initiated by the Ministry of Justice of China and four other DeBund partners and lawyers were included in the "Talent Pool of Foreign-related Legal Services of Shanghai" , selected by the Shanghai Bureau of Justice.

Further, in 2018, the "Gesture Unlock Patent Right Case" represented by DeBund lawyers was selected by the website of people.cn as one of "Top 10 Typical Patent Cases of the Year 2018". Another two cases represented by DeBund lawyers including the case of a housemaid in Hangzhou committing arson and the "parrot case" in Shenzhen were included in "Top 10 Typical Criminal Cases of the Year 2018" selected by editors of the People's Court Daily.

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5. The Chinese Legal Environment

Understanding the legal environment is an essential step in learning how a country works and how to avoid unnecessary risks.
This chapter will introduce some of the basic differences between China and other legal environments, especially as these relate to the operation of foreign businesses in the country. The main topics to be reviewed are as follows:

1. Corporate governance in Chinese companies
2. Chop Management
3. Negotiating and concluding contracts
4. Enforcement and settlement of disputes
5. Ongoing compliance issues in China
6. Intellectual property in China

5.1 Corporate Governance in Chinese Companies

Understanding how Chinese companies are governed is important both for those who own or manage Chinese companies (including Wholly Foreign Owned Enterprise (WFOEs) and Joint Ventures (JVs)) and for those who interact with them. This chapter will cover some of the basic concepts that are common to most Chinese corporate entities.

Investor

In a WFOE, the investor(s) functions as the highest authority of the Company. The investor's power includes making resolutions regarding the increase or reduction of the Company's registered capital, the assignment, split-up, dissolution, liquidation of the Company, revising and amending the Company's Articles of Association ("AOA"), electing and changing directors and supervisors, and determining the Company's operational guidelines and investment plans. Additionally, the investor may exercise its power to approve reports of the board of directors/executive director, reports of the board of supervisors /supervisor, annual financial budget, profit distribution and loss recovery plans.

In order to have a binding effect on the Company, the investor's resolutions must be made in writing and executed by the investor. If the investor is not a natural person, the resolutions shall be signed by the legal representative of the investor, or alternatively by the authorised person of the investor as filed with the Chinese company registry authorities. The term "legal representative of the investor" refers to the person who is duly authorised to represent the investor according to the applicable laws of the country where the investor is incorporated and/or the AoA of the investor.

Legal Representative

Every company incorporated in the PRC has a Legal Representative who is a natural person. The position can be filled either by the Company's General Manager or by the Chairman of the Board (or by the Executive Director for companies with only one director). The Legal Representative's name would normally appear on a company's business license. The Legal Representative has considerable power of control over the company as their signature is seen to represent the company as far as third parties are concerned. If a Legal Representative of a Company has entered into a contract on behalf of the Company with a third party despite disagreement in the Board, and even in cases where the Legal Representative has overstepped his/her authority, the Company will still be bound by the Legal Representative's signature and the contract will remain valid.

Due to the importance of this role it is very important for investors which start a company in China to ensure they appoint the right person for the position of Legal Representative.
There are normally no restrictions as to the nationality of the Legal Representative and there is no requirement for him/her to be residing in China.

Board

All companies in the PRC Must have a Board of Directors or an Executive Director. If the company has a Board of Directors, it must consist of three to thirteen Directors. The appointment of the Directors must be included in the AOA and registered with the competent registration authority. If the Company has relatively fewer Shareholders or is of a relatively smaller scale, a sole Executive Director may be sufficient.
In a WFOE the Board of Directors has responsibilities that include carrying out the resolutions made by the Investor(s) (while in a JV the Board is the highest authority), determining operation and investment plans and formulating the company's basic management system. In addition, the Board is responsible for working out the company's annual financial budget, profit distribution and loss recovery plans. The Board has the power to hire, dismiss and determine the salary of the company's General Manager and the person in charge of the company's finances. The company's AOA can also grant the Board additional functions.
The Board of Directors must have a Chairman who convenes and presides over the meetings of the Board. The appointment of a Vice Chairman is optional. Currently there is no requirement for any of the directors to be China residents.

Supervisor(s)

The appointment of a Board of Supervisors or a sole Supervisor is mandatory for all companies in the PRC.
Generally, a Board of Supervisors must consist of at least three members and at least one-third must be elected by the staff and workers of the Company. For a Company that has relatively few Shareholders or that is relatively small in scale, the appointment of one or two Supervisors is sufficient. The Supervisor cannot be a Director or a senior manager of the Company. The post of Supervisor is elected every three years by the Shareholders/Investor.
The role of a Supervisor is to monitor the financial affairs of the Company and to ensure that the Directors and senior managers comply with relevant laws and the company's AOA. The supervisor has the authority to initiate proceedings against the Directors and senior managers should the need arise. They can also propose, call, and preside over interim Shareholders' meetings if the Board of Directors fails to act. In addition, the Supervisor may also make proposals at Shareholders' meetings and perform any other duties delegated to him or her in the AOA. The Supervisor has the right to observe and speak at meetings of the Board of Directors but not have a vote. Like other positions, there is no requirement for the supervisor to be a China resident. Many multinational companies appoint the group CFO or controller to act as supervisor of their China WFOE (provided, of course, they are not a director or member of the management team of the WFOE).

Management

Senior managers are appointed and dismissed by the Board of Directors. Senior managers include the General Manager, Deputy General Manager(s), Finance Manager and any other persons listed as such in the AOA. There is no requirement that the General Manager be Chinese.

The responsibilities of the General Manager include managing the day-to-day business operations of the company and implementing the resolutions of the Board of Directors. The General Manager also executes the company's annual operational and investment plans and may exercise any other responsibilities conferred upon them by the Board of Directors. The General Manager attends the meetings of the Board of Directors as a non-voting delegate.

Legal Obligations and Liability

Directors and senior managers take on a fiduciary duty to the Company. If they neglect their responsibilities, break laws, or violate provisions of the AOA, and cause losses to the Company, they may be exposed to civil liability. This could include being required to pay economic compensation to the Company or to third parties.

In addition to civil liability, a Director or senior manager may also be held criminally liable if their misconduct constitutes a violation of criminal law. For example, embezzlement, a disregard for safety measures that results in or contributes to a serious industrial accident, failure to report or falsely reporting serious industrial accidents, serious environmental incidents and hiring minors to conduct hazardous work may result in criminal liability.

Under certain circumstances the Legal Representative could be held liable and, in some cases, may be held in the country and not be allowed to leave in the event of insolvency of the Company or in some cases where the Company is being prosecuted.

There are certain restrictions on a person becoming a Director, Supervisor or senior manager of a company. A person would be barred if they have a criminal record for economic crimes such as corruption, bribery, embezzlement, etc., and 5 years have not elapsed as of the completion of the execution of the sentence. Or, they would be barred if they were an officer of a company which was declared bankrupt or liquidated for which he/she was accountable and 3 years have not elapsed as of the bankruptcy or liquidation of the company (the same applies to the situation of the company being ordered to close down or whose business license being revoked where he/she was accountable for such situation), or high personal indebtedness that he/she cannot discharge.

5.2 Chop Management

All incorporated companies in China require "chops". A chop is a signature stamp that represents a legal entity or a natural person and performs a similar function to the signature in western organizations. A chop is necessary for approving decisions relating to the operations and management of a Company and for legally authorizing documents. A Company may have a wide range of chops, each of which are used for specific purposes and apply to different types of documents. The State Council issued regulations that restrict the engraving and use of chops. The shape, size and design of chops for legal entities are strictly regulated.

Chop types
Mandatory Chops

The Company Chop
The company chop is the most significant chop in a Chinese company. It is necessary for approving decisions relating to operations and management, and for legally authorizing documents. It provides the legal capacity to make and execute agreements, provide guarantees, transfer assets, and legally bind the Company. It is used on all official business documents including contracts, internal/external memoranda, and documents filed with the government. A document stamped with the Company Chop is

deemed approved by the Company and is legally binding. Changes to corporate documents or alterations to the name or business scope of the Company require the application of the Company Chop.

Following registration, all Chinese companies must apply for a Company Chop from the local Public Security Bureau (PSB). The local PSB then appoints a qualified chop-maker to produce the Company Chop. The PSB will retain a specimen stamp to be used to determine the authenticity of a Company Chop stamp in the event of a dispute. The Company's Legal Representative is normally entrusted with the chop. It is important to note, however, that anyone in possession of the Company Chop may use it to bind the WFOE. It is for this reason that chop management is extremely important.

In addition to the Company Chop, there are two other mandatory chops:

The Legal Representative Chop

This chop represents the signature (i.e. the authority) of the Company's designated Legal Representative and, to an extent, the company itself. It square-shaped and engraved with the name of the Legal Representative. It is normally used in combination with the Company Chop or Finance Chop. It is used on numerous legal and official documents such as applications for tax registrations, issuing authorization letters, contracts, and bank transactions. The company's banks also keep a specimen stamp of this chop to verify the company's documents when necessary.

The Finance Chop

This chop is commonly used together with the Legal Representative Chop for banking transactions such as cash withdrawals, wire transfers, or changes to account information. It is usually controlled by the Finance Officer of a company for conducting daily financial transactions. The company's banks also keep a specimen stamp of it to verify the authenticity of the company's documents upon presentation to the banks.

Other Chops

In addition to the above, some other chops may be created to serve various purposes. These chops, however, are not mandatory. The decision as to whether or not to have such chops made rests with the Company itself, depending on its business needs and its internal structure. They each have a very specific scope and power. Once created and registered with the PSB, each will carry the legal effect pursuant to its purpose. In theory, all official chops of the company should have a specimen registered with the PSB.

Contract Chop: The only function of the Contract Chop is to execute contracts. It may be used in place of the Company Chop to execute contracts, and the company can have more than one, unlike the Company Chop. In certain cases, the parties to a contract may specify in the contract that it shall only become effective with the Company Chop and the signature and/or the chop of the Legal Representative of the company.

Invoice Chop: used specifically to validate Tax Invoices.

Human Resource Chop: may be used for all human resource activities including signing labour contracts with employees, authenticating employment verification letters, and issuing internal memos.

Risk and Safeguards of the chops

The risk of fraud must be taken into account when formulating chop management procedures. Forgery or misuse of official chops in China can expose both the Company and the individual to legal ramifications. Technically, anyone who is in possession of the Company Chop can legally bind the company. Even though individuals responsible for forgery or misuse of a chop may be held civilly or criminally liable, significant damage to the Company can result from the lack of sufficient internal controls. It is highly recommended that companies create clearly written internal policies to safeguard chops to ensure that they are never used without the explicit approval of the General Manager, the Board of Directors, the investor, or the authority that the Company prefers. One possible safeguard is to maintain a log book containing all instances of use of the chops with the relevant approvals. Another consideration is to deposit the chops with a professional service provider such as the Company's lawyers or accountants.

5.3 Negotiating and Concluding Contracts

In the past, foreign investors widely assumed that "Contracts in China don't matter and are meaningless". While this view is false, it is important to understand the cultural context of contracts in China. While it is not necessary to have a lawyer present in all negotiations, it is recommended to have your contracts drafted, or at the very least reviewed by lawyers who are experienced in working in China.

Understanding a contract

In China, contracts tend to be less wordy and less complex than their counterparts in western countries. Despite China's long history, the legal profession in China is rather new, and China has one of the lowest numbers of lawyers per capita in the world. Using a simple (bilingual) contract is a good policy to increase the chances that the other party reads it and understands the content and commitments. A contract which has been thoroughly negotiated and is well understood by both parties is more likely to be performed. To further ensure that the contract is well understood by both parties, it is also recommended that a lawyer be the one to translate the contract.

Contracts with government departments

Administrative law is less developed in China compared to most western countries. For this reason, it is difficult to enforce contracts against organs of the state or of the local government. In many cases, local industrial parks (which are run by local governments) will provide economic incentives and support to the investor for their investment projects if the investor agrees to set up a company in the industrial park. While the government authorities will do their best to abide by their obligations, it is important to note that if for some reason they are prevented from doing so, (for example by a change of policy on the provincial level or the state level) the foreign investor will have little recourse.

Due diligence and proper execution

Prior to executing a contract, it is important to check that the signatory parties validly exist and are identified properly. A common method of identification is to ask Chinese parties to provide a copy of their business license (chopped with the company chop) and AOA. The company's registration can also be checked at the State Administration of Market Regulation (SAMR). As mentioned in the previous section, contracts are normally executed by either affixing the Company Chop or the Contract Chop. While the signature of the legal representative is legally binding, the standard practice is o insist on having the contract chopped.

5.4 Enforcement and Settlement of Disputes

Handling contractual disputes

In China, negotiation is the most common way to resolve contractual disputes. However, if these negotiations fail, then more formal option, such as arbitration or litigation, are available. Similar to the rest of the world, arbitration and litigation are costly affairs, and in many cases, a simple cost benefit analysis would lead parties to compromise. In China, the desire to negotiate and compromise may be enhanced by local factors: local protectionism and/or the fact that judges themselves would normally tend to push parties toward a compromise throughout the legal proceedings.

Dispute resolution clause

It is strongly recommended that the parties include the mechanism for dispute resolution in the contract itself. Then, if and when a dispute does arise, the parties will already have agreed to a resolution method and can use their energy on negotiating a resolution. If all else fails, a last resort before exploring the other options of arbitration or litigation, consider engaging a law firm to send a demand letter to the other party. Typically, the demand letter will lay out your grievances and request a remedy within a set amount of time, which if not met, could result in legal court proceedings. Sometimes the involvement of legal counsel combined with the threat of court proceedings will compel the other party into action.

Litigation

As mentioned previously, if negotiations (and the demand letter) fail, the parties may choose to settle their differences in court. The rule of law in China is heavily influenced by European civil law, and by China's own history and culture. In civil law, previous court decisions are not considered binding precedent or even used as persuasion. Moreover, up until 1979, the legal profession was viewed as bourgeois by the Communist government and was not allowed to be practiced. Despite the modern Chinese courts' relatively short history, the courts are evolving and progressing towards operating in a manner that more closely meets foreign investor expectations.

Even so, it is important to be prepared for the differences in the Chinese legal system. It should be understood that regional courts may operate with unspoken biases and desire to protect local interests. Another difference is the court's reliance on formal documentation, such as production of authenticated, sealed, or notarized documents, and less so on witness testimony. Limited time is devoted to witness examination and cross-examination and perjury is sanctioned lightly. Furthermore, the choice of remedies may be more limited than expected. Generally, orders to compel or stop actions are difficult to enforce, and damage awards are likely to be much more modest than in the west. It may even be difficult to enforce the judgment itself.

Arbitration

Arbitration is often preferred to litigation by foreign investors and can be an option if agreed to by both parties. In China, the China International Economic and Trade Arbitration Commission (CIETAC), which operates in Shanghai, Beijing and Guangzhou, is the most well-known arbitration authority. CIETAC is considered to be a more neutral and flexible party than the courts. CIETAC's arbitration standards include arbitral procedures allowing parties to select their own arbitrators (which can be foreigners) and control the venue, the language, and the laws of the proceedings. Parties may also determine the order of the proceeding itself. Another advantage to arbitration is that the outcomes are not public, thereby protecting business secrets as well as reputations. Arbitration can provide an enforceable decision, which becomes final and binding when rendered and cannot be appealed. Even though in some cases arbitral awards may be set aside or be denied recognition, options to challenge an arbitral award are limited.

5.5 Ongoing Compliance Issues in China

Compliance in China is a vast subject that would fill many books on its own. Formulating a China compliance strategy is, however, an absolutely necessary task that should involve lawyers and other China experts. That said, to illustrate both the broadness and granularity of regulatory compliance in China, below are a few of case studies that are illustrative of some of the everyday challenges, big and small, faced by companies doing business here.

Case No. 1:

An import-export company was incorporated in Shanghai. They applied for customs registration certificates after incorporation but didn't immediately commence doing business. The manager of the company didn't realize that the company had to to perform an annual Customs examination every year before June 30, even though it was clearly mentioned in the registration certificate. When the company planned to commence the import-export business several years later, their customs declaration online system was blocked because it had not completed the annual examinations. The company's leadership and Legal Representative were required to meet the authorities to remedy the issue, as well as make admissions of wrongdoing.

Case No. 2:
An individual performed an equity transfer of his coffee shop. After the transaction, the restaurant was punished by the AIC because the company was operating the business beyond its legal business place. The transferee used the terrace outside the shop for additional seating, even though the terrace did not belong to the business. The transferee attempted to blame the transferor but was unsuccessful in assigning blame because they failed to do their diligence.

Case No. 3:
An individual purchased a trading company and obtained all necessary licenses, including a number of special licenses. However, she ultimately stopped regularly operating the company, maintaining records or even paying attention to it at all. After a number of years had passed, she decided to set up a new company in China. However, unbeknownst to her, because of her non-compliance with various requirements of company ownership, the first company had been blacklisted by all authorities (SAIC, Tax Bureau, Custom, etc.). Deregistration became extremely difficult, and heavy penalties were imposed, including a heavy tax penalty due to the absence of tax declarations and missing VAT invoices. Moreover, she was unable to incorporate a new company without fully remediating and deregistering the black-listed company.

While these are just a few narrow examples of real-world compliance problems people have faced, they should make it clear that big problems can arise from small oversights in China. Especially nowadays, with the authorities are taking such issues more and more seriously, a compliance strategy, and attention to it, is crucial.

5.6 Intellectual Property in China

Protecting intellectual property rights

Many foreign investors operate under the false assumption that there are no protections for intellectual property in China and that there is no point in registering it. On the contrary, infringement, while rampant, can be combated and protections enforced. To do so, however, intellectual property rights should be registered and recorded in China as soon as possible. China is beginning to take intellectual property protection much more seriously, and even has newly formed specialized intellectual property tribunals to handle these issues.

Registering your intellectual property

China is a first-to-file jurisdiction. This means that the first party to file a registration application on a piece if IP essentially owns it. In some cases, this may mean having to buy back your own mark, name or patent from a third party, which can be very time consuming and costly. If caught unaware that another party has registered your IP, you may be surprised when your product is unceremoniously seized for infringement. To avoid some of the pitfalls listed above, it is recommended you enlist the help of law firm to protect your intellectual property.

Enforcement

There are two tracks for intellectual property rights enforcement in China. The first option is to pursue enforcement through an administrative track, which is considered the quickest method. The government agencies are staffed with persons specialized in certain areas of IP. While the local agency will investigate if they find your complaint satisfactory and can issue orders to halt infringement, the associated fines are low; three times the illegal revenue or 100,000 RMB, whichever is lower. Additionally, if their decision is unsatisfactory, it cannot be appealed and would have to be pursued further in court proceedings.

The second option for enforcement, civil or criminal, is through the courts. The new intellectual property courts currently only operate in Beijing, Shanghai and Guangzhou, with no change to the current practice in other areas in China. These courts can award monetary damages, and like the administrative agencies, these courts can also issue orders to prevent continued and future infringement. Additionally, the decisions can be appealed.

6. Financing a Company

It is advisable to consult with the bank at an early stage when setting up a company, as the financing of a company's capital is complicated and subject to many regulations. It is also important to check with the local regulatory body on applicable rules and regulations as these might differ between cities and provinces.
This chapter will introduce you to some financial issues in setting up a company, like:
• Investment / Financing a Company
• Banking Procedures for Company Finance

6.1 Financing a Company

Setting up a company

Once a decision on the type of legal entity has been made, the next step is an application at the SAIC (State Administration for Industry and Commerce). There are set periods for each step to be completed, but the time commences from the date where the relevant authorities consider the information submitted to be complete.
The application includes a feasibility report (or business plan), audit reports, a bank reference letter, a feasibility report (if the project is covered by a Negative List), and the articles of association of the company (including total capital, registered capital and funds borrowed by the company). Although there is no longer a capital requirement, the authorities have indicated that there is a ratio requirement between total investment and registered capital. This must also be specified in the LLC's Articles of Association and Feasibility Study Report, if applicable.
The amount of the registered capital is negotiable, but it should be ample, because additional registered capital, if required, takes time and effort. The difference between the total investment and the Registered Capital is the Investment Gap (also called Borrowing Gap), which is the amount available for foreign debt financing (more info on Foreign Debt further in this article). If the Registered Capital is not fully paid up, the Investment Gap is only available in the same proportion as the paid up part..
Once the company is set up, it can be financed through bank loans, shareholder loans or - more often - a combination of both.
Companies must set up at least 2 bank accounts after the incorporation of the legal entity. These are namely the capital account and the basic account. Some companies may elect to open other general accounts. The basic account can be opened only at one bank. This account is especially for cash withdrawals and basic revenue collections and expenses and salary payments. Procedures, costs and required documents vary for different banks.

Foreign Debt loans and Domestic Loans

- Foreign Debt loans are loans provided by offshore banks (i.e. banks based outside mainland China), overseas affiliate companies or individuals, and are capped at the level of the Foreign Debt Quota. These loans are subject to the approval and registration of the State Administration of Foreign Exchange ("SAFE"). A special bank account must be opened to receive foreign debt loans. Foreign debt loans can be granted either in a foreign currency or RMB, as agreed upon between the borrower and the lender. The borrower and lender will also determine the interest rate.
- Domestic Loans are loans provided by onshore banks (i.e. banks based in mainland China) to a foreign invested enterprise in China. Such loans are normally granted in RMB (except in very exceptional cases in export trading financing or overseas investment). The amount of an RMB loan is determined by the banks based on

their own standards. Banks in China rarely grant credit loans to foreign invested enterprises and usually require one form of security or another (mortgage, pledge). They can also sometimes accept a corporate guarantee provided by a foreign parent company of the borrower or a Standby Letter of Credit ("SBLC")/guarantee issued by an offshore bank as a guarantee. This guarantee/SBLC can be issued in a foreign currency or RMB. When this guarantee/SBLC is called, it becomes a Foreign Debt of the borrower. Effectively, a foreign debt loan is created from the guarantor to the borrower and the borrower will have to ensure that a sufficient Foreign Debt Quota is available to avoid penalties imposed by SAFE.

As of 2013, interest rates on RMB-loans are no longer restricted. The mechanism of a PBOC base rate remains the same, however. The current base rate for 1 month-12 months period is 4.35% p.a, at the time of writing (May 2019).

Foreign Debt Quota

Foreign Debt Quota is the cap amount that an onshore company can borrow from outside mainland China. There are two methods for determining the Foreign Debt Quota of the company: 1) the Investment Gap method, and 2) Macro Prudential Management method. Foreign invested company is allowed to choose one from the methods.

- Under the Investment Gap method, the sum of short-term (less than 1 year) foreign debt balance and total historically occurred mid- to long-term (over 1 year) foreign debt amounts should not exceed the Investment Gap. Foreign debt denominated in RMB is monitored on historical occurrence basis (to permanently consume the Foreign Debt Quota).
- Under the Investment Gap method, foreign debt from the above mentioned call of overseas guarantee for onshore borrowing should not exceed the sum of the company's net assets value and the Investment Gap.
- Under the Macro Prudential Management method, the Foreign Debt Quota is determined at multiples of the company's net assets value. (The current multiply is 2, set by PBOC.) The "management balance of foreign debt" is the company's foreign debt balance calculated on risk weight factors. The "management balance of foreign debt" should not exceed the Foreign Debt Quota. Under this method, the Foreign Debt Quota can be restored upon repayment (revolving), regardless of the currencies or financing tenor.

Working capital versus fixed assets loans

- *Working capital loans* (local and foreign currencies) can only be used to finance genuine working capital needs. The facility limit granted by a bank cannot exceed the estimated working capital needs based on established formulas. The borrower will have to provide the bank with supporting documents showing the genuine working capital need (invoices, etc.). Working capital loans will mainly be in the form of a revolving credit facility.

- *Fixed assets loans* (local and foreign currencies) can only be used to finance fixed assets or capital expenditure. The purpose of the loan needs to be clearly defined in the facility letter. Fixed Assets loans will mainly be in the form of a term loan but can also be structured as a revolving credit. In either form, the loan needs to have an element of amortization, as bullet loans are not allowed.

Shareholders loans (coming from outside China)

Shareholder Loans are subject to having sufficient Foreign Debt Quota available and need to be approved by both the Ministry of Commerce and SAFE. If the shareholder loans have a term of one year or above, approval of the National Development and Reform Commission ("NDRC") may be required (if it relates to a specific industrial project).

Bank loans
It is recommended that the registered capital plus loans should be sufficient to allow the company's operation for the first years. Loans from local banks or from foreign banks are difficult to obtain if the company does not make a profit or without shareholder guarantees.

Conclusion
Each financing strategy has its pros and cons, and several elements will need to be balanced before making a decision. Some foreign companies prefer their Chinese operations to be self-reliant, in which case they will not inject shareholder loans and their Chinese subsidiary will rely wholly on (more expensive) bank financing if they can get it. Other companies will be more sensitive to the overall financing cost and will prefer to finance (a part of) their operations through shareholder loans. Some companies consider a mixed strategy: financing their long-term fixed assets investments though shareholder loans and their short-term working capital needs through short-term bank loans. As mentioned above, the Foreign Debt Quota will be critical.

Ø Due to complexity, frequently changing regulations and fast-evolving market conditions, it is advised to involve the bank as early as possible in the company-founding process.

Ø Note*: different regulations are applicable when registered or established in a Free Trade Zone.*

6.2 Banking Procedures for Company Finance

Supervisory bodies
The People's Bank of China (PBOC) is China's central bank, which formulates and implements China's monetary policy. The PBOC maintains the banking sector's payment, clearing and settlement systems, and manages the official foreign exchange and gold reserves. It oversees the State Administration of Foreign Exchange (SAFE) for setting foreign-exchange policies.
The China Banking and Insurance Regulatory Commission (CBIRC) was formed by merging the former China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC) in 2018. CBRC was officially launched to take over the supervisory role of the PBOC. CBIRC is responsible for the regulation and supervision of banks, asset management companies, trust and investment companies, financial lease companies, commercial factoring companies, other deposit-taking financial institutions and insurers. Its mission is to maintain a safe and stable banking and insurance system in China. It is very important to understand the banking system in China, as it will affect one's business.

Policy banks
Three "policy" banks, the Agricultural Development Bank of China (ADBC), China Development Bank (CDB), and the Export-Import Bank of China (Chexim), were established in 1994 to perform government-directed spending functions. These banks are responsible for financing economic and trade development and State-invested projects. The ADBC provides funds for agricultural development projects in rural areas, the CDB specializes in infrastructure financing and Chexim specializes in trade financing.

Domestic commercial banks
In the commercial banking business, the four State-owned commercial banks (the "big four") are the biggest players. They are the Bank of China (BOC), the China Construction

Bank (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC). In addition to the big four State-owned commercial banks, there are several smaller commercial banks -- for instance, the Bank of Communications, China Merchants Bank, China CITIC Bank, and Shanghai Pudong Development Bank. These banks are also active players in a wide range of banking services, including accepting deposits, extending loans, and providing foreign exchange and international transaction services.

City commercial banks
Currently, there are around 100 city commercial banks in China. Local governments have historically exerted a huge influence over city commercial banks, and it is not uncommon for local governments to hold a large bulk of those banks' shares. The city commercial bank market is oriented towards supporting the regional economy, but also towards financing local infrastructure and other governmental projects. In recent years, some city commercial banks have started extending their business beyond their home region as well.

Foreign banks
Over the years, foreign banks have flocked to China in droves in pursuit of new opportunities in the world's second-largest economy. Foreign banks are represented by over 400 different financial institutions in mainland China. Most foreign banks in China can provide financial services in both RMB and foreign currencies.

Bank accounts

RMB account types

- *Basic account:* used for cash deposits and withdrawals, and payment of salary and bonuses to employees. Only one basic account can be opened, irrespective of the number of banks used.
- *General account:* for managing cash collections, account transfers and fund deposits. Cash cannot be withdrawn from a general account.
- *Capital account (cross-border):* for receiving RMB-denominated capital injections and capital increases from overseas shareholder. In principle, only one RMB capital account can be opened with a bank located in the same city as the company.
- *Special account:* for special purposes such as maintaining credit cards, agency business, reconstruction or infrastructure building. Cash withdrawals and the settling of sales income are not allowed in a special account.
- *Temporary account:* used for receiving draft remittances, inward electronic remittances and other temporary business activities. Cash withdrawals and account transfers in compliance with certain regulations are allowed from a temporary account.
- *Foreign debt account (cross-border):* to receive proceeds from loans from overseas. Foreign Debt registration and approval by SAFE are required to receive an overseas loan.

Foreign currency account types
Capital account: for receiving capital injections and capital increases. In principle, more than one account can be opened with banks located in the same city or in different city as the company.

- *Settlement account:* this account is for the purpose of revenue and expenditure in current foreign exchanges and may also be available for capital account expenditure with permission from the State Foreign Exchange Regulatory Bureau.
- *Foreign debt account:* to receive proceeds from loans from overseas. Foreign Debt registration and approval by SAFE are required to receive an overseas loan.

Summary of key documents needed to open bank accounts

- Certificate of Registration or Approval certificate issued by Ministry of Commerce (MOFCOM) or the relevant provincial or municipal people's government.
- Business license issued by the State Administration for Industry and Commerce.
- Joint Venture contract and the relevant documents (applicable only when the foreign invested enterprise is a joint venture company).
- Valid approval documents for a foreign-invested enterprise, whenever needed.
- Organisation credit code certificate, issued by RMB basic account bank.
- Identification documents of the legal representative, directors and authorized personnel. Many times, the original passport of the legal representative or even a visit of the legal representative may be required. This depends on bank policy and should be checked once more with the bank branch.
- Company chop and special chop for finance (Approval to make a company seal/chop is issued by the police department).
- Account application form and other relevant documents provided by banks.

Payment methods

Dealing with banks in China can be an unusual experience. Even though the banks are there to provide a service, their main focus and effort goes into ensuring that all transactions are in accordance with government regulations. Banks can be heavily penalised if they fail to follow procedures, and bank staff who make mistakes can easily lose their jobs.

Generally speaking, the following documents need to be provided for each single payment or transaction:

- An application
- An invoice (notice of payment or receipt)
- A contract or other authorisation
- A customs declaration sheet (cross border transactions only)

Simple transactions, such as payment applications are sent by courier, fax or via internet banking. For more complicated transactions it might be necessary to go to the bank in person. When receiving payments from overseas or when making payments to overseas, many times visit to the bank is required. Again, this could still be different pending on bank branch its requirements. It is practical to choose a bank near one's office.

Cash

Paying cash is a method mostly used to keep transactions out of the books. To avoid any misunderstandings about transactions being taxed or not being made, it is advised to make payments by bank transfer.

Bank acceptance draft

Bank acceptance draft is most widely used for local payments. The bank acceptance draft is a draft requested and signed by the applicant. After the bank's approval and acceptance of the draft, the bearer of the draft presents the draft to the payer for payment upon maturity, or several days prior to the draft's maturity (subject to rough estimation of mailing time). The payment term should not exceed twelve months for electronic draft and six months for paper draft, while the draft should be presented for payment within ten days upon maturity of the draft.

The bank acceptance draft can be used for the settlement of a claim and debt after a physical commodity transaction and the bearer may request a discount from the opening bank or the bill centre before the maturity of the draft if cash is urgently needed. The bank acceptance draft can be transferred by endorsement prior to maturity of the draft.

Telegraphic transfer (T/T)

Telegraphic transfer is an electronic means of transferring funds. A common banking term, “T/T” is used to indicate a cable message from one bank to another for the purpose of transferring money. T/T is the easiest payment form.

Letter of credit (L/C)
A Letter of Credit (L/C) is a letter from a bank guaranteeing that a buyer’s payment to a seller will be received on time and for the correct amount. In the event that the buyer is unable to make payment on the purchase, the bank will be required to cover the full or remaining amount of the purchase. This form of payment is widely used for cross-border trade settlements.

Financing tools

Bank loan
Foreign-invested enterprises can obtain loans from both domestic and foreign banks. Bank loans can be granted in both local and foreign currencies. When applying for a loan facility from a bank, the foreign-investment enterprise is required to submit relevant documents, including but not limited to the Business License, latest financial report, feasibility report of the project, senior management description, product introduction, market analysis, distribution channels, and land use certificate.
Security, in terms of a bank guarantee, parent company guarantee, or mortgage is usually needed to support the credit, especially for companies in their starting phase. Such securities can be one of the most important factors considered by local banks when delivering the facility.
The approval of a loan facility will generally depend on the availability of funds, the creditworthiness of the enterprise, and government policies. In the current financial market, priority will normally be given to the priority industries encouraged by the government.
The interest rate charged on a facility denominated in RMB is related to the Benchmark Lending Rate set by PBOC. Additionally, it is not normal practice to grant facilities (i.e. general corporate loans) with a term (tenor) of more than five years in China. Some banks, however, offer structured longer tenor loans.
Shareholders’ loans
Shareholders’ loans provide flexibility in committing investment amounts depending on project needs, without the formalities that would come along with an increase in registered capital. An increase in registered capital would require approval/registration of the MOFCOM or its local commission (COFTEC), while a shareholder loan falling within the total investment amount would not require such approval, unless it is attracted from off shore. In that case SAFE registration is required.
Shareholders’ loans also provide flexibility in terms of timing. If mentioned in the articles of association of the company, there may be prescribed time limits for contributions of registered capital. This does not apply to contributions by way of shareholder loans. Though arranging a shareholder loan between the shareholder and the subsidiary is more flexible than increasing the registered capital, still relevant administrative work needs to be followed up with your bank and SAFE to make sure you can proceed with this type of financing.
With regard to shareholder loans between joint venture partners, it should be noted that PRC parties that are not financial institutions are in a legal/regulatory grey area when it comes to extending shareholder loans because of the lending restrictions under PRC banking regulations. It is important to realize this before proceeding, to become familiar with the relevant particulars of the legal/regulatory framework, and to proceed carefully.
The shareholder loan would need to be executed and registered with SAFE within 15 days of being entered into. Late registration may result in a penalty.
Entrustment loan

Entrusted loans involve a financial institution (normally a bank) as an agent of entrusted funds from a lender, and then funds provided solely by the lender to a borrower who has been designated by the lender. The loan amount and term are appointed by the lender, and the loan yield and risk shall be taken up by the lender. The lender and borrower can be affiliates within a group or can be companies without any direct relations. The lender is required to justify the fund source by providing supporting evidence to the financial institution who acts as the agent. The disbursed fund should not be utilized in prohibited areas by regulations.

Foreign exchange

All activities in relation to foreign currency exchange receipts and payments or foreign exchange operations, regardless of whether they are performed by domestic or foreign enterprises and individuals, are under the administration of the State Administration of Foreign Exchange (SAFE) and its local offices. There are restrictions on foreign currency exchange in China, and thus the RMB is not freely convertible. Bank loans denominated in foreign currency cannot be exchanged into RMB except for transactions with export goods background; however, if the facility has been raised overseas, it can be convertible but is subject to restrictions.

After separation of the capital account and the current account, RMB transactions under the current account are freely convertible (subject to certain procedural controls) as long as the transactions are considered commercially legitimate. In the case of capital account transactions, the convertibility of the currency is subject to the permitted scopes.

Overall, it is important to keep in mind that foreign exchange transactions between overseas entities and China is tightly controlled by SAFE. This is a larger issue in China than elsewhere and may pose challenges with effectively managing such transactions.

7. Accounting and Fiscal Policies

When China became a member of the WTO in 2001, certain sectors of its market opened up in accordance with obligations under the WTO. However, China still sought to shield local industries vulnerable to strong competition from foreign investors. As a result, all transactions will need government approval at some level depending on the industry and the size of the transaction.

This chapter will help you to understand the different financial policies in China and how to handle certain situations.

- Formation of the Current Accounting System
- Accounting and Audits of Financial Statements for foreign companies
- Main Taxes in China
- Invoice System
- The Hong Kong Route
- Transfer Pricing
- Individual Income Tax Liabilities for Expatriates in China

7.1 Formation of the Current Accounting System

Over the past 30 years, China has developed a new economic system where the economic sphere is partially liberalized, while the government maintains a tight grip on the Chinese State. The opening and transformation of China has been the main driver behind the development of a comprehensive and modern accounting system.

Under the prior more "communist" structure, prices were set by a central pricing authority relying on information and data provided by entities under the supervision of central, regional and local authorities. Accounting rules were primarily established with an eye toward gathering information for the implementation of national economic policies and resource allocation in the planned economy.

China's accounting system has a rather brief history. Prior to 1979, China was a planned economy and did not have any general accounting standards or industry-specific standards to speak of. Instead, accounting was mostly used to track whether units were meeting their production targets. In the wake of the "Reform and Opening Up" policy launched in 1979, a new need arose for suitable accounting standards to be adopted by for-profit companies.

Over the years, measures were taken to integrate China's accounting system with the International Financial Reporting Standards (IFRS). This first occurred in the area of foreign investment and was later expanded to the whole economy.

Starting in the early 90s, the Chinese government has slowly reformed its financial reporting system. The evolution towards a market economy in China totally overwhelmed the old accounting system in many aspects, such as revenue recognition, cost structure and wages, conservatism and provision, fixed assets, etc.

For example, fixed assets on a Chinese communist enterprise's balance sheet included equipment, buildings, machinery and any other long-term assets. However, land could not be included, because the State was considered the country's only legitimate owner of land. Assets were mostly valued according to the strict historical-cost principle.

In 2006, the Ministry of Finance (MOF) issued new Chinese Accounting Standards (CAS 2006). It is expected that these new accounting standards may become a requirement for foreign investment enterprises (FIEs) in the next few years.

In general, these new standards reflected all international financial reporting standards (IFRS) principles, although several differences exist to reflect unique circumstances in China.

CAS 2006, dubbed PRC GAAP, became effective on 1 January 2007 for all listed companies and has been updated regularly. The latest revision was in 2014 and is expected to be adopted by all medium and large-sized enterprises across Mainland China within the next few years. With regard to non-listed foreign-invested enterprises, adoption is encouraged but there is no specific timetable for enforcement.

Generally speaking, the New PRC GAAP is more principle-based than the Old PRC GAAP, meaning that financial staff are required to exercise their discretion more frequently. For example, for the use of fair value measurement, the enterprise itself must determine whether the transaction has commercial substance and whether fair value can be reliably measured according to the circumstances. In addition, the New PRC GAAP contains more disclosure requirements, such as a sensitivity analysis of financial instruments.

The role of the Ministry of Finance and other regulatory bodies

In China, unlike in the West, the authority for formulating, promulgating and administering accounting standards does not lie with recognized professional accounting organizations, such as the Accounting Society of China (ASC) or the Chinese Institute of Certified Public Accountants (CICPA), but with the Ministry of Finance (MOF). Instead, the ASC and CICPA are responsible for regulating, governing and monitoring the reform and development of the accounting profession in China. The CICPA also assumes administrative authority, delegated by the MOF, to serve as the bridge between the government and practicing accountants.

In practice, important industries and accounting rules are also co-developed with various regulatory bodies (National Development Reform Commission, China Banking Regulatory Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, State Taxation Bureau, etc.) who issue specific accounting rules.

Main challenges and issues in relation to the accounting industry and practice
Overall, the progress towards good implementation and use of accounting in China has been recognised by international institutions like the World Bank: "Under the leadership of the Ministry of Finance, the Chinese strategy for improving the quality of accounting and auditing standards and practices has evolved as a good practice model that may be followed by other countries."

The challenges and issues facing the China accounting profession and stakeholders can be summarised as follows: transition from a planned economy to a capital economy, the size and complexity of a country that has the vastness of a continent, and multiple stakeholders with different and sometimes conflicting objectives.

As discussed in the World Bank's report, the implementation of high accounting standards depends on the main stakeholders: the company's management and accountants, external accountants and regulatory bodies. Objectives need to be accomplished in all of these three areas.

One important objective is the education and training of internal and external accountants. Efforts need to be increased to teach students about the latest accounting concepts and their implementation, as well as to promote the continuous training of practitioners.

The China Securities Regulatory Commission (CSRC) ensures that listed companies apply appropriate accounting standards and also review the audit practice. There are around 60 audit firms that are accredited to audit listed companies. However, non-listed companies, which still cover a large part of the Chinese economy and are currently monitored by the Ministry of Finance, are not transparent and are also not subject to strict monitoring and enforcement by regulatory bodies.

The main issue faced by China is the lack of adequate resources in implementing accounting standards. It is reported that many corporate accountants and their auditors lack the relevant skills to correctly apply Chinese accounting standards.

To address this, the Chinese government is pushing for the emergence of Chinese firms that can serve as competitors to the Big Four accounting firms. They are encouraged to accompany Chinese companies everywhere. Several audit issues have been raised: the lack of documentation to support auditors' opinions, the lack of quality assurance, the lack of analytical procedures along with substantive procedures, etc.

Conclusion
For any firms that come to China, it is important to keep these limits and challenges in mind alongside the great opportunities offered by this market. Above all, with the firm's best interest at heart, we recommend working with competent professional internal and external accountants from the start when doing business in China.

7.2 Accounting and Audits of Financial Statements for Foreign Companies

The accounting year of an enterprise begins on 1 January and ends on 31 December.

The accountancy law in China stipulates that companies must keep three kinds of primary accounting records: journals, a general ledger and subsidiary ledgers, as well as appropriate supplementary memorandum records. Computerized accounting systems, if utilized, can be regarded as the venture's accounting records.

All accounting documents, books and statements prepared by a FIE must be in Chinese, but they may also be written concurrently in a foreign language.

Books and records should be recorded in renminbi (RMB), unless agreed otherwise by relevant authorities and partners. If a foreign currency is used, the financial statements must be converted into RMB at year-end for the preparation and auditing of the annual financial statements. Typically, most FIEs choose to record their books in RMB because their income and expenses are largely denominated in the local currency.

Audited financial statements
FIEs are required to engage a Chinese-registered CPA firm (which also includes the approved Sino-foreign joint venture CPA firms) to audit their statutory annual financial statements. It is generally the duty of the FIE's board of directors to appoint the auditor. A foreign CPA firm may also be engaged alongside a local CPA firm in performing auditing or related work, but the Chinese-registered CPA firm must issue the report.

Audits are required under company law, accounting regulations and income tax laws in China, and audited financial statements should be filed with the tax authorities, together with the annual income tax returns. FIEs are required to provide the auditors with all the enterprise's documents, books and reports. The accounting statements to be submitted for an annual audit include the balance sheet, income statement, statement of cash flows and relevant supporting notes. Audited financial statements must be submitted to tax authorities within four to six months of the year end, depending on local government requirements.

Chinese Accounting Standards vs IFRS
Despite the increasing convergence of Chinese and international standards, the financial reports of a Chinese company cannot simply be merged with accounts produced using international standards. In addition to more straightforward obstacles such as the PRC

GAAP's mandatory use of the RMB in all financial reports, there are several potential technical differences to be aware of:

- **Choosing a Valuation Method**

  Under the IFRS, one may choose the valuation method for certain types of fixed assets. The company can value these assets either using the historical cost principle, or by applying a revaluation of assets. Chinese accounting standards, however; only allow fixed assets to be valued according to their historical cost.

- **More Detailed Rules in Chinese Accounting Standards**

  For certain items that are common in China, the Chinese accounting standards have more detailed rules than the IFRS. An example is the merger of two companies controlled by the same entity and having similar interests. Chinese accounting standards require that the comparative figures be restated, whereas there is no specific rule for this in the IFRS. In practice, various methods are used.

- **More Detailed Rules in IFRS**

  Conversely, the IFRS have rules for situations that are uncommon in China, such as more detailed employee benefit plans. Apart from paying employees with company stock, Chinese accounting standards do not address certain types of employee benefits commonly offered by multinationals. Difficulties can arise when the parent company attempts to translate such a package to its Chinese subsidiary. In this case, the company may need to consult with the Ministry of Finance as to how these transactions should be recorded.

- **Delayed Implementation of IFRS**

When new updates to the IFRS are released, the Ministry of Finance first reviews them to determine whether the new rules are appropriate for China and whether to incorporate them into the Chinese accounting standards. As a result, the adoption of new IFRS standards is often delayed, or does not happen at all. This can lead to further divergence if a corporation has established entities in countries that have already adopted the new IFRS rules.

Mapping: Converting Chinese Financial Reports

The problem of differing accounting standards is most apparent when an overseas parent company requests financial information from its Chinese subsidiary. As the two companies are required by law to follow different standards, the information from the Chinese subsidiary needs to be 'translated' to fit into the overseas parent company's books. This procedure is known as 'mapping'. Larger multinationals tend to have specialized software for assisting the corporate group with this process, but as this software tends to be very expensive, SMEs often need to do their conversions manually.

There are two major points a company needs to be aware of when 'mapping' its books. First is the divergence of accounting rules between Chinese and international accounting standards, as discussed previously. Whether performed in-house or outsourced to a trusted advisor, the company's accountant will need to take a detailed look at the differences between the PRC GAAP and the target accounting system, as well as explore whether any of the firm's activities are affected, often spending several days in the process.

If outsourcing accounting work, it is important to notify your accountant of the need to translate your accounts as soon as possible and ensure that this information is shared throughout the company. If the accountant only learns of this request later on, this may significantly delay the process.

The second is the difference in accounting entry codes. Conversion is a one-time procedure that the outsourced accountant needs to complete when first contracted by a new company.

Once the accountant determines which Chinese entry matches which foreign entry, these figures can be automatically converted.

How to File

Accounting Software

Enterprises are required to file their accounting software with the tax bureau. Kingdee and Yonyou, two China-based software companies, currently hold the biggest share of China's accounting software market, with Yonyou, the leader, controlling over 25 percent of the market, followed by Kingdee, Inspur and foreign providers such as SAP and Oracle.

China's statutory filing requirements for financial and accounting reports are set out in a number of laws and related regulations. In principle, these reports must be submitted to the tax bureau and the enterprise's local branch of the Ministry of Finance, either quarterly or annually. In practice, though, monthly filing is often required by the tax bureau, usually at the end of the month.

The annual filing report should be submitted within 45 days of the year-end for domestic enterprises or within four months for foreign-invested enterprises; quarterly filing reports are required within 15 days of the quarter-end. These deadlines may be extended upon approval from the tax bureau in charge.

Note: financial and accounting reports must still be submitted on time even if the company has no taxable income or other taxable items for the current period, and even if the company is exempt from tax as part of an incentive period.

Online Filing vs Filing in Person

Enterprises can choose to physically file their financial reports at the tax bureau in person or do so online. Reports can also be submitted through qualified agencies. Due to its convenience, online filing is becoming increasingly common, with some cities like Dalian no longer accepting physical filings.

The filing procedures do not differ substantially. When receiving a financial report, the tax authorities enter the information into a system called the "China Taxation Administration Information System" (CTAIS). This determines which accounting standards should apply. Additionally, the time requirements and formatting standards for the report are almost the same for both physical and online filing. One main advantage to online filing is that it automatically adapts to regulatory and legislative changes.

As the specific rules for filing can vary from city to city, company financial departments need to pay close attention to local regulations.

A Summary of Accounting Requirements

1. Although CAS 2006 has substantially converged with IFRS, there are additional considerations to be taken during the implementation due to the special circumstances in China. A number of transactions or events under the specific environments in China may result in accounting treatments different from those derived from the principles and description in IFRS. Some of the differences are not explicitly described in the accounting standards.
2. To resolve CAS 2006 implementation issues, you need to know the thought process of the standard setters. This requires an accumulation of experience. For those accounting treatments that are not explicitly stated or would not be able to be derived directly from the principles and description in the standards, verbal interpretations from the standards setters might be needed.

Source: Doing business and investing in China www.pwccn.com

7.3 Main Taxes in China

The purpose of this section is to provide an overview of the main taxes for foreign enterprises in the People's Republic of China (PRC), and includes a note on accounting regulations.

Value added tax

Value Added Tax (VAT) is charged on the supply of goods, provision of repair, replacement and processing services in the PRC as well as on the import of goods into the PRC. In addition, the transformation from Business Tax (BT) to Value Added Tax

(VAT) (the “B2V Reform”) has expanded to cover the construction, real estate sector, financial and consumer services sectors as of 1 May 2016. All industries under the BT regime have been transformed to the VAT regime.

As a result of the credit system, VAT is actually borne by the final consumer. If input VAT exceeds output VAT in a certain period (e.g. a month or a quarter), the excess can be carried forward to the following periods (except that the excess of input VAT would be refunded on export sales). Normally the VAT payable is due on a monthly basis.

Since 2009, input VAT credits have been available for VAT paid in the purchase of fixed assets (except when the fixed asset is exclusively used for production of non-taxable and exempted goods, for employee welfare purposes, etc.). To reclaim or offset VAT on purchases or services, a foreign invested enterprise needs to apply for General Tax Payer status.

In order to further reform the VAT, as of 1 May 2018, all industries that are subject to 17% (sales of goods, imported goods, sales of labour services) and 11% (transportation service, postal services, construction services, etc.) are adjusted to 16% and 10% respectively. Certain small-scale businesses, as defined by authorities, may be entitled to a lower rate (i.e. 3%), but they are not eligible for VAT credits. It is always best to verify the rates with the tax officer.
Exports are generally free of VAT; however, the refund of VAT incurred on the purchase of goods used for export may be limited. In contrast to the European VAT system, input and output VAT in China may not be parallel or “cost neutral.” It should be taken into account that in China there is a difference between the commercial invoice (generally a request for payment) and the tax invoice (for VAT or Income Tax administration).

Corporate income tax

The new Corporate Income Tax Law (CIT Law) became effective on 1 January 2008. The CIT rate was made uniform at 25 per cent for foreign enterprises. Companies that were entitled to a reduced tax rate under the old income tax law are being transitioned to a full 25 per cent CIT rate over a five-year period. The “two-year exemption and three-year half-rate reduction” tax holidays have been removed in the new CIT Law. The new CIT Law also offers some preferential income tax treatment to qualified investments, e.g. a lower CIT rate of 15 per cent may be applied to high-tech companies or technology advanced service companies.

As of January 2019, the State Council has announced measures to reduce taxes for small and medium sized enterprises in China. Companies with less than RMB 1 million in taxable income are exempted from paying Corporate Income Tax over 75% of their taxable income, whereas the 25% would only be taxed at a 20 per cent CIT rate. This results in effective CIT rate of 5%. Additionally, the new announcement also stated that if companies have between RMB 1 million and RMB 3 million of taxable income, they will be exempted from paying CIT over 50% of their taxable income and again the remainder of taxable income is subject to the 20 per cent CIT rate. Similarly, this would mean an effective 10% CIT rate.

Companies are required to maintain transfer pricing documentation in accordance with CIT Law; the level of documentation is based on the volume of related party transactions. Transfer pricing has become increasingly important in recent years. If tax authorities discover that transfer pricing irregularities lead to unpaid taxes, they will take corrective action, which includes collecting back taxes, charging interest and imposing penalties. More details are found in in 7.6

The calculation of CIT is based on revenue, cost, operating tax and expense, including sale, administrative financing expenses.

The formula for the CIT is:
CIT payable = (revenue – cost – operating tax – expense) * 25%

Not all expenses can be deducted for the CIT. Specifically limited are expenses for entertainment, welfare of staff, training for staff and advertising expenses.

- For entertainment expenses, one can only deduct 60% of the actual amount incurred or 0.5% of the revenue, whichever amount is smaller.
- For the personal welfare of staff, one can deduct up to 14% of the staff salary; if the amount is over 14%, then the balance cannot be deducted. If the amount does not reach 14% of the salary, then the actual amount is used.
- For the training of staff, one can deduct up to 2.5% of the staff salary; if the amount is over 2.5%, then the balance can be deferred to the next year. If the amount does not reach 2.5% of the salary, then the actual amount is used.
- Advertising expenses can be deducted up to 15% of the revenue; if the amount is over 15%, then the balance can be deferred to next year. If not, then the deduction is the actual amount.

In China, losses can be deferred for a period of 5 years.

Other taxation
Consumption tax (based on value, volume or units of goods) is charged on the production, processing and importation of certain luxury goods. Consumption tax is levied in addition to value-added tax. There is a vast array of other forms of taxation applicable to various business or investment activities in China, including the Urban Maintenance and Construction Tax, Education Levy, Local Education Levy, Stamp Duty, Cultural Business Levy, Deed Tax, Real Estate Tax, Land Appreciation Tax, together with various mining taxes, motor vehicle taxes.

Moreover, foreign companies that do not have legal establishments in the PRC are liable to be charged with withholding tax on their PRC-sourced income including interest, dividends, rental, royalties and capital gains. Dividends received by foreign investors from their foreign-invested enterprises in the PRC are subject to withholding tax for profits derived after 1 January 2008.

In addition to the above passive income, the income derived from services provided by foreign companies to Chinese companies is also subject to withholding VAT, as well as withholding CIT if a permanent establishment is considered to be constituted in China.

The PRC has signed agreements with most of its major trading partners, including Belgium, Luxemburg and the Netherlands, to avoid double taxation of income. Individual Income Taxes are addressed in Section 7.7.

Common tax planning structures are via Hong Kong or Singapore. It is recommended to consider the legal and tax structure for one's business activities in China ahead of making the actual investment.

Customs

The PRC General Administration of Customs administers the import and export of goods into or from the PRC and collects customs duties and import taxes (including value added tax and consumption tax) for goods imported into the PRC. The average duty rate is approximately ten percent. Importing raw materials into the PRC to produce goods for export purposes could be treated as processing trade, thus generally not subject to customs duties and import taxes, unless there is a specific regulation. But the transaction would be subject to approval by the Commission of Commerce, the Customs authorities and the Tax authorities. In addition, goods imported from overseas into the appointed bonded zones are generally not subject to any customs duty or import taxes. To put one's goods on the "automatic import license goods" list, importers must apply for an automatic import license in advance.

7.4 Invoice system

The term "fapiao" might be one of the most important Chinese words for entrepreneurs who run a business in China. "Fapiao" means "official invoice" in China and it is an indispensable supporting document for all commercial activities. The "fapiao" will contain a date, a brief description of the expense in Chinese, the name of the issuing company, it's official "chop" (a red stamp) and a set of codes used for verification. Most "fapiao's" are printed on a small machine using special paper issued by the tax bureau.

Although "fapiao" is the official invoice in China, it is actually similar to what is called a "receipt" in Western countries. (The equivalent of what is called an "invoice" in Western countries is usually referred to as a "payment notice" in China.) Once a "fapiao" is issued, it has to be recorded as taxable income and relevant tax has to be paid under the current PRC VAT regime, even if payment has not yet been received.

Example of a fapiao

The Chinese tax authority strictly controls the printing, purchasing, issuing and keeping of "fapiao." For most enterprises in China, an essential step before starting operations is to apply for tax registration and to buy the pre-printed blank "fapiao" or special hardware and software from the tax authorities to print these invoices. To be able to issue "VAT deductible fapiaos" a FIE must have the General VAT Taxpayer status. Then it can buy VAT fapiaos from the tax bureau - between 25 and 50 sheets worth RMB 10,000 per sheet – the variance in the quantity of sheets depends on the tax officer. There is a limit of value per sheet. Enterprises must safely store and keep "fapiao," and should not destroy the "fapiao" without authorisation from the tax authorities.

When an enterprise purchases goods or services in China, it must obtain the corresponding "fapiao" from the suppliers. The "fapiao" from the supplier is the evidence of the transaction for the purpose of accounting, taxation or even litigation.

The official tax invoices can be classified into three categories:

- Special VAT invoice: can only be purchased and issued by VAT general taxpayers for sales of goods and/or providing VAT taxable services. The special VAT invoice is the main evidence for the Chinese buyer to credit the input VAT against output VAT for domestic purchases. If VAT small scale taxpayer wants to print a special fapiao, this fapiao needs to be printed by the district office and application for this has to be made by the company.
- Plain invoice: the substitute of special VAT invoices for the enterprises which are not allowed to purchase and issue special VAT invoices. The main users of plain invoices include VAT small-scale taxpayers, and some special VAT general taxpayers.
- Special invoice: refers to receipt vouchers issued for businesses with a special nature, specified scope and particular target.

Be aware of fake fapiaos, which are offered via the internet and telephone marketing. The fapiao usually has a local tax office number and cannot be easily tracked, but the tax authorities can find out if the number is an original number or a copied number. Using fake fapiao is a crime and punishable by severe fines and other administrative punishments, such as the loss of the business license. In severe cases imprisonment may result.

7.5 The Hong Kong Route

Hong Kong has a tax regime that offers competitive rates compared with many other countries. The combination of the existence of a solid legal and regulatory framework, the lack of foreign exchange restrictions and an abundant supply of financial liquidity, makes Hong Kong home to many corporations doing business in Asia.

Hong Kong applies a (territorial) tax regime under which tax is only levied on persons carrying on business in Hong Kong and with profits from that business arising in Hong Kong (i.e. onshore sourced profits). This means that offshore profits are not taxed in Hong Kong. A flat corporate tax rate of 16.5 per cent is applied to the onshore net profits. The tests used to determine the source of different types of profits are different, but the broad guiding principle is that one looks to see what the person has done to earn the profits and where he has done it. Dividends received by a Hong Kong company from an overseas investee are generally offshore in nature and therefore not taxable in Hong Kong and there is no withholding tax on dividend distributions.

Hong Kong has entered into tax treaties for the avoidance of double taxation with more than 30 countries, including China, Belgium, the Netherlands and Luxembourg. The tax treaty network will continue to expand.

The use of a Hong Kong company (with appropriate business substance – has employees on its payroll, has physical office, pays local taxes etc.) as the intermediate holding company between the Chinese entity and the foreign owners could be a type of structure that provides certain fiscal benefits. A typical structure would involve a foreign entity owning 100 per cent of a Hong Kong company, which in turn owns 100 per cent of the Chinese entity. Under the applicable regulations, dividends may be repatriated from the Chinese entity, via the Hong Kong intermediate holding company, to its foreign (e.g. Benelux) shareholder at reduced dividend withholding tax rates. In this respect, it is important to ensure that the relevant tax treaty conditions (such as tax residency and beneficial ownership requirements) are fulfilled. In addition, due to the favourable tax treaties which Hong Kong has with certain European countries, royalty distributions from a Hong Kong company to such a European intellectual property holding company may also enjoy a favourable tax treatment. Separately, a Hong Kong holding company (with appropriate business substance) may also offer greater flexibility in the transfer of company ownership. This set-up allows for reduced administrative burdens in the transfer and potentially a reduced taxation on the gains realised from the transfer of ownership (subject to China tax rules on indirect equity transfer – see further below).

The Chinese tax code includes anti-avoidance regulations, allowing the tax authorities to adjust the total tax liability in China if, for instance, a FIE indirectly transfers China taxable properties in a transaction without a reasonable commercial purpose that results in the avoidance of corporate income tax liability. Based on recent precedents, it appears that the Chinese tax authorities will be applying this regulation more stringently, effectively leaning more towards applying the substance-over-form approach. Tax avoidance through the use of tax havens or structures set up with the single purpose of benefitting from tax-favourable treaties might be subject to certain reclassification or adjustment of applicable tax liability. Specifically, the use of holding company structures to transfer offshore equity interests that represent ownership in Chinese taxable properties has come under more scrutiny from Chinese tax authorities, resulting in Chinese capital-gains-tax liability. Therefore, professional advice should be sought when setting up the structures. More details on setting up a company in Hong-Kong can be found in section 4.7.

7.6 Transfer Pricing

Transfer pricing ("TP") is the price at which enterprises transfer physical goods and intangible property, and also relates to the provision of services or financing between associated enterprises.

With the dramatic increase in global trade and cross-border direct investments, companies tend to have more and more related party transactions. Therefore, TP has become one of the most important and complex issues in global business as well as in China.

What are China's TP regulations?
On 29 June 2016, the State Administration of Taxation (SAT) issued the Public Notice Regarding Refining the Reporting of Related Party Transactions and Administration of Transfer Pricing Documentation (SAT Public Notice [2016] No. 42, hereinafter referred to as the "Public Notice 42").

The following relationships between enterprises shall constitute a "related party relationship" as stipulated in Public Notice 42:

(i) One party directly or indirectly owns 25% or more shares of the other party; or a common third party directly or indirectly owns 25% or more of shares of both parties;
(ii) One party owns shares of the other party, or a common third party owns shares of both parties (less than the percentage as specified in item (i)), the total debt between both parties accounts for 50% or more of either party's total paid-in capital, or 10% or more of one party's total debt is guaranteed by the other party (except for loans or guarantees from or between independent financial institutions).
(iii) One party owns shares of the other party, or a common third party owns shares of both parties (less than the percentage as specified in item (i)), the business operations of one party depend on the proprietary rights, such as patents, non-patented technological know-how, trademarks, copyrights, etc., provided by the other party.
(iv) One party owns shares of the other party, or a common third party owns shares of both parties (less than the percentage as specified in item (i)), the business activities,

such as purchases, sales, receipt of services, provision of services, etc., of one party are controlled by the other party.
(v) More than half of the directors or senior management of one party are appointed or assigned by the other party, or simultaneously serve as directors or senior management of the other party; or more than half of the directors or senior management of both parties are appointed or assigned by a common third party.
(vi) Two natural persons who are spouses, related by lineal consanguinity, siblings, or in other custodianship/family maintenance relationships have one of the relationships as specified in items (i) to (v) with one party and the other party respectively.
(vii) Two parties substantially have common interests in other ways.

In other words, not only equity relationships between related companies would constitute a "related party relationship", also non-equity based relationships based on the above-mentioned provisions may constitute this.

Public Notice 42 provides new transfer pricing compliance requirements in China, including Annual Reporting Forms for Related Party Transaction (RPT Forms), Country-by-Country Reporting (CbCR), and Transfer Pricing Documentation (TPD), all of which are substantial changes to the existing rules.

The number of RPT Forms has increased to 22 tables (from 9 tables), including the CbCR, while the TPD requirement has adopted a three-tiered approach, including master file, local file and special issue file.

The CbCR Forms are required for the Chinese resident enterprise if:

- it is the ultimate holding company of the group with consolidated revenue over RMB 5.5 billion, or
- it is nominated as the CbCR Reporting Entity

If the company meets either of the following criteria, a master file should be prepared:

- have cross-border related party transactions and belong to a group which has prepared the master file, or
- the total amount of related party transactions exceeds RMB one billion

The thresholds for local files depend on the types of related party transactions, which are listed below:

- 200 million for tangible assets transfer (in the case of toll processes, the amount in the annual customs record for toll processing should be included)
- 100 million for financial assets transfer
- 100 million for intangible assets transfer
- 40 million for other related party transactions in total

The special issue file is required for taxpayers engaging in cost sharing agreement or falling under the thin capitalization requirement. And there is no specific threshold criterion for the special issue file.

Taxpayers need to submit the RPT Forms together with the annual income tax filing. For example, the local file / special issue file of TPDs should be completed by 30 June 2018 for related party transactions during the 2017 fiscal year (i.e. 1 January 2017 to 31 December 2017), while the master file should be completed within 12 months after the close of the same fiscal year of the group's ultimate holding company. Taxpayers should submit TPD within 30 days upon the tax authorities' request.

What is the current China TP environment?

According to statistics from the State Administration of Taxation ("SAT"), the income derived from anti-tax avoidance has been soaring in recent years. The SAT has been reinforcing its professional expert team in assessing TP audit cases with an aim to intensify the anti-avoidance audit and tax adjustment. The attention of the tax authorities has been expanded from coastal areas of Guangdong, Jiangsu, and Shanghai to all over the country.

Chinese tax authorities have expanded the investigated transactions beyond traditional buy-sell transactions to service transactions, transactions involving intangible properties, equity transfers and other transactions. The Chinese tax authorities have also widened their focus to include cost-sharing arrangements, controlled foreign companies, thin capitalization, general anti-tax avoidance regimes, and especially tax planning activities involving overseas cost allocation and the use of intermediate holding structures and tax havens.

Furthermore, as Chinese tax authorities are refurbishing their current STA Rules (a very dedicated effort led by the State Administration of Taxation, or SAT, China's top level tax administrative authority), more China-oriented TP concepts and practices are expected to be introduced. Also, it is expected that following their active support for the Base Erosion and Profit Shifting ("BEPS") action plans, Chinese tax authorities will press harder on challenging taxpayers' TP model through formal and informal investigations. Thus, the taxpayers should be more careful when during the planning and implementation stage of their TP model.

In summary, taxpayers facing TP issues, such as audits and tax adjustments involving China, are recommended to be well prepared to prove their proper compliance disclosure and TP solutions for long-term risk mitigation.

What can you do to mitigate TP risks in China?

TP Planning:

TP risks can be mitigated if taxpayers in China can plan their TP policies well and ahead of time. You are expected to integrate TP issues with other tax considerations and current trends to make sure strategies in one area do not contradict other effects. You should focus on managing both risks and opportunities by exploring creative but practical and sustainable TP strategies and methodologies.

TP documentation preparation:

TP documentation must demonstrate that the taxpayer's policies are in line with the arm's length standard by applying regulatory requirements for appropriate methodologies. You should ensure that the company's documentation requirements are addressed in an efficient and effective manner, that they represent sound economic analysis, and that your transactions are documented in a consistent, integrated and systematic manner.

Advance pricing arrangement (APA)

An Advanced Pricing Arrangement (APA) helps taxpayers plan for future tax liabilities, reduce the risk of non-compliance, and minimise the time and cost of compliance on a yearly basis. Taxpayers are encouraged to seek professional assistance with the above-mentioned points to mitigate their TP risks in China.

7.7 Individual Income Tax liabilities for Expatriates in China

Compared to Chinese employees, expatriates face more complicated Individual Income Tax compliance issues. Aside from the domestic IIT laws and regulations in China, the double tax treaties between China and the country where expatriates are (or can be) treated as the tax residents, govern the Individual Income Tax liabilities for expatriates in China.

IIT system

The decision of amending China Individual Tax (IIT) law was made on August 31, 2018. The amendment unveils a new IIT regime mixing aggregate and scheduler taxation systems and refines the IIT law in multiple areas. These changes impact not only every taxpayer, but also enterprises and other market players. It can be anticipated that the majority of the existing IIT rules and regulations will be reviewed and modified according to the new IIT law. There will also be new IIT policies and regulations.

The new IIT law, effective as of 1 January 2019, revised the income categories and implementing comprehensive taxation on wages and salaries, remuneration for labour services and author's remuneration, as well as royalty income. It also optimizes tax rates structure and adjusting tax brackets to reduce tax burden for taxpayers deriving comprehensive income and business operation income, especially for taxpayers at low- and middle-income level. The new IIT Law also earmarks the initial establishment of a comprehensive deduction system, which is comprised of standard basic deduction, specific deductions, additional special deductions and other deductions.

Tax calculation

Individuals who have a domicile in China or individuals who do not have a domicile in China but have resided in China for an aggregate of 183 days or more within a single tax year shall be deemed as resident individuals. Income derived by resident individuals from inside and outside China for income sourced from China shall be subject to IIT pursuant to the amended IIT Law. Individuals who do not have a domicile in China and have not resided in China or individuals who do not have a domicile in China but have resided in China for less than 183 days in aggregate within a tax year shall be deemed as non-resident individuals. Income derived by non-resident individuals from China shall also be subject to the amended IIT Law.

Individual Income Tax Rates (Applicable to General Income) is as below:

Level	Annual Taxable Income	Tax Rate (%)
1	if not exceeding CNY36,000	3
2	for the part exceeding CNY36,000 but no more than CNY144,000	10
3	for the part exceeding CNY144,000 but no more than CNY300,000	20
4	for the part exceeding CNY300,000 but no more than CNY420,000	25
5	for the part exceeding CNY420,000 but no more than CNY660,000	30
6	for the part exceeding CNY660,000 but no more than CNY960,000	35
7	for the part exceeding CNY960,000	45

Level	Taxable income per month	Tax rate (%)	Quick calculation deduction
1	The part not more than CNY3,000	3	0
2	The part more than CNY3,000 but no more than CNY12,000	10	210
3	The part more than CNY12,000 but no more than CNY25,000	20	1410
4	The part more than CNY25,000 but no more than CNY35,000	25	2660
5	The part more than CNY35,000 but no more than CNY55,000	30	4410
6	The part more than CNY55,000 but no more than CNY80,000	35	7160
7	The part more than CNY80,000	45	15160

(Note 1: The "Annual Taxable Income" as mentioned in above table refers to the remainder after deducting the CNY60,000 quota, special deductions, additional special deductions and other deductions under the law from the annual general income received by a resident individual in a single tax year

Note 2: The “Taxable income per month” as mentioned in above table refers to the remainder after deducting the CNY5,000 quota, special deductions, additional special deductions and other deductions under the law from the monthly general income received by a resident individual in a single tax month.

Note 3: For wage and salary income, labour remuneration, author's remuneration and royalties received by a non-resident individual, the payable tax shall be calculated according to the monthly income converted from the annual income provided in this table.)

Per the Circular of the State Council on Issuing the Interim Measures for Additional Special Deductions for Individual Income Tax (GuoFa [2018] No.41), additional special deductions for individual income tax include six types of additional special deductions for the expenses of children's education, continuing education, medical treatment for critical illness, home mortgage interest, house rental, and elderly support as provided in the Individual Income Tax Law.

- Children's Education
  For taxpayers, the expenses of full-time education for the academic qualifications of their children can be deducted at the standard quota of CNY1,000 per child per month. Education for academic qualifications includes compulsory education (primary school and junior middle school education), senior high school education (general senior secondary school, secondary vocational school and secondary technical school education) and higher education (junior college, undergraduate, postgraduate and doctoral education).

- Continuing Education
  For taxpayers, the expenses of their continuing academic/degree education received within China can be deducted at the standard quota of CNY400 per month for the duration of the continuing academic/degree education. The deduction period for continuing academic /degree education for the same academic qualification/degree shall not exceed 48 months. Expenses of the continuing education for professional qualifications of skilled or professional workers received by taxpayers can be deducted at the standard quota of CNY3,600 in the year when the relevant qualifications are received.

- Medical Treatment for Critical Illness
  Within a taxable year, for the medical expenses incurred by a taxpayer that are relevant to the basic medical insurance, the such expenses that are individually borne and paid by the taxpayer after medical insurance reimbursement (including those that are to be individually borne under the medical insurance directory) cumulatively in excess of CNY15,000 can be deducted as they are actually incurred up to the standard limit of CNY80,000 per year at the time of final settlement and payment of tax by the taxpayer.

- Home Mortgage Interest

Where a taxpayer or his/her spouse purchases a home within China for the taxpayer or his/her spouse with an individual home loan taken alone or jointly by the taxpayer or/and his/her spouse from a commercial bank or from the Housing Provident Fund, the expenses incurred from the payment of mortgage interest on any home loan for first-time home buyers can be deducted at the standard quota of CNY1,000 per month in years when such mortgage interest is actually incurred, provided that the deduction period shall not exceed the maximum of 240 months. A taxpayer can only enjoy the deduction for mortgage interest on a home loan for first home buyers once. For the purpose of the Measures, a home loan for first home buyers refers to a home loan for a home purchase subject to the mortgage interest rate applicable to first home buyers.

- House Rental
  The expenses incurred from the rental of a house in the main working city of a taxpayer by the taxpayer who does not own a home in such main working city can be deducted at the following standard quota:
  1. If the main working city is a municipality directly under the Central Government, the capital of a province (or the capital of an autonomous region or prefecture), a city specifically designated in the State plan or any other city determined by the State Council, the standard deduction shall be CNY1,500 per month;
  2. If the main working city has a registered population within municipal districts of more than 1 million, the standard shall be CNY1,100 per month; if the main working city has a registered population within municipal districts of not more than 1 million, the standard deduction shall be CNY800 per month.

- Elderly Support
  Expenses of elderly support incurred by a taxpayer from the provision of support to one or more elder dependent can be deducted at the following uniform standard quota:
  1. if the taxpayer is a single child, the standard deduction quota is CNY2,000 per month; and
  2. if the taxpayer is not a single child, the deduction quota of CNY2,000 per month may be allocated between the taxpayer and his/her sibling(s) provided that the deduction quota allocated to any one person shall not exceed CNY1,000 per month.

During the period from January 1, 2019 to December 31, 2021, foreign individuals meeting the definition of resident individuals may choose to enjoy either additional special deductions for individual income tax or the preferential tax-exemption policies on allowances for housing subsidies, language training expenses and children's education expenses, etc. in accordance with the Circular of the Ministry of Finance and the State Administration of Taxation on Issues concerning Individual Income Tax Policies (Cai Shui Zi [1994] No.20), the Circular of the State Administration of Taxation on Imposing and Exempting Individual Income Tax on Qualifying Subsidies Granted to Foreign Individuals (Guo Shui Fa [1997] No.54) and the Circular of the Ministry of Finance and the State Administration of Taxation on Exempting the Hong Kong or Macao

Housing Subsidies Received by Foreign Individuals from Individual Income Tax (Cai Shui [2004] No.29). After making a choice, foreign individuals cannot make changes within a tax year.

As of January 1, 2022, foreign individuals will no longer enjoy preferential tax-exemption policies on allowances for housing subsidies, language training expenses and children's education expenses and shall enjoy additional special deductions as required. As is the nature of new policies and regulations in China, as these are constantly changing, it is recommended to carefully review the latest information to updated about this subject.

Filing and payment

The following individual income shall be subject to individual income tax:

1. Wage and salary income;
2. Labour remuneration;
3. Author's remuneration;
4. Royalties;
5. Business income;
6. Interests, dividends and bonuses;
7. Income derived from leasing of property;
8. Income derived from transfer of property;
9. Occasional income.

For the income set out in Item 1 through Item 4 of the preceding paragraph (hereinafter referred to as "general income"), the individual income tax shall be calculated on a consolidated basis by the tax year for resident individuals, but on an item-by-item basis by month or by time for non-resident individuals. For the income set out in Item 5 through Article 9, received by taxpayers, the individual income tax shall be calculated respectively. The general income received by a resident individual is taxed for individual income tax purposes on a yearly basis; where there is a withholding agent, the agent shall withhold and remit the tax in advance on a monthly or timely basis; where a taxpayer needs to handle the final settlement of individual income tax on his or her general income, he or she shall handle such final settlement between March 1 and June 30 of the year after the year the income is received.

For wage and salary income, labour remuneration, author's remuneration, and royalties received by a non-resident individual, the withholding agent, if any, shall withhold and remit the tax due on a monthly or timely basis for the non-resident individual, and such individual does not have to conduct the annual tax filing.

Taxation of wages and salaries

Income taxable under the “wages and salaries” category includes basic salaries, awards, bonuses, hardship, Foreign Service allowance, equity based compensation, etc. Taxable income can be in the form of cash, in-kind benefits, market securities and any other forms of economic benefits.

Reimbursements of business-related expenses to employees and certain non-taxable fringe benefits, if the amount is reasonable and supported by valid receipts, are not taxable. Please contact tax advisor for professional guidance about this matter.

Equity Income Taxation in China

Income derived from equity awards is normally taxed on the date when it is vested (restricted share units) or exercised (stock options). Different from the normal wages and salaries, equity income can be taxed separately and enjoy a preferential IIT treatment if the company is listed and completes the tax registration of its equity plan with the appropriate tax bureau.

8. Human Resources

Successfully managing human resources is a key factor in whether a business will survive and thrive in China. China's continued high market growth has resulted in an unsatisfied demand for experienced managers and made it more difficult to hold on to qualified employees, especially when competitors are more than willing to poach top talent and are drawing from the same small pool of resources.

This chapter will help you to prepare for the HR climate you will find yourself in when setting up your business in China.

- Introduction to Human Resources in China
- Introduction to Chinese Labour Legislation
- Clarification for Employers and Employees: The Employee Handbook
- Salaries and Benefits
- How to Retain Staff

8.1 Introduction to Human Resources in China

Skillfully managing human resources plays a critical role in whether a business will succeed in China and holding on to qualified employees is a formidable challenge. This reality is exacerbated by China's lack of a large enough pool of experienced senior managers who can manage talent, lead the organisation and develop an effective reward structure within the organisation.

Talent wars

China's talent shortage, especially at managerial levels, has been a headache for most multinational companies (MNCs) operating in the country, as they face huge challenges in attracting and retaining the right people. To complicate the situation even more, they are now also facing new competitors in the war for talent, as domestic companies lure away key talent from MNCs. These (often listed) local companies can offer stock as part of the remuneration package.

Employee recruitment

The best human resources strategies start at the recruitment level. Ensuring that the right people for the right jobs are hired is crucial to a successful business strategy. It requires time and patience to find the right staff.

Different approaches to recruitment are required for filling different positions:

- Campus recruitment, job fairs, websites (including paid service sites and college-related web pages) are more effective when recruiting for supervisory or junior management positions, and for clerical or operational positions.
- Internal referral programs, job placement programs and networking are best suited to filling senior management, executive and middle management positions, as well as niche positions that require substantial experience.
- Internet recruitment sites that charge fees for use (e.g. zhaopin.com and 51job.com) are important channels for finding

qualified middle management, but executive recruitment typically requires the use of specialized executive search firms.

- While both national and local newspapers play a role in recruitment, advertising for positions on the company homepage and other internet channels has a bigger impact in recruiting for positions at all levels.
- Social media is a good medium to spread the word of a job application if the right peer group can be reached but is not a tool for recruitment. These apps are more suitable for image building to attract potential future candidates.

Talent retention policy

Finding the right person for the job is just the tip of the iceberg. In China's competitive market, holding on to employees is an increasingly difficult task. It is an employee's market, and poaching is a common occurrence, leading to a double-digit turnover rate in some positions. Chapter 8.5 describes more in detail how to retain good employees.

Average base salary movement

Over the past five years in China, the average base salary increased by eight to nine per cent annually, and although the speed of salary growth is declining it is still higher than in Europe where the average salary increase for the same time frame was roughly three per cent. Companies thinking about coming to China need to take this difference into consideration. China is not truly a low-cost country anymore. It remains low-cost for low-level positions compared to the Benelux but on all other levels, the salary levels are growing rapidly to match those of developed markets, and because of the fierce fight over a small talent pool in China, salaries are becoming more and more competitive.

Geography also plays a large part in base salary calculations. Base pay in second tier (provincial) cities is generally roughly 75 to 80 per cent of that in first tier cities. However, salaries for top executive positions in second tier cities often match those of first tier cities and are sometimes actually higher, as people need a financial incentive to relocate from first tier cities to work in such locations. The steep rate of pay progression in China and the unusually high pay dispersion (or the ranges of pay in the market for a given job) are also factors in accelerating turnover.

Pay dispersion in China's market is now 300 per cent, which means employee A can earn three times as much as employee B for doing the same job in a different company. The possibility of large pay increases lures top managers away from their current positions, as they can find instant promotions by joining competing firms. These exponential pay rises explain why hiring top managers in China has become so much more expensive than in other markets. Companies in China should consciously move away from only trying to align pay with this extremely dispersed market and should instead work on implementing pay-for-performance schemes and clear career progression tracks.

Salary development for employees in China is also determined by cultural aspects. The life of young man can be defined by his salary: will he be able to provide for the woman he wants to marry, give her and the family the status they expect? In 1 tier cities people who remain too long (over 3 years) in the same job with the same salary are regarded with suspicion by their friends and recruitment agencies.

A logistics company needed temporary staff for an order picking project of 3 weeks. They hired a recruitment agency to help them find staff. They would receive a 3-days training to work with handheld scanners, with which they would work in the project. As the company felt responsible towards its employees, they would hand out a certificate as proof of the training, which the temporary staff could use to their advantage in the future. The recruitment agency recommended giving the certificate after the project. The staff did their training and the company gave the certificates, against the advice of the recruiter, right after the training. The next day the HR manager calls the agency in despair: the people did not show up at work. The agency found out that the people went to the competitor, looking for a job, which would pay them 1 RMB more per hour, now they had received this training and a certificate. In this developing market salary is still more important than loyalty.

Benefits
It is common in China to provide such benefits as commercial insurance for employees (medical coverage, life insurance and long-term disability), housing-related benefits (supplementary housing funds) and some cash allowances (meal, transportation and housing). More information on this subject can be found later in chapter 8.4.

8.2 Introduction to Chinese Labour Legislation

The role of labour law in China should not be underestimated by current or future employers. Many changes in Chinese labour legislation have been introduced in recent years, which have also led to an increased awareness among employees of their rights.

The Chinese employment model is comparable with the system we know in the Benelux. Therefore, foreign investors from the Benelux can benefit from their previous experiences in order to optimise their employment relationships. However, although the models are comparable, small differences can still have a big impact, so it is important that a correct employment agreement and employment handbook are used within the company. If different branches of the company exist throughout China, local rules should also be checked, as these may differ from place to place.

Employment agreement
An employer has the obligation to provide the employee with a written employment agreement as soon as the employee starts work. In case the employer fails to provide the agreement within one month of the employment commencement date, the employee can claim double salary over a period of up to one year that he or she was working without a contract. After one year of working without a contract, the employment will convert into an open-ended contract. This rule does not apply to part-time workers.

Subjects that have to be stated in the employment agreement are:

• Name, address and legal representative of the employer
• Name, address and ID card number of the employee
• Term of the employment. Options are fixed term, open-end or upon completion of a task
• Job description and place of work

- Working hours and rest hours/days
- Salary: minimum wage is set by the local government and overtime pay is mandatory
- Social insurance
- Workplace safety rules and policies - standard as set by the State

Other matters an employer should consider including in the labour contract are:

- Probation period – the maximum probation period is based on the length of the term of employment in the employment agreement: one month probation if the employment length is three months to one year, two months' probation if the employment length is one to three years, and six months' probation in the case of an open-ended contract.
- Non-competition clause (not related to the confidentiality clause) – the employer can agree on a non-competition clause with key management personnel for a maximum period of two years during which period the employer has to pay the employee a reasonable monthly compensation (check the applicable local regulations for the amount, which can be as high as 50% of the past pay). The employer can try to end the commitment, but a minimum period of three months will usually be applicable. A non-competition clause can only be applicable to senior key employees who are also committed to a confidentiality clause.
- Confidentiality clause – the period of confidentiality can be unlimited, and no compensation is required, as long as it is part of the employment contract and the Handbook. The onus is on the company to prove that the information is confidential, amongst others by ensuring that any confidential information is clearly stamped as confidential.

In addition to the individual employment agreement an employee handbook within the company is a legal obligation. An employee handbook will provide more clarity to staff and can also play a relevant role in disputes between the employer and employee. See chapter 8.3

Continuation of the employment

When the employer decides to extend the employee's employment, the former should bear in mind that the term will be converted into an open ended-contract by law if the employee has already been employed under one or two fixed term agreements or has been employed continuously for ten years. Due to new legislation, the calculation of the number of fixed term agreements can differ depending on the start date of the employee and the location, so checking on a case-by-case basis is recommended.

Termination and compensation

Termination by the employer

In general, the employer cannot end the employment unilaterally without a cause which is listed in the law. Different causes have different termination requirements. For instance, the employer can (if meeting all the legal requirements) terminate the employment immediately if the employee is not suitable for the job during the probation period and in any urgent situation, such as a serious breaches the company's rules (of course with sufficient evidence of the breach and the clarity of the rule).

When a fixed term contract expires and the employer does not wish to renew the contract, the employee is entitled to termination compensation which is related to the cause.

The employer has to pay the same compensation and respect a notice period of 30 days or in lieu of the notice period a financial compensation, in case of termination due to:

- The employee's inability to resume their work or to perform the work the employer arranged when returning after the conclusion of medical treatment due to illness or a non-work related injury
- The employee's incompetence after training and adjustment to the position
- A material change of objective circumstances resulting in the impossibility for employer and employee to agree on the amendment of the employment
- A reduction of the workforce for economical and organisational reasons. Communication with the labour union or employees, and submission of a plan to the labour administrative department, are required in cases where 20 employees or more than ten per cent of the total workforce are being laid off. The employer needs to re-hire dismissed staff if re-hiring within six months after reduction of its workforce.

Please note that it is possible that a higher compensation and/or additional compensation(s) have to be paid depending on the circumstances and that the employer has to provide sufficient documentation and/or substantial proof to support the existence of the cause and the circumstances as described by the employer.

The employer is not allowed to terminate the contract in cases of occupational disease, pregnancy or during maternity/nursing leave, or if the employee has been employed for 15 years or more and is less than 5 years away from retirement. In case of an occupational disease or injury, the employer has to consult with the work-related injury insurance company/policy and involved local governmental department.

Severance payment
The calculation of financial compensation for termination is based on one month's (average) salary (including some fixed components) for a continuous period of 12 months prior to the termination (with a maximum of 12 years) with the employer. A period of less than six months counts for half a month's salary and a period longer than six months but less than one year shall be counted as one month's salary. The one month salary amount is capped at three times the average salary of the previous year of all employees in the city where the company is registered as announced by the local government. So, if the employee is earning more than three times the average, the amount which is above three times the average will not be taken into account.

In case of violation of the law by the employer, the employee may be entitled to twice the usual amount of severance payment (or to be reinstated). Employers should take into account that due to a mix of newer and older legislation, the calculation of the relevant employment years in such matters can be more complicated. So, doing precise calculations on a case-by-case basis is recommended.

Termination by mutual consent
Although an employer does not need prior approval from any authority to dismiss an employee with or without payment of severance pay, it is common practice for employer and employee to negotiate the terms of the termination of the employment. This way, the employer may prevent an employee who does not agree with the termination from going

to the Labour Arbitration Committee. In recent years the number of labour disputes has risen drastically.

In the case of termination of over 20 or more employees, it is required to get a prior approval from the labour bureau of the local government.

Termination by the employee
During the probation period the employee can terminate his employment by giving a notice period of three days. After this, the employee has a notice period of 30 days for terminating his employment, unless a situation arises where the employer violates regulations as mentioned in the law. In that case, the employee is entitled to end the employment agreement immediately and receive severance pay. Examples include cases where the employee is forced to perform dangerous tasks in violation of the rules and in which the employer fails to pay the social insurance premiums stipulated by the law.

Employing through staffing agencies
Companies with a representative office (or without any entity) in China can only employ local employees through staffing agencies. For other companies with a legal entity in China, the labour dispatch arrangements are stricter: the company may only use labour dispatch for temporary, auxiliary or substitute positions. For permanent positions they need to hire directly, and the number of employees hired through the staffing agency is subject to a maximum percentage

The staffing agency will be the formal employer of the employee, and the employee will be dispatched to work at the company which also selected the employee. The company will sign a service contract with the staffing agency for its dispatching services, payroll management and additional services. The staffing agency will enter into an employment agreement with the employee for a statutory minimum period of two years.

8.3 Clarification for Employers and Employees: The Employee Handbook

An employee handbook, also known as the employee manual, is a book given to employees by their employer. The handbook usually contains corporate regulations and procedures, corporate culture, company vision and strategy. The employee handbook is an important communication tool between employers and employees. A well-written handbook sets forth the employer’s expectations for employees and describes what they can expect from the company. The employee handbook can act as the constitution of the company.

Why have an employee handbook?

- Help new staff to learn about the company
- Protection of the mutual benefits of employees and employers. An employee handbook should describe the legal obligations as an employer and the employees’ rights. Meanwhile, it should also clarify corporate rules and regulations. It can serve as a tool for companies to protect themselves from potential employee fraud and abuse of loopholes in the labour legislation. For example, according to Article 39 of Chinese Labour Contract Law, an employer may terminate an employment contract if the employee materially breaches the employer’s rules and regulations. However, in practice, without a clear definition of “material breach” in the

handbook, the employer might find that it is in a difficult position when a dispute arises.

What should an employee handbook include?

· Company background introduction, including company history, company current status, company vision, corporate value and corporate culture.
· Global policy, such as business code, integrity code, competition law compliance policy, anti-discrimination policies and complaint and reporting procedures.
· Local policy, such as policy of promotion and demotion, salary adjustment policy, recruitment policy, and policy of commercial confidentiality.
· Compensation and benefits, including on which day the employees receive their pay (usually the beginning or the end of the month), pay cycle (normally on a monthly basis for 12-16 months' salary, with the exceeding part usually paid to employees at the end of the year), bonus and commissions strategy, social security, commercial insurance and other benefits.
· Guidelines for training and development, which include the policies on training and performance appraisal and their application procedures.
· Work regulations and procedures, including work-hour Systems (see for explanation Tips here under), working hours, attendance, punctuality, leave policy and reporting absences; leave application procedure, annual leave regulations, resignation application procedure, procedure of handling on-the-job injury, etc.
· Behavioral code and disciplinary action procedures defining different levels of misconduct (usually divided into three levels: minor misconduct, moderate misconduct, severe misconduct) and related discipline actions, usually including oral warning, written warning letter, compensation for caused damage and termination of the labour contract. The employer should clearly define in the handbook what kind of behavior is the "material breach" of the corporate rules and regulations.
· Labour contract management including signing of the Employment Contract, probation period management and cessation or termination of Employment Contract.

"I agree" form

The "I agree" form is also part of the content and should be included on the last page of a handbook. This is the most important part of the handbook: without this form, even a well-written handbook has no value.

New employees must sign the form stating they have read and understood the information and have accepted the terms of the employee handbook. In the form, it should clarify that failure to do so within a timely manner may result in termination. The "I agree" form should be well kept by the HR department or direct superior.

If the employee refuses to sign the employee handbook, which rarely happens, this does not make the handbook less valid. Make a note of the fact and ask the employee to sign for refusal.

Tips:

·Emphasise in the employee handbook that it is part of the labour contract signed by employees with the company.
·Clarify the time from when the handbook is effective and to whom the handbook is applicable.

·Regardless of global policies or local policies, procedures for reporting complaints must be included. Local and global integrity officers must be defined as well. The rights and obligations of the reporting person should be clearly defined and the procedure of handling such complaints and reports must be stipulated.
·The minimum number of days of annual leave as prescribed by law is 5 days for employee who worked less than 5 years, 10 days for those who worked for more than 5 years but less than 10 years and 20 days for those work over 20 years. The accumulated working years are not limited to the working years with one employer. Annual leave cannot be rolled over unless it is indicated in the handbook. Employees can argue that the inability for them to enjoy annual leave is caused by the employer e.g. due to insufficient staff. If there is any un-used annual leave left when the employee is terminated and the contract ends, it has to be paid in lieu and the compensation of 1 annual leave day can be up to 300% of the daily salary.
·Normally in China, employees work eight hours per day. If the company decides to have one hour of lunch time for employees, the handbook must specify that the lunch hour should not be regarded as a working hour. Otherwise, the extra hour will be regarded as overtime. In China, there are types of work-hour systems, i.e. standard work-hour system, flexible work-hour system and comprehensive work-hour system. One of the aforementioned work-hour systems may be applied according to the contents or nature of the employee's job. Except the standard work-hour system, the company should get an approval on application of the other two work-hour systems within the company from the local labour bureau.
·Revisions to an employee handbook vary from company to company. For instance, at many larger companies, a revised handbook comes out annually or at other regular intervals. In any case the Handbook should be signed by the employees annually.
·All final explanatory rights to the Employee Handbook reside with the company.

8.4 Salaries and Benefits

A salary consists of a net salary, social benefits and tax, together constituting the gross salary. In employment contracts, it is normally the gross salary that is mentioned. A company-specific pension is normally not part of the salary, as it is in many Western countries. Taxes and benefits vary between the first tier cities and even more significantly between cities and towns. Differences can be significant. Companies with multiple branches should take these differences into account. It can have a major impact on their HR administration.

Social benefits and tax

The social benefits consist of an employer portion and an employee portion when declared and paid, but the employer can choose to contribute both, although this is not often done

Tax and social benefits are comparatively high. The PRC Individual Income Tax will be amended per 1 January 2019. See chapter 7.
Income is taxed after the social benefits have been deducted. Benefits are calculated on a salary base, starting from the average lowest income of the previous year and capping at three times or five times the average income of the employees depending on the specific benefit. Taxes and benefits are calculated on the monthly income and have to be paid monthly.

For important functions, bonuses against targets or Key Performance Indicators (KPIs) are common, reaching amounts of three months' salary or more.

For local staff, all cash allowances such as meals, transport and expenses are taxable, if there are no related and approved receipts. When hiring new staff, it is common to ask for an original salary calculation at the previous firm.

Pension

The individual pension is not company related but paid into an individual personal account. The pay-out is limited.

Housing Scheme

The housing scheme is organised similarly. Payments from the housing fund can be made when the employee buys a new home or renovates an existing home.

Because these schemes are not related to a company and do not promote company loyalty, some companies have additional benefits for executives, such as a supplementary housing fund, housing loans, and a company car, or for foreign invested companies, so-called "phantom options". This grants the receiver a cash payment at a designated time or in association with a designated event in the future, of the market value of an equivalent number of shares of the corporation's stock, without actually possessing the shares. All these benefits have their advantages and disadvantages, and none fit every situation.

8.5 How to Retain Staff

The talent shortage in China has been exacerbated in recent years due to the explosion of the employment market, caused by multinational organisations setting up operations here and local companies expanding. Although China has a large educated workforce compared to the world's other emerging economies, it possesses only a limited qualified pool of talent that is suitable for the positions required by foreign enterprises.

The China Employee Attraction and Retention Survey has revealed that turnover of professional staff has stabilised at a high level. Apparently, a quick change of jobs has become an accepted practice among Chinese employees. Compared to professionals and individual contributors, leaders felt less loyalty to their companies and were less likely to stay. Contrary to what is usually found in Western cultures, where employee satisfaction and engagement typically increase as organisational levels get higher, leaders in China are less inclined to feel that they have good managers, great company leadership, or a creative or fun workplace culture.

The issues of development and retention need to get a high priority in the Chinese market. Companies in China are struggling to retain their professionals and employees, resulting inevitably in higher salaries or excessive recruitment costs. However, throwing more money at a problem only works for the short term. Companies need to formulate some more sophisticated approaches, and these should be adopted to attract and retain their employees. Promotion of "softer" benefits is more likely to keep their best professionals, which is getting more essential for companies in the Chinese environment.

Factors that influence retention

To address the problem, one needs to ask: what makes people stay with a company, and what makes them decide to leave? Chinese employees list guaranteed cash compensation, career development opportunities, working climate, quality of leadership and organisational attributes such as company reputation, marketing and product quality, as the five most important aspects they consider when looking for a company to work for. Compensation and career development are at the top of the list.

When it comes to why people stay, leadership quality, respect and recognition, and alignment of job and interest occupy the top three positions, while compensation comes in fifth place. Quality leadership is crucial in finding and keeping talent throughout the company structure. This is also reflected in the top reasons listed as to why people leave: low-quality leadership and lack of timely career development opportunities. The lesson here is that money may be the key in attracting the right talent to the job, but it's not enough to make them stay. In order to retain employees, companies need to focus on the entire business structure of the company, offering quality leadership, career development opportunities, and respect for employees.

Relationships

The top three employee retention drivers are directly related to employees' relationships with bosses and colleagues. Employees generally will be glad to stay with an organisation if they have a good manager or boss with great leadership. Good leadership also means that employees are more often recognised for individual contributions, thus leading to more opportunities to develop themselves. Chinese culture believes in a harmonious working environment, and hence Chinese workers put a heavier emphasis on their relationships with their immediate superiors and colleagues.

It is crucial to understand Chinese culture. No one likes to be embarrassed or to "lose face," and hence avoiding embarrassing situations is especially important to Chinese employees. See also chapter 2 about Cultural differences. Reprimanding Chinese employees too harshly (even in private) should be avoided. Instead, use "soft" constructive criticism through a discussion, and emphasise the positive aspects of an employee's performance. Try to be indirect in your manner of presenting criticism.

Money matters, but . . .

Sufficient compensation is still among the most important reasons for employees leaving their positions for new pastures, and this has been confirmed by several studies. It is undeniable that many employees leave because competitors are offering higher salaries. A company that does not offer a compensation package at or above market rates is unlikely to be able to keep its top employees, regardless of other factors. Labour costs are surging in China, and organisations need to conduct frequent salary reviews to keep pace with market standards. With the country's rapid economic development, the majority of Chinese workers are in the pursuit of money.

However, contrary to other work characteristics, dissatisfaction with pay is not related to employees' commitment to an organisation. Rather, it is their dissatisfaction with various intangible aspects of work. When making a decision to stay or leave, employees weigh both the advantages and the disadvantages. If their current organisation provides them with strong leadership, growth opportunities, and a compatible culture and work associates, then competitors' offers of high financial rewards will not outweigh employees' commitments. Likewise, employees who are dissatisfied in these areas begin to look elsewhere and can be attracted by those who are offering higher salaries. Then compensation becomes the official reason for leaving. Organisations need competitive salaries, but compensation alone is insufficient for retaining valued talent.

What to do?

The following policies and practices can help alleviate the turnover problem in China:

- Select the right people
- Provide more assistance in career development
- Improve the leadership skills
- Offer training for development opportunities
- Offer the right compensation
- Examine retention factors more closely

Select the right people

Ensure that the organisation assigns the right people to the right position. By doing this, the organisation and the leader reduce the chance of dissatisfaction being felt by the employee and the company. In addition to evaluating employees' competence, skills, experience and knowledge, organisations need to take steps to understand candidates' expectations and motivations, and then match them with what the organisation can provide.

Traditional job interviews are not particularly accurate in predicting a candidate's future performance because interviewers cannot be completely objective. Hence, it might be better to conduct employee screening through a neutral third party in an assessment. The tasks in an assessment centre usually reflect the potential ability and motivations of candidates to perform in a new position, and the group interaction allows assessors to find out the key personality traits of the candidate, which can greatly impact his or her future performance. Large employers of graduates, who want to hire a relatively large number of people for a similar job role, frequently use assessments by third parties. It is also widely used when a median to high-level position search comes to the final or penultimate stage of the recruitment or development process.

An assessment centre is usually conducted by a group of assessors with the employer's HR team, as well as departmental managers. The cost varies depending on the length, tasks involved, and the number of employees required to be assessed. The organisations are willing to spend money on it to ensure they have the right people on board. Compared to the loss of business, time and energy caused by a mistake in hiring, the cost of an assessment centre can be easily justified.

Provide more assistance in career development

One of the main reasons to leave is lack of development opportunities with the current employer and the alternative of better career opportunities elsewhere. Employees who are satisfied with their accomplishments, and who have received recognition for their contributions, are less likely to leave in comparison with employees who feel less content. Chinese can be impressed by a good title, as it gives them "face". This has led to title-inflation in China's business world.

Companies, regarding the particular needs of Chinese employees' emphasis on the benefits for individual development, can provide more and more assistance for career development. There are several ways to make the assistance visible and available. First, annual surveys can be arranged to collect employee feedback for those who may not have many other opportunities to confidentially express their views. Second, a company can conduct regular face-to-face conversations, in order to strengthen the supervision of the organisation. Third, organisations can seek help from consulting companies providing professional development plans for employees. Based on employees' specific needs for development measured in assessment, a development plan can be composed of three main parts: pointers for experience-oriented learning on an individual level; coaching from superiors; and a training/coaching program from internal or external sources.

Integrating succession planning and career development, making long-term plans for talented staff required in the future, and developing the employees from within the company are vital. A development program can become a strong motivational factor for career and the development-orientation of Chinese staff. This, together with integrating strategic planning and talent planning, can greatly contribute to the success of the company in China. The planning for talent needed in future and the development of potential talent for future positions is crucial for international companies in China. The lack of resources makes it challenging to undertake career planning for all employees and to foresee all future needs, but through pursuing such objectives a company will see increased output from its employees.

Improve the leadership skills
Having a good manager is more related to employee retention than any other single work factor. Skills such as handling performance issues or conflicts are essential for many new and experienced managers in their daily work. It is crucial for the leaders to provide Chinese subordinates with a corporate culture characterised by harmony and informality and to build close and trusted personal relationships with them.

Since one of the most valuable and most used retention methods is having a succession management program and offering training and development opportunities, providing training or coaching for leadership would be an ideal strategy for ensuring the existence of good managers. Chinese employees may tend to lack certain strengths, such as the ability to ask questions, self-correcting skills, giving positive feedback to their subordinates, and presentation skills. These can all be good topics for coaching. Chinese workers can work effectively under a system of regular performance appraisals. Additionally, they grow accustomed to interpreting feedback from superiors and also expect their managers to make a career plan for them.

Offer training for development opportunities
Action learning is a highly effective method for the development of Chinese employees in certain functions such as sales. Chinese staff often has good theoretical knowledge but may lack practical experience. Hence, action learning can encourage Chinese employees to put their knowledge into practice and to develop certain skills rapidly. The company can increase the understanding of the overall processes by using job rotation and thereby increase employee satisfaction levels.

Self-directed learning and e-learning are found to be the most challenging approaches for the development of Chinese employees. Chinese staff does not have a tradition of planning their own learning in the company as it is seen as a company or supervisor's task. Many lack the self-awareness and self-management skills, as well as skills in using the English language. Thus, face-to-face training is more effective for Chinese employees than self-directed learning or e-learning.

Offer the right compensation

Although compensation is seen as much less of a retention driver than intangible factors like having opportunities for development, being recognized for individual contributions, and having a good manager, the Chinese still put heavier emphasis upon compensation than Western workers, since the two groups are living in different stages of economic development.

Many Chinese employees from the young generation are ambitious and prefer spending more time on work, while caring more about short-term income. They are eager to improve their knowledge and competence at work to achieve rapid development, while Western workers put higher value on a work-life balance.

It will be wise to provide Chinese employees with basic benefits and to then tailor additional benefits to different needs of employees. It is believed that linking pay to performance has high value and this is frequently used by HR departments, although this incentive should be combined with other methods to ensure success.

Examine retention factors more closely

To deal with turnover effectively, organisations need a precise understanding of why employees leave, why they are dissatisfied, and the degree to which discontent is most likely to cause turnover. Also, organisations should have a clear view of the turnover situation of different talent groups. For those in operational roles, for example, turnover causes and rates can be very different than for those at managerial levels.

Studies have suggested that official turnover reasons fail to tell the whole story. It is partly because of the Chinese culture that sensitive issues such as poor relationships are not often listed as official reasons. Outsourcing to neutral third parties can help uncover employees' real reasons for dissatisfaction, which may not be perceived by their respective HR departments. Arranging regular follow-ups with current employees, and using surveys, interviews, and day-to-day discussions, will help organisations to understand the issues and meet employee expectations before it is too late.


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During the first eight years of the 21st century, exponential business growth created job-hopping opportunities for almost everyone with a good education, English language skills and some international business experience. This early heat for job-jumpers has cooled down a bit, but there are still a lot of opportunities for the most competent individuals, and retention therefore remains a top priority.

The above paragraphs mention, and it is true, that to retain staff and/or decrease turnover in your company, the right recruitment decisions, opportunities for advancement, quality leadership, and personal talent development opportunities are very helpful.

As such, assessment and development of talent and leadership at all levels has become more important, not only for retention, but also to ensure staff competency, and even more to predict their potential for future success. That is why Assessment Centers are implemented as routine tool in the talent management cycle of high-performing companies. Following Assessment reports and based on the strengths and weaknesses (development needs) for specific job functions, development programs are designed and rolled out. In this manner, the talents, managers and leaders get tailormade training, coaching or mentoring to improve in specific areas of need. These assessment and development techniques are put in place to select the best talent, to place them in the proper place, and to develop their expertise and performance further, thereby making the company more able to compete at the highest levels and conquer fierce market competition. What follows is a real-world example that highlights these ideas and processes at work.

CASE STUDY, by Wise Wings

BUSINESS PERFORMANCE GROWTH THROUGH ASSESSMENT CENTERS AND LEADERSHIP DEVELOPMENT

The case study concerns a global tool assembly company, with production and sales in China, and a mixed cultural staff of 200 employees, including 26 managers. Over the course of three years, they developed a tremendous business volume downturn due to fierce competition and bad leadership, leading to poor company performance. The headquarters had already replaced several GM and MT members, to no effect. Finally, they realized there was a shortfall in qualified leaders able to manage teams effectively. This shortfall existed because the management team lacked leadership skills, and because there were many cultural misunderstandings between the Chinese and western staff. Essentially, the challenges they faced included unqualified leadership, ineffective communication skills, unclear departmental thinking and vision, inefficient working practices, and problematic attitudes towards dispute management.

Among all of these challenges, leadership was viewed as the single most important issue in terms of its impact on workforce management within the company. The organization knew that it needed to remedy this but also understand that replacing people was not necessarily the best solution. They wanted a way to develop performance-driven leaders through a customized leadership development program. With that in mind, a consultancy company (Wise Wings) designed a complete assessment centre and development process to enhance leadership competencies throughout the management team, and to redefine the company's vision and organisational culture.

THE PROCESS
To achieve business performance growth through Talent and Leadership Development, the project development consultant focused on 3 stages:

- Stage 1 – Individual Assessment Center & Development – 2-month Program
- Stage 2 – Team & Organisation Development - 2-month Program
- Stage 3 - From Local to Global – Long term

Stage 1–Individual Assessment Center & Development – 2-month Program

Competency Analysis

- Sit together with the executives to discuss challenges and set common goals.
- Develop a specific competency model for each function that talents, managers and leadership at the company must comply with.
- Focus on 8 competencies for Assessment & Leadership Development: Leadership, Delegation, Problem Solving, Persuasion, Team Orientation, Result Orientation, Stress Resistance, Decisiveness, Loyalty.

Assessment Center
An Assessment Center conducted by a consultancy company (Wise Wings) consists of:

- Personality and psychometric ability testing
- Assessment exercises – 3 Business cases& role plays, depending on profile and level - 1 European and 1 Chinese consultant/psychologist
- A competency-oriented report with pointers for strengths & development needs
- Development program: based on development needs: specific training/coaching for individuals. Workshops for teams.
- Specific feedback for individuals, HRM for implementation of development and change to optimise the company.

Individual Coaching
Based on assessment center reports, results of personality tests, observation of business cases, role plays and competency focused interviews, the development program was designed to enhance the management team members competencies.
The coaching sessions were tailor-made and based on the individual development needs per competency.

Stage 2 – Team & Organisation Development - 2-month Program

Team Work Development

- Create a Team Vision and enhance teamwork
- Define team performance measurements
- Learn about how individuals on the team complement each other
- Team Building sessions

Management by Objectives& Project evaluations (Performance management)

- From company to individual level
- From yearly to monthly, weekly, daily breakdown

Stage 3– From Local to Global – Long term

Sustaining the Transformation

- Top global leadership development program: 5 key leaders
- Further management/leadership training courses for MT
- Implement organisation development & change management.

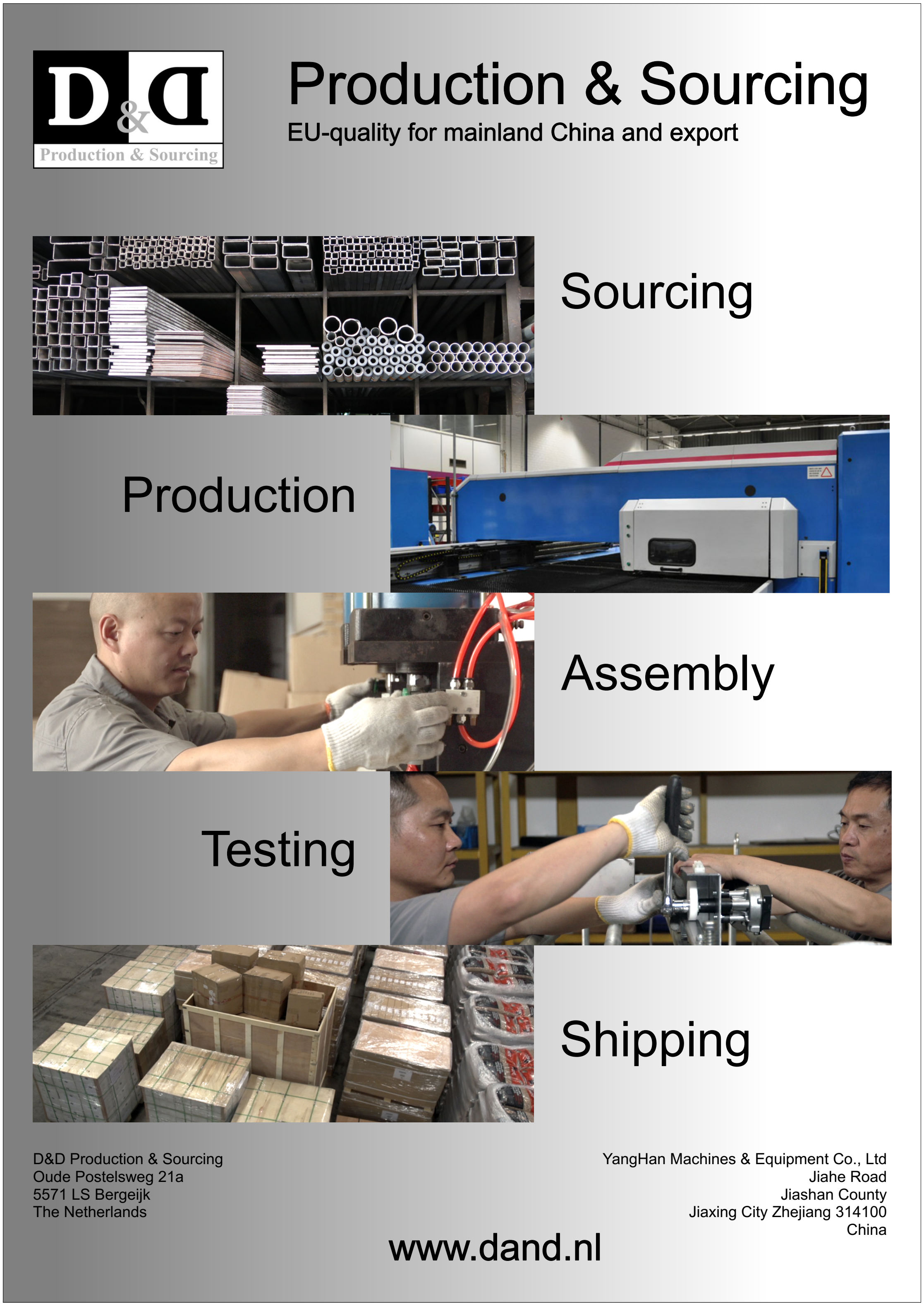
Forming the Organization

- 3 continents with 12 different countries
- MBA Leadership development program for key company leaders
- Extend the model to all of them: culture, system, teams

OUTCOMES

The 26-personof leadership team went through an incredible transformation. People who struggled to communicate effectively with each other now work cohesively and collabouratively. Team members were able to see a clear vision, build trust within the organization and instill confidence in all of the employees that the leadership team can solve any issues collabouratively. The impact of the project on the company performance was measurable:

- Favorable performance trends resulted in world-wide organizational improvement. The company was selected as the best performing in the world with:
  - Best profitability of the group
  - Best growth rate: 70% growth per year
- Significant reduction in customer complaints.
- A solid foundation for further expansion was built.
- The company became an exemplary model for all companies within four global Business Units worldwide.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9. Manufacturing and Sourcing

9.1 Introduction

Many European companies make use of China's enormous industrial resources and have parts, assemblies and subassemblies or even complete end products made there. These companies can choose between starting their own factory in China or outsourcing the work to a Chinese company. This article gives you an insight into the opportunities that exist in terms of manufacturing in China, either under your own management or via outsourcing approach.

The article's author is Jan van der Donk, co-founder/director of D&D Production & Sourcing. He has experience of (outsourced) manufacturing in all its guises in China. D&D Production & Sourcing has operated its own company in China since 2006. D&D started out as a purchasing organization initially, and subsequently developed its manufacturing capability in China in order to satisfy customer demand. Much of this practical experience has been incorporated in this article, so it is well worth reading.

"Why produce in China", section 2 of this article, establishes why China is and continues to be interesting as a manufacturing location.
The next section, "Situation in China", describes the industrial landscape in China. This section is structured around a number of key characteristics that are important for all entrepreneurs.
The fourth section, "Produce/outsource", describes the various ways in which manufacturing in China can be organized. As previously mentioned, companies can either produce in their own factory in China or outsource to Chinese partners.
Finally, section 5, "Conclusion" presents conclusions and three important tips for entrepreneurs who want to have industrial goods made in China.

9.2 Why produce in China?

China has been called 'The World's Factory' for several decades, and with good reason. Since the time when China tentatively opened up in the 1980s under the rule of former leader Deng Xiaoping, the country has experienced turbulent growth and developed in leaps and bounds, particularly in the area of industrial manufacturing.

There are a number of compelling reasons why companies in Europe consider manufacturing in China:
Costs
The manufacturing costs in China are still significantly lower than those in Europe. This advantage, in combination with the extensive industrial infrastructure, makes China an excellent option for reducing the cost of an industrial product.
Local market.
More and more European companies are starting to sell their products in the Chinese market. In view of the country's 1.3 billion inhabitants, the internal market cannot be ignored and offers very attractive opportunities. However, the market is difficult to access because of the much-publicized cultural and language barriers. Some companies have been successful, but there have also been many failures. There are several possible reasons for failure in the Chinese market and we will refrain from discussing them all here.

However, one major cause of failure needs to be highlighted: the distance between Europe and China and all the associated obstacles such as long transportation times, import duties, currency risks, after-sales issues, etc. This is one argument in favour of producing locally in China (possibly via a partner).
Capacity
The sheer size of the country and the number of inhabitants mean that the capacity there is enormous.

Situation in China

Whatever the approach, producing in-house or working with a manufacturing partner, every entrepreneur will have to deal with the characteristics of China's industrial landscape. We will mention a number of prominent characteristics here and discuss them so that you are fully aware of the background.

a. Suppliers

China's industrial sector is well developed and strongly tends to favour vertical integration. For example, a manufacturer of machines in China makes everything in-house. The supply chain is much less finely meshed than in Europe/America. In other words, suppliers are difficult to find.

You might think that you can find suppliers on Alibaba, to name one possible approach. However, you should bear in mind that these companies are often intermediaries and not the producer of the goods. This is a consequence of the licenses that are required for export. Many producers do not have an export license. Be aware that you may be doing business with either a producer or a trader. Identifying a trading partner's exact status is difficult. Organisations such as BenCham can help you here.

In our experience, outsourcing manufacturing to a Chinese company is the best approach for simple parts. The situation is very different when it comes to complex products or even complete end products. A great deal of communication back and forth is required in this case.

b. Materials

Basic materials in China are offered according to Chinese standards (as you would expect), or sometimes American standards. The material properties need to be subjected to in-depth analysis by an expert to ensure procurement of materials of the right grade and quality.

Semi-finished products are also available in China. However, the specifications must be documented exactly and also monitored in practice. When standards are applied, the Chinese have a habit of purposefully working to the lower limit. For example, you order a 50 mm diameter shaft to a tolerance of +/- 0.5 mm. Your supplier delivers a shaft that measures 49.5 mm or even less.

Off-the-shelf items (fasteners, components, etc.), in particular European brands, are readily available in China. However, they are often much more expensive than in Europe. You are advised to consider local alternatives. They can be just as good and are mostly much cheaper, however you should always request the data sheets and certificates though. Obviously, you can also buy items at knock-down prices. The quality is commensurate with the low price.

c. Quality

As mentioned earlier in our experience, manufacturers in China have a different perception of quality. For example, Chinese suppliers invariably target the lowest tolerance limit.

So professionally organised quality control procedures are essential. You can subcontract this activity to certified parties such as SGS/TUV. Or you can employ your own quality controller.

d. Banking and finance

Different names are used for money in China. The official name is Renminbi(人民币) which means 'The money of the people'. In addition, the words Kuai(块) and Yuan(元) are often used.

When starting an own company in China, a license is required for writing an invoice. This license is issued in stages; at the beginning of the procedure, only a limited amount may be invoiced per month. The amount gradually increases, but this arrangement can obviously cause liquidity problems.

The banking sector is nowhere near as well developed as it is in Europe. Many, trivial transactions require a physical visit to the bank, which is very time-consuming. Payments are a further challenge. China does not allow free movement of capital when it comes to foreign capital. As a result, there are many rules which foreign investors need to study closely. For example, a foreign parent company can deposit capital relatively easily, but using this capital in China is not as simple. This money is earmarked and each transaction requires a physical visit to the bank! In addition, withdrawing money from China (e.g. in the form of a dividend) is also subject to many rules and maybe restricted. Expert advice should also be sought in this area. The Chinese State Administration of Foreign Exchange is strict!

e. Environment

The environment is an increasingly important aspect in China. The current five-year plan sets strict requirements in this area. You must make sure that the companies you do business with comply with the legal requirements. Otherwise, you may find that a factory is closed by the government for months, completely out of the blue

9.3 Produce/outsource

In the light of the above, China is obviously interesting when it comes to producing goods. This section looks in greater detail at the considerations and pros and cons in relation to manufacturing more complex (end) products in China (or having them manufactured). This can be achieved by starting up a) your own manufacturing site or b) by outsourcing.

Let us consider setting up your own manufacturing facility first. Then we will look at outsourcing, with a particular focus on an outsourcing strategy that seeks to support business continuity.

- Your own factory in China

The costs of a manufacturing plant in China are (still) significantly lower than those in Western Europe, both in terms of buildings and machinery, and in terms of staff.

The complexity of setting up your own manufacturing facility is very much dependent on the type of manufacturing required. Building a chemical factory is more challenging than setting up an assembly facility. Whatever the requirement, a number of aspects always apply in each case.

Legal person

Not all industrial sectors allow a foreigner to become a full owner, so you have to work with a Chinese shareholder (Joint Ventures). A great many issues need to be clarified beforehand, but it is not appropriate to discuss them all here. At all events, legal advice must be sought in this situation.

Setting up a WOFE (Wholly Owned Foreign Enterprise) is a further possibility. You are then the sole owner of the company in China and you do not have a Chinese partner. Setting up a WOFE is a particularly difficult process that resembles the Echternach procession (three steps forward and two steps backward). It is a process that you can arrange yourself but be sure to engage a competent legal adviser.

Government

Based on our experiences to date, we can state that good collabouration with the Chinese government is perfectly achievable. This has been the case with regard to dismissal cases, working conditions and also setting up a factory. If you have the support of the local Chinese government authority, regarding an industrial park that is under development for example, you will find it much easier to resolve licensing hurdles, problems associated with establishing a business, fiscal issues, etc. Local government authorities often have to achieve targets set by the district or provincial government in relation to economic growth scenarios and they will do everything in their power to help a Western investor bring his manufacturing plans to a successful conclusion. So, developing good contacts with the local government authority is highly advisable.

Location
In a large country like China, the choice of location is not a foregone conclusion by any means. Here again: seek good advice. A good location depends on where your market is in geographical terms (e.g. agriculture in North China) and the availability of professionally trained staff (e.g. electronics in the Guangdong region), etc. Furthermore, the subsidies offered by local authorities may differ and it is worth drawing up a comparison. The distance to a port, airport or main railway line is a further consideration.

Staff
There is a generous, sometimes overwhelming, supply of Chinese staff. You should note however that Chinese educational qualifications differ from our own qualifications. Nowadays, more and more Chinese speak English, particularly the younger generations. However, this immediately results in a higher salary level.

As said, there is no shortage of staff. The general staff shortage that we see in Western Europe in 2018 does not apply in China.

Management
A frequently asked question is: do I appoint a Western (European) or Chinese General Manager? There is something to say for both approaches and here too, advice from (experienced) partners can steer an investor in the right direction. It is easier to communicate with a European manager and the company language is better understood. However, a Chinese manager has a better feel for Chinese dos and don'ts and will find it easier to build up a relationship with (local) governments, which is also quite important. A good command of Chinese is a huge advantage for a European manager and one that should not be underestimated. Without that knowledge, a manager has to operate with one hand tied behind his/her back and is always at a disadvantage compared to Chinese colleagues and business partners.

Business licenses
A company must have the required licenses in China. A trading company only needs import and export licenses. A manufacturing site that produces for the local market only requires a manufacturing license. If you want to produce and export, you must have all the associated licenses.

Company stamp
Having a company stamp is extremely important in China. It carries more weight than the signature of the director and is a legally binding instrument. A company generally has several stamps: a company stamp and many others. These stamps leave a circular imprint with the company number inside and are always used with red ink. These stamps must always be safely locked away.

- b. Outsourcing in China

Outsourcing is another approach that can be adopted by manufacturing companies to maintain their competitiveness. Applying the right strategy when outsourcing is imperative if you want to guarantee continuity for your business. There are two options: multiple sourcing versus single sourcing.

Multiple sourcing
Multiple sourcing is mainly used when the risks at both ends (i.e. the customer and the supplier) are high. This is the case when the relationship between the parties is unbalanced; i.e. one of the two parties has significant exposure when working in this relationship. For example: the supplier is completely dependent on his customer's turnover and may experience problems when the turnover fluctuates. Conversely, when a customer sources a business-critical product from a large supplier, problems may arise if the supplier is much larger/more powerful than the purchaser who may not be able to exert much influence as a result. In both cases, the relationship between the parties is unbalanced and multiple sourcing is probably the wiser approach.

Disadvantage:
The customer has to split the total volume, will not be able to negotiate as good a deal and needs to monitor multiple suppliers. These disadvantages can be significant and costly in the case of a complex product.

Benefit:
The greatest level of security regarding the supply of goods.

Single sourcing
Single sourcing can be chosen in a balanced relationship where each party is of equal importance. Mutual dependency results in mutual respect. A good working relationship is in the best interests of both parties, so they will be more inclined to "go that extra mile" than in the case of other customers/suppliers.

The customer will be able to negotiate better agreements with the supplier in terms of costs or cost savings, because both parties have an interest in ensuring that the product sells successfully on the market. The supplier will be prepared to provide more information about costs.

Benefit:
Management can focus its attention on a single supplier.
The supplier will respond better.
Stocks can be managed more accurately when dealing with a single source as opposed to several sources.

Disadvantage:
Less flexibility with regard to your supply chain.

Conclusion and tips
Producing in China is and will remain interesting, both now and in the future. It is definitely worthy of serious consideration. Because of the distances involved and cultural and time differences, this is not a venture that you should enter into lightly. Based on our experiences, we would like to offer the following three tips in conclusion:
Tip 1: Involve the Chinese government.
Tip 2: Be prepared for a horrific experience when working with Chinese banks.
Tip 3: Use the Benelux Chamber of Commerce in China (BenCham).

In this chapter, we first lay out some of the advantages and risks of developing a sourcing activity in China, and then describe a proven sourcing methodology.

9.4 Strategic aspects of sourcing from China

As China produces between 20 to 50 percent of the world's products, such as electric vehicles, air conditioning units, computers, mobile phones, and photovoltaic solar panels, as well as chemicals such as PVC or Titanium Dioxide, it has earned the title, 'factory of the world.' China is also increasingly effective in producing a wide range of high-end machinery and industrial parts, equipment, and systems.

Cost advantages and fast developing digitization

Despite an undeniable upward trend in labour costs, China still offers attractive labour costs in many industries. There are also significant cost differences between regions depending on whether they are so-called first, second or third tier cities/regions.

While the unskilled labour force in China is shrinking due to an aging population and, therefore, becoming more expensive compared to new low-cost countries, China offers a pool of skilled personnel in many industries, from skilled operators to technicians to engineers. On top of this, China has embarked on a journey of digitalization aimed at automating its factories (the "Made in China 2025" national project). This is becoming an important generator of productivity improvements and new competitive advantage.

In addition, many suppliers have been exposed to the OEM world where price discussions are cost based. Therefore, many suppliers are open to negotiate based on cost + margin instead of pure price.

Size and attractiveness of local market open to incremental innovation

As commonly known, China has a large domestic market, supported by years of high growth, and is open to incremental innovation. This means that customers are ready to test new features and that they tolerate initial development/deployment issues, provided that the vendor reacts swiftly to reinforce customer satisfaction. The omnipresence of social media in China contributes to customers' expectations of very quick reactions from vendors.

Over the years, export markets, while still relevant, are becoming less strategic for the best Chinese manufacturers. As a foreign buyer, you will be evaluated according to your commitment to the local market.

Fast developing supply chain clusters

Industries tend to cluster together in specific regions, with companies specializing in the assembly of specific products establishing near each other, surrounded by a network of companies manufacturing related parts. In the electronic assembly industry, no other region in the world is able to provide such a large number of economically attractive suppliers for each step of the process and such a wide range of components and parts. We can see similar trends in other industries such as the development of electrical vehicles, unmanned autonomous vehicle (UAV), automation and robots, and digital marketing, among others.

In addition, local equipment suppliers have developed machines and process equipment at lower capital costs than the traditional European or Japanese machine vendors. For less critical elements in the production chain, the availability of such lower-cost production equipment provides another competitive advantage to Chinese-based manufacturing facilities.

Infrastructure and effective international logistics

Over the last several decades, China has completely rebuilt its infrastructure network, including airports, ports, highways, high speed trains, telecommunications, providing many advantages in international logistics.

In general, administrative procedures may appear complex but are applied efficiently by government agencies. However, the rise of new regulations, such as those strengthening environmental protection, render enforcement at various government level temporarily challenging. Under these circumstances, working with local officials leads to practical solutions.

9.5 Challenges of sourcing in China

Various challenges and pitfalls lie in the way of successful sourcing. The challenges are to identify suppliers, to select good ones, and to ensure that selected suppliers remain as good as they appeared to be when the initial contracts were signed.

Quality – rethink your quality assurance process

You must rethink your current sourcing and procurement process, especially on quality assurance. Do not assume that what you currently do in your home country can by copy-pasted in China.

1. specification stage: do not assume that the supplier knows and understands your home market requirements. Identify your product Critical to Quality and ask your local supplier how they can best meet them at product concept stage.
2. supplier selection criteria: the basic principle in qualifying a supplier is to explicitly address any risk of any problem in any area (product, logistics, process, etc.).
3. regularly in production during procurement. Western companies and Chinese companies have totally different sets of expectations. Assuming that a Chinese supplier knows what buyers expect will always lead to troubles.

Financial risk

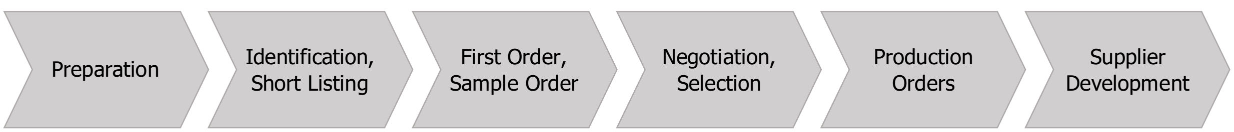
Some complications in qualifying Chinese suppliers include the fact that transparent financial data are not readily available, and we cannot assume that Chinese companies supply accounting or credit data. Be aware of increasing suppliers' difficulties caused by drying up US exports and the disappearance of informal credit markets.
A good practice for qualifying suppliers is information cross-checking.

Operation risk

It is crucial to ensure that that your suppliers remain compliant with the latest and upcoming China regulations, such as those related to environmental protection (rules on air quality, waste and water treatments, noise), employee's regulation, among others. Nowadays, the rules are enforced are various level of government authorities, meaning that compliance is no longer a trade-off. There are multiple examples of factories shut down at very short notice for non-compliance, so it is very important to proactively evaluate and mitigate these risks with your suppliers.

9.6 Proven process for successful sourcing in China

The key steps in a sourcing project are as follows:



1. Preparation: identify and validate your requirements
2. Supplier identification and short listing
3. First order or sample orders and lessons learned/Industrialization (batch production)
4. Negotiation and supplier selection
5. Production orders – supplier management, including quality control
6. Supplier improvement and scope extension

Step 1: Preparation

Understand and define your requirements for a successful sourcing arrangement:

• Select the items to be sourced, understand volume forecast
• Set up the project team and allocate resources
• Set targets and verify their alignment with the company's business objectives

Step 2: Identification and short listing

The objective at this stage is to identify a few suppliers who could reliably source the product.

Essentially, this involves answering the following three questions:

- Does the supplier understand what I want (equipment)?
- Can the supplier make what I want?
- Can the supplier make it consistently (process, quality assurance)?

Answering these questions requires a visit to potential suppliers to evaluate their shop floors and other relevant departments.

Bear in mind that Chinese suppliers have seen their share of "price benchmarking exercises." Western buyers contact them for pricing, use their quote to put pressure on existing suppliers, and the supplier never hears from the buyer again. As a consequence, simple emails asking for pricing are often discarded or receive a safe "high price" answer, so it is wise to consider visiting them to introduce your project.

Step 3: First order – sample order

The first purchase order or a large sample order is extremely important. It is the first moment when both suppliers and buyers can test the full production process and identify areas where the procedure can be improved.

Thus, it is important to make sure the supplier has clear understanding of all aspects of a delivery, especially when engaging in a "long haul" supply chain where geographical distance and time difference between buyer and supplier are large.

This understanding should include the product specification, as well as its packaging, labelling and marks, possible user manual or other documentation (language, etc.), certifications, quality control protocol, pre-shipment inspection requirements, traceability requirements, and many other details that cannot easily be improvised at the last minute.

It is also important to ensure clear payment terms. Misunderstood payment terms or unclear language in a letter or credit can lead to wasted energy and delivery delays.

Step 4: Negotiation and Supplier selection

China's 'negotiation culture' is well established, so be prepared to go through several rounds of price and commercial terms discussion. It is possible to engage a commercial negotiation based on cost instead of price which could be a guarantee against pushing a supplier to accept a price they cannot afford leading to quality problems later-on.

Make sure to define the commercial terms and conditions in a Chinese purchase agreement legally enforceable. Your standard home country conditions will not be enforceable in China, and a supplier's implicit conditions from the purchase order may not be to your advantage.

Step 5: Production orders – supplier management

Production orders can safely commence once the communication channels are clear, the product requirements are clarified, and the operational details of ordering the goods and shipping them from China to the destination country are tested.

In the West, this is the moment when a sourcing project moves to routine procurement. Confidence is high, all supplier data is in the database, and the procurement administrative officers know how to place orders.

With China procurement, one cannot become complacent, because of the "quality fade" most buyers will experience if they do not maintain an active role in quality control. Buyers should "take control" of the quality control process and define clear quality and inspection plans. Taking control does not mean a commitment of lots of resources from the buyer, but it certainly requires a conscious and explicit planning of such matters.

Step 6: Supplier development

There are often opportunities for developing suppliers that will not only provide an important quality guarantee but can also become a long term competitive advantage.

Some typical areas might be:

- Product improvement: a buyer indicates to the supplier some features or small modifications to improve the product. Sometimes there are "nice to have" features that a Western supplier will not be interested in implementing because of expected low sales volume, but that a Chinese supplier may develop economically thanks to the lower cost of technical resources.
- Process improvement: advice to the supplier in terms of manufacturing processes, quality control or traceability. Such improvements can bring the supplier to another level in terms of reliability.
- Scope of work: after a supplier successfully produces certain parts, many buyers may ask the supplier to assemble several other parts in order to benefit from local China pricing for standard components or to benefit from lower labour costs. Sometimes buyers use this scope-widening to take advantage of the natural currency hedging of the RMB linked to the USD to address USD-linked markets in Asia.

9.7 In Conclusion

While the business environment has changed dramatically over the last decade, sourcing in China does still provide great opportunities, especially in key sectors such as the electronic industry, where China has already proven itself. It is also the case in those industries identified as key national priorities, such as renewable energy, transportation, robotics, new material and pharma-biotech.

Successful sourcing in China will require initial investments in time and certainly in local talents. It is not realistic to engage in local sourcing without a trusted local team.

Although sourcing in China alone used to be a viable business model, you can generate much more sustainable value by enlarging the project scope, such as by combining sourcing and local product development activities. Not only will you be able to lower costs and improve quality, but you may also find other ways to tap into markets in your home country or in Asia.

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10. International Trading System

Economic globalization is the trend of the times, and peace and development represent the shared aspiration of all peoples. China-Benelux economic and trade ties concern not only the well-being of the people of the two regions, but also world peace, prosperity and stability. Cooperation is the correct option for China and the Benelux, and a win-win approach will lead to a better future. China's position is clear, consistent and firm. China is firmly committed to the sound development of China-Benelux economic and trade relations, as well as the improvement of the multilateral trading system. China is firmly committed to protecting property rights and intellectual property rights, as well as the lawful interests of foreign businesses in China.

This chapter will introduce you to the key elements you need to know in order to operate smoothly:

- Updates of Customs Environment in China
- Starting Your Business in China
- Payment Conditions in International Trade
- Introduction to Logistics in China
- Selection of a Logistics Supplier

10.1 Updates of Customs Environment in China

Depending on who you talk to, people will tell you that trade in China is relatively easy and manageable or that it consumes an unreasonable amount of their time and energy. In some cases, companies face tremendous difficulties in importing or exporting goods.

In many cases, these difficulties will have one of the following causes:

- A misunderstanding of the import and export requirements and procedures. For instance, a company tries to export a product that is not included in its business scope; or a company tries to import a product that is subject to CCC certification (quality certification) and has not obtained such certificate.
- The selection of a poor logistic service provider: some service providers will focus on large business and have limited patience for small, complicated shipments; others will provide excellent customized services but be ill equipped to handle many large shipments efficiently, consistently and transparently.

In fact, China has a very modern and advanced regulatory system for imports and exports that makes it relatively straightforward once you understand how it works. In recent years, along with the continuous revolution imposed on implementation of the system, especially the nationwide Customs clearance integration and the merger of CIQ into GAC, the import/export process has been simplified and made easier to understand.

10.1.1 Basic facts to better understand import/export procedures

Import/export procedures may vary depending on types of products and even on the port of import. Most foreign invested trading and manufacturing companies have the right to import/export, provided they have applied and have written this into their Business License and obtained a 18-digit Uniform Social Credit Code. For some items on Customs declaration form, companies need to fill in the code, such as "consignee/consignor". Nevertheless, it is still common to use a local third-party import/export Agent, particularly when the imported product is subject to complex non-tariff measures, such as product inspection, testing, and labelling.

Parties Involved in International Trade

Recently, China Customs has been paying closer attention to the information of parties involved in foreign-concerned contracts. Per the latest version of the Customs declaration form, details of the following parties will be disclosed to Customs via columns on declaration form:

1. Domestic Consignee/Consignor
   This column shall state the name and code of the legal person, other organization or individual within China who is registered with Customs, and who enters into and performs the import/export trade contract.
2. Overseas Consignee/Consignor
   Overseas consignee generally refers to the buyer or the consignee designated by the contract in signing and executing the export trade contract. Overseas consignor usually refers to the seller in signing and executing the import trade contract.
3. Declarer Entity
   This column is for the name and code of the import-export enterprise if it is handling the Customs declaration on its own, the name and code of the Customs broker entrusted to handle the Customs declaration.
4. End Customer or User/Manufacturer or Vendor
   The End Consumer or User column shall state the name of the known entity within China that will consume or use the imported goods and the Manufacturer or Vendor column shall state the name of the entity within China which manufactures or sells the export goods.

Daily declaration and documentation requirements

Back in 2013, China Customs initiated the move towards paperless Customs clearance and issued a milestone regulation - GAC Announcement No.25 2014 "announcement on further deepening the reform of paperless Customs declaration operation" - which officially expanded the scope of application to nationwide Customs. With subsequent related orders and announcements issued, so far, companies use paperless Customs declaration throughout the whole import/export process. To use paperless Customs declaration, companies can use the following websites:

1. China E-port[1];
2. Internet Plus Customs[2];
3. International Trade Single Window[3].

Companies will simply upload relevant information to these websites and then be transferred to in-charge Customs database. Based on the information given, Customs will act accordingly and all subsequent interactions between Customs and the company can be implemented via internet. In most cases, after confirmation of the declaration by Customs, companies can print the Customs duty & VAT memos via Internet plus Customs and pay duty/VAT accordingly

The documents need to be prepared by the importers/exporters, although this can also be subcontracted to qualified logistics companies/brokers. Importers/exporters must make import and export declarations with Field Customs for all imported or exported goods. It is not possible to make an exhaustive list of all the requirements for documentation, as they may vary according to the country of destination (in case of exports). The following table illustrates the documents typically required for import/export & inbound/outbound declaration/registration with Field Customs:

[1] Reference link: http://www.chinaport.gov.cn/index.htm
[2] Reference link: http://online.customs.gov.cn/
[3] https://www.singlewindow.cn

Import	Export	Inbound	Outbound
Import Declaration Form	Export declaration Form	Inbound registration from	Outbound registration form
Purchase Contract		Purchase Contract	
Commercial Invoice		Commercial Invoice	
Packing List		Packing List	
Manifest		Bill of loading/Waybill	
Bill of loading/Waybill		Entrust letter of Customs declaration (as appropriate)	
Entrust letter of Customs declaration (as appropriate)		Other documents as requested	
Import/Export License (as appropriate)			
Other documents as requested			

[1] Reference link: http://www.chinaport.gov.cn/index.htm
[1] Reference link: http://online.customs.gov.cn/
[1] https://www.singlewindow.cn

Please note that certain goods may require additional documentation, such as import licenses, quality certificates, pre-shipment investigation certificate, etc.

Import / export licensing

The Chinese government imposes controls on certain types of goods. Enterprises that import or export controlled goods need to submit the related import/export license or supporting certificates during Customs declaration. The import/export license should be applied for and obtained before lodging the Customs declaration. Failure to submit the license may lead to delay of customs clearance, additional storage costs, return of goods, etc.

Import and export licenses are required for many products. The procedure for obtaining such a license depends on the product. The procedures are frequently complicated and time consuming. Working together with specialized agencies is often necessary.

Some products are not permitted to be exported at all, while there are certain categories of products that can be exported only by companies that have a special export license (e.g. dual-use products).

Commodity inspection

All import/export goods are subject to Customs inspection on a random or compulsory basis depending on the type of goods. While the inspection is being carried out, the consignee/consignor of the import/export goods or his agent shall be present and shall be responsible for moving the goods and opening and resealing packaging.

In addition to Customs inspection for all goods, certain commodities are subject to legal inspection. Before April 2018, the legal import/export commodity inspection was conducted by AQSIQ and the local Bureau of Import/Export Inspection and Quarantine, which was also sometimes referred to as the CIQ. The inspection covers the requirements for safety, hygiene, health, and environmental protection, as well as relevant quality, quantity, weight, etc. Import/export commodities failing inspection requirements will not be allowed to be imported or used in China or exported out of China. Please note that as of April 2018, CIQ has been merged into Customs, which means Customs will be in charge of both Customs inspection and legal inspection. For details, please refer to 10.1.3.

Customs duties

Import duties need to be paid on many items subject to different duty rates. The applicable category and the import duty level can easily be ascertained by calling the Customs department or reviewing the Tariff Book. The Harmonised System (HS) used in China is mostly the same as in Europe, although sometimes more classifications can be found, which may lead to unexpected and higher import duty rates.

There are bonded zones in the ports, and even in some development zones where uncleared/bonded goods can be stored, so that cash flow is uninterrupted and import duty and VAT (Value Added Tax) is paid later at import. Import VAT is typically levied at the rate of 16 per cent. Temporarily imported/exported goods can be declared through a special Trade Mode (in the declaration form) in order to suspend the assessment of Customs duty and VAT.

If exporting, the exporting company (supplier or trading company) will act as the legal EoR and will invoice in foreign currency. Exports are zero rated for VAT purposes. The VAT export refund should be applied for by the EoR from the Tax bureau.

For imported goods, the base to calculate customs duty is the CIF (Cost, Insurance and Freight) price of imported goods. The insurance and freight fees for international transportation are subject to customs duty/import VAT. If the imported goods are traded with FOB or other terms, the enterprise should also declare the Insurance and Freight.

Freight

The calculation of freight should be as follows:

Freight = Basic freight rate from the location of manufacturing to the customer’s point of delivery

Insurance

Insurance Premium = (Cost + Freight) × 0.3%

Customs duty and import VAT

The Customs duty, import VAT and consumption tax (if applicable) payable on the majority of imported goods is calculated as follows:

Customs duty = CIF price × ad valorem rate of duty

Import VAT = (declared value + customs duty + consumption tax) × VAT rate

Consumption tax = (declared value + customs duty) ÷ (1 - Consumption tax rate) × Consumption tax rate

As such, the value declared bears a direct relation to the amount of import tax paid.

10.1.2 Nationwide Customs Clearance Integration

Background

Over the past few years, China Customs has periodically implemented integration pilot projects between Customs authorities in neighbouring areas, known as "regional integration of Customs clearance". Under these projects, China Customs has implemented a unified management of goods examination and document approval, aiming to improve the consistency and unity of law enforcement and facilitate enterprise.

Finally, on July 1st, 2017, the "Nationwide Customs Clearance Integration Regime" officially took effect across the country. Under this reformed regime, Risk Management Centers and Duty Collection and Supervision Centers are established to manage key Customs services and supervision of various Customs offices. By unifying key Customs responsibilities under these national level centers, China's government hopes to reduce clearance time and costs.

"Two Centers"

Under the regime, three national Risk Management Centers are established in Shanghai, Huangpu, and Qingdao, to provide high-level oversight and management for Customs risk prevention and control activities that are to be carried out at customs clearance points across China. The goal includes the safe entry of goods imported by air, land and sea (except for small craft commuting between Hong Kong and Macau).

These centers also will be responsible for setting "safe entry" parameters for paperless clearance for import and export licenses, certificates of origin, other certifications, as well as setting tax collection and administration standards in Customs systems.

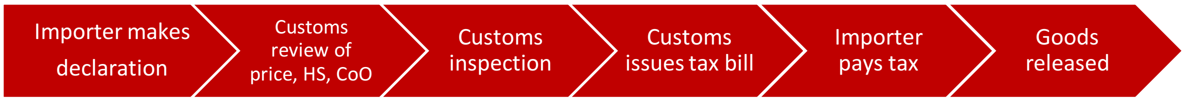
Three Duty Collection and Supervision Centers are established in Beijing/Tianjin, Shanghai, and Guangzhou, and these verify the accuracy of duty filings for goods imported through all Chinese ports. They examine, in particular, use of appropriate Customs classifications, valuations, and country of origin declarations before/after release of goods. Please refer to below form detailed responsibility scope of each Duty Collection and Supervision Centre:

DCSC	**Commodities**	**Chapter in Tariff Book**
Shanghai	Mechanical and electrical category	8 chapters covering: • Ch 84-87 • Ch 89-92
Guangzhou	Chemical category	30 chapters covering: • Ch 25-29 • Ch 31-40 • Ch 68-83
Beijing/Tianjin	Agriculture and forestry, textile industry, food, drugs, light industry, aircraft industry and others	50 chapters covering: • Ch 1-24 • Ch 30 • Ch 41-67 • Ch 88 • Ch 93-97

Key updates on import/export process

Before the implementation of integrated nationwide Customs clearance, most issues were reviewed prior to the release of goods, including inspection for consistency with declaration documents, Customs valuation and classification issues, etc. Post-import actions were also performed as appropriate by the Customs audit department or other departments. After the implementation of the new regime, most imported goods will be released after the declaration passes the automated system check, while declarations with high risk will be identified for further review, in which a comprehensive Customs inspection and audit will be performed after the release of goods. This new process is called "one-time declaration, multi-step treatment". A comparison between the old and new process is set out below:

- Before



- After

10.1.3 Consolidation of CIQ into GAC in China

Background

During the First Session of the 13th National People's Congress held on 13 March 2018, the State Council promulgated an institutional reform plan, shifting the administrative responsibility of the China Entry-exit Inspection and Quarantine Bureau (CIQ), originally belonging to the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), to the General Administration of Customs (GAC).

Main Highlights

After the consolidation, the declaration requirement, inspection staffing, procedures and release orders will all be unified, and consigner and consignee will be able to pick up goods by the release order of Customs at the Single Window. The certificate of Inspection for Goods Inward/Outward will no longer be required and the Certificate of Inspection circulation between Customs and CIQ will become an internal procedure.

Effective from 20 April 2018, after being registered with Customs, newly registered enterprises will be able to submit both Customs and "inspection and quarantine" declarations at the same time. Old enterprises should go to Customs to renew and consolidate their registration information. Previously, Customs and original CIQ held different enterprise rating systems as shown below:

Customs enterprise rating system	Original CIQ enterprise rating system
Advanced Certified Enterprise, General Certified Enterprise,	AA, A, B, C, D (5 levels)

General Credit Enterprise;
and Discredited Enterprise
(4 levels)

After consolidation, the CIQ enterprise rating system will be abolished while the related requirements could be merged into AEO management of China Customs. The detailed criteria revision of AEO was issued in November 2018.

Under the original management mode, CIQ is responsible for issuing the certificate of origin (CoO) for export products and managing the marks of CoO, while Customs focuses on the verification of import and export processes, and drafts multilateral and bilateral regulations pertaining to CoO etc. After the consolidation, import/export data and enterprise/commodity information would be more comprehensive, meaning supervision and control is expected to be unified and improved. Therefore, requirements on management of CoO identification would be correspondingly clearer and stricter. Please generally keep in mind additional tariffs in relation to the CoO verification and declaration caused by trade tensions between US and CN going forward in 2019.

10.1.4 Advice on dealing with changes in the China Customs environment

Nationwide Customs clearance integration regime

With the rollout of the Nationwide Customs clearance integration regime, it is expected that enterprises will benefit as follows:

- Enterprises could choose to conduct Customs declaration at another Customs different from the importation port since the nationwide Customs system has been unified.
- Previously, different regional Customs authorities had different interpretations of Customs laws and regulations. Upon the implementation of "two centers", the risk management centers and duty collection and supervision centers are expected to conduct uniform inspection and to minimise the inconsistency of regulation enforcement.

To adapt to the reforms, companies are advised to focus on the following:

- Embrace the changes from Customs reform proactively: The new regime has been rolled out for less than 2 years and it is to be expected that it would time consuming for enterprises to cooperate with newly established risk management centers as well as duty collection and supervision centers. It is suggested that enterprises prepare sufficient documents and enhance pre-communication with port Customs and in-charge Customs.

- In response to the implementation of nationwide Customs clearance integration regime, a series of practical regulations related to enterprises' daily import/export operation has been released. It is recommended for companies to be prepared for the new regulations and improve internal daily operation management to adapt to the updates.
- As stated above, the new regime will be beneficial to enterprises in several ways. To maximize potential benefits, enterprises should gain a better understanding of the new regime and follow-up policies.

Consolidation of CIQ into GAC in China

The reform program breaks the segregated management situation between Customs and CIQ, and is expected to facilitate more efficient clearance, reduce clearance costs and optimize services, and build a new clearance supervision system. With the strengthening of enforcement, the new customs authority is expected to implement stricter supervision and control on special restricted imported goods (e.g. solid waste).

To adapt to the reforms, companies are advised to focus on the following:

- Clearance and declaration management: Update your internal customs system and ensure staff are trained on the internal data exchange of "single system" and "paperless declaration", as per the changes to clearance and declaration processes;
- Enterprise rating system: Keep a lookout for regulation changes to the customs enterprise rating system (certification criteria of AEO) and improve the communication with in charge Customs;
- Compliance management: Train the in-charge staff with knowledge necessary for both Customs and previous CIQ matters. Pay more attention to regulation requirements and administration measures, and update internal working procedures when regulations change.

10.2 Starting Your Business in China

10.2.1 Trade Mode Selection

Based on prevailing China Customs regulation, different transaction types are subject to different Trade Modes (TM). Currently, there are approximately 100 different types of TM. The TM impacts tariffs, license requirements and import/export procedures and etc. The common TM in China daily operation includes General Trade, Toll Processing Trade, Contract Processing Trade, and Temporary Import/Export, etc.

General Trade

General Trade is the most common TM declared by importer/exporters. General Trade is unilateral import of goods into the customs territory or unilateral export of goods out of the customs territory. If the importer/exporter declares General Trade, no further Customs supervision after finishing the declaration procedure is required. During the importation procedure, the Customs duty/import VAT and consumption tax (if applicable) should be paid based on the dutiable value of import goods under General Trade. For exportation, usually no Customs duty/export VAT is imposed, with some exceptions. In addition, usually no exemption for license requirement will be granted under General Trade.

Processing Trade

Processing Trade is a common TM for manufacturing companies in China. Processing Trade is divided into Toll Processing and Contract Processing. For Toll Processing, the raw materials are provided by the overseas principal free of charge. The manufacturing company charges a processing fee to the overseas principal. The title of the raw materials and finished products remains with the overseas principal. For Contract Processing, the processing company purchases the raw materials from overseas company, then conducts manufacturing accordingly and sells the finished products under its own title. No Customs duty/VAT are imposed when the company declares Toll Processing Trade or Contract Processing Trade, if the finished goods can be exported to overseas. However, if the manufacturing company sells the finished goods or relevant bonded materials to China's domestic market, the company is requested to conduct claw-back taxes.

10.2.2 Tariff Measures

Tariff Classification

Tariff classification of goods refers to the assignment of a Harmonized System ("HS") code to each individual product. The HS is an internationally standardized system of numbers and product descriptions designed for the classification of traded products maintained by the World Customs Organization. The HS Code of each goods determines the Customs duty rate, consumption tax rate, VAT refund rate, anti-dumping, countervailing rate and safeguarding measures during importation/exportation. In addition, the classification is a significant principal criterion for determining substantial transformation. Also, China has signed or is planning to sign the Free Trade Agreements (FTA) with many countries/regions, and the classification of goods will impact the application of preferential duty rate. According to the prevailing China Customs regulation, the tariff classification references include National Tariff Handbook, Explanatory Notes, Domestic sub-heading explanatory notes and Classification Decision/Ruling issued by China General Administration of Customs (GAC).

Customs Valuation

The legal basis for China Customs Valuation is WTO Valuation Agreement and GAC Order [2013] No.211&213. The major principles of Customs Valuation is that the dutiable value is based on the actual transaction value, which reflects commercial arrangements and the price is arm's length and without the influence by related party. The target of Customs Valuation is not to set a price but to arrive at a Customs Value in all circumstances with the six Customs Valuation assessing methods (i.e. Transaction value (price paid or payable), Value of identical goods, Value of similar goods, Deductive Value, Computed Value, Fallback (or flexible) value), which means that the Customs Value may not be the actual price paid for goods. Therefore, the dutiable value may need certain adjustments based on the transaction value. The adjustments include additions and deductions:

Additions	Deductions
Commissions and brokerage (except buying commissions)	Buying Commission
Packaging / containers	Charges for construction, installation, assembly, maintenance or technical assistance, undertaken after importation on imported goods such as industrial plant, machinery or equipment, except for warranty
Appropriately separable value of the following items undertaken by the buyer free of charge or at a loss • Items included in the imported goods • Items needed for the production of goods • Materials consumed in the production of goods • Design and development (done outside of the country of importation) • Royalties and license fees related to the imported goods and paid as a condition of sale	Interest changes (with conditions) • the charges are as a result of financing by the buyer for purchase of the imported goods; • the financing agreement was made in writing; • the interest charges are listed distinguishingly; • the buyer can demonstrate that the claimed interest rate does not exceed the level for such transactions prevailing in the country where, at the same time when, the finance was provided, and the price actually paid or payable for the imported goods is very close to that for the identical or similar imported goods for which there is no financing arrangement.

Royalties and license fees • Related to the imported goods • Paid as a condition of sale	Domestic Freight and insurance
Proceeds of resale paid directly or indirectly to the seller	
International freight and insurance	

Country of Origin

Country of origin is used to determine whether imported products shall receive MFN (Most Favored Nation) treatment, which is the duty rate applied between WTO member countries and whether preferential treatment can be applied, and is to implement trade measures such as anti-dumping duties, countervailing and safeguarding measures, national quantitative restrictions or tariff quotas. Additionally, country of origin is used for the application of labeling and marking requirements, the purpose of trade statistics and government procurement as well.

Per the WTO, two basic principles in determining non-preferential rules of origin are: 1) wholly obtained, i.e. goods is completely grown or produced within a certain country; 2) substantial transformation, i.e. i) goods is manufactured from materials that may have originated in many countries; ii) three different methods to determine "substantial transformation": change in tariff headings, value-added method and specified working process.

Regarding the preferential origin, as we mentioned above, China has signed or is planning to sign FTA with many countries/regions. FTA can potentially offer significant customs duty savings through usage of the preferential tariff rate, which is lower than the MFN rate. However, the application of preferential tariff rate needs to satisfy certain criteria, including but not limited to rules of origin, shipment rules and invoice flow. The specific criteria might be different from different FTA.

Currently, US-CN Trade Tension is a hot topic worldwide. The Rules of Origin under non-preferential framework is very different between China and US. Regarding products to be imported to China/US, it is necessary for the importer to further review the country of origin of the goods in case the products are sourced from US/China and subject to additional duty upon importation. Sometimes the goods produced in EU but containing US/China sourced essential material or key parts would also be determined as US/China in origin and accordingly subject to additional tariff.

From China importation perspective, in relation to the additional tariff, the calculation formulas are as follows:

Customs Duty = dutiable price * (currently applicable duty rate + additional duty rate)
Consumption Tax = consumption tax dutiable price upon importation * consumption tax rate
Consumption tax dutiable price upon importation = (dutiable price + customs duty) / (1-consumption tax rate)
Value-Added-Tax (VAT) Upon Importation = VAT dutiable price * VAT rate
VAT Dutiable Price = dutiable price + customs duty + consumption tax

Advance Rulings of Customs in China

On 26 Dec 2017, General Administration of Customs (GAC) published the Interim Administrative Measures for Customs Advance Rulings of the People's Republic of China (GAC Order No.236), which came into effect from 1 February 2018. The order indicates that prior to the actual import and export of goods and upon application by companies, Customs could provide advance rulings for customs affairs related to the import and export activities, such as the HS code, customs valuation method, and country of origin.

The release of GAC Order No.236 is another important milestone for China Customs to implement the WTO Trade Facilitation Agreement and to respond to enterprises' demand for more certainty and predictability on international trade, which will have a positive impact on China's trade security and facilitation.

10.2.3 Non-Tariff Measures

The Chinese government imposes controls on certain types of goods. Relevant import/export licenses or supporting certificates should be applied for and obtained before lodging the customs declaration. Failures to do so may lead to delay of customs clearance, additional storage cost, return of goods, etc. Certain commodities requiring import/export licenses are also subject to compulsory inspection conducted by CIQ (which has been merged with Customs). The inspection covers the requirement for safety, hygiene, health, environmental protection, and avoidance as well as relevant quality, quantity, weight, etc. Import/export commodities failing the inspection are not allowed to be imported/used in China and shall be destroyed/re-exported from China. The non-tariff measures in China include relevant importation/exportation licenses and China Compulsory Certification (CCC). Compared with the importation/exportation licenses that linked with products HS Code, CCC is based on a product's function and performance according to the following regulations: GB-Standards, Implementation Rules and CNCA-Standards. In addition, in China, CCC includes application, exemption and out of catalogue products confirmation.

10.3 Payment Conditions in International Trade

The financing of trade transactions follows international practices regarding Letters of Credit. Chinese banks have extensive correspondent relations with foreign banks and generally follow standard payment procedures. Foreign bank branches in China may further ease the settlement of international trade issues. However, there are some unique aspects about trade finance when dealing with China.

Letters of credit

Letters of Credit (L/Cs) are the most commonly used instrument for trade financing. The main attraction of Letters of Credit is that they guarantee payment and receipt of title from an independent party (a bank), as long as commercial and shipping documents are presented in accordance with the terms of the Letter of Credit, regardless of the underlying contract.

- The seller can base a credit decision on the financial soundness and stature of a bank, rather than on those of the buyer whose creditworthiness may be unknown.
- The letter of credit from a Chinese buyer also allows him a method of financing purchases or to ensure compliance with shipment dates, quantities and receipt of certain critical documentation. The cost in China of an L/C is relatively low and trade finance is often available from local banks.
- Credit insurance covers the bank and not the company, which is the buyer, because the bank takes the risks and not the buyer. European banks nevertheless do not recognise all the branches of a Chinese bank in this regard, as the Chinese banks do not guarantee all debts of their branches.

Other trade finance options

There are three other common methods of payment used when trading with China. Each method provides varying degrees of protection. The buyer wants to get what he pays for and the seller wants to be sure he is paid. Choosing the correct method of payment is an essential part of the trade process.

Cash in advance

This involves high risk to the buyer, but security for the seller. It is done when the buyer has a very high degree of trust in a seller or the buyer has no other choice but to pay in advance. This form is generally used when the transaction is low-value or when the relationship is new.

Documents against payment and documents against acceptance

These methods are used in on-going business relationships, as they provide some protection (and some risk) for both parties. The seller ships goods to the Chinese buyer, but forwards shipping documents (including title document) to his bank for transmission to the buyer's bank. The buyer's bank is instructed not to transfer the documents to the buyer until payment is made (Documents against Payment, "D/P") or upon guarantee that payment will be made within a specified period of time (Documents against Acceptance, "D/A"). Once the buyer has the documentation for the shipment, he or she is able to take possession of the goods. The buyer and seller both assume risk in the transaction. The advantages of D/P and D/A are that they are easier to use and in Europe less costly to organise than L/Cs.

Open account

The O/A is the least secure form of payment for a seller. Under this agreement, the buyer agrees to pay within a designated period after shipment (30, 60 or 90 days). An open account is used only when the seller has absolute trust in the buyer's desire and ability to purchase the goods.

Trade Services Utility

Trade Services Utility (TSU) is a centralized matching and workflow engine. It provides timely and accurate comparison of data taken from underlying corporate purchase agreements and related documents, such as commercial invoices, transport and insurance. The advantage of using TSU is that the banks of buyer and seller are able to compare the accuracy of trade documentations automatically through this system, which increases the efficiency of documentation circulation far beyond that of LC.

Several regulations under current account issued by State Administration of Foreign Exchange (SAFE)

For the purpose of further supporting the development of substantial economy, advancing the reform of trade facilitation and trade compliance, SAFE classifies enterprises into rank A, B and C and implements the following supervisions under the current account.

- SAFE has established a verification mechanism for matching trade flows with cash flows. It monitors the total amount of payments and receipts of foreign currency of enterprises and may trigger an inspection when the data of trade flow is highly deviate from the data of cash flow.
- If rank A enterprises want to delay payments/receipts for more than 90 days, they are required to report to SAFE within 30 days from the date of import/export of the goods.

- It is forbidden for rank B and rank C enterprises to sign contracts which allow more than 90 days for payments/receipts.
- Enterprises are required to report to SAFE in advance if the payments/receipts periods are more than 180 days.

10.4 Introduction to Logistics in China

The diversity and challenges found in doing business in China are also found in logistics. Many people will expect differences in pricing, regulations, infrastructure and climate within Europe. After all, the European continent consists of several countries in different stages of economic development, with great geographical variety as well. China is roughly the same size as continental Europe and therefore variation in geography and economic development also has a considerable impact on China's logistics sector. This section aims to highlight some of the differences, trends and challenges influencing logistics in China.

Infrastructure

China's infrastructural development has followed its economic development over the past decades, starting with the rapid strides made in the eastern provinces. China's most well-known port cities, such as Shanghai, Hong Kong, Ningbo, Tianjin, Qingdao and Dalian, are all located on the eastern seaboard and cater to large production centers in their hinterlands. Smaller satellite ports have been developing in these areas alongside the large ones, often specialising in certain industrial products and catering more to the domestic and regional markets.

Besides the significant developments of airport and port infrastructures, railway and especially high-speed railway also scored major progress with a swiftly expanding railway network in China under "The Belt and Road" policy in recent years. In 2018, the operating length of China's railway system reached over 127,000 kilometres, ranking second in the world. Today, the high-speed railway network has connected more than half of Chinese cities with a population above 500,000. Furthermore, road infrastructure also developed rapidly with continuous extensions of road networks. In 2015, the total road length in China ranked second in the world and the total length of expressway ranked first in the world. Road improvements substantially increased the accessibility of road transport in China, 99.99% of Chinese towns and townships and 99.87% of administrative villages had access to roads.

In the past decade, the central government has pushed for the development of the inland provinces with its "Go West" policy. Under this policy, the western regions enjoyed support in infrastructure construction, foreign investment, environmental protection, education and talent retention. From 2000 to 2016, the Chinese government invested 6.35 trillion yuan ($914 billion) in 300 major projects, mostly in infrastructure and energy, in western regions. In the 18 years since the "go west" strategy was implemented, more overseas investors have come to western China in search of opportunity. More than 200 German companies have set up operations in manufacturing, environmental services, vocational education and other industries. With the ongoing China-US trade war, the Chinese economy urgently needs to address entrenched structural imbalances and find sustainable growth momentum in the future, and new content is required to be added to the "go west" strategy. More efforts might be made to streamline administrative approvals, reduce taxation and fees, cut transaction costs and etc.

China Railway Express for Belt & Road

China Railway Express (CRE) has connected 80 Chinese cities and 48 European cities in 14 EU countries, such as Belarus, Germany, France, Belgium, Holland, Austria and Poland, under the Belt & Road Initiative (B&R). According to the relevant agreements, CRE will enjoy easier port customs clearance processes and unified service standards, as well as more secure freight tracking systems built on uniform information platforms. Though the trains are operated by a variety of independent companies, the CRE containers have been delivered for free by the Chinese government as part of a brand overhaul.

Free trade zone in China

For more than thirty years, China has facilitated economic growth by attracting foreign investment through Special Economic Zones ("SEZ"). As part of these efforts, in 2013 China's first Free Trade Zone ("FTZ") was established in Shanghai, which was followed in 2015 by three additional FTZs in Guangdong, Fujian and Tianjin.

Companies registered in FTZs enjoy various benefits, including fewer restrictions on customs procedures and business registration, expedited approval of foreign investment, more encouraging trade policy and a suspension on import/export taxes. Each FTZ also has a specific industry and development focus, supported by additional corresponding regulatory policies.

The FTZs have generally been successful in attracting substantial foreign investment and have made significant contributions to China's economic development. In the first half of 2016, a total of 4,923 foreign-funded companies were established in the four FTZs, with total investments amounting to RMB 359 billion. In 2016, the four FTZs attracted foreign investment of RMB 87.96 billion, which was an increase of 81.3% compared to the previous year.

On 31 March 2017 and 13 April 2018, the Chinese State Council announced that it had approved the launch of eight new FTZs. From now on, total number of FTZs is thirteen. In contrast to the existing FTZs, which are all located in rich coastal areas, the new FTZs are mainly located in underdeveloped areas in China's interior.

China’s free trade agreements

The Chinese Government deems Free Trade Agreements (FTAs) as a new platform to encourage opening up to the outside and speeding up domestic reforms. They are an effective approach to integrating into the global economy and strengthen economic cooperation and multilateral trading systems with other economies. Currently, China has 24 FTAs under construction, with 16 Agreements signed and implemented already.

Companies considering doing import/export business in China should prioritize FTAs in their supply chain plans, but also be aware that that doing business in FTAs requires close cooperation between logistics (Customs), finance, tax, and business teams, among others, as well as Standard Operating Procedures (SOPs) to outline the functions and responsibilities of different personnel.

China Free Trade Agreements Network

Implemented	Under Negotiation	Under Feasibility
Hong Kong/Macau, CEPA	Regional Comprehensive Economic Partnership (RCEP)	India
Pakistan	Gulf Cooperation Council (GCC)	Columbia
New Zealand	Japan and South Korea	Moldova
Peru	Sri Lanka	Fiji
Iceland	Pakistan (Second Phase)	Nepal
South Korea	ASEAN Upgraded	Mauritius
ASEAN	Israel	
Georgia	Norway	
Chile		
Singapore		
Costa Rica		
Switzerland		
Australia		
Taiwan ECFA		
Maldives		
Asia-Pacific Trade Agreement (Bangladesh, India, Laos, South Korea, Sri Lanka)		

10.5 Selection of a Logistics Supplier

How to find a suitable logistics supplier?

Registered company

Verify whether the company is a registered company in China. Check the business license and whether the name on the invoice is the same as the name on the business license. Check with the local government body (for example, the department of industry or commerce that is in charge of company registration) to get confirmation of the accuracy of the information the logistics firm has provided.

Local knowledge and network

Experience in the local market is necessary to avoid unexpected problems in shipping goods locally and even more when exporting goods through Customs. The experience level of the logistics provider, considering all the work that is expected of him, needs to be clear. Find out the company's local background and experience. How long has this company been active in China in this specialisation, and do they have the know-how to conduct this kind of business in the country? Check whether their distribution network is extensive, as well as their contacts, whether they have significant capital investment, and what their government relationships are from the provincial level to the central government and its ministries.

Professional service

Some forwarders can arrange shipment to Europe and the USA, others only to countries in Asia, and some only offer services in China. Do they have local offices at the destination? What other services can they provide -- insurance, warehousing, trucking, consolidation, door-to-door services? A professional logistics provider, while of course considering its own profits, also shows how it finds ways to support the client and how to decrease the logistics costs as much as possible.

Sharing of experience

Try to get information about selected suppliers through any people with experience in the same field, and then judge if their performance meets your firm's standards.

Business attitude

The way the supplier communicates, and his ethical values, should be on the checklist when screening a logistics partner.

International or local logistics supplier

The choice between an international or local supplier should be made based on the nature of the services required. If the logistics services needed are international, using the services of an international company can be more practical, as they can offer integrated solutions worldwide. There are several large and small international logistics services providers operating in China. Most international logistics companies need to outsource some of their services to Chinese local companies, as they are not allowed to offer services in certain areas or lack the good connections some local companies have. In some cases, it is necessary to use the services of Chinese providers only, for instance in the transport of hazardous goods, which is not a sector open to foreign providers.

11. Corporate Social Responsibility

This section provides an overview of the main Corporate Social Responsibility (CSR) issues companies should consider in China and the business drivers used for addressing them. It also provides basic ideas for companies to start thinking about responsible practices in the workplace, community and environment.

11.1 What is CSR?

CSR is a company's commitment to operate in an economically, socially and environmentally sustainable manner. Such commitments also provide the company a social and environmental license to operate with regard to its stakeholders. If implemented well, CSR can contribute to further business success. In other words, CSR is not about how companies spend their money (or donations or contributions to charities), but rather about how they make their money (i.e. in a responsible and sustainable manner).

Responsible business practices are most effective – both for business and for stakeholders – when integrated with regular business operations and connected to a vision of the future.

Why CSR in China?

China has developed a lot in the last few years. Its economy has been growing fast and even though the disparity between the wealthy and the poor is increasing, extreme poverty is disappearing. Between 1982 and 2010, 680 million people rose above the poverty line, reducing the extreme-poverty rate from 84% in 1980 to 10% in 2013. It is now below 5%. Yet, this development has come at a heavy (environmental) cost. In the most recent publication of China's Five Year Plan, in 2011, China placed more emphasis on measures to reduce pollution, increase energy efficiency and assurances for a stable, reliable and clean energy supply. Another topic in the Five Year Plan was decreasing social inequality. This indicates that China's central government understands how expensive and counterproductive resource-intensive industries are for China's future economic growth and that the country needs to focus on sustainable economic development.

Sustainable development can be driven by a business itself when it integrates responsible and sustainable business practices in its operations. This behavior can also provide new opportunities and contribute to making more sustainable global value chains, which can be very good for China. In this light, it is important for foreign companies to follow the trends of sustainability and CSR to maintain their comparative advantages in China and in the rest of the world.

FAQs about being a CSR-practicing company

How will this help my business?

There is growing evidence that managing social and environmental issues in the value chain is good for business. The benefits can include:

- Better management of supply chain risks (and through this, avoiding disruptions in your supply chain)
- Better reputation management
- Improved access to financing (e.g. government subsidies or bank credit)
- Increased transparency: this makes it easier to spot issues and it gains trust from your customers
- Increased productivity
- Reduced costs (e.g. through energy savings)
- Opportunities to target new customer groups and/or develop new products
- Increased trust (from stakeholders, government, customers)
- Improved staff retention and better access to talent

In short, it makes business sense to spend some time considering where and how you can integrate more responsible business practices into your operations and your value chain.

My business already gives money to charities every year. Isn't that enough?

It is great to support charities, and this is one element of being a responsible business. However, when your business does not further address issues in the workplace, environment, marketplace or community in other ways, this is a very narrow scope of CSR and not very effective. As mentioned, CSR is not about how to spend money, but rather about how to make it (i.e. fundamental business practices).

Is this going to cost me money?

Yes, it will. But improving business practices saves money in the long run. Savings can come in different ways, such as improved energy savings, higher productivity, reduced employee turnover, decreased wastage and less downtime. Integrating responsible business practices into your value chain will make your business more resilient to deal with changes in the business climate. It can also bring surprising new opportunities for new customers or even new products.

I'm working within the law. Why do I have to do more?

A business can be legal but still cause negative impacts, such as pollution, creating waste or practicing labour laws that are outdated. In the quickly evolving regulatory framework in China, it is important to make sure your company is indeed operating in full legal compliance. CSR, however, is about going further than the law by decreasing negative impacts which might still be allowed within the law, and ideally about making a positive impact.

Furthermore, there is often a higher expectation for internationally operating companies to go beyond the law in their business behavior, especially in countries where legislation may be much less stringent than in Europe. For example, in many countries a minimum wage does not exist or is set below a reasonable income. Providing this fair income is seen as a responsibility for business, even if local laws do not cover it.

Keep in mind that your responsibility does not end with your own activities but also includes activities further up or down your value chain. For example, consider that working with suppliers that harm the environment can also harm your reputation.

11.2 The Hottest CSR topics in China

HR/labour

Fundamental factors for a responsible business include looking after employees, providing them with a decent livelihood, and ensuring a safe and secure workplace. Ensuring this creates an environment that will support productivity. It is also likely to reduce employee turnover and absenteeism, saving costs involved in training new staff. This responsibility also extends to a company's supply chain and whether they choose to work with suppliers (and suppliers of suppliers) that also integrate these practices in their business operations.

According to the International Labour Organisation (ILO) decent work is productive, delivers a fair income, features security in the workplace and provides social protection for families.

What can I do?

Comply with the law: Chinese labour law and health and safety standards set stringent standards for employee conditions. Make sure to be 100% familiar with these laws and standards and that they are enforced. At a minimum, employees should receive a fair and equal living wage, compensation for overtime, days off, reasonable working hours and a safe working environment.

Following international guidelines, employees should be engaged as important stakeholders in a business.

Health & safety
For every accident in the workplace, time and money is lost. In 2011 workplace accidents claimed a total of 75.572 lives in China. The reported statistics are likely to be vastly below the actual number. The mining, construction, manufacturing sectors and transport sectors are particularly prone to high numbers of accidents and fatalities, but occupational health and safety is an issue that needs to be addressed in all work settings, regardless of sector.

What can I do?
Comply with the law: the two main laws overseeing health and safety in the workplace are the Work Safety Law (2002) and the Law on the Prevention and Cure of Occupational Diseases (2002). Additional standards can be found under the State Administration of Work Safety.

Environment
All businesses have an impact on the environment. For a business, it is important to review what and how big the environmental impact is and how to reduce it. Protecting the environment often leads to significant savings in energy and resources; it will help reduce the risk of fines and it will make a business more resilient in light of future climate change. Businesses will also increasingly be confronted by scarcity of resources and with volatility in energy prices. It is shrewd business strategy to consider adapting business operations to be less vulnerable to these changes.

Manufacturers and producers generate large amounts of waste. Farmers have an equally big impact through the use of fertilizers and pesticides as well as the conversion of natural habitats. Some businesses may feel they have a small impact on the environment and choose not to do anything. But when adding its activities together and through its supply chain, small businesses can have a big impact on the environment, which makes this topic relevant to all businesses.

What can I do?
At a minimum: comply with the law. The Environmental Protection Law of the People's Republic of China is the main law overseeing environmental quality. It sets out the legal limits of pollution allowed. In 2015 it was updated, further increasing liability and responsibility for stakeholders, including business, and enhancing transparency requirements.

All businesses can do simple things like reducing electricity usage, lowering the heat in winter, using air-conditioning wisely, conserving water and increasing recycling efforts. These efforts, while making less of an impact on the environment, can also save money.

Businesses also have an impact on the environment in the materials they choose to use. Choices in packaging which can lessen environmental impact include using less packaging, switching to biodegradable materials, buying recycled materials and using chemicals that are not harmful when discharged.

By taking a closer look at products and production processes, companies can go further: for example, by using the waste products from one process as a resource for another product. Also consider the consumer impact your product may have sometimes the heaviest environmental impact is in the way your product is used, and small changes made in how to use the product can have big effects.

Community

We all belong to the global community: no matter how small a business is, all companies have an impact on the bigger community. To be known in the community as a good business will often make the company a preferred workplace for talented staff and create more good will towards the company, which can in turn be leveraged in discussions with local governments. Businesses who understand these points can be active members of the community. At a local level, they may sponsor a community event or partner with an NGO to contribute to a cause important to the community.

The indirect impact of a business on its immediate and local community on a daily basis is often ignored.
These communities are affected by the presence of the business in many ways, such as noise, pollution and traffic congestion. Responsible businesses should add value to the communities they affect, rather than cause negative impacts and create community conflicts. Community contact should be an important element of good stakeholder management for a business.

What can I do?

The following is a list of ways to engage with communities, including getting to know the local community and finding out their opinions on the surrounding business operations. The involvement may be smaller in urban communities, but more engagement might be required for mining and agricultural operations which affect larger rural communities.

Bribery

Bribery is detrimental to fair business practices, as it removes transparency and distorts market prices. Bribery can also hurt good businesses by compromising the quality and safety of products, increasing the cost of production and attaching a bad reputation and image to the profession or industry. Bribery can take many forms. By definition, it includes offering, promising, or providing too much benefit to a person with the intention of obtaining or retaining an improper advantage, by encouraging the person to act, or refrain from acting, in connection with an official duty. To ensure that they are transparent, many multinational companies today do not permit their staff to accept even small gifts.

One thing to note is that Chinese commercial staff will frequently blame missed sales targets on the refusal of the company to work "the Chinese way". Although that could be sometimes true, it is also exaggerated because not all companies base their purchasing behavior exclusively on bribery.

Foreign companies engaged in corruptive practices need to take into account that, when they are caught, the punishments are high and that they will not have the backing of a Chinese network, which means they have no entry to the best legal defenders. Nor will they be supported by their head office, which will deny any involvement. Since corruptive practices in China may also have legal consequences in the country where the head office is located, they may be punished twice.

Companies need to be above reproach, have well described procedures that will bring corruptive practices to light and also punish staff involved.

What can I do?

There are certain steps to help minimize bribery, including reviewing company practices with senior management and sales staff, assessing the prevalence of bribery and corruption in the company and the industry, and assessing how this has affected business practices. Additional methods to reduce bribery include acting internally by introducing anti-corruption policies and programs within the organization – a company can identify departments that are more prone to bribery and then establish guidelines on the value of gifts that are acceptable to give and receive.

11.3 Where Can I Start?

Responsible business practices are most effective when they connect to the core activities of a business. For example, it does not make much sense for an IT company to focus on child labour when most of their impact is in the energy used for data centers. Instead, a focus on other energy sources, such as switching to renewable energy sources, would be more effective. Therefore, the best starting point to do more with CSR is to identify what matters most to your business.

A company can take several steps to decide where to focus its energy and attention and to shape a CSR-policy:

- assess your value chain and what your company is already doing;
- decide on the most relevant topics to your value chain and where you can have the most impact;
- prioritize and set objectives based on the current situation and in dialogue with your stakeholders;
- use existing resources, guidelines and experts when needed;
- regularly evaluate progress and any problems that arise;
- communicate about your activities, both internally and externally.

11.4 Sources to Consult

Some sources we can recommend:

- CSR guide Dutch embassy: www.rvo.nl/sites/default/files/2014/07/CSR%20Guide%20English.pdf
- OESO guidelines
- ISO260000
- MVO risk check: www.mvorisicochecker.nl/en
- Website MVO: china2025.nl/mvo-china-een-interessante-business-case/

BenCham has a CSR platform where members share best practices and training.


CHINA
GROWTH HACKERS
"DATA,
CREATIVITY,
CURIOSITY"
Andrew Chen
CHINA GROWTH HACKERS
Did you know that 70% of all new products and services in China do not succeed? Or that more than 50% of online stores in China fail to generate profit?
It's therefore time for a new approach. Welcome to China's first Growth Hacking Agency!
Based out of Amsterdam and Shanghai we help international startups and corporates to achieve rapid and sustainable digital growth in China. We apply our own successful framework and experiment with the latest Chinese growth hacks.
We draw inspiration from Growth Hacking and Lean Startup principles, where testing and validating assumptions for a (new) business idea are fundamental. By doing so, we help you get answers to the following four questions:
Problem
Which problem or pain point can be Identified with your Chinese audience?
Product/service
What will you offer to create value for your Chinese audience?
Audience
Who is your target audience?
Method
How will you communicate your product/service to your audiences?
New product /service? We help you test and launch a new product through data-driven product development.
Existing business? We help you scale your online store or social account rapidly by applying growth hacking techniques.
With our team of experienced growth hackers and digital marketeers we do this in four different ways:
1. EXECUTION
2. TALENT SOURCING
3. EDUCATION
4. SOFTWARE
Contact to know more about how each of our services help you GROW !
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12. E-commerce market in China

Certain factors exist in the China markets which create significant new opportunities for companies to sell their products and services, including the market size, a growing upper-middle class and a high demand for European consumer goods and services. But through which channels should companies sell their products and services? Is the offline market the best way for a company to enter the Chinese market, or is the online market a more suitable option? Or, should an omni-channel approach be the best way forward, combining your off-line and on-line sales with brand building via social media? This chapter will present some insights into the online Chinese market and different strategies which can be chosen to start selling in China with e-commerce.

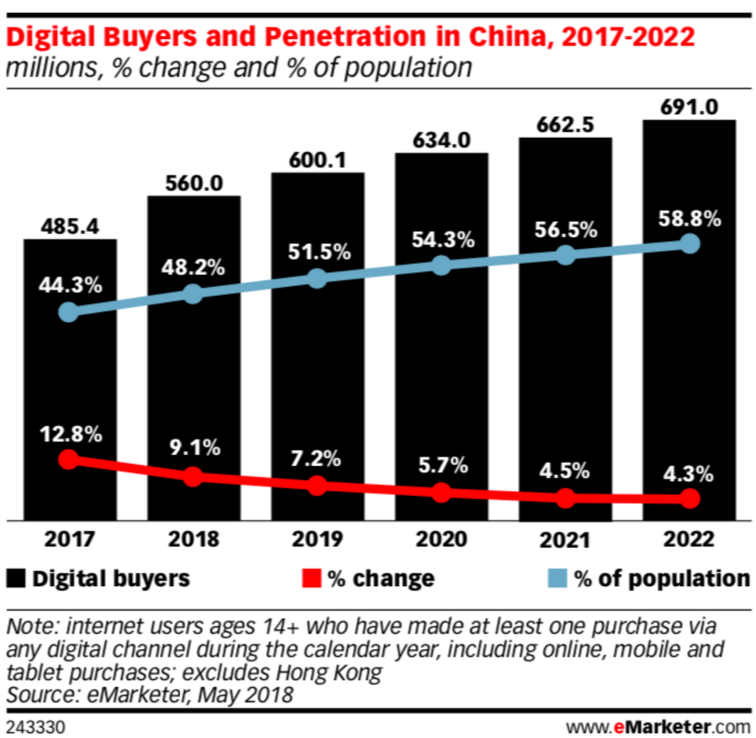
It will introduce you to:

- China's e-commerce growth
- Trends in the online Chinese market
- China's e-commerce landscape
- What you need to be able to sell online in China

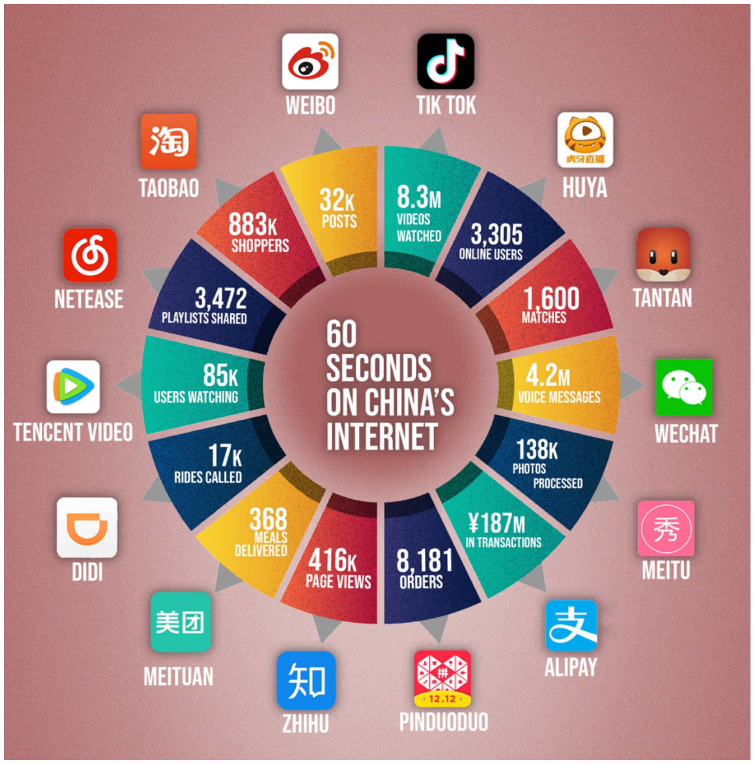
12.1 China's E-commerce Growth

China has the largest e-commerce market in the world with almost a 40% larger online retail market than the US. According to consultancy firm PwC, 96% of China's 1.4 billion people population shop online every month and 60% every week, compared to the global average of 21% weekly.

The total retail sales forecast in 2019 for China will grow with 7,5% to reach $5.636 trillion in 2019. Retail ecommerce sales is predicted to grow at a much higher rate of 30.3% to $1.989 trillion. The share of ecommerce sales in relation to total retail sales would be then a staggering 35.3%. This indicates that ecommerce should always be one of the channels a brand should sell through in the Chinese market let alone brand itself through.



Not only do Chinese consumers shop more online than the global average, they also spend many more hours on the internet. The average Chinese internet user spends about 25 hours per week online, while the global average is only 16 hours per month. Of these 25 hours per week, 5 hours are dedicated to visiting online shopping marketplaces.
An average minute spent online in China looks on like this:



Sources: baijiahao.baidu.com, econsultancy.com, ifeng.com, prnewswire.com, qudong.com, sina.com.cn, wenku.baidu.com

Drivers for this incredible growth in ecommerce according to McKinsey and Dezan Shira are:

1. The growing use of mobile devices in combination with the continued development of popular Chinese social media platforms, which help to increase the exposure of goods and drive e-commerce sales. For example, during the biggest sales event of the year, Singles day, 99% of the purchases made online were via mobile.
2. The demand for branded products in second and third tier cities is exploding.
3. Distrust in locally produced products, because of safety concerns or counterfeiting, drives consumers to buy overseas via cross-border e-commerce.

12.2 Trends in the Online Chinese market

Online Business-to-Consumer platforms

E-commerce in China is becoming more and more professional and organized. From the start of online sales in China till 2010 the vast majority of online sales to consumer were done by individuals (C2C). This has changed, as current already more than half of the online sales are conducted by registered companies (B2C), and this is expected to continue to rise in the coming years. As such, China is currently already the largest market worldwide in terms of absolute B2C sales numbers.

Roughly half of online B2C sales in China are made directly by online retailers, while the other half is generated through shops on online marketplaces, such as Tmall and JD. A third option for product providers is to sell products on websites of established online retailers

(B2B2C). Unlike Tmall and JD, they are not just platforms, but actual retailers. They will sell products for a share of the profit without asking an entrance fee. An example of one these retailers is Ymatou, Kaola.com or VIP.com. When offering a product on another retailer's website, finding the right partner is obviously very important, this is often called a "TP" partner. Where "TP" stands for Tmall Partner. These partners can operate for a brand a store on Tmall and sometimes also on other platforms.

Cross-border e-commerce

Foreign products are in high demand in China and the Chinese consumers use different channels to purchase them. For some time now, there has been a lively trade of overseas products on C2C platforms. Agents buy the products and import them or copy those products directly in China., this type of agents are being called "daigous". Currently, official B2C channels are gaining in popularity for buying overseas products, which are either shipped directly from abroad or sent from a bonded warehouse in China.

The Chinese government launched several pilot-zones for cross-border e-commerce in cities such as Shanghai, Guangdong, Tianjin and Fujian. Regulation on the import via cross-border e-commerce is less strict and creates lower barriers of entry to the Chinese market than for traditional offline import. For example, imports authorized in these pilot zones are not required to have a Chinese entity, import duty and VAT are not applicable (only the personal parcel tax) and the certification and approval of products is much easier. Also, for cross-border e-commerce there is a special VAT applicable. This percentage is 11.2% and this is a combined VAT of import VAT and consumer VAT.

88 million Chinese consumers bought overseas products online with a total value of approximately US$ 24 billion. On average a consumer spends around $1050 per year via cross-border e-commerce. Most cross-border e-commerce shoppers come from Tier 1 cities in China, with respectively 22%. Overseas product purchases were equal to 11% of domestic Chinese e-commerce and this ratio has remained stable over the past years. This ratio is expected to remain stable in the coming years; cross-border e-commerce will increase in absolute numbers as it grows along with the rest of the Chinese online market. The major e-commerce platforms Tmall.hk, Kaola.com, JD Worldwide, VIP.com and Jumei.com capture 90% of the cross-border e-commerce market.

Mobile and social

The use of mobile devices for payments in China is enormous. Around 500 million people use mobile payments. More than 90% of all these mobile transactions go via AliPay, belonging to Alibaba, or WeChat Pay, belonging to Tencent. This is because the adoption of QR codes has been very high In China. For merchants as well as shoppers, selling and buying becomes very easy. It is predicted that by 2021, 79% of all Chinese will be paying most of their products by mobile.

Social media also play an important role in the rise of m-commerce. The popular messaging app WeChat (Weixin) 900 million active users that spend on average 34% of all their time on their mobile in this app. In recent years, WeChat has grown to become the most important social platform in China. With corporate WeChat accounts, customer service and promotions can be provided in several innovative ways. Even direct sales are possible within this social media platform through a WeChat Store.

O2O business model
The O2O business model has experienced increasing attention over the past years. O2O is bi-directional; Online-to-Offline and Offline-to-Online. O2O e-commerce platforms attract customers online, but the real consumption of services must be experienced offline. For example, customers can buy a restaurant voucher online and later use it to dine in the restaurant. The reverse O2O concept is also used often in China. An example from Offline-to-Online is when a customer is visiting a store, where they can feel and try the product, then scan the QR code to buy it online and have it delivered at home.

O2O has grown enormously with the enhancement of mobile internet and the massive growth of internet-powered devices such as smartphones and tablets. The opportunities of implementing O2O business models are massive. The company that masters online and offline models has the advantage to offer the (potential) customer options to select online consumption over all channels as well as offline consumption.

Legislative framework
In order to guarantee that the country's e-commerce develops in an orderly manner, the Chinese
government has stepped up its efforts to enact a comprehensive legislative framework while carrying out stricter enforcement measures. From 2019 onwards, China has enforced a new e-commerce law. In this regulation, the c2c e-commerce by diagous will be restricted. Almost every seller online needs to have a business registration and also sellers must pay tax and be able to issue a tax invoice (fapiao) to consumers. For brands there will be a stronger IP protection. Defense against fake goods and rampant infringements of IP will be stronger because the marketplace platform operations shall assume joint and several liability if IP is infringed.

Besides this, already in China's 2013 National Development and Reform Commission (NDRC), the Ministry of Finance (MOF), and 11 other departments jointly released the *Circular on Further Promoting the Sound and Rapid Development of E-Commerce*, which regulates inter-departmental coordination, improves policies, management systems and standards concerning e-commerce transactions, logistics and distribution, as well as customs clearance services, accelerates the application of web (electronic) invoices, among other steps.

Some of the relevant regulations for e-commerce providers are:

- Electronic Signature Law (2004): establishes the concept that an electronic document is as valid as a paper document and regulates the application and acceptance of electronic signatures
- Standards for Online Transaction Platform Services (2005): an industrial code of practice that clarifies the general comprehensive standards for e-commerce in China, especially the obligations of online transaction platform providers
- Standards of Online Transaction Services (OTS Standards) (2009): stipulates the operating requirements for online payment platform providers and require online transaction parties to use their real identities in transactions, and provide authentication information (such as business licenses and tax registration certificates) for verification purposes

12.3 China's E-commerce Landscape

Online retail in China is characterized by heavy competition and fast developments. Whether involved in B2B, C2C or B2C e-commerce, it is essential to have a clear and well thought out strategy to enter the online Chinese market (also see chapter 3). The country's size and complexity make e-commerce an effective channel as costs to connect with customers across the country are relatively low. However, companies should make thoughtful choices regarding specific channels and platforms.

Business-to-Business (B2B)
The B2B market is dominated by third-party platforms which are connecting overseas buyers with Chinese factories and suppliers. Although B2B platforms offer Chinese companies the opportunity to buy from foreign companies as well, this hardly ever happens. The biggest player in B2B e-commerce is Alibaba Group with a 47% market share. The remainder of the market is divided by other platforms, such as Global Sources and HC360.

The Chinese B2B market is still in its start-up phase compared to the European and North American markets. The main reason that China is slower than European and North American SMEs is that their investment and ICT adaption is much lower. However, with rising costs in China and increasing industry investment in e-commerce order management, logistics and payment handling systems, the B2B market is expected to develop quickly over the next few years.

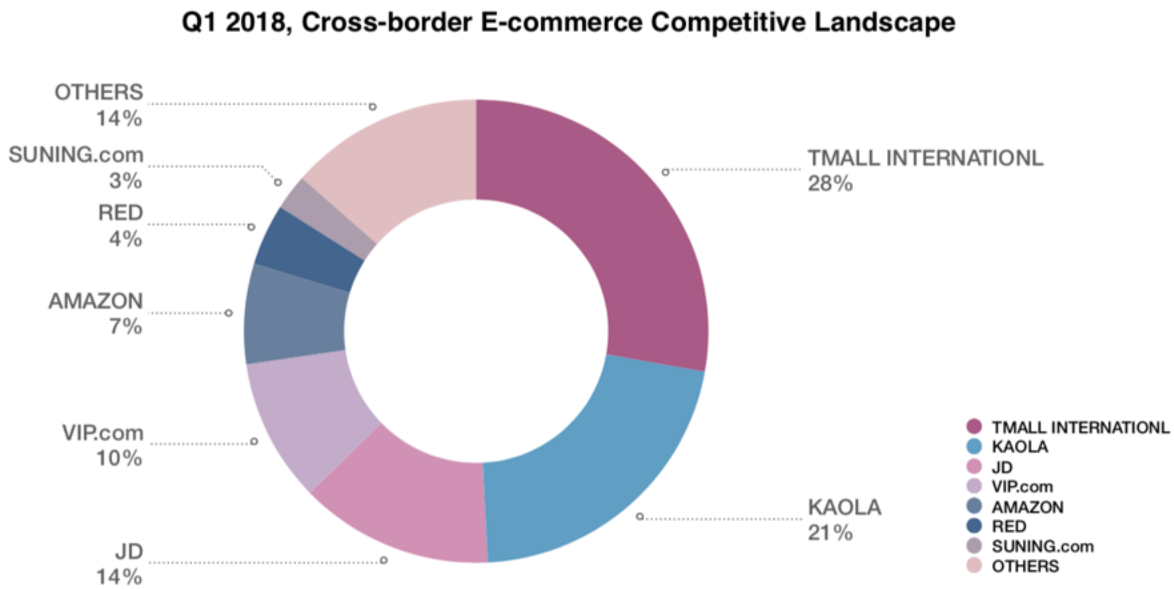
Consumer-to-Consumer (C2C)
Until recently, the consumer-to-consumer (C2C) channel dominated China's online shopping market. With a 95% market share, Taobao, launched by Alibaba Group, is the most important channel in C2C. Taobao is open for everyone with a Chinese identity to sell directly to consumers. The downside of this is that Taobao has no control over the online trade in fake products, which negatively influences its international reputation. Alibaba has been taking steps to improve Taobao's image of selling real brands by including in their conditions that merchants selling fake goods will be reported to the police and penalties could include prison terms.

Business-to-Consumer (B2C)
The Chinese Business-to-Consumer (B2C) market increased rapidly over the past years in terms of online retail sales. The market is dominated by third-party platforms. The following list is a selection from the large range of available platforms:

Tmall	Tmall is a part of the Alibaba Group. Consumers prefer to shop on Tmall because of the authenticity of the products that are being offered.
WeChat	WeChat, in Chinese called Weixin, is the most common used social media tool in China and can be compared with a combination of WhatsApp and Facebook which also offers online payment.
JD	Started by selling household electric appliances but has widened their product range. They are the first marketplace where consumers can exchange old electric appliances with a newly bought one. JD has their own logistics

department and can therefore offer a pickup service when consumers want to return their goods.

Suning	Suning.com ranks among the top three Chinese B2C platforms. The focus is on household appliances, but it also offers other products i.e. books, cosmetics and baby products.



With a 58% share of the total e-commerce revenues, Tmall is the biggest player in B2C platforms. Setting up a Tmall store seems like the best option as its registered users' base is the biggest of all the B2C platforms, but the downside of Tmall is that the required set-up investment is significantly higher than for other platforms. Companies should therefore make a well thought out decision on which platform they want to sell. They can choose one of the above described platforms which offer a wide range of different product categories. Another option is to choose a platform on their category focus (vertical marketplace). Examples of category focused platforms are Yihaodian (food and drink), Jumei (cosmetics), Dang Dang (books and entertainment), Shangpin and Glamour Sales (full-priced luxury fashion) and VIP (discounted fashion).

12.4 What Do You Need to be Able to Sell Online in China?

In order to sell online in China, it is necessary to consider which online channels will be used. Would it be a single channel strategy or a multi-channel strategy? Selling in a B2B or a B2C environment? Within your own branded web shop or through third-party platforms?

The following aspects must be considered in order to be able to sell online in China:

- Online channel(s)
- Ongoing operation of the chosen channels
- Logistics
- Online marketing
- Customer support
- Legal support

- Branding
- Taxes

Online channel(s)
Every company considering selling online in China will face the key questions regarding which business model to adopt and which channel(s) to use. The company's options for channels will depend on various factors, including the company's offline presence in China and the budget for up-front investment. Therefore, it is extremely important that companies do (or outsource) a market scan in China which gives insights into the market, the marketing needs and its competitors.

A company planning to sell online in China needs to choose an online channel strategy or a multi-channel strategy whereby a combination will be made. Companies can choose to set up their brand-owned web shop or set up a shop at a third-party platform:

- Brand-owned web shop. Selling with your own brand web shop gives you a strong control over your brand and the pricing. You will be able to collect and analyze data which can be used for online marketing. However, you need to take into consideration to host and license the website in China in order to avoid a slow-reacting website or blocked content.

- Third-party platforms. The B2C third-party platforms are enormous in China. As mentioned before, you can either choose for a platform with a wide range of product categories or for a platform focused on a specific product category. See the Business-to-Consumer section above for examples of third-party platforms. With the use of third-party platforms, companies can benefit from a larger audience and enjoy shared marketing efforts. However, start-up costs for some platforms are very high, the presence of competitors and the inability to obtain customer data are disadvantageous. Also, with marketing costs being up to 50% in some categories, it can be extremely hard to be profitable.

To start doing business on an online trading platform, foreign invested companies are required to upload pictures of their business licenses, passports or identity certificates of their legal representatives and company bank account information for examination and approval by the online trading platform. After approval, they must prominently display their business license information on their store homepages. For representative offices of foreign enterprises, certificates of registration and organization code certificates (or tax registration certificates) issued by the competent Chinese authorities should be submitted to the platform. For enterprises in some industries, such as the cosmetics or food industry, specific permits are required.

Some online platforms set minimum threshold levels for enterprises that can be listed as enterprise vendors on their platforms. Also, some platforms require B2C vendors to pay technical service fees or commissions. It may also be necessary for the B2C vendors to pay a deposit to the platform in case of a breach of any service terms.

Operation of the chosen channel(s)
After choosing the channel(s), the company needs to decide on a strategy: who is going to do the ongoing operations and how will it be done. Shop management service and payment are both important aspects in the operations.

Payment

Very few Chinese shoppers use international credit cards such as MasterCard and Visa. The most popular payment methods in China are cash-on-delivery and third-party payment solutions. With 54% of the market share, Union Pay is the leading third-party payment solution. Two other big payment solutions come from Alibaba (Alipay) and Tencent (Tenpay/WeChat payment), who have their own payment platforms which are integrated with social media platforms and can be used for direct payment transfers, online gaming, taxi bookings, travel, paying bills and so on.

Alipay offers online payment solutions to merchants who want to sell directly to consumers in China. These merchants receive payments directly to their bank accounts, which means there is no need for them to set up a company or open up a bank account in China. A one-time setup fee of US$1,000 is required to use Alipay for cross-border payments. There is also a transaction fee of 3 percent or 7 percent on each transaction. Alipay also offers options for domestic payment solutions in China, with transaction fees ranging from 0.7 percent to 1.2 percent.

PayPal is available in China but only has a very small share in the Chinese domestic market, and Chinese usually only use PayPal when they purchase items/services from abroad.

Logistics
An online shop is not permitted to simultaneously engage in delivery and provide online payment options in addition to selling products. Therefore, most online shops outsource the delivery process to freight forwarders such as EMS, TNT, China Post, etc.

The most important choice on the logistics part is whether you are going to warehouse your products in China or plan on shipping directly from the home country. Although the willingness to wait for a product is decreasing, Chinese consumers will generally accept a longer waiting time for orders from abroad. In the eyes of the consumer, direct shipping from abroad can even be a sign of trustworthiness. A delivery time of two weeks is not unusual, which makes it easy to work with pick & pack in the home country. However, the costs of direct shipping from abroad are significantly higher than when bulk quantities are shipped. For high turnaround volumes, storage in China will decrease operational costs, logistics costs and turnaround time. This does require IT integration for the order placement and customer information to print labels.

Different logistic options are available to companies selling in the Chinese e-commerce market. These logistic options include the following list:

- Express – Directly to the consumer
- Post – Directly to the consumer
- Air freight – As cargo to warehousing in China
- Sea freight – As cargo to warehousing in China
- Train freight – As cargo to warehousing in China

The reason to choose for one of these options depends on the shipping volume, weight, shelf life and costs for transport and storage.

Online marketing
When entering the Chinese e-commerce market, companies need to make choices for online marketing. For more information see chapter 3.

Customer support
Chinese consumers use customer services not only after-sales, but also pre-sales. To generate and retain customers, a customer service tool is necessary to offer different types

of service options and also to collect and store customer data. For customer service in China companies have the following options:

- Live Web Chat – Allowing visitors to have an audio/video –chat from your shop to contact you directly
- WeChat – Allowing followers to have a conversation including pictures and video with you directly
- Call center – trained agents who will answer questions from customers by phone. Email – Allowing customers to send their question, request or complaint by email to your company

Customer service companies can make reports which give insight in the number of requests per topic, agent performance, customer service availability, marketing performance and online conversions.

Legal support

A foreign invested company that intends to provide network services to other trading parties with its own online platform needs to apply to the Ministry of Industry and Information Technology (MIIT) for an Internet Content Provider (ICP) license prior to conducting business registration. Meanwhile, enterprises that directly engage in product sales through their own online platform need only to report to the telecommunications administration authorities for record-filing.

This means that foreign investors can engage in online sales without an ICP license from the MIIT provided that their online platform is not open to any third-party vendors. They will, however, still need to apply for an ICP filing number (备案) if any relevant website content is hosted in China.

A foreign invested company engaging in online sales and related services needs to display its business license prominently on its main webpage or the webpage on which the operational activities take place. Furthermore, they are required to establish a reasonable system for the return and exchange of goods, maintain sales records, and strictly protect consumers' privacy and commercial secrets. They should also abide by the Law on the Protection of Consumer Rights and Interests, and the Law on Product Quality.

Legal aspects in China are very difficult to handle without specific China knowledge and experience. Always take advice from a local expert who is familiar the latest regulations. For more information on legal aspects see chapter 5.

Branding

In order to sell a product or service in China you need a brand name. Companies can either choose to enter the e-commerce market in China with their western brand name or they can choose to create a China brand name.

Taxes

The taxes payable for online businesses are the same as those applicable to other foreign invested companies in China:

Corporate Income	Tax 25% of profit
Corporate Income Dividend	Tax 5% - 10%
Value Added Tax	Usually 16%
Cross-border VAT	11.2% (but restricted to some rules)
Business Tax	5% of turnover
Individual Income	3% - 45% taxed progressively

13. Localization

Transitioning from exporting to China into genuinely localizing into the Chinese market

Outline

Over the course of the previous chapters, the reader has hopefully gained more understanding of many of the basic aspects of doing business in China.

He or she will most probably have realized that the Chinese market offers big opportunities for many businesses, but that securing a successful entry and growing profitably in China requires some serious rethinking of how to approach the market and operate within it.

This section attempts to bring these elements together and highlights what it really means to enter the Chinese market and to become sufficiently localized. We will cover both the market aspects and operational aspects of running a China based business.

13.1 Market Aspects

The three main points related to the market that require special attention are the product or service fit or adaptation to China, the way brands, products and services are marketed (with a special attention to digital marketing) and what Chinese consumer and customers expect from customer service.

Product and solution fit

In the past, Western products were sold in China with no specific adaptation other than affixing Chinese labels and user manuals. Gradually, products had to pass Chinese certification (e.g. CCC) but these were not often far from EU standards. This was enough to satisfy most basic needs of consumer and businesses.

Increasingly, Chinese consumers have developed their own expectations and requirements: local fashion trends, quick adoption of technology and digital solutions by consumers, locally designed solutions to fulfill local needs and solve local problems.

Chinese businesses also approach their operations differently from Western businesses. In particular, they adopt a stronger focus on flexibility and quick reactivity then most of their Western counterparts. They also demonstrate fast adoption of innovation and tendency to accept the risks inherent to new solutions.

In addition, China has seen the rise of increasingly competitive domestic companies, with deep understanding of their market, and a will to use any means at their disposal to win. This is leading to an extremely dynamic and competitive market.

All this means that nowadays, Western companies will have to offer a value proposition that (1) brings something genuinely new compared to existing organizations in China and (2) fulfills specific Chinese needs or solves real Chinese problems as opposed to Western market needs and problems.

Doing so is certainly not self-evident. It requires time and effort to devise prior to entering the market and to validate within the market. More than a few Western companies realize, after spending time, energy and capital to set up in China, that the products they thought were strong and unique, were not. In some cases, they already exist in China in some form, or they do not address the real needs and application that competing products in the market do. This all makes it much harder to position a differentiated product and successfully grow in any market segment. Marketing and Distribution

Targeting and Scaling

Everyone knows that China is a huge market, both in terms of geography and in terms of people. This is one of the attractive aspects of China. But it has practical consequences at the outset of a market entry project. The first point is that no one can cover the country entirely from day one. Therefore, very early on, any business will have to make a conscious decision about the market segments and the regions it is targeting and will cover. And more often than in the past, the selected regions may not necessarily be tier-1 cities where every other company is already located.

While taking first steps in China requires preparation and clear choices (segment, cities, etc.) in order to test products and operational capabilities, once business picks up, the sheer size of the market leads to an explosive growth that must be followed. Failing to follow the growth will certainly open the door for one or several Chinese competitors to dive in and take a dominant position.

Therefore, any successful localization requires serious thoughts toward operational scalability.

Digital marketing

Retail business or the development of any consumer products cannot be successful in China without a serious digital marketing strategy. But digital marketing is very different in China. It differs in terms of the way Chinese consumers use social networks, in terms of the platforms they use (no Facebook, no google, no twitter …), in terms of age breadth (the adoption of technology by older Chinese people is astonishing) and in many other ways. It absolutely cannot be expected that transposing what worked in the West will also work in China. This is one of the areas where localization is the most needed.

Competition

Chinese companies are competing in an extremely aggressive manner. This is true both in the consumer goods segment and the business to business sectors. When a Western company enters the Chinese market, it dives into this very competitive environment. Any initial competitive advantage will allow the Western company to successfully secure first customers. But relying on these initial competitive advantages for long term success is dangerous. In many industries, the speed at which Western competitive advantages erode with respect to Chinese competitors is surprising.

This effect is often blamed to a tendency of copying. In fact, nowadays, intellectual property right can be effectively protected, and the erosion of competitive advantages is increasingly due to the effectiveness of a few Chinese competitors using all tricks in the book to compete.

Channels and Indirect Sales

Indirect sales and distribution are often seen as a way to access the market without committing resources in China. While an indirect sales model can be a short-term solution to test the market, really successful indirect businesses do have resources in China to manage and guide their channels. It is the only way to deeply understand the rapidly shifting market trends and the emergence of local competition. In addition, successful indirect sales businesses use multi-tiered models with many channels, which require local management.

Relying on a single master distributor may be a viable solution for Western vendors but is fundamentally another type of export business into China, not the type of market entry that can lead to the success at the scale of the Chinese market.

Customer Service

Expectation regarding customer service is one of the areas where the West and China differ a lot.

While Westerners tend to favor reliability (i.e. lack of failure) even if resolution of the rare failures may take a little while, Chinese will favor quick reaction to failures even if these failures are more numerous, and even if the eventual resolution of the failures takes time.

Schematically, Chinese will prefer a product that fails once in a while but whose customers service personnel is instantly reachable, immediately jump on the case and shows great concern and support to the customer (even if the resolution takes a certain time) as opposed to a product that almost never fails but for which the customer service is hard to reach.

This is a serious challenge to new entrants, as providing such customer service across the country at the early stage is challenging. It gives one more reason to select first target segment and region wisely. It also calls for a systematically organized customer service that allows efficient outsourcing.

On the other hand, it also offers opportunities, as what matters most is the engagement toward customer more than the real resolution. It allows to have part of the customer services function part of the sales job and responsibility, which is why we put this as part of market aspects and not operational).

Failing to understand this aspect may doom a brand's image very quickly in the age of digital marketing

The Chinese market is large enough for trends to evolve in different ways then in the rest of the world, and for many companies to identify these trends and play them at their own advantages. Any business willing to enter the Chinese market will need to acknowledge this fact and act on it. Failure to do so will almost ineluctably lead to poor performances.

13.2 Operational Aspects

No market entry strategy can be successful without efficient operations. We already talked about the importance of being lean and focused in the early days but ready to scale once business picks up. Here we will focus on three main operational aspects: manufacturing, access to local resources and location selection.

Manufacturing - Factory Processes

Most business will run Chinese production operations in China for the Chinese market. IT may be manufacturing but also some service operations. We will focus here on manufacturing, but most points are also valid for service focuses operations.

The main question is should we just copy the processes we developed back at home or should localize the operations to match the local way of doing things. In general, the answer will be a mix: keep some of the key aspects of the home country processes but allow for some flexibility to take advantage of the local reality. Some key aspects of home define processes are what makes the products and services special and differentiated. But others will be there by habits or because of the local reality in Europe and can be changed in China.

For a manufacturing operation, these questions come down to:

- Should we keep the same end to end production process using the same machines, or should we used a different set of machine, less (or more) automation, more quality control steps, … Visiting Chinese factories may help to get ideas of how some of the good companies leverage the use of people and machine in a different manner. In addition, with the current push toward higher productivity across China, it is interesting to see how Chinese plants are evolving.
- What parts do we localize to alternative suppliers as opposed to import from the traditional supplier of its Chinese facilities?
- Should we not rethink the end to end quality assurance and quality

- control system to consider, realistic expectations from internal functions and external suppliers.
- Should we localize in China older products or should we industrialize new products into Chinese operations. It is an open question, but it is demonstrated that, once the right infrastructure is in place in China and the headquarters are open minded for it, introducing new products in Chinese factories allow to take advantage of the vast network of Chinese suppliers to run the cost of product down. But this certainly requires local new product introduction (NPI) resources and in some case some changes in the design and process initially considered.

Local resources

A big part of managerial responsibility is the ability to find and allocate resources in an efficient manner. In this section, we will list three types of resources whose access and management are particular in China.

Human Resources

It is known for many years that finding the right human resource in China is a challenge and that keeping the good resources is even more of a challenge. This is compounded by the fact that good and experienced professionals can be surprisingly costly nowadays. A few points to keep in mind:

- The location of a business' operations has an impact on the people that can be found or attracted. The more developed a city, the wider the variety of people to be found. But the costlier also, because the cost of living is rising rapidly, in particular, real estate. In fact, an increasing number of professionals will take positions in slightly less developed cities in order to enjoy a less costly environment.
- Chinese employees will obviously consider compensation packages while deciding to stay or leave a company, but they will also look at other aspects. In particular, Chinese executives will look at things such as: the future of the company in the Chinese market, the role they can play in the company and whether the company's top management "gets China", whether they have real chances of having an impact on decision or whether there is some "glass ceiling" for them, do they have a real chance to become part of a worldwide team, …
- Chinese companies use compensation but also many other ways to attract and keep their teams. Many companies with high growth are also attractive for ambitious professionals because their strategy and ambitions resonate to Chinese. A Western company needs to seek some of these levers it can activate to keep their Chinese personnel.

Supplier and service providers

China is covered by a multitude of suppliers and service providers of various sizes, most looking for new contracts and opportunities. While many Chinese successful companies are historically vertically integrated, this fabric of dynamic and hungry business offers all sorts of resources to do assist day to day operations.

In the West, companies are used to outsourcing most of their non-core businesses to professional organizations that will free executives' mind from non-core worries. In China, even though such service providers exist, they are less developed. A decision will be to opt for a Western managed organization or to opt for hand-on management of smaller Chinese entities. Depending on the level of maturity of a business, one of the other may be better.

In terms of part or equipment suppliers, China now counts numerous local companies with excellent products and machinery, and a wide customer service network. These companies may not be known outside of China but opting for them in China may be very beneficial.

Government

It may seem strange to list government agencies as one of the resources to tap into. However, Chinese authorities at all levels (Central, provincial, municipal, district) are actively supporting many initiatives toward economic development as well as a more sustainable and environmentally friendly industry. Foreign companies can promote their competences and abilities with local government and leverage a good image to get easier access to resources their Chinese counterparts are certainly leveraging.

Working with various level of government requires effort and continuity. It also requires acquiring some experience to avoid problems. This is beyond the scope of this article. But we want to highlight a few points.

It is a shared idea that the different levels of Chinese government apply different standards of regulations for Chinese and Foreign invested enterprises (FIE). But all people in the field will tell you that this is no longer the case. The trend is clearly toward a even playfield. Obviously, there are still too many examples of unfair treatment. But the trend is clear, and it is toward regulations being applied with the same strict hand to both Chinese businesses and FIE.

In the past, the regulatory environment could change really fast for a particular company. In fact, in the past, local authorities could impose arbitrarily imposed changes in many areas. This was mainly because regulations were not implemented properly and in a even playfield manner. Local authorities had much discretional power to waive compliance to some rules and to award special advantages to particular companies. Once the local leader would change, or for any other reason, this discretionary decision could be reversed.

This is much less the case nowadays. In fact, many regulatory bodies at the local level no longer report first to the local government but first to the vertical hierarchy up to the central government level. Therefore, it is much harder for a local leader to award special advantages or waivers to support local economy.

Still, this does not mean that Western companies in China will operate in a stable regulatory environment. Fast changes are still to be expected. But no longer because of local trends, but more because of the reality of changing China. Some laws and regulations will be changed because their ineffectiveness was demonstrated, or because China is pursuing increasingly developed policies (environmental protection, new energy, labour protection, support to innovation, support to advanced manufacturing, …).

Therefore, Western business still need to navigate in a changing landscape. But nowadays, it is possible to get a sense of the main direction of the changes. In case of doubt, lean toward more Western style policies (labour protection, environmental protection, higher end/higher value business, innovation…). These policies will eventually win and most probably sooner than later. A bias toward these "advanced" policies is a safer bet. Banking on China remaining a low cost and low regulation country is not. Incidentally, this is precisely what Western companies have experience with back at home and what Chinese companies are struggling with. So, it must be an area where Western companies are able to demonstrate sustainable competitive advantages, and maybe even build a strong image with marketing value.

Location selection

For many years, the question of location was rather simple: open a small commercial branch in one of the tier-1 cities (Beijing, Tianjin, Shanghai, Guangzhou, Shenzhen) and build the business. Then pick an industrial zone for a factory, where local authorities offered good tax rebate, possibly some other advantages such as free or cheap land, …

It would not come to mind settling in tier-2 or tier-3 cities.

Now, with the trend toward a more even playfield within China, the difference between cities is less about how good a deal can be done on tax rebate, but more about the other aspects important for a company: cost, access to skills, general environment, market potential, local risks, availability of infrastructure.

The level offered by most cities and regions across the country is rising for all the decision criteria listed above. Still there are real differences between cities and regions regarding the maturity and openness of local authorities with respect to Western business, the access to skill and ability to attract talents, the size of the addressable market within reasonable distance, and the evolution of cost.

In general, tier-1 cities and some tier-2 cities are leading the way. Some tier-2 cities will offer an environment, access to talent, and infrastructure very close to tier-1 cities, but at a lower cost. Within these tier-2 cities, some will have very experience local authorities really keen to assist foreign companies by devising policies that are relevant and also packaging existing policies in ways that Foreign companies can benefit from them more easily.

When cost is a more pressing issue, companies may be tempted to venture further away. But this step must be taken cautiously and with the full knowledge of what it means to be further from more established supplier and service provider network, "internationally minded" authorities and other advanced infrastructure. What may be good for a Chinese company that knows how to operate across the country may not be as good for a Western company that is still learning the basics of doing business in China.

Conclusion

If you do not do that, you are virtually doomed.

Can decide whether to touch the market (export, light distribution) or dive in it. If you dive, make sure you are ready to learn how to swim and to commit to the Chinese market in all aspects.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14. Abbreviations

ADBC	Agricultural Development Bank of China
AIC	Administration of Industry and Commerce, also SAIC
APA	Advance Pricing Arrangement
AQSIQ	Administration of Quality Supervision, Inspection and Quarantine
ASBE	Accounting Standards for Business Enterprises
ASC	Accounting Society of China
AWEX	Agence wallone à l'Exportation et aux Investissements étrangers
BSCI	Business Social Compliance Initiative
BT	Business Tax
CB	Certification Body
CBRC	China Banking Regulation Commission
CCC	China Compulsory Certification
CDB	China Development Bank
CEO	Collective Economic Organisation
CIETAC	China International Economic and Trade Arbitration Commission
CIF	Cost, Insurance and Freight
CIQ	Customer Information Quality
CIT	China Income Tax
CLC	Container Loading Check
CNNIC	China Internet Network Information Center
CPA	Certified Public Accountant
CPC	Communist Party of China

CSR	Corporate Social Responsibility
CSRC	China Securities Regulatory Commission
D/A	Documents against Acceptance
DIE	Domestically Invested Enterprise
D/P	Documents against Payment
DPI	During Production Inspection
DTA	Double Taxation Agreement
DUPRO	During Production Check
EIA	Environmental Impact Assessment
EIT	Enterprise Income Tax
EJV	Equity Join Venture
EOR	Exporter of Record
EPB	Environmental Protection Bureau
Ex Works	Directly from the supplier, not including transportation, all costs for the buyer (INCOTERM)
FCPA	Foreign Corrupt Practices Act
FDA	Food and Drug Administration bureau
FIE	Foreign Invested Enterprise
FICE	Foreign Invested Commercial Enterprise
FIT	Flanders Investment and Trade
FOB	Free On Board
FRBE	Financial Regulation for Business Enterprises
GAC	General Administration of Customs
GDP	Gross Domestic Product
GS	German Safety Certification

IAS	International Accountancy Standards
ICBC	Industrial and Commercial Bank of China
IFRS	International Financial Reporting Standard
IP	Intellectual Property
IIT	Individual Income Tax
ILO	International Labour Organisation
IOR	Importer of Record
IP(R)	Intellectual Property (Rights)
IPO	Initial Public Offering
JV	Joint Venture
KMT	Kuo Min Tang (Republican Party in China, later Taiwan)
KPIs	Key Performance Indicators
L/C	Letter of Credit
LLC	Limited Liability Company
LOI	Letter of Intent
MEP	Ministry of Environmental Protection
M&A	Merger and Acquisitions
MNCs	Multinational Companies
MOFCOM	Ministry of Commerce
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
MOU	Memorandum of Understanding
O/A	Open Account
OEM	Original Equipment Manufacturer
PAR	Project Application Report

PBOC	People's Bank of China
PRC	People's Republic of China
PSB	Public Security Bureau
PSI	Pre-shipment Inspection
RC	Registered Capital
REACH	Registration, Evaluation, Authorization and Restriction of Chemicals EU Directive 2002/95
RMB	Renminbi or Yuan, Chinese currency
RO	Representative Office
RoHS	EU Directive 2002/95, restricts the use of hazardous materials in electrical and electronic equipment
RPF	Request For Proposal
SAIC	State Administration of Industry and Commerce
SAFE	State Administration of Foreign Exchange
SAT	State Administration Taxation
SAWS	State Administration of Work Safety
SME	Small and Medium Enterprise
SOE	State-owned Enterprise
STA	Special Tax Adjustment
TP	Transfer Pricing
TT	Telegraphic Transfer
USP	Unique Selling Proposition
VAT	Value Added Tax
WFOE	Wholly Foreign Owned Enterprise
WTO	World Trade Organisation

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CHAPTER 17
BENELUX CONTACTS IN CHINA

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