Doing Business in China
Part 1-Why Do Business with China Anyway?

I have written this article to try to give the reader some of my acquired knowledge about "Doing Business in China" that I have gained over the last 10 years. This is article is Part 1 of a series of three article to be published in Recharge Asia magazine. The articles are designed to give the reader interested in doing business in China base information and a point from which to start working on that objective.

In recent years the World has beaten a path to the door of China to do business. The World has seen great opportunities in China, to create working arrangements of different types, to take advantage of the latent capacity of China for economic manufacturing and provision of goods to the Global marketplace. Historically, China was one of the great trading nations of the World over 200 years ago. The legacy of new developments in China throughout history are many - paper making, gunpowder, porcelain and china, etc. The Chinese Empire declined rapidly in the 1800s as it failed to keep pace with the technological progress in Europe. After successive intrusions in the 1800s and early 1900s into China's geopolitics by external forces China became a weakened republic. In the past several decades, the end of internal strife and closed policies of the past have opened the avenues for China and the World to press forward and prosper together.

Why do business in China any way? Well, certainly the potential of the domestic market is enormous. The change in the lifestyle of the population from a substantially agrarian to modern industrialized society has increased the demand for modern conveniences that were for so long absent from China. The official population count is 1.325 billion people. The population is increasing by about 12-13 million per year (the current population of Pennsylvania or Belgium), a net increase of population of 1 person per 2.6 seconds. The balance between urban and rural population is changing rapidly with development and growth of smaller cities and migration of population from the country to the cities. The current split of population is urban, 42.99% and rural 57.01%. Most of the urban population lives in the East and the South. The vastness of China is notable. The country has an area of 9.6 million square km. Even though the official language is Mandarin, or Putonghua, the dialect more commonly spoken around the greater Beijing area there are numerous other dialects spoken in different parts of China. The most common are Cantonese and Shanghainese. In fact there are over 70 dialects nationwide.

As is well known, China is a rapidly rising global economic power. The overall growth has averaged a robust 7% to 8% for more than a decade and the GDP growth for 2007 was of 10.7 percent and that for 2008 is predicted to be 10.1% and 9.2% in 2009. Last year there was a 6% rise in trade surplus, to a total of S$189 billion in 2007 with the rest of the world. Total exports in 2007 hit US$1.147 trillion dollars, up 18 percent from 2006. This was a decrease in growth from the rate in the previous year, attributed to the general slowdown in the global economy. Imports rose 20 percent at the same growth rate as in 2006 to US$958 billion. Retail sales in 2007 rose by 13% to 9.15 trillion Yuan (US$1.22 trillion.)

China’s joining of World Trade Organization (WTO) is critical step for the country’s future development. China officially joined the WTO on 11 December 2001. This move has great significance for the country’s economy and the future of global trade.

Establishment of a Socialist Market Economy

China has changed from its centrally controlled market to one of a socialist market economic system. The pattern has been formed in which public sector plays main role alongside non-public sectors, such as individual and private companies, to achieve common development. According to plan, China is forecast to have completed its change to a socialist market economy by 2010.

China’s economy developed at an unprecedented rate. China's accession to the WTO will bring both opportunities and challenges to the country's employment market. Employment opportunities in agriculture will decrease sharply, while volume in tertiary industry is expected to grow dramatically. Secondary industry, job opportunities will increase in some sectors. Industries, including computers and IT products, automobiles, electronics, petrochemicals, steel and machinery, were started late in China and are not very developed or competitive and are more likely to be badly influenced.

China and the WTO

China has agreed to implement systemic reforms designed to establish a more transparent and predictable regime for business dealings. China also made a commitment that will help foster predictability in business dealings. China's WTO accession agreement will help U.S. companies doing business in China by addressing many of the trade restrictions and problems U.S. firms have experienced. The following are a few highlights of the agreement:

1. China's import licensing system can no longer function as a trade barrier. Importation and Investment Approvals can no longer be conditioned on whether competing domestic suppliers exist or on performance requirements of any kind.
2. China agreed to only impose, apply or enforce laws, regulations or other measures relating to the transfer of technology consistent with WTO Agreement on Trade-related Investment Measures.
3. In line with WTO Technical Barriers to Trade (TBT) Agreement, China cannot use technical regulations, standards and conformity assessment procedures as obstacles to trade. China will now base technical regulations on international standards.
4. China committed to significantly reduce tariffs on industrial products. China's industrial tariffs declined from a 1997 average of 25 percent to 8.9 percent by January 1, 2005. For a few products, reductions will continue until 2010.
5. China completely eliminated tariffs on beer, furniture and toys. (1997 tariffs averaged 70 percent, 22 percent and 23 percent, respectively.) Other products to be reduced are: cosmetics, distilled spirits, medical equipment, motor vehicles, paper products, scientific equipment and textiles.

6. China the joined Information Technology Agreement (ITA) and eliminated tariffs on products under ITA January 1, 2005.
7. China's implementation of WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPs) is important step toward improving intellectual property environment.
8. China has made steady progress in improving its intellectual property regime. However the World looks to China for continued improvement concerning enforcement of intellectual property rights. Full implementation of the TRIPs Agreement will continue those efforts and further enhance China's development of intellectual property protection, particularly for the high-tech industries.

<u>Chinese Business Opportunities</u>

Everybody knows that industries have moved and continue to move from Western countries to China and most people believe that they know why too. Compared to the West labor costs are low, facilities costs are low and, at the moment, regulatory controls on operations of manufacturing are less stringent than in other countries. These things are subject to change. If one conducts a SWOT analysis the opportunity to conduct business in China shows the following:

<u>Strengths</u>

1. Available lower cost labor
2. Available technically competent workforce
3. Favorable national, provincial and local governmental incentives for foreign investors providing employment and export opportunities to China
4. Stable investment environment compared to many other countries
5. More joint venture partnerships with foreign companies improves the knowledge base, quality and pricing, by increasing competition

<u>Weaknesses</u>

6. Work environment of the last 50+ years has given the older workforce a “mindset” work attitude rather than one of adaptability and the development of skills
7. Despite Government attempts to eradicate them there are still too many counterfeit products produced and sold
8. Without a reliable local Chinese partner the supply chain into the domestic market and to factories is too long to manage
9. In the imaging supplies industry there is a ready willingness of suppliers to sell compatible infringing products without any attempts to redesign

<u>Opportunities</u>

10. Despite 9. above, there is today better awareness and acceptance of intellectual property rights and this will continue to improve in future
11. There are more standards being introduced and adopted in all industries in China – product safety, performance and environmental
12. As the industrial infrastructure including banking continues to improve, the secure ability to reinvest profit into China is becoming a comfortable reality

13. With more investments and material encouragement under the National Government 11th 5 Year Plan there will be an acceleration of local R&D into new products, innovation and technology

Threats

1. We have over recent years already seen a lot of bad publicity of accusations of dumping, quality and safety issues which are reflected in Global customer perceptions
2. China needs to avoid becoming a victim of its own success – inflation, rising operational costs, instability resulting from growing disparity in wealth regionally and demographically
3. The growing attraction to investors of other areas in Asia as strong alternatives, with lower costs and similar advantages

What are the different options of how to enter business in China?

There are a number of different ways to enter business in China. The choice made would depend on size, type of business and the corporate objectives of any company. The most popular alternatives are as follows:

Licensing

Technology transfer is an initial market entry approach used by many companies. It offers short-term profits but runs the risk of creating long-term competitors.

Franchising

China is developing laws that specifically address franchising. Virtually all foreign companies who operate multiple-outlet retail venues either manage the retail operations themselves with Chinese partners (typically with a different partner in each major city) or sell to a master franchisee that then leases out and oversees several franchise territories.

E-commerce

The E-commerce environment is still fairly immature due to the lack of defined regulatory powers over the industry, effective Chinese certificate authentication systems, secure and reliable on-line settlement systems, and an efficient physical delivery system.

Trading Companies

With careful selection, training and constant contact, U.S. firms can obtain good market representation from a Chinese trading company, many of which are authorized to deal in a wide range of products.

Local Agents

China is witnessing an explosion in local sales agents who handle internal distribution and marketing. Most of these firms do not have import/export authorization, and must work with a licensed Chinese importer. Although they add a link to the distribution chain, agents offer relatively low-risk local market representation.

Representative Office

A representative office is just a subsidiary of a foreign company in China. Representative offices are the easiest type of offices for foreign firms to set up in China, but they are limited by law to performing liaison activities and must not engage in any trading or business activities directly or on behalf of the parent company.

Joint Venture

A joint venture is usually established to exploit the market knowledge, preferential market treatment, and manufacturing capability of the Chinese partner along with the technology, manufacturing know-how and marketing experience of the foreign partner. To be successful such joint ventures require good partners, time and patience. In JVs constant monitoring of critical areas such as finance, personnel and basic operations is needed. There are two types of JVs:

1. Sino-Overseas Equity Joint Ventures (EJV).
2. Sino-Overseas Cooperative Joint Venture (CJV)

The major difference between an EJV and a CJV is that the investment of foreign investors in a CJV does not need to be converted into shares or even if the investment is converted into shares, the distribution of profit, the bearing of risk, the sharing of liability and the assignment of property do not need to be decided on the basis of the shares of investors. Moreover, investment payback ways and administration in a CJV is more flexible.

Wholly Owned Foreign Enterprise (WOFE)

These are 100% foreign owned companies, originally developed for the specific purpose of encouraging foreign investment in manufacturing for export in Special Economic Zones (SEZs) in China. The establishment of a WOFE (usually said as “woofy”), avoids import restrictions-including relatively high tariffs-and provides greater control over both marketing and management. These entities can now, since recent changes in regulations, trade within China and sell wholly foreign manufactured goods in China. The establishment of a WFOE helps retain greater management control and IPR protection. The laws related to WOFEs require that these companies either provide advanced technology or be primarily export-oriented. There has been the restriction of the prohibition of WOFEs operating in a number of service and public utility sectors, but there promises to be some change of this in the future.

Will the Venture be Successful?

Why some foreign-funded enterprise became successful when entering the China market while others fail, and why some grow relatively faster than the rest? The reasons why can be very complex and are certainly varied. There are factors that can determine how well or badly a foreign enterprise will do in China. They include such factors as the enterprise's development strategy. In China to be successful foreign-funded enterprises need to implement long-term development strategies. Adopting a long-term outlook for the business is important. Only concentrating on short-term gains is a mistake because the creation of a profitable, stable and long lasting business takes not only money and other resources but also time. In addition to the adoption of such long term development strategies, the strategy also needs to be a flexible one, as market conditions are constantly changing due to globalization. The leadership of the top management of the company also plays a pivotal role in the success of the company. In the face of many business pressures including greater competition brought about by globalization, management today needs to possess stronger judgment, decision ability, adaptability and greater foresight to ensure business success. The ability to look over the business horizon is crucial in order to be ready at all times to react to any changes. Forging a concept of competitiveness of the enterprise so that it will grow together with the economy is also important. Treating the company staff with an open attitude while cultivating core values in the enterprise values, creating a corporate vision and communicating this to the workforce fosters an important togetherness within the organization. This is important to enhancing and maintaining the organization's strengths. It is vital for an organization to have a strong organization structure dealing with its cash flow, flow of information and manpower movement in order to ensure its success in China. Foreign-funded enterprises must understand China's culture, especially regarding the culture of Guangxi. With a good relationship, business can become smoother and probability of failure will be greatly reduced. Stronger bonds can also be built with the customers, suppliers and partners.

Part 2 of this series of articles will deal with "Tips on How to do Business in China" including all those things you need to know about creating a network of relationships in business.