China Business Handbook 2016

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www.cbbc.org
Foreword: Stephen Phillips

It is my great pleasure to introduce the China Business Handbook 2016, in which British businesses seeking guidance on the Chinese market will find a wealth of practical advice and expertise informed by the experience of experts from the China-Britain Business Council (CBBC) and CBBC members already doing business in China.

CBBC, which has over 60 years of first-hand experience in the Chinese market, is the leading organisation which helps British companies to develop their business with China. We have 11 offices in the UK and 13 across key locations in China, and we work in close partnership with UK Trade & Investment and the Foreign & Commonwealth Office.

As business relations between our two countries go from strength to strength, there has never been a better time for British or Chinese companies to make use of the support offered by CBBC and the wider network of UK organisations. What is more, China is changing and new opportunities are emerging in different sectors and different parts of the country. The team at CBBC work hard to ensure we keep abreast of these developments to help British business.

CBBC and our base of nearly 1,000 members can provide authoritative advice for anyone wanting to know about the ever-expanding and changing opportunities in China. The wide variety of practical support and guidance we offer to British companies is only an email or telephone call away, be it to the UK or to any of our offices across China.

CBBC’s China Business Handbook has been launched to coincide with the much-anticipated state visit to the UK of Chinese President Xi Jinping. I am sure this visit – and those in the future – will further spur on bilateral trade and investment.

I would like to extend special thanks to all of the CBBC members who have contributed to this excellent handbook. It will be a valuable reference for companies thinking of trading with China for the first time, as well as for those experienced ‘China hands’ who would like to know more about specific business issues, such is the breadth of the topics covered. I hope you find it an instructive read, and we welcome any feedback.

Stephen Phillips,
Chief Executive
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About this Handbook

The China Business Handbook 2016, written by the China-Britain Business Council with extensive contributions from our member companies in their specialist fields, is an encyclopaedic collection of information and advice.

You will find in-depth, practical tips on a range of the most common issues companies face when doing business in China, from general operational considerations to accounting, legal matters, taxation, HR, due diligence, property, trade regulations and more. We hope it is just as instructive for companies with prior experience of China as for companies looking at this vast and diverse market for the first time.

The handbook is best seen as a guide to dip into as circumstances arise, rather than as a tome to be read cover-to-cover. It is designed so that readers can easily find the relevant chapter to solve the issue they happen to be facing. Broadly we cover the following:

- **Chapter 1 – China Business Environment.** The first chapter sets the scene for all overseas companies. It sets out the latest macro developments and trends with the intention of helping UK companies to understand some of the overriding issues which will affect their business operations in China.

- **Chapter 2 – Trading with China: Exporting & China Supply Chain.** The second chapter provides UK exporters with an outline of the main routes to find and reach clients in the Chinese market, as well as the key strategic considerations for companies whose supply chain includes China. We also discuss new developments in areas such as pilot free trade zones, Chinese ports, payment transfers, and practical tips on how to prepare for business travel in China.

- **Chapter 3 – Incorporation & Operating Businesses in China.** The third chapter gives an introduction and practical considerations for companies thinking about setting up and operating a business in China. This includes different legal entities and tax implications, the rental market, marketing and HR issues, and also some useful case studies for illustration.

- **Chapter 4 – Protecting your Business Interests.** The fourth chapter will help companies trading with and operating in China to understand some of the challenges of the business environment, and to mitigate risks to their business interests. This includes due diligence, the use of contracts and dispute resolution options, cybersecurity, as well as intellectual property protection and enforcement.

Our China Business Handbook is an annual publication, which enables our members to keep up with the very latest developments in this dynamic and exciting market.

We welcome enquiries from members who would like to contribute to, or suggest ideas for, the 2017 publication. Please contact Chief Editor Mick Ryan at: michael.ryan@cbbc.org.cn

This handbook is designed so that readers can easily find the relevant chapter to solve the issue they happen to be facing. It’s not a tome to be read cover-to-cover
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Chapter 1 sets the scene. As an introduction to the rest of this handbook it sets out some of the macro developments and trends which shape the business environment, with the intention of helping UK companies to understand some of the overarching issues which will affect their trade and business operations in China.

In the first section of Chapter 1 we put China’s remarkable re-emergence as an economic power into context, and look at how recent slowing growth is changing the economy, but does not fundamentally undermine the rising demand for UK goods and services. To the contrary today’s China more than ever needs and wants what the UK has to offer. We then examine how the economy is transforming, key policies and drivers which influence it and some of the challenges which China is facing.

The second section focuses on the increasing economic interdependence between China and the UK, both in terms of the volumes and predominant forms of bilateral trade taking place, and the investment flows which generate jobs and growth.

In the third section we discuss two major long-term initiatives through which the Chinese government aims to take the economy to the next stage of growth: “Made in China 2025” and “One Belt One Road”.

The last two sections of this introductory chapter focus on UK government and CBBC’s work in China on behalf of British companies. We start by showing how the improved political relationship has led to the state visit to the UK of Chinese President Xi Jinping. Then we look at strategic projects to position the UK an integral part of China’s economic development and transformation. Finally we outline the support which is available for UK companies starting up or operating in China, including the FCO’s and CBBC’s regional networks across China.
China’s Inexorable Rise

1980s to Present: China’s Return to Prominence

Since the implementation of the ‘Reform and Opening Up’ policies which started in late 1978, China has experienced rapid economic development. Since then, growth in the Gross Domestic Product (GDP) has averaged nearly 10%, peaking in 2007 at 14.2%. Today China has become the second largest economy in the world behind the US.

Despite slower economic growth in recent years, partly as a result of the global financial and economic crisis, in 2014 China’s GDP still grew by 7.4%, bringing it to a historic high. The Chinese government expects GDP growth in 2015 to be around 7%.

These changes have made China a major economic powerhouse for Asia and the world.

There was media interest in late 2014 when International Monetary Fund (IMF) figures showed that the size of the Chinese economy had overtaken that of the US when measured by Purchasing Power Parity (PPP).

However, even using the more common Nominal GDP (as in the graph above), it is clear that China continues to grow, and that it has arrived as a major power in the world economy.
Overall, there has never been a better time to export to China and this will continue to be the case as China’s proportional contribution to world GDP grows.

**Economic Slowdown**

The slowdown in GDP growth to 7% has been widely reported as a dramatic shift from the country’s past performance, which saw growth rates consistently exceed 10%. Yet the effects of this lower rate of growth should not deter any business looking to enter the Chinese market. The increase of China’s GDP in absolute terms still makes China very attractive to foreign businesses that want to export there.

Professor Danny Quah of the London School of Economics, in an article for independent think tank the Brookings Institution in February 2015, gave a considered analysis of China’s new growth rates when considering it in absolute terms. In 2005, when China was growing at around 12%, it was equivalent to an annual increase in GDP of USD 274 billion (China’s GDP then was USD 2.3 trillion). This increase represents the potential market for an exporter. Using the same principle applied to China today with its GDP of USD 11.3 trillion, a 7% growth in 2015 represents a GDP increase of USD 790 billion. This is almost three times greater than the absolute growth in 2005.

Overall, there has never been a better time to export to China and this will continue to be the case as China’s proportional contribution to world GDP grows.

**New Normal**

Changes to China’s business environment are nothing new, but the overall direction has for a long time been growth, growth and more growth. The direction is changing. At the 2015 World Economic Forum in Davos, Premier Li Keqiang told the world of a new focus – a “New Normal” of “higher-quality growth for the long run” – in exchange for which China is willing to accept lower overall GDP growth.

With rising wages and a decreasing working population, China is taking steps to move away from labour-intensive cheap exports, which are susceptible to shocks in global demand. Rather, China will seek to rebalance towards a more highly mechanised and service-oriented economy, with a heightened reliance on domestic demand and added emphasis on environmental sustainability.

**China Outbound**

In order to move away from low cost export manufacturing and towards a longer term vision for sustained economic growth, one strategy the Chinese government is pursuing is promoting investment around the world in companies, infrastructure projects, energy and other assets.

China’s outbound Foreign Direct Investment (FDI) amounted to USD 116 million in 2014 – an increase of 15.5% over the previous year. For the first time ever, China has become a net capital exporter.

This is good news for the UK, which is Europe’s most attractive destination for Chinese investment. In 2014, the UK received USD 5.1 billion of Chinese investment, more than any other EU country with the exception of Luxembourg, and nearly 30% of Europe’s total.

**RMB Internationalisation**

The Chinese government has been prioritising financial sector reform since the Communist Party’s Third Plenum policy session in November 2013. This has had a number of key themes, including interest rate and capital account liberalisation and the much-touted internationalisation of the renminbi (RMB). These are broadly speaking one interconnected nexus of how to use the currency to greater effect in national development, and allow the RMB to be an active mechanism for growth, trade and diplomacy.

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China already has a semi-porous exchange rate. The number of “taps” is extensive: R/QDII and R/QFII were some of the first reforms to be introduced, alongside the major central bank swaps. In the last half year we have seen this supplemented first by the Shanghai-Hong Kong Stock Connect, followed by the mooted introduction of QDII2 and eventually Mutual Fund Recognition (MFR). Between all of these, RMB is available more easily than ever before in the capital markets or for foreign companies in the real economy, including the availability and usage of cheaper offshore RMB sources. However, it is worth bearing in mind that taps can be turned off as easily as they were turned on.

The purpose of RMB internationalisation is manifold too. First is the security, which comes with having a reserve currency, and the eventual ability to print money with minimised inflation. Secondly, there are reduced business costs for companies as they begin to use RMB instead of the dollar for trade in distant lands. Lastly there is the profile and “face”, most notably in the clear recent drive to embrace the RMB into the IMF’s Special Drawing Rights mechanism. The whole concept will play a part in related initiatives also, such as the One Belt One Road push westward and is likely to continue as a central concern for the Chinese government.

**Changing FDI Laws**

China has been undergoing reform in its FDI policy and the consultation process shows welcome signs that the private sector – including foreign entities - is being listened to. But the pace of reform could, instead should, be faster. Further reforms many include increased use of the “negative list” system which has been used so far for the pilot free trade zones. In Shanghai in particular, a number of successful pilots involving RMB, such as cross-border RMB pooling, have now been rolled out across the country; the industry awaits the next round of reforms, such as cross-border FX pooling (non-RMB), cross-border e-commerce RMB settlement and RMB gold trading. Likewise ownership restrictions have been lifted for certain niche businesses such as foreign-owned hospital and recruitment firms.

**Infrastructure Investment Funding**

The World Bank has estimated that the demand for infrastructure financing in Asia is around USD 800 billion per year, but the World Bank and the Asian Development Bank can only provide in the region of USD 30 billion per year, which leaves the the way open for infrastructure investment from other institutions. Partly in response to this, China launched two such in late 2014: the Asian Infrastructure Investment Bank (AIIB) and the Silk Road Fund.
In 2015, the State Council unveiled a national plan, ‘Made in China 2025’, which sets a new course for Chinese manufacturing in the next decade.

The AIIB, which is expected to be in operation by the end of 2015, has initial capital of USD 100 billion, with China providing USD 50 billion and the remaining funds contributed by other members, of which it is expected to have 57, including the UK. China will spearhead the bank. As the first major Western country to apply to join, the UK is in a good position to participate in rule-making.

The USD 40 billion Silk Road Fund has been positioned as a medium-to-long term development fund that places emphasis on investment opportunities and providing financing and investment services. The development of infrastructure such as railways, roads and pipelines is at the top of its agenda. The Silk Road Fund is open to investors from outside China, and sub-funds are expected to be established to attract more international cooperation.

One Belt One Road

‘One Belt One Road’ (OBOR) is an initiative which was launched by President Xi Jinping in 2013 to focus on improving and creating new trading routes, links and business opportunities between China, passing through over 60 countries along the way, across Asia, Europe, the Middle East and Africa. It comprises the Silk Road Economic Belt – a land route connecting China with Western Europe and South-East Asia – and the 21st Century Maritime Silk Road, a sea route which runs west from China’s east coast to Europe through the South China Sea and the Indian Ocean.

OBOR is expected to help China realise its ‘Going Out’ strategy, opening up new markets for some of China’s industrial overcapacity, creating new markets for export, ensuring energy security for the country, and bringing new investment to underdeveloped areas, while at the same time strengthening China’s regional political and economic influence. There is a full section on OBOR later in this chapter.

Made in China 2025

In 2015, the State Council unveiled a national plan, ‘Made in China 2025’, which sets a new course for Chinese manufacturing in the next decade. The aim is to produce more advanced technology and products with less environmental damage and enhanced use of the Internet for intelligent manufacturing, with a view to improving international competitiveness and the long-term prospects of Chinese equipment exporters.

The State Council has also announced a special fund of USD 6.2 billion (RMB 40 billion) to support emerging industries, and to encourage private equity for small and medium-sized companies.

Global Industrial Capacity Building

The government’s next Five-Year Plan (2016-2020), to be published in late 2015, will set out its priorities, targets and guidelines for a range of social, economic and environmental issues. A key theme is “global industrial capacity building”, which refers to China working with developed and developing countries to maximise global capacity and productivity. New initiatives are expected to emerge to enable China to capitalise upon complementarities between its capacity and economies of scale in some industries and markets, and the operational and technological capabilities of developed countries, while it seeks also to maximise the potential of partnerships with developing countries.
Challenges and Changes in the Economy

Middle Income Trap

Since 2010 China has been an “upper middle income” country, according to the World Bank’s classification based on per capita gross national income. However, with the slowing GDP growth some wonder if it will follow the path of many other developing economies into the ‘middle income trap’.4

In addition to its decelerating economic growth, according to McKinsey5 China’s debt burden has soared to 280% of GDP. The government is thought to have the resources to solve this – but not indefinitely, hence recent reforms to make local governments take more responsibility and, through initiatives such as the debt-for-bonds swap, to subject them to market discipline.

Rising Labour Costs & Ageing Population

China’s rising labour costs have started to cause difficulties for its exporters, and they are also making it harder to sustain the construction and manufacturing sectors, which have been the key engines of growth so far. The relatively high inflation seen since 2011 seems to have dissipated but there is no doubt that costs for companies are higher today than they ever have been, not least in the crowded coastal provinces. The situation is brighter inland and in the west of the country, where the government has been encouraging growth, based often on higher levels of surplus labour.

Furthermore, China’s population is ageing before it has become a developed country. In 2012, China for the first time recorded an absolute decrease in its working-age population (aged 15-59), of 3.5 million, and this is estimated to shrink by another 200 million before 2050. The over-60s demographic has on the other hand has grown by an average of 10 million a year since 2010 to 220 million (18% of total population). By 2050, The Economist magazine estimates that there are likely to be just 2.5 working-age (income tax paying) adults for every person over 65, down from eight today.

Stock Market & Property Prices

As a consequence of its investment-led growth, China has a number of sectors which are commonly perceived as bubbles. The most reported of these is the property market – particularly in the key urban centres of Beijing and Shanghai – which has seen prices increase substantially over the last decade, although there has been a levelling off in recent years. Pricing in these cities is now approaching those of major international property destinations such as London, Hong Kong and Tokyo. Given the preponderance of savings and real estate investment amongst the Chinese population, it is not immediately obvious that this will see any relief in the near term.

One of the major problems has been the lack of investment alternatives for China’s new urban middle classes, for whom property remains a natural option. More recently, the government has attempted to expand the choices available by encouraging the growth of domestic securities, and specifically the stock market. This in turn has led to a second, more recent bubble in the Shanghai and Shenzhen indices, which became clearly overvalued before the recent downturn. Realistically, much change is still required here before the inherent issues with Chinese valuations are solved, including the greater involvement of institutional investors. However in the meantime, a very small proportion of corporate funding is done through the stock market and a very small proportion of the population has direct or indirect exposure to it.

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4 Middle income trap occurs when a country’s growth slows and eventually plateaus after reaching a middle income level.
5 www.mckinsey.com/insights/economic_studies/debt_and_not_much_deleveraging
Corruption Clampdown

Since assuming office in 2012, President Xi Jinping has spearheaded a significant anti-bribery campaign in China. The initial focus was on corrupt officials and resulted in over 180,000 government officials being “disciplined” in 2013 alone. More recently however the campaign has expanded to members of state owned and private companies as well, and it is having a profound impact on business conduct in China.

One side effect is that government officials are proving hesitant to make potentially risky decisions such as the approval of new investment and procurement projects. Investment bank Merrill Lynch has estimated that the campaign may have cost the economy more than USD 100 billion in 2014 alone, possibly including a 0.6% fall in the country’s investment-driven GDP.

While anti-corruption efforts may negatively affect business efficiency and investment led growth in the short term, in the long term they should help China unleash the potential of private investment and create better conditions for long term growth.

Changing Import Mix

Having grown at an average of 13% per year from 2007 to 2013, import growth all but halted in 2014, and in the first half of 2015 imports have fallen quite significantly – 15%. At a macro level this turnaround is by and large a result of a fall in commodity prices (China is a major importer of raw materials); but also because of slowing investment growth (China has the world’s highest investment-GDP ratio) and slowing GDP growth.

But the macro figures mask huge variances by sector and geography. It is therefore important for UK exporters to get granular, and to understand that there has also been a change in the type of products China is importing and the direction of travel. There is still an increasing hunger for imported consumer goods amongst China’s middle income demographic, especially beyond the developed coastal cities, and purchases are increasingly conducted online – the Chinese government predicts the online retail market will expand by 30% in 2016.

China’s Future Role in the New World Order

The fundamentals of the Chinese economy remain strong, as the economy goes through the transition needed to continue its development. China’s GDP already makes it the second most important economy in the world and it continues to grow.

China’s investments around the world and new-found buying power to import goods are not only having an impact on the macro level, but also make a difference to companies in the UK, large and small. As the Chinese middle class grows, demand for high quality goods and services of the kind that are produced in the UK will continue to increase, which is good news for British exporters. As for companies which should be attractive to Chinese investors, it is important to start thinking about what that might mean for your business.

CBBC believes that there has never been a more opportune time to begin doing business in China. For any companies wishing to make use of that opportunity this guide provides a basis to take the first steps towards profiting from this huge and dynamic market.
1.2 UK-China Trade & Economic Interdependence

Unprecedented Trade Volumes

In 2014, bilateral trade of goods between China and the UK reached GBP 50 billion. This was an increase of 15% on the previous year, with UK exports increasing by 37%, and UK imports from China increasing by 7%.

Within the first six months of 2015, UK exports to China increased to GBP 9 billion (a 20% increase on the first half of 2014). China now accounts for 13.3% of all UK non-EU exports and 5.9% of all UK global exports, and is a bigger market for UK exports than France, Ireland or the Netherlands.

The Import and Export Mix

UK imports from China rose in the first six months of 2015 to GBP 16.7 billion from GBP 15.3 billion in 2014. There is a marked difference between the commodities which China exports to the UK and those the UK exports to China. Whereas UK exports are dominated by engineering and healthcare, imports are dominated by consumer goods such as clothing, furniture and domestic appliances.

Other notable commodity sectors exported by the UK to China include mechanical and electrical machinery, power generating machinery and pharmaceuticals. Their prevalence explains regional variations in exporting, whereby the Midlands alone accounts for nearly half of UK exports.

It is worth noting too that the mix is changing. In 2013, for example, passenger vehicles made up 37.5% of all UK exports to China – valued at GBP 4.4 billion. Despite this figure increasing by GBP 1.1 billion to GBP 5.5 billion in 2014, however, the share of overall exports accountable to passenger vehicles fell to 34.9%.

Source – HM Revenue & Customs – Note: UK exports are valued on an FOB UK port basis whereas imports from China to the UK are based on CIF UK port and as such include freight costs to the UK and other ancillary charges. For this section about British trade we quote in GBP. As of 1 April 2015 GBP 1 = USD 1.48 = RMB 9.2
The UK’s export successes follow established trends within the Chinese economy such as encouragement for Chinese manufacturers to up-skill their manufacturing processes or policies which have created competition within social services such as healthcare and education.

Increasing Interdependence
The importance to the UK of our trading relationship with China can best be seen when we consider that China is now the UK’s third largest trading partner after the US and Germany.

Although the balance of trade remains in China’s favour, with the volume of UK exports to China since 2010 increasing at a much faster rate than imports, the trade gap has been closing. In the early 2000s China exported to the UK five times more than the UK exported to China – now this has fallen to double.
Key Trends Going Forward

Looking to the future it is important to consider the areas of current growth. The decline of China’s overall GDP growth figures, from the heady heights of double digit growth to a ‘new normal’ level of 5-7% annual growth, can be rationalised by certain factors such as export figures, population stabilisation, and changes in economic drivers in different regions. Just as current exports from the UK have followed Chinese government policy for Chinese industry and society, the next big market opportunities will follow the most recent government policies.

One area that has seen rapid growth in recent years is consumer spending on domestic items. Following government encouragement to expand the domestic consumer market, in the last two years, China’s retail sales of consumer goods have risen 29% to GBP 2.3 trillion and now amount to three times the size of the UK’s consumer goods market. With Chinese household savings deposits growing at the same rate there is clear stability in the rate of growth of retail expenditure.

A record number of Chinese students – 58,810 – newly enrolled in the UK in 2014. This was up 4% on the previous year and up 59% on 2009. Chinese students enrolling at UK universities now outnumber those from the rest of the EU combined. Considering university fees and living expenses, Chinese students bring up to GBP 5 billion each year to the UK economy.

The Great British Brands Festival

CBBC’s Great British Brands Festival series enables British retailers to sell UK products directly to Chinese shoppers through high-profile sales exhibitions. With 10-day to three-week festivals in eight Chinese cities in 2015, and more festivals planned, 2016 will be unrivalled opportunity for established companies or those new to China to showcase and sell their products.

To find out more please visit www.GBBF.uk
China’s investments overseas, driven by sovereign wealth funds, state owned enterprises and increasingly the private sector, are making an impact in the UK. Over the past five years Chinese investment into the UK has grown at an average rate of 85%. In 2014, Chinese investment in the UK reached GBP 3.4 billion – more than into any other major EU country - and accounted for nearly 30% of all Chinese investment into the EU.

Attracted by the stability of the UK economy, world class financial and professional services, London’s position as a leading global financial centre, and openness from both industry and government, Chinese investors are increasingly positive about the UK. A greater understanding of the UK’s regional skills, economic demands, investment potential and connectivity within the UK and Europe has led to Chinese investors setting up in the UK in sectors such as finance, ICT, automotive and retail, with the potential of more investment in large public infrastructure projects in energy and transport sectors.

Bilateral investment, in addition to opening new markets and developing new skills and technology, also brings jobs and private wealth to each local economy. For example, in the last four years, Chinese investment in the Midlands has created and secured over 5,000 jobs directly and within the UK’s manufacturing supply chain. The same is true of UK investors in China, such as Jaguar Land Rover, GKN and Rolls-Royce.

Investment from companies who operate internationally or globally also draws smaller companies into global markets. This can be seen not only in engineering related operations but financial and professional services, design, retail and healthcare. With China’s ‘Going Global’ initiative, and more recently ‘One Belt, One Road’, which both encourage Chinese enterprises to operate overseas, the scope for British companies of all sizes to partner with China is increasing and will continue to grow.

China Outbound

CBBC’s China Outbound programme is a far-reaching platform enabling UK companies to partner with Chinese companies going global – perhaps the defining trade and investment trend of our times.

Each year CBBC organises a flagship China Outbound Conference in Beijing, as well as a series of focused seminars in key cities across China.

For further information please see www.ChinaOutbound.org

China’s retail sales of consumer goods have risen 29% to GBP 2.3 trillion
1.3 Long-term Transformation: Made in China 2025 & One Belt One Road

Made in China 2025

The “Made in China 2025” plan was released by the Chinese government in May 2015. It is part of a long-term vision for the future of China’s manufacturing sectors with “Three Steps” intended to continue to make China into one of the world’s manufacturing powers.

**Step 1:**
By 2020 – further strengthen China’s position as a major manufacturing nation; master key technologies in selected important fields; raise the standard of smart manufacturing; and markedly reduce consumption and emissions.

By 2025 – improve the all-round quality of manufacturing sectors and the integration of industry and IT; substantial focus on energy consumption, material consumption and emissions in line with advanced global levels; establish a group of competitive multinational companies to significantly elevate China’s role and position in global industry and value chains.

**Step 2:**
By 2035 – raise China to a mid-ranking position among the most powerful manufacturing nations; substantially increase innovation; develop key sectors to realise important breakthroughs; make China a leading player in worldwide innovation; and complete China’s industrialisation.
By 2049 – China to be among in the leading ranks of the world’s most powerful manufacturing nations; in the main industrial sectors enable China to drive innovation and possess distinct competitive advantages

**Step 3:**
By 2049 – China to be among in the leading ranks of the world’s most powerful manufacturing nations; in the main industrial sectors enable China to drive innovation and possess distinct competitive advantages; and form world-leading technological and industrial systems.

The Made in China 2025 plan highlights ten key sub-sectors, all highly pertinent to UK expertise:

- Integrated circuits and professional equipment
- High-end numerical-control machine tools and robotics
- Aviation and aerospace equipment
- Marine engineering equipment and high-tech ships
- Advanced rail transit equipment
- Low-energy and new-energy cars
- Electronic equipment
- Agricultural machinery
- New materials
- Biopharmaceuticals and high-performance medical equipment

The plan highlights five major objectives:

1. **Establishing Manufacturing Innovation Centres**
   By 2020, China will establish around 15 such centres to boost technological breakthroughs and innovation in key fields, chief among which are new-generation IT, smart manufacturing, additive manufacturing, materials manufacturing, new materials and biopharmaceuticals.

2. **Encouraging Smart Manufacturing Projects**
   Outstanding companies will be involved in setting up smart projects or digital factories to promote smart techniques in key industrial processes, to robotise key posts, to oversee the optimal use of smart techniques in the production process, and to optimise the supply chain.

3. **Investing in Strong Industrial Bases**
   Research centres known as the “Four Bases” are being mapped out and established to overcome bottlenecks in developing core infrastructural components, techniques and materials, and production technology.

4. **Emphasising Green Manufacturing Projects**
   Green projects will be set up, as well as key model projects in the fields of energy efficiency and environmental protection, the comprehensive use of resources, re-manufacturing and the industrial adoption of low-carbon technology. A thousand model green factories and a hundred model green industrial parks will be established by 2020.

5. **Emphasising High-end Equipment Manufacturing Projects**
   Innovative and industry-specialised projects will be set up in a number of fields: large aircraft, aircraft engines and gas turbine engines; civil aerospace; smart/green trains; low-energy and new-energy vehicles; marine engineering equipment and high-tech ships; equipment for smart integrated electricity grids; high-end numerical-control machine tools; nuclear power equipment; and high-end medical equipment.
What next?

Chinese companies will be encouraged to forge links with foreign companies based on “strong-strong” cooperation and complementary strengths, so as to improve their global competitiveness. They will want to develop intellectual property, by drawing on overseas expertise in R&D, design and engineering structures. This will also involve international acquisitions to accelerate new technology development and to position Chinese companies firmly in the global supply chain.

More R&D centres will be established in provincial regions or indeed in third countries with advanced manufacturing industries, including specialist technological R&D centres. The blueprint for China’s industrial parks will evolve in line with policy changes – with clusters of themed R&D parks to be mapped out and efforts made to implement model projects. For example, Zhangjiang Hi-Tech Park near Shanghai has already set out its Action Plan for a Global Technology Innovation Centre.

Now that “Made in China 2025” has been announced, this plan will gradually move into the implementation phase. CBBC will keep our members up to date on its progress. Indeed CBBC will publish a specific report on this by the end of 2015. We can help with learning about specific sub-sector initiatives, and also help find Chinese strategic partners and business opportunities. We also suggest that UK companies look at the Ministry of Industry and Information Technology’s website: www.miit.gov.cn

For more information, please contact Zhang Qiuming, CBBC’s sector lead for advanced manufacturing and transport in China: qiurong.zhang@cbbc.org.cn
The Silk Road Economic Belt is a land route designed to connect China with Central Asia, Eastern and Western Europe

What is One Belt One Road?

The One Belt One Road (OBOR) initiative comprises a number of political, economic and infrastructure developments within a single strategic plan that was put forward by President Xi Jinping in 2013. Its blueprint, as described by the Chinese government, is to connect the vibrant East Asia economic circle at one end with the developed European economic circle at the other.

It will encompass over 60 countries and has two elements:

1. **The Silk Road Economic Belt** which is a land route designed to connect China with Central Asia, Eastern and Western Europe. It will also link China with the Mediterranean Sea, the Persian Gulf, the Middle East, South Asia and South-East Asia.

2. **The 21st-Century Maritime Silk Road** – a sea route rather than a road – which runs west from China’s east coast to Europe through the South China Sea and the Indian Ocean, and east into the South Pacific.

It is part of China’s aims to realise its ‘Going Out’ strategy, leading to new markets for some of China’s industrial overcapacity, creating new markets for export, and securing energy and resource supplies. It is also seen as an attempt to re-establish some of China’s historical trade routes, and to promote China as an economic powerhouse in the region.
What will it mean for China?

Improving Prospects for Provinces Along OBOR Routes

OBOR’s aims include improving prosperity in underdeveloped parts of China, particularly in the west of the country, and increased integration, connectivity and economic development along both routes through the movement of goods, services, information and people.

Helping to Seek Outlets for Overcapacity

The infrastructure investment and building boom of the last few years has left China with an overcapacity in several sectors. This is especially true of steel, cement, coal, shipbuilding and glass. OBOR is a potential solution in terms of finding new outlets for China’s production capacity.

Creating New Markets for Products and Services

Exploring new overseas markets to boost China’s economic growth is a key objective of OBOR. The diversification of Chinese exports into developing countries will extend the lifecycle of products and will also assist China in upgrading traditional industries and developing emerging industries.

Securing Energy Supplies

Reducing reliance on sea routes for the supply of energy resources is another motive. China has, for example, already surpassed the US to become the world’s largest net importer of petroleum. Currently, imports of petroleum rely heavily on the sea routes of the Strait of Malacca and the Indian Ocean. Land routes across Central Asia and the Middle East will provide alternative trade routes.

Strengthening Regional Influence

OBOR will also help to extend China’s influence by both land and sea, enabling it to develop existing economic bonds with South-East Asian countries and to create new areas for cooperation with other neighbours and regional powers such as Russia and India.

Why Is It of Interest to UK Companies?

UK companies can play an important role in supporting the development and connectivity of China’s provinces and neighbouring countries, while simultaneously benefitting from new commercial opportunities both within China and in countries along the routes.

Certain provinces, such as Xinjiang and Fujian, are positioned as “core areas” of the OBOR initiative due to their geographical locations. Xinjiang aims to become a financial hub in West China and Fujian will focus on further development of its logistics, shipping and marine sectors.

Many western provinces, such as Sichuan, Shaanxi, Chongqing, Xinjiang and Yunnan will be more focused on infrastructure and urbanisation projects, and expanding its international trade opportunities. Some underdeveloped western provinces, such as Gansu, Ningxia, Shaanxi and Xinjiang that have excellent natural and agricultural resources, will need to upgrade its technologies and improve productivity and efficiency. It is important that UK companies consider how they can become part of the process. Eastern coastal provinces, such as Fujian, Guangdong, Jiangsu and Zhejiang are also expected to present new opportunities in more advanced sectors, such as finance and professional services, shipping and logistics, advanced manufacturing, e-commerce, healthcare and life sciences.
UK companies can play an important role in supporting the development and connectivity of China’s provinces and neighbouring countries

**Infrastructure**

A critical aspect of OBOR is the creation of solid transport networks (road, rail, sea and air) linking China to its neighbouring developing countries, which will spur greater cross-border trade. Chinese state owned and private firms will seek to secure contracts for projects along the OBOR route, and this will give rise to the possibility of partnerships with UK companies that possess capabilities in different areas including project management, operations, advanced technologies, intellectual property and design.

**Advanced Manufacturing**

Chinese companies are looking to expand their operations overseas and many have already cooperated with foreign countries along these routes. OBOR also aims to help China upgrade its own manufacturing industry. Investment in key sectors is expected to promote advances in high-speed rail, high-tech marine, ICT, aerospace, biotech, new materials, and green and energy saving technologies. UK companies may find many new opportunities to sell to or partner with Chinese manufacturers.

**Financial and Professional Services**

OBOR will require significant financing to fund infrastructure projects, as well as a range of advisory services to support its development. The UK’s world-leading financial and professional services sector is well placed to meet this demand. Accountancy and legal firms can advise Chinese enterprises on how to avoid risk in third country markets, for example on PPP projects, tax and corporate structures, and on relevant litigation issues.

Opportunities will be varied, and careful planning, sufficient due diligence and risk assessment are strongly recommended. To learn more about OBOR and more opportunities by sector and by province, please visit www.cbbc.org to view CBBC’s comprehensive September 2015 report with the Foreign & Commonwealth Office on opportunities for UK companies and where to find them.
1.4 Policy Dialogue & Support for Companies

**Government to Government Exchange**

The UK and China have a number of regular, structured top-level dialogues in place, which cover a spectrum of political, cultural and economic activity. These include:

- **People to People Dialogue (P2P)** is one of the UK’s key ministerial-level interactions with China. It showcases cooperation between the UK and China on a range of social policy issues, and allows both sides to share knowledge in areas such as science and innovation, education and global health. In September 2015, Vice Premier Liu Yandong travelled to the UK for the P2P Dialogue hosted by the Secretary of State for Health Jeremy Hunt.

- **Economic & Financial Dialogue (EFD)** focuses on bilateral collaboration across a range of economic policy areas. In September 2015, the Chancellor, George Osborne was hosted by Vice Premier Ma Kai in Beijing for the 7th Economic and Financial Dialogue.

- **Strategic Dialogue** on international and regional topics that concern both the UK and China. In August 2015, State Councillor Yang Jiechi, and Secretary of State for Foreign and Commonwealth Affairs Philip Hammond co-chaired the China-UK Strategic Dialogue in Beijing.

- **Joint Economic & Trade Commission (JETC)** is a high-level government-to-government forum which aims to foster closer bilateral trade and investment co-operation by improving market conditions and facilitating increased business opportunities for both countries. UK Trade and Investment, and the Chinese Ministry of Commerce (MOFCOM) are heavily involved in JETC. In May 2014, Secretary of State for Business Innovation and Skills Dr Vince Cable, held a bilateral meeting with China’s Minister of Commerce Gao Hucheng.

**Promoting a Healthy Business Environment**

**Strategic Prosperity Fund**

The purpose of the UK Foreign and Commonwealth Office’s Prosperity Fund is to create the conditions for global growth. By funding targeted initiatives, the Fund focuses on areas where the UK is a world leader and has high quality policy and commercial expertise to offer China.

There are three key work strands to promote:

- Sustainability
- Openness
- Opportunity (for UK companies to contribute)

CBBC leads or supports a range of projects under the Prosperity Fund, with the aim of building a healthy business environment in China, including working to promote sustainable economic development in line with international best practice.
CBBC Business Environment Projects in 2015 and 2016

Below we list some examples of some high profile projects CBBC is involved in in 2016 to develop China’s business environment. Some are Strategic Prosperity Fund projects and others are initiated directly by CBBC.

**E-commerce Anti-counterfeiting Efforts**
Starting with a cooperation agreement with China’s largest e-commerce company Alibaba Group, CBBC are coordinating the efforts of the UK business community to promote the effective protection of intellectual property rights online. From a series of roundtable meetings and pilot projects with Alibaba, best practice will be discussed and presented to the relevant Chinese government departments as well as other e-commerce platforms across the country so as to improve the commercial environment for British stakeholders.

**Public-Private Partnerships (PPP)**
This programme aims to educate the Chinese government authorities in how to approach and successfully develop major infrastructure projects and their investment requirements using global best practice. UK experts will develop relationships with Chinese sponsors of PPP, with the intent to promote the UK as the source of professional advice and assistance. CBBC has been delivering a series of workshops, training sessions and roundtables since early of 2014 covering key cities including Beijing, Shanghai, Changchun, Harbin, Chengdu, Dalian and Hangzhou.

**One Belt One Road**
CBBC has published a landmark piece of research into this new long-term policy, and how the UK can become an integral part of it, in cooperation with the Foreign & Commonwealth Office. Our findings identify opportunities for British businesses in China and numerous other countries besides, with key sectors including infrastructure, energy, financial and professional services. In 2016 CBBC will continue to lead various forms of research and engagement with OBOR, across several provinces and sectors. To find out more please visit: www.cbbc.org.

**Made in China 2025**
In late 2015, CBBC will publish a dedicated report on this new initiatives aims to enable UK companies to understand this new and exciting Chinese policy from a practical perspective, so that they can be part of China’s restructuring from a nation of cheap manufactured goods to a ‘manufacturing powerhouse’ further up the value chain over the coming decades. CBBC will deliver a series of webinars, as well as cross-China and cross-UK briefings on this important topic.

**Accelerating Innovation**
CBBC is leading on a project to facilitate connectivity between UK and China “innovation ecosystems”. By fostering collaboration between universities’ incubators and accelerators, innovation and tech transfer centres, the project aims to be a bridge for innovation collaborations between UK and China businesses. Later in the year we will deliver an extensive set of guidelines and workshops for policymakers in planning and managing UK-China firm collaborations for accelerated innovation. NESTA, and innovation charity will also deliver a set of policy recommendations as part of this project.

**Pilot Free Trade Zone (FTZ) Development**
CBBC will facilitate British and other organisations providing input and other forms business support throughout 2016, to continue to support Shanghai FTZ development in 2016. Successful pilot FTZs will be an important catalyst for international trade and investment flows and have a direct and positive impact on increasing global prosperity.
Support for Businesses: CBBC & Partner Organisations

China-Britain Business Council

The China-Britain Business Council (CBBC) is the leading organisation helping UK companies grow and develop their business with China. We help companies of all sizes and sectors, whether new entrants or established operations. CBBC has worked with China for 60 years and our team has extensive experience of doing business there. We offer practical in-market assistance, services, industry initiatives and a membership programme delivering access, seminars and networking through our network of 13 offices in China and 10 in the UK. www.cbbc.org.

UK Trade & Investment in the British Embassy and Consulates General

UK Trade & Investment (UKTI) is a UK Government department working with businesses based in the United Kingdom to ensure their success in international markets, and encourage the best overseas companies to look to the UK as their global partner of choice. UKTI helps British companies of all sizes to grow their business through international trade by offering expert advice and practical support through a range of programmes. UKTI is located throughout the UK and around the British Embassy and four Consulates Generals in market. CBBC is UKTI’s strategic trade service delivery partner for the mainland Chinese market.

EU SME Centre

The EU SME Centre is a European Union funded initiative helping Small & Medium-sized Enterprises get ready to do business in China. The Centre provides practical information, confidential advice, and training in the areas of business development, legal issues, standards and HR to facilitate market access for European SMEs. The Centre also acts as a platform to facilitate coordination amongst Member State and European public and private sector service providers to SMEs. The EU SME Centre is operated by a consortium of European Chambers of Commerce, led by CBBC and also including the Benelux, French, Italian and EU Chambers and Eurochambres. For more information please see: http://eusmecentre.org.cn/

EU–China Business Association

The EU-China Business Association (EUCBA) is an EU-wide federation of national non-profit business organisations in the European Union with specialisation and particular expertise in exchange of knowledge on investments and trade with China.

EUCBA promotes direct investment and trade between China and the EU through international exchange of information and joint projects of its members – providing European companies a stronger base for expanding trade cooperation with China. EUCBA unites 18 members in 18 countries, for which CBBC is the UK representative. For more information see: http://www.eucba.org/en/

CBBC & UK Government Network in Regional Cities

The PRC is a vast country spanning 27 provinces, four municipalities and two special administrative regions. Across the country, differences in economic prosperity, consumer behaviour, socio-demographic and economic trends are considerable.

Generally speaking the most prosperous parts of China are along the large cities of China’s eastern and southern coasts, where Western interaction, investment and imports have been most prevalent. While the coastal areas are more economically developed, their economies are no longer growing at the speed of before, and markets for UK companies to export to or invest in are becoming more competitive.

By contrast the regional cities of China’s inland are where opportunities, and demand for foreign exports and investment, are growing the fastest. For this reason the UK government and CBBC have set up coordinated networks across China’s regions to help UK companies better understand the opportunities which exist and make sure the UK is well positioned to be the partner of choice for Chinese companies.
1.5 Regional City Networks

**CBBC’s Regional City Network**

Through 60 years of engagement, CBBC has built up exceptional connections with government and business across China. With offices in 13 Chinese cities, in addition to 10 around the UK, CBBC’s network allows you to reach even more markets and businesses across the country.

CBBC has a team of experienced bilingual advisers based in our offices across China and the UK, who provide advice and support to companies whether they are looking to enter the market, grow their existing China business or support Chinese companies expanding their global presence.

**The UK Government’s Regional Cities Network in China**

Working in close collaboration with CBBC, the China Regional Cities Network is made up of more than 20 officers, both UK diplomats and locally engaged members of staff, operating out of 11 locations across mainland China.

The focus is to strengthen UK diplomatic representation in Chinese provincial regions and understand the dynamics of China’s emerging economic powerhouses and to build influential relationships with a wide range of stakeholders, including government and other major decision makers, which will ultimately benefit a range of UK interests. A key intention is that this will encourage more British companies to see the value of doing business in China’s provinces. If you would like to be added to the mailing list for regular updates on provincial developments please send an email marked “Mailing List” to: china.regional@fco.gov.uk
CBBC has **10 UK offices** and **13 offices across key locations in China**. This in-country network provides invaluable **local insight, access and knowledge**.
This chapter is intended to provide UK exporters with an outline of the main routes to find and reach clients in the Chinese market, as well as some of the key strategic considerations for companies with China as part of their supply chain. We also discuss new trends such as pilot free trade zones, and some practical tips on how to prepare for your business travel in China.

In the first section we cover the most popular routes to market for exporters, including the key types of Chinese business partner in the process, as well as how to choose and manage them effectively.

The second section introduces the thriving area of Chinese e-commerce, key emerging trends and the different business models which UK exporters can use to access this ever expanding sales channel.

The third section deals with some of the practicalities of getting products through mainland Chinese ports and customs, the key intermediaries which are needed, and the common Incoterms, pricing and lead time considerations which you ought to be aware of when arranging shipments to your Chinese clients.

The fourth and fifth sections discusses strategic considerations for China as part of your supply chain, including successful sourcing and management of manufacturers. We touch on mitigation of non-delivery and other risks, and best practices for quality assurance. These sections also cover long-term strategies for nurturing the capabilities of your Chinese based facilities or partners, to maximise their effectiveness as part of your global value chain.

The sixth section looks at the recent developments of China’s pilot free trade zones, some key changes relating to international companies in China, and examples of how the policies piloted since 2013 in the Shanghai zone are being replicated in other zones and are starting to affect the business environment for foreign companies at a nationwide level.

The seventh section is about the issue of cross-border payments for companies trading with or in China, including the trend towards encouraging RMB as a settlement currency, different payment terms, as well as trade finance products which are available from banks specialised in cross-border transactions with China.

Lastly, CBBC has provided a practical checklist for UK business people travelling to China, including how to prepare before the trip, practical issues in getting around and business etiquette to be aware of when meeting Chinese counterparts.
2.1 Exports: Routes to Market

**Distributors & Agents**

In this section we outline some of the most common ways to establish sales channels to Chinese clients and customers, and the business partners involved in the process.

A distributor generally purchases goods from the producer at a discount and sells them on at a profit. There are different ways to structure an agreement with a potential distributor. They may be the sole licensed distributor, or one of several distributors responsible for different territories or types of client. An agent will typically take responsibility for selling, promoting, winning orders, problem-solving and debt collection in exchange for a commission on sales. However, they do not usually handle goods themselves, leaving you to find another service provider for logistics and customs.

Operating through a business partner such as a distributor or agent can have many advantages, including the reduction of time and costs accrued in entering the market and the benefit of your partner’s local knowledge and network. They not only help overcome entry barriers but can also assist with collecting market data, tracking regulatory updates, and responding to retailers on your behalf. Distributors can provide useful insight into market trends, especially if they work with several categories of product.

Nevertheless, there are also drawbacks. Employing a third party results in additional cost in the supply chain. You may also lose some control over the marketing, image and intellectual property rights of your brand in the market, increasing the risk of your product being copied or counterfeited. Be aware that not all distributors will have their own import licences – if they do not they may have to employ another third party, adding to your intermediary costs.

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**How Your Chinese Partners Help You:**

- Speed of market entry
- Access to local knowledge of logistical issues for imported products
- Knowledge and connections to deal with Chinese administrative issues, regulations and customs
- Access to relationships with Chinese retailers regionally or nationally, and thus a ready-made sales network
- Well suited to companies for which little or no product adaptation is needed for the local market

**The Challenges:**

- Loss of margin for your business or increased shelf price
- Loss of oversight and control of your products’ marketing and sales
- Reliance on agent/distributor to generate sales proactively
- Difficulty of finding a suitable distributor
- The distributor may not prioritise your products and they may be unwilling to invest in marketing and advertising
- Distributors may request exclusive sales rights in order to differentiate themselves from competitors, which increases your reliance on their sales ability
Managing your Partner

Once a working relationship is established, the distributors and agents need to be managed actively. This may be achieved by the following:

• Visiting regularly at a senior management level, in order to reinforce your interest in and commitment to the agent and the market. This also provides opportunities to learn about the market and the popularity of your products;
• Helping with marketing and sales strategy planning;
• Providing regular training for the sales and after-sales staff;
• Linking performance to incentives and agreeing milestone targets.

China’s size means you might need a number of business partners to cover different regions. It can take time to find the right partners.
China has become the world’s second largest global e-commerce market, generating an estimated market revenue of GBP 1.34 trillion in 2014

Exporting Directly to Retail Clients

Some British producers may be able to sell products directly to Chinese retailers without distribution partners in China. However, goods can only be imported through a company which has an import/export licence under Chinese law. Therefore only the biggest retailers tend to have the relevant licences, while other companies must use a licensed intermediary.

Exporting directly not only makes it possible to generate better margins, it is also an opportunity to more closely understand the retail system in China and to receive feedback on sales volumes and consumer preferences. However, it may be difficult to justify shipping costs to retailers unless large volumes are guaranteed.

Exporting via UK-based Consolidators/Exporters

A further option for any UK business can be to use a British or European consolidation company that can handle the exports from the UK for you. This option may seem to be the most straightforward, but the non-Chinese consolidator will often either lack the knowhow for the Chinese market and/or need to use local agents and distributors in China anyway, which will increase costs. It also makes it difficult to control customer relationships and your pricing and brand image in China. This option may be attractive to smaller producers that do not have budgets for market visits, or the time required to compare or to carry out due diligence on Chinese distributors.

Using Online Platforms

Increasingly, retailers in China are looking to the internet to access consumers, and British exporters are exporting more to clients running online stores than ever before. On some of the e-commerce platforms, goods can be shipped directly to end users from the UK, but more often an e-commerce specialised business partner and importer are required as part of the process. There is more about Chinese e-commerce in the next section.

Finding Distribution Partners & Clients

A good starting point for identifying potential partners and clients is the Overseas Market Introduction Service (OMIS), which CBBC delivers in partnership with UK Trade & Investment (UKTI) in China.

OMIS can be used to tailor a list of potential customers, agents, distributors or other business partners and arrange a meeting programme for when you visit China. These projects are subsidised as part of UKTI’s export promotion scheme. To find out more about OMIS, please see: www.cbbc.org/services/research/

When choosing an agent or distributor as a business partner, a company should consider the following:

- Company size, history and ownership (private or state-owned)
- Quality and quantity of the sales force
- Customer feedback and trade/bank references
- Regional coverage
- Types of outlets covered
- Transportation and warehousing facilities
- Does the agent/distributor have a genuine interest in representing your product?
- Can they benefit from actively promoting your products (is it a win-win)?
- Do they also represent any competing companies/products?
- Can you communicate effectively with your counterpart?
2.2 Using E-commerce

**Trends**

China has become the world's second largest global e-commerce market, generating an estimated market revenue of USD 2.06 trillion (RMB 13.06 trillion) in 2014. Research firm eMarketer forecasted that the Chinese e-commerce industry would be worth almost half that of the global e-commerce industry by 2018.¹

By January 2015 China had reached 649 million internet users, but it still has a relatively low internet penetration rate of 47.9%, which indicates that there is significant room for growth in the years ahead.

Chinese consumers are generally not familiar with international e-commerce websites and many do not understand English or use international credit cards. Some Chinese platforms, however, do not require a company to be registered in China to sell products on their website. This can allow Chinese consumers easier access to UK products.

Within China, its size and complexity makes e-commerce a particularly effective channel through which to connect with customers across the country at a relatively low cost. It is important to recognise though that China has its own unique e-commerce market landscape, so companies should carry out comprehensive research before committing to entering the market.

It is important to understand the frequently changing government regulations and the local business landscape. CBBC recommends UK companies visit China to meet local partners and supporting staff who may be involved. A good local partner can act as a sensor of industrial trends and as a guide to building necessary business relationships. In addition, the success of e-commerce activities is heavily dependent on pre-sale consultation and post-sale support services. A local partner would be in the best position to handle these issues.

Spending online is highest in China's Tier 1 cities and the provinces of the wealthy east coast, such as Shanghai, Beijing, Guangdong, Jiangsu and Zhejiang. However, data from payment system Alipay also shows that online spending is growing fastest in China’s less affluent but rapidly expanding interior provinces and Tier 3 and 4 cities. Growing income levels, increased smartphone penetration and a lack of bricks-and-mortar stores have helped to accelerate the growth of e-commerce in these areas.

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¹ [www.emarketer.com/Article/Retail-Sales-Worldwide-Will-Top-22-Trillion-This-Year/1011765](www.emarketer.com/Article/Retail-Sales-Worldwide-Will-Top-22-Trillion-This-Year/1011765)
Fashion, including clothing and footwear, represents the biggest single e-commerce category. Computer related products as well as electronics and household electrical devices are also important. Together, these categories made up 80% of total spending online in 2014.

It is worth spending some time researching the market in order to establish whether a brand is likely to appeal to Chinese consumers, and how demand is likely to vary among different regional and demographic sub-groups. Compared to larger international brands, less well-known names can find building awareness with Chinese consumers difficult, so marketing may be required to ‘educate’ the market and build brand visibility.

**Singles’ Day**

China’s Singles’ Day, which takes place on 11th November (“11/11”) each year, has now established itself as the most important date in the Business to Consumer (B2C) e-commerce calendar. All e-commerce platforms now take part in the event, which was initiated by Alibaba and entails discounts of up to 50%. In 2014 Alibaba achieved over USD 9 billion in sales in the course of 24 hours, making it the biggest single day in the world for e-commerce.
E-commerce Business Models

A key question facing any company looking to sell online in China is which business model to adopt. There are several potential business models, depending on whether the company already has an offline presence in China and how much up-front investment it is willing to make.

1. **Local China Presence (direct-to-consumer)**

Larger brands/retailers with a local China presence may look to sell directly via a local Chinese website with e-commerce order processing capabilities. This requires companies to have a full legal entity in China and to invest in order management, logistics, and customer service systems. However, a preference in China for third-party platforms means that even larger British retailers, such as Marks & Spencer and ASOS, have concentrated on building presence on e-marketplace stores rather than investing heavily in their own sites.

2. **Third Party Platforms**

The most popular route to market for most foreign brands is to establish a presence on domestic third-party platforms, such as Tmall or Jingdong (JD.com). Most of the leading Chinese third-party platforms require vendors to have a local Chinese business licence, tax registration documents, and locally registered trade marks before they are able to set up a store. It is also necessary to have local inventory in China and fulfilment/customer support. This means that companies have to either (a) establish a local Chinese entity or (b) appoint a trusted local partner to hold inventory, manage the online store and provide returns support or customer service on its behalf.

3. **Cross Border E-commerce**

There are a growing number of cross border e-commerce platforms, some of which provide end-to-end solutions for brands to sell via their platform direct to Chinese consumers. The government has recently approved the setting-up of pilot cross-border e-commerce zones in a number of cities, where e-commerce companies can purchase foreign goods in bulk and store them in bonded warehouses.

Tmall also has a cross-border platform, Tmall Global, to cater to the growth of cross-border demand, while a number of other platforms are in the process of establishing end-to-end cross-border services for foreign brands. These cross-border platforms effectively bypass the need for companies to establish a local legal entity or to appoint a local distributor.

4. **Cross Border E-commerce (via Overseas Website)**

Chinese consumers are increasingly shopping directly from overseas websites. According to market research firm Nielsen, in 2013 18 million Chinese cross-border shoppers spent more than USD 35 billion on foreign sites. Some product categories and brands are unavailable in China for regulatory reasons, while high import duties for luxury goods leads many Chinese shoppers to look overseas for bargains.

Companies can also opt to sell direct to Chinese consumers from a UK-hosted website. Although this means longer shipping times for the customers, it can be a good starting point to test the market and begin building some brand awareness in China. A first step may be to create a Chinese language version of a UK website, integrate Chinese payment options to the site and start creating some Chinese language digital content to drive traffic to the UK website.

There are advantages and disadvantages to each business model which are summarised in the following table.
### Model

<table>
<thead>
<tr>
<th>Local China presence (direct to consumer)</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Strong control over brand/pricing</td>
<td>• Full local entity and Internet Content Provider (ICP) licence required</td>
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<tr>
<td></td>
<td>• Better website performance</td>
<td>• Significant financial investment required (platform/system build, local customer support, order management, etc)</td>
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<tr>
<td></td>
<td>• Easy to collect and analyse data</td>
<td>• Costs of site design, SEO and social media</td>
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<tr>
<td></td>
<td>• Fast delivery (local warehousing)</td>
<td>• Local payment capability required</td>
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<td></td>
<td>• Better level of customer service</td>
<td></td>
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<table>
<thead>
<tr>
<th>Local China presence (direct to consumer)</th>
<th>Above benefits plus:</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Large user base for greater traffic flow</td>
<td>• Full local entity/trusted partner required</td>
</tr>
<tr>
<td></td>
<td>• Leading standardised data analysis tools</td>
<td>• Costs for e-store deposit/commissions, SEO, store design and social media</td>
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<tr>
<td></td>
<td>• Take advantage of platforms’ third-party tools (where available)</td>
<td>• Local China team or partner required for fulfilment, customer service and support</td>
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<tr>
<td></td>
<td>• Own website can drive traffic to the store</td>
<td>• Competition on platforms</td>
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<table>
<thead>
<tr>
<th>Cross-border (via third-party website)</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• No legal entity in China or ICP licence required</td>
<td>• Partner may be required for import and/or logistics fulfilment and customer service</td>
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<tr>
<td></td>
<td>• Higher traffic then a stand-alone website</td>
<td>• Higher commission service charge for end-to-end service</td>
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<tr>
<td></td>
<td>• Lower cost/investment</td>
<td>• Longer shipping time</td>
</tr>
<tr>
<td></td>
<td>• No need for local inventory</td>
<td>• Cross-border sites get less traffic than main domestic platforms</td>
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<td></td>
<td>• Bonded zone options for faster delivery</td>
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<tr>
<th>Cross-border (via overseas website)</th>
<th>Pros</th>
<th>Cons</th>
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<tr>
<td></td>
<td>• No legal entity in China or ICP licence required</td>
<td>• Limited Chinese traffic to site</td>
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<td></td>
<td>• Low cost/investment</td>
<td>• Longer shipping times</td>
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<td></td>
<td>• Can start selling quickly</td>
<td>• No local customer service and returns handling capability</td>
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<td>• Limited Chinese take up of common Western credit cards</td>
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<td>• Chinese language website creation required anyway</td>
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<td>• Website performance issues with servers outside China</td>
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Tmall is a pure platform that provides a ‘mall experience’ for premium brands to set up their own internal websites

Becoming an Established Player: Setting up on Tmall

Tmall is undoubtedly No. 1 in the online retail market in China, although in recent years its dominance has been undercut slightly by JD.com.

Tmall is a pure platform that provides a ‘mall experience’ for premium brands to set up their own internal websites. The platform has 70,000 international and Chinese branded store fronts, over 500 million registered user accounts and an average of 100 million daily unique views.

Tmall has a number of strict requirements that vendors need to meet before they can set up a store, which makes the platform more suitable for international companies and brands with an existing entity in China:

• Tmall requires store-owners to put down a deposit of RMB 50,000-150,000 (GBP 5,260-15,790), depending on the product category and store type, an annual technical service fee and a commission on each transaction (roughly 5%).

• It also requires brand-owners to have local inventory in mainland China, relevant customs (CIQ) and quota certificates and to have already registered trade marks with the Chinese Trade Mark Office.

• Finally, vendors also have to be able to meet Tmall’s 72 hour delivery guarantee, have a clear returns system in place and a local Chinese customer service function.

This effectively means that brand-owners need to have an existing legal entity in China, or to have a contract in place authorising a local distributor/agent to manage the Tmall store on their behalf. Setting up a company in China requires investment of both time and money. However, some brand-owners may be reluctant to entrust management of their online store to an unfamiliar third party.

Tmall Global is a Hong Kong hosted version of the website which enables companies with no legal presence in mainland China to sell cross-border to Chinese shoppers. The advantage of the site is that it does not require suppliers to hold local inventory in mainland China, and products can be shipped to customers direct from their home country, from another region such as Hong Kong, or from a bonded zone in China. The site also has the flexibility to sell product categories with tight regulatory restrictions in China, such as foods, cosmetics and health products. Lower value items can also be shipped direct to shoppers free of import duty.

Visit Tmall’s English language website for more information about setting up on Tmall or Tmall Global:
http://about.tmall.com/
Alibaba & CBBC Intellectual Property Cooperation

In September 2014, CBBC and Alibaba Group signed a Memorandum of Understanding (MoU) to reinforce and promote intellectual property (IP) in Chinese e-commerce.

Under the provisions of the MoU, CBBC has been helping UK companies to understand and better utilise Alibaba’s notice-and-takedown mechanisms, in order to address the issue of infringing product listings found on platforms such as Tmall, Alibaba.com, Taobao and 1688.com.

A strategic aim of the MoU is to systematically reinforce the processes Alibaba uses to protect IP. Through quarterly roundtables, UK companies are also able to benefit from Alibaba’s detailed explanations of how current systems work, and the opportunity to propose changes or new initiatives Alibaba could adopt to protect brands’ IP.

Alibaba has responded very positively to points raised by UK stakeholders and is willing to continue to work with British users of their platforms through CBBC’s activities and several specific follow-up initiatives and spin-off projects which are already underway.

For more information or to become an MoU stakeholder, please contact CBBC’s IP lead directly: Michael.Ryan@cbbc.org.cn

The following resources will help you find out more about exporting to China via e-commerce:

- CBBC’s business guide E-commerce in China: http://www.cbbc.org/services/resources/china-reports/
- CBBC’s webinar on selling online to China: https://www.youtube.com/playlist?list=PLv_tMYysg7RODn2hCkPWBaYTRYz2MpFL
- UKTI’s e-Exporting Programme which can help you reach Chinese consumers through e-marketplaces: https://www.gov.uk/e-exporting

If you would like to talk to a CBBC advisor about making use of e-commerce in China then please email either of CBBC’s e-commerce leads:

UK Enquiries:
Mark.Hedley@cbbc.org

China Enquiries:
Shu.Xie@cbbc.org.cn
China represents an attractive market for British manufacturers. Many are drawn by the opportunity, and set up an entity there or appoint an agent to enable them to supply the market locally. This brings with it the challenge of having to deal with Chinese Customs, in order to get goods to market.

Customs rules, and their implementation, can be hard to understand. Most issues can be resolved, even prevented, but you need the inside track on how the system works.

Choose your HS Code

Harmonised System (HS) Codes is the international system used for categorising all products traded between countries. Whatever your product is, there is an HS Code for it. China Customs holds a complete list (www.hsbianma.com) which can be used to check product categories and understand import tax rates, required documentation, licences or testing.

However, you can only find out so much from China Customs’ website. Public information on a given HS Code may be incomplete. Sometimes, it is only people in the industry (e.g. specialist import agents) that have an accurate understanding of what can be brought in, and under which HS Codes.

For any product, there may be a range of potential codes that could be used, and picking the right one is an important skill. For example:

- There may be different HS Codes for an item brought ‘in bulk’, and one brought in as a ‘finished product’;
- Different sizes, shapes, materials, even colours, can merit their own codes;
- Each HS Code category also tends to have an ‘Other’ code that may cover some products in the category;
- Choosing the correct HS Code is important because tax and documentation requirements vary from code to code. The onus is on the importer to prove to Customs, based on the detailed nature of the item, that the HS Code has been correctly applied.

Know Your Incoterm Obligations

Depending on how the goods you are importing are priced, the amount of work required at the UK and China ends varies. The table below highlights the main tasks, which the exporting (UK end) and importing (China end) parties are respectively responsible for under the main Incoterms.
The most cost effective solution is often for the exporter to arrange shipping to the Chinese port of destination (i.e. quote CIF), then to contract the subsequent import services to an agent in China. But this does require hiring expertise locally to arrange for a shipping agent to get the goods successfully cleared through China Customs.

Choose an Import Price

If you are bringing your own product into China through a China subsidiary, then there can be some difficulty in setting the import price. For example, choosing between the cost price, thereby leaving margins in the China business, and the sales price, thereby taking profits out of China. There may be other fees, such as design or royalty fees, that might be included in the cost of goods.

A key consideration in these questions is of course tax. A higher import price will generally increase the costs of import, through import duty, whereas a lower import price will keep more profit in your China subsidiary, leading to a higher corporation tax bill.

It is important to understand that Chinese tax authorities will have an expectation of the profitability of a foreign-owned Chinese subsidiary. Furthermore, given the difficulty of obtaining financing for foreign-owned entities in China, it is crucial to plan for sufficient cash to support a China subsidiary.

A few key guidelines to follow:

- The bottom line is use a price that represents a true and authentic cost price to the importing entity;
- Start as you intend to continue.

Importing the same item again at a significantly different price will be challenged by Customs. Customs keep a record of all historic prices per HS Code, so significant swings by the same importer will be flagged up;
- Thorough financial planning is key; figure out what level of costs and income the business will have, and use such data to inform pricing decisions.

Payment within 3 months

Since 2014, the State Administration of Foreign Exchange (SAFE) has started rejecting overseas payments for imported goods more than three months after goods were imported. Therefore, it is important to plan payments in time, to avoid money getting orphaned in China.
Choose a Port

The ability, speed, and cost of importing goods can vary considerably by port. Therefore, choice of port may not necessarily be decided just by proximity or transport links to the end user. It is not uncommon for importers to import through a port where they or their clearance agents have established processes and relationships, then trucking goods a considerable distance to market. In some cases, this may be as extreme as transporting goods by bonded truck from a seaport to a landlocked city inland to clear customs there.

There are no hard and fast rules regarding which ports to use, and which to avoid. It depends on product category and local practices, and in most cases proximity will trump other considerations. However, the single most important decision you will make regarding your importation is choosing the right customs clearance broker, and they may be tied to a particular port, in which case a detour may be the best choice.

Working with Customs Clearance Brokers/Agents

This is the most important decision to make, and key to making the import process go smoothly. Customs clearance is a localised business in China. Typically, clearance brokers have two areas of expertise: product category; and locality.

There are certain agents that are very good at certain product categories and those that have particular strong networks in a certain port, or even both (e.g. cosmetics in Shanghai).

Do not assume the customs brokers attached to your freight forwarders are the right ones for the job. You need a recommendation from someone in your industry to find the most appropriate customs broker.

Here are some tips to finding the best customs broker for your import order:

- Find out from industry peers who they have used that got the job done. Network within the industry until you get an introduction to the right outfit;
- Engage a customs broker who is legally registered with Customs and who is AA or A certified. Regional customs classify the local brokers from AA to D;
- Find a customs broker with good relationships with Customs. To look up details for any customs broker you can search on this Chinese Customs web-tool: http://www.customs.gov.cn/publish/portal0/tab9408/
- Have independent brokers in your key import regions, and do not rely on the same broker for all points of entry. Requirements vary across the country and only local brokers will be able to offer you the best advice and services.

Import Brokers Classifications

AA-A: Outstanding compliance records and receive excellent treatment from Customs

B: In good standing and receive ordinary treatment from Customs

C-D: In poor standing and subject to strict conditions by Customs
Get the Documents Right

Thoroughly preparing the documents required to clear customs is the only way of getting goods through customs without incurring delays and storage charges. There are three levels of documentation to be aware of:

1. **Importing Entity Documentation.**
   These are the registration documents of the company importing the goods (the importer of record), including business licence and tax registration certificate.

2. **Goods Documentation.**
   These must be prepared by the exporter and sent to the importer in China as early as possible.

3. **‘Exceptional’ Documentation.**
   This is where companies commonly get stuck, and it includes category-specific documentation that you must check in advance. This is a large, mixed bag of items, including: hazardous goods certificates; certificate of origin; quality certification; product manual; and letters of credit. It is important for exporters to understand from customs brokers exactly what is required for your product.

To get documentation right, there are a couple of important factors to consider:

1. You need a very good person in your company to translate English into Chinese for your products. Every business has its own “internal language” or jargon. Translating this into Chinese is your responsibility; do not rely on the import agents.

2. There is a steep learning curve for the exporters, whether they are independent suppliers, or your own company in the UK. They need to learn a China-specific way of preparing documents. Many shipments will not clear without a Certificate of Origin (C/O). If you are using airfreight, any delay in getting the C/O will lead to very expensive customs-warehouse charges.

Beware of Wooden Packaging!

This is a relatively minor detail, but it often seems to get missed, and causes unexpected delay and expense. Chinese port customs regularly require that goods with wooden packaging be fumigated. As this includes wooden pallets and crates, this can end up encompassing many goods, even if they themselves are not wood, or packaged in wood.

Consider alternative plastic packaging, or allow for extra time and expense if wood is unavoidable.
Clearing Customs

Once you have your documents, it is time for the customs application. The General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ, commonly known as ‘Customs’) is responsible for inspecting and supervising the import of most product categories.

Customs operate on a policy based on “inspection application first, customs declaration second”.

The process generally is as follows:

1. Application for inspection
2. Acceptance by Customs
3. Quarantine and inspection by Customs
4. a. Quarantine treatment notice for goods not passed
4. b. Insurance of certificate and goods released for goods passed
Time it Right

When it comes to importing goods into China, you have to plan for:

**The Known.** Public holidays such as Chinese New Year and National Day can be anticipated. Your goods must be planned to arrive three weeks before or after. The airlines shut down air freight to China, so when the holiday is over, there is a massive backlog of airfreight, and at Customs. These periods must be noted and factored in to any delivery promise.

**And the Unknown.** This refers to China’s political timetables. Some of these, such as the annual ‘Two Meetings’ do follow a set pattern, but many, such as political campaigns or ‘Victory Day’ in 2015, are almost impossible to anticipate. This can impact customs clearance.

Also take into consideration shipping times when planning ahead. Sea freight typically takes 30-45 days from Europe to China, while air freight is significantly quicker at three to seven days. Avoid shipping via sea freight at the start of January, only to find out the expected date of arrival is Chinese New Year.

Avoid guaranteed delivery dates to clients, because these can end up very expensive. Not only do you have to compensate clients for late delivery, but Customs charges you for storage of goods as well.

Free Trade Zones (FTZs)

This presents a relatively new opportunity for bringing goods into China. However, there are a couple of points to note:

- FTZs do not represent a ‘back door’ means of bringing goods into the market. To get goods from the FTZ into the ‘mainland’ they still need to go through regular import channels;
- Goods can be held in the FTZ close to end markets for up to 30 days before customs clearance procedures (and tax) need to be completed. This is of particular appeal to companies with significant inventory (e.g. online retailers) who can import products, hold them in the FTZ pre-sale, and complete the full import once the goods are sold.

Finding Support

Third-Party Logistics Providers (3PL) are firms that provide logistics services for importers in a certain area, including: transportation; warehousing; cross-docking; inventory management; packaging; and freight forwarding.

Fourth-Party Logistics Providers (4PL) target management of the entire supply chain process and offer comprehensive strategic solutions. 4PLs are usually general contractors that manage other 3PLs.

You can also find good third-party agents that can help import goods and sell to distributors and customers in China, acting as a trusted conduit between your company and the market in China.

Also take into consideration shipping times when planning ahead. Sea freight typically takes 30-45 days from Europe to China, while air freight is significantly quicker.
Sourcing from China

Sourcing can be defined as the process of searching for and locating items and/or a primary factory with the ability to produce them; including the due diligence of confirming authenticity of the factory upon identification, and the full agreement of all procurement terms for both parties.

Responsible sourcing can be performed by an individual or by a professional entity and is a crucial early step in supply chain management. It requires not only the understanding of the product to be produced and procured, but also of issues influencing the intended partner factories. The sourcing process will vary depending on certain influencing factors:

- **Product**: What is it? What materials, finish, dimensions and requirements?
- **Industry**: Is this a commonly produced mature product, or is it an innovative niche item?
- **Quantity**: Critical to understanding whether the factory has the ability to produce, whether economies of scale pricing can be enjoyed, as well as sampling and production lead times.

If we assume that the product is a unique, never-before-seen item made from uncommon materials and in small order quantities, the likelihood of sourcing a China factory willing to help with development is remote. Chinese manufacturers are aware of the limitations regarding the ability and drive to innovate. However, the immense skill to recreate and perfect concepts is a real strength of China manufacturers to remember when sourcing in China.

**Background Considerations**

The vast majority of factories were established and continue to grow by targeting the world's largest markets for the products in which the factory specialises. The low-cost manufacturing advantages China can offer have been brought about over several decades of socio-economic development and political policy making, and not least by the very real lure of producing products for the world’s biggest industrial companies and consumer goods retailers. In order to work with a first-choice factory with high order criteria, smaller companies with smaller orders may consider piggybacking off their larger competitors’ high volume orders. However this can be a bruising, uncompromising and difficult experience.

Therefore being realistic with the attractiveness of your business to a Chinese factory is sensible. It may be that the biggest and best factories will simply be unsuitable partners. By comparison a less impressive smaller factory, which has good, experienced and eager management, will often provide a better prospect. Sourcing is a compromise between many such factors.

This leads onto the critically important question of quantity. Factories will set Minimum Order Quantities (MOQs) for various reasons, often higher than the average buyer may wish to accept especially when targeting Just in Time (JIT) purchasing. Factors affecting factories’ flexibility on MOQs include:

- Production/assembly line capacity;
- Raw material supplier MOQs, including packaging and printing. Raw material suppliers in China are often state controlled and will invariably offer no credit terms to the buying factories;
- Management costs increase for training all production line staff to produce/assemble new items;
- Worker output consistency will be impacted with the introduction of increasingly varied items;
- Worker profit – the majority of workers get paid per item produced/assembled so will be very dissatisfied and unenthused to work on small orders;
• FOB local charges will be levied on the factory for every shipment they prepare, meaning that the larger the order, the lower the shipment charges per item;
• Factory cash flow vs admin costs.

Therefore, what might initially appear to be stubborn desire on the part of a factory for more revenue, may in fact be a reasonable request.

Interaction With Potential Manufacturing Partners

It is generally best not to consider any entity a manufacturing partner unless they are a Managed Sourcing Company or a primary factory.

A primary factory (one which takes responsibility for final assembly and shipment) will use numerous regular outsource factories to supply components, packaging, plating, finishing, painting, machining, or any one of hundreds of processes that make a product complete. So being aware of this but allowing the factory to control their own supply chain is important. If changes need to be made to components, the primary factory should take responsibility for resourcing themselves, assuring the quality.

Factories will likely have several salespeople who will each have abundant online enquiries arriving daily from all over the world. They will also have daily emails and Skype calls with their existing, paying clients, so getting their attention and responses is a fine balance between being clear, concise and firm.

The keys to Successful Communications with Chinese factories throughout the sourcing process are to:

• Give a clear and concise explanation of the product. Using Chinese is all the more effective;
• If emails are not clear enough and Skype is not accepted, there is likely a language barrier. If the English content is technical, then one is effectively relying on a Chinese sales person (non-technical) to communicate a technical message to an engineer in Chinese. Proceeding down this path can get complex and costly. Find someone that can help communicate for you in Chinese;
• Ask directly “does your company produce this item?” Many photos and descriptions will be copied and used across the internet;
• Be honest about quantities and ask the factory’s Minimum Order Quantities (MOQ);
• Patience is a virtue, but China based companies generally work to a high tempo, so remember to chase emails if no response is received after 48 hours;
• Asking three questions but getting only one answer is common. Structure emails simply and clearly with basic punctuation and no unnecessary waffle to avoid confusion. Press for the remaining two answers;
• Offer target pricing if the project is time sensitive and the product is largely unknown.

Face to Face

Your company or a representative must meet with the factories producing your orders. Ideally before production even begins a visit can take place so as to confirm all details communicated are accurate while also performing an audit of the facilities and business licences. Of equal importance is the benefit of meeting the owners and management of the business, to understand the roots, the current challenges and the future plans for the factory. This can be incredibly helpful in forming a decision about whether or not this factory is the right fit.

Payment and Risk

Payment to a properly sourced (audited and visited) factory will bear no greater risk than with any business identified in the West. However the benefit of dealing with a Managed Sourcing Company or a factory directly, as opposed to a trading company or other agent, is usually that the company actually producing the order is known, and operates from a traceable address.
Ask yourself: “Can we trust paying 40%+ upfront to a ‘company’ that has not been visited yet?” Mitigating sourcing risk requires far more than simply using an online platform and choosing a listed company to be a supplier, but unfortunately that is how many companies’ sourcing activities start and finish. Paying a company you have not audited and have little ability to chase will be a huge gamble and is therefore inadvisable. If you cannot find the time or resources to visit an identified China factory, then you need to find a third party that can, on your behalf.

**Quality Assurance**

Skipping forward and assuming that all due diligence has resulted in the successful sourcing of a factory, including:

- Satisfactory price, payment term and shipment negotiation,
- Agreed product quality level,
- The satisfactory completion of a factory audit,

One remaining responsibility is the action of effective production inspection(s).

The importance of being able to conduct independent quality inspections on China based production cannot be overstated. Quality control is largely achieved by inspecting production as part of a broader quality assurance system, including inspection/testing methodology, inspector/factory training, auditing and the production sample handling and storage process.

It is advisable not only to rely on a factory’s own quality assurance system. Factories will have their own concept of quality and its importance to the products. For certain items, product quality can only be achieved by using the factories, which already have quality built into the product via the machinery, equipment and staff that they employ.

For products which need tooling in order to be produced, submitting 3D drawings for the tooling makers to use will help limit any unexpected issues. However, samples from the tooling will need to be checked before production can be signed off.

In fact, checking pre-production samples is one of the best ways to ensure production will be accurate, as it transcends language barriers and cultural confusion. Within a matter of seconds dimensions, colour, surface finish, material feel and overall appearance can all be assessed and confirmed/rejected. Rejecting products with quality problems is essential and one can generally follow an “acceptable quality level/limit” rule, expressed as a percentage of defects in a batch or other easily quantifiable form. This system is useful when batch size is larger than can be reasonably inspected.

By showing a factory at the stage of pre-production that a system is used, will leave little room for later debates regarding what is and is not acceptable quality. Agreeing what the method of rework or compensation shall be in the event of a quality issue should also help save time later on.

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The importance of being able to conduct independent quality inspections on China based production cannot be overstated.

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This section on sourcing from China and quality assurance was written for CBBC by member company and strategic sourcing specialists Chinawand.

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The Changing Nature of China in Global Supply and Value Chains

British companies for many years opted to locate part of their supply chain in China in order to cut costs and to establish a foothold in one of the world’s most alluring markets. For many, China has become a valuable – sometimes indispensable – part of their supply chain as well as a source of revenue growth.

These days, however, constraints on labour supply, a less accommodating policy environment and increasingly capable Chinese domestic competitors are forcing many companies to rethink the nature of their presence in China.

For those considering developing more complex technical capabilities internally (for the purposes of this article section called “offshoring”) or externally (termed “outsourcing”) in China, either in a bid for long-term success in the Chinese market, to leverage and develop an existing supply chain, or for both of those reasons, this article outlines a few considerations that can be crucial when increasing the complexity of operations in China.

Understanding Current Practices

Given the time and resources required to handle the additional complexities and ambiguities when locating part of your value chain in a Chinese setting, it can be helpful if the process is initiated with as much clarity as possible with regard to the relevant workflows in their current setting.

In most companies, some daily operational workflows remain un- or under-documented. This is sometimes simply because it takes time to write them down; and sometimes because the operational reality for certain groups or individuals is perceived to be at odds with the requirements they would be faced with, if workflows were to be set down in explicit documentation, rather than based on tacit acknowledgement. In other instances, official workflow procedures do exist, but for various – sometimes similar – reasons, daily work is undertaken in a way that does not comply with them.

Whatever the reasons for differences between procedural dictate and operational reality, understanding those reasons and (re)aligning documentation with practice is important. It ensures that procedurally unaddressed issues are not transplanted to an environment where the cost of informal workarounds are higher than at home, both with regard to the implementation of specific workflows, as well as the more general issue of building a culture of attention to detail, procedural or otherwise.
Adapting to the Chinese Context

Ensuring that robustness of documentation translates into operational efficacy in your Chinese organisation is likely to require attention to its particular needs with regard to capability-building, whether culturally determined or caused by other differences in its internal or external environment.

There are of course many ways of addressing such needs; for example by adjusting workflow documentation to local requirements, by decreasing workflow complexity, through on-the-job training or by building organisational culture. Most of these approaches will most probably constitute some part of the solution although the latter, of course, very rarely is a short-term endeavour.

Implementing increasingly complex workflows within a framework of both accountability and autonomy requires time in any offshore organisation – often more time than hoped for or even expected. The impact of differences in skill-levels, language and culture, time-zone differences and physical distance on knowledge-intensive communication and teamwork, and on the consumption of time during iterative phases of design, engineering, testing and production implementation can be hard to gauge.

Gradual Capability-Building

The most prudent approach to capability-building in a Chinese context (and presumably in many other places) is in most cases a gradual one. The tales of time and money squandered in a newly formed department or subsidiary tasked with responsibilities beyond the short-or medium-term reach of its capabilities are legion. Other companies have opted to start capability-building by offshoring and/or outsourcing either fairly mature products or more straightforward workflows and only then started handing over responsibility for more complex tasks. In a recent study of the impact of offshoring and outsourcing on product development, one successful case had started by offshoring all production, then parts of production ramp-up, testing, refinement and detailed design, then outsourced all embedded IT, offshored parts of the system level design and finally outsourced all production. Such a gradual approach to outsourcing and offshoring, although unlikely in itself to guarantee a successful outcome, in many cases certainly seems to be an important part of it.

Attention at Headquarters

Various companies have chosen different types of human resources to drive, facilitate and support the establishment of new capabilities in China. Some have drawn on talent within an existing Chinese organisation, others have dispatched or hired more or less transitional expatriate managers or engineers, or new Chinese staff with sufficient international experience, English skills and technical expertise.

Regardless of the human resources deployed in the Chinese organisation, however, the attention of management at headquarters is of paramount importance. This is for reasons of accountability, and to ensure that various stakeholders and sources of knowledge at home, and possibly at other sister companies, are given sufficient resources and encouragement for them to take constructive part in a dialogue that can facilitate capability-building informed by both existing know-how and Chinese particularities.

This section on building value chain capabilities in China was written for CBBC by member company and product engineering, sourcing and manufacturing specialists SinoScan Group.

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Update on the Pilot Free Trade Zones

The first in a wave of “pilot” free trade zones started with the China (Shanghai) Free Trade Zone (SFTZ), launched in September 2013. Its aim was and is to market-test a series of trade, investment and financial reforms with a view to their eventual implementation across China. In parallel with the expansion of the SFTZ’s original boundaries following the initial roll out of reforms, the concept of the pilot free trade zone is increasingly being used by the Chinese government to earmark different regions for accelerated reform to promote cross-border trade, investment and finance. There are currently four pilot free trade zones in China, with additional zones being considered by other regional authorities:

- **Shanghai Free Trade Zone:** comprising the Lujiazui Finance Area, the Integrated Bonded Areas, the Jinqiao Development Area and the Zhangjiang High-technology Area
- **Guangdong Free Trade Zone:** comprising the Nansha Area of Guangzhou, the Qianhai and Shekou Areas of Shenzhen and the Hengqin Area of Zhuhai
- **Tianjin Free Trade Zone:** comprising the Tianjin Port Dongjiang Area, the Tianjin Airport Area and the Binhai CBD Area
- **Fujian Free Trade Zone:** comprising the Fuzhou, Xiamen and Pingtan Areas

The SFTZ, being the first of the four zones to be established, has become the base model to be followed by each of the other zones in developing their own separate regimes – the high water mark of liberalisation among China’s pilot free trade zones. To implement their respective trade and investment policies locally, however, the authorities of each zone are responsible for the passing and implementing of regulations in their respective zones. Each zone therefore displays a slightly different policy emphasis reflecting local priorities – examples include integration of the Guangdong FTZ with Hong Kong and Macao; development of the Tianjin FTZ with the wider Beijing-Hebei region; and the liberalisation of trade, investment and personnel exchange between the Fujian FTZ and Taiwan. However, the reforms in all of the zones are crafted from a common blueprint.

The nationwide replication of the policies originally developed in the SFTZ has been gradual. Key policies originating in the SFTZ which have been replicated in the form of national legislation include the removal of generally applicable minimum registered capital requirements and capital contribution deadlines, the reform of the enterprise annual inspection system, the lifting of restrictions on foreign ownership of certain e-commerce businesses and the issue of large scale certificates of deposit.

**2015 Negative List Applies Across all Four Zones**

Under the “negative list” approach, if one seeks to establish a foreign-invested entity in a free trade zone in an industry that does not appear on the negative list (last revised in April 2015), this generally requires only a filing to be made, and no longer requires prior foreign investment approvals from the Ministry of Commerce and National Development and Reform Commission. Pioneered in the SFTZ, the negative list has been made applicable to all four zones in 2015, with the process of implementation being the most advanced in the SFTZ.

The first negative list was launched in the SFTZ in 2013, covering 190 restrictions and prohibitions. This list was reduced to 139 in 2014, and 122 in 2015. The 2015 revision is the negative list that applies in all the four zones. It eliminates restrictions and prohibitions in a range of manufacturing sectors covering certain beverages, chemicals, pharmaceuticals and industrial equipment as well as other retail, real estate and media services. In the sectors it covers, the 2015 negative list also aims to set out the various foreign investor and foreign invested entity specific qualifications and other requirements on market access which, by not applying to purely domestic entities, fall outside the principle of “national treatment”.
National Security Review Applies Across all Four Zones

In parallel with the negative list’s new approach to foreign investment, an enhanced national security review regime applies to foreign investment in the free trade zones. Key differences from the national rules (which were introduced in 2011) include the express requirement for reviews of greenfield investments, the expansion of the range of sectors reviewed and factors considered, and the ability of the review body to issue a conditional clearance.

SFTZ Sets Pace of Development in Other Pilot Zones – some examples

Free Trade Accounts

As the SFTZ continues to open up, the Shanghai headquarters of the People’s Bank of China (Shanghai PBOC) has enabled banks in Shanghai to establish independent business units to provide a special bank account facility, known as a free trade account, to residents of the SFTZ. These free trade accounts enable RMB funds, including those borrowed from outside China, to be freely remitted between RMB accounts outside of China and the SFTZ for the following purposes:

- Current account transactions such as service fee payments;
- Repayment of RMB denominated loans (for a term longer than six months) borrowed by the account holder from banks in Shanghai;
- Industrial investment, including investment by way of new establishment, mergers and acquisitions and capital increases.

This year, Shanghai PBOC extended the functionality of the free trade account to include the free movement of foreign exchange funds between the SFTZ and outside China, making it a dual currency account. It has been reported that preparation is underway for free trade accounts to be introduced in the other three zones, either simultaneously or consecutively.

Cross-border Financing

In parallel with the Chinese government’s efforts to internationalise the RMB, Shanghai PBOC has introduced relaxed policies on the use of cross-border financing in the SFTZ. In 2014, Shanghai PBOC issued a new policy permitting SFTZ enterprises to borrow an aggregate amount of offshore RMB up to the amount of their paid-up registered capital (multiplied by 1). This was followed by further rules from Shanghai PBOC in 2015, which enables this limit to be applied for the borrowing of offshore foreign currency as well as RMB. The new rules increase the multiplier to 2 and simultaneously introduce a weighting-based formula in the application of the limit. The new formula gives borrowers the flexibility to tailor their offshore debt profiles based on term, currency and other weightings. The new scheme is simultaneously being tested in the Qianhai Area of the Guangdong Free Trade Zone. Funds borrowed under the new scheme have to be used either in the SFTZ or outside China and certain transfers to mainland China bank accounts outside the SFTZ are subject to the existing foreign debt regulations.
**Commodities**

Closely associated with the development of the SFTZ are the efforts to promote Shanghai as China’s key hub for commodities trading. The Shanghai International Energy Exchange, established in November 2013, will be the first futures exchange in China that will grant direct trading access to overseas participants outside China. The exchange’s consultation draft rules were published in 2015 and its first crude oil futures contract, which will trade in the SFTZ, is expected to be launched by the end of 2015. Also being developed in the SFTZ in the course of 2015 are 10 other commodities exchanges which will admit direct foreign participation.

**Finance Leasing**

The Tianjin authorities have issued a series of policies to facilitate the development of the finance leasing industry in Tianjin. The Dongjiang Port Area of the Tianjin Free Trade Zone is a key hub of this development. Here, the establishment of finance leasing subsidiaries with no minimum equity capital requirement and of aircraft leasing subsidiaries for the undertaking of multiple projects will be permitted, and it will be possible to register single project companies within the same group under a common address. The Tianjin customs authorities have followed through by permitting leasing companies registering with Dongjiang customs to have the flexibility of undertaking aircraft import and export inspection formalities at a different port, and a timeframe of 10 business days has been set for the processing of export tax refund applications made by finance leasing enterprises.

**Other Zones Implementing SFTZ’s Policies – some examples**

**Local Cross-border RMB Financing Initiatives**

The Guangzhou branch of the People’s Bank of China announced that borrowers established and conducting business or investing in the Nansha or Hengqin Areas, as well as borrowers from other parts of Guangdong province investing in key projects in the two areas, would be eligible to borrow RMB funds from banks in Hong Kong and Macao for their activities in the two areas and for outbound investment projects. Together with a similar scheme first announced in Guangdong’s Qianhai in 2012, RMB cross-border financing reform is now effective in much of the Guangdong Free Trade Zone and it is expected to be extended to the Shekou Area in short order. A similar scheme is being tested in the Xiamen Area of the Fujian Free Trade Zone for Xiamen borrowers to raise RMB financing from banks in Taiwan.

In collaboration with CBBC, the International Experts Consultation Group has produced a total of 12 discussion papers and two think pieces since June 2014 in response to specific requests from Chinese policymakers. The findings of the discussion papers have been delivered through a series of discussions and joint activities with Pilot Free Trade Zones’ key decision makers.

The intention is to provide practical support for the development of China’s Pilot Free Trade Zones’ policy development. Through interaction with the relevant authorities, the intention is to use the experience of the UK’s economic development to support the China’s economic and trade liberalisation, as well as its long-term sustainable development.

Successful Pilot Free Trade Zones will be an important catalyst for economic reform and will greatly enhance international trade and investment flows. This will have a direct and positive impact on increasing global prosperity.

This section was written for CBBC by full service law firm and CBBC member company Linklaters LLP in July 2015.

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International trade and cross-border payments are nothing new to the Chinese since China opened its doors to the world over 30 years ago. Chinese companies have been trading with their overseas counterparts in different currencies for many years. In China, USD, GBP, EUR and other freely convertible currencies are available for trade settlement and trade finance.

**USD and Other Currencies are Accepted While RMB is Encouraged**

USD is still considered to be one of the most popular international trade settlement currencies in China. Meanwhile, in line with the gradual internationalisation of the Chinese currency renminbi (RMB), RMB has been encouraged to be used as a contractual and settlement currency for both imports and exports. Many overseas businesses are said to benefit from trading with Chinese companies in RMB. For example, overseas importers may be able to negotiate better trade terms with Chinese exporters since it removes exposure to the risk of foreign exchange fluctuations for the Chinese companies.

Recent SWIFT data shows that growth in RMB payments is supported by an increasing number of banks. In May 2015, over 1,000 financial institutions used RMB for payments between China and Hong Kong, representing 35% of payments across all currencies. This was a 22% year on year increase in the number of institutions using RMB, and up from 29% two years ago. ²

Overall, RMB strengthened its position as the fifth most active currency for global payments in value and accounted for 2.18% of payments worldwide in May 2015.

**Trade Settlement and Trade Finance Products are Widely Used by Chinese Companies**

Banks in China can provide export and import trade settlement services and trade finance products to their customers. In fact, trade settlement and finance products are widely used for international trade in China already. These services and products have played important roles in promoting China’s imports and exports in recent years.

For trade settlement, Documentary Letters of Credit, Documentary Collection and Telegraphic Transfers (T/T) are basic and traditional services for all banks in China. Banks can provide services strictly according to international practices, including advising Letters of Credit, negotiations with Letters of Credit, as well as collections of Documents against Payments (D/P) or Documents against Acceptance (D/A).

Footnote:
² Source: SWIFT RMB Monthly Tracker 2015 (www.swift.com)
Banks in China can also provide trade finance facilities, such as:

**For exporters:**
- Adding confirmation to incoming Letters of Credit and pay/accept as a confirming bank;
- Providing pre-shipment finance to Letter of Credit beneficiaries;
- Providing finance to the beneficiary against the documents under export Letters of Credit;
- Discounting accepted bills with recourse to the beneficiary;
- Forfeiting (purchasing) the accepted bill without recourse to the beneficiary.

**For importers:**
- Issuing Import Documentary Letters of Credit
- Providing finance under import Letters of Credit
- Issuing Standby Letters of Credit or Letters of Guarantee

Furthermore, some banks in China, depending on their business focus, can provide receivable finance, such as factoring, supply chain finance, commodity finance and other new products, including structured finance, to facilitate international trade between Chinese and overseas companies.

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Travelling to China for business can be an enjoyable experience. In order to make sure your trip goes smoothly, CBBC has prepared a list of things to watch out for. While not exhaustive, it is recommended that you take these points into consideration both before and during your stay in China.

Before you leave: Preparing for your Trip

Remember to apply for a visa: Most travel to China necessitates obtaining a visa. There are two main types of visa depending on the nature of your trip. M visas are issued to those who intend to go to China for commercial and trade activities; while F visas are issued to those who intend to go to China for exchanges, visits, study tours and other more general activities. The processing time for most Chinese visas is typically four working days (though this can be expedited with a premium charge).

In the case of very short term trips there is also now an option for visa-free transit. This option is available in Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Harbin, Shenyang, Dalian, Xian, Guilin, Kunming, Wuhan, Xiamen, Tianjin and Hangzhou and can be used by anyone with confirmed onward transit within a 72 hour period.

Change money: China’s currency is the renminbi (RMB, also yuan/CNY). It is a good idea to change some money before you go to China. It is also important to note that outside large hotels and some international shops, vendors will rarely accept international credit/debit cards. However, most of the large banks have ATMs that accept international credit/debit cards (at a fee).

Pack wisely: Weather varies dramatically across China. Some parts of the country can be extremely warm and humid or cold depending on the season. It is important to look up the relevant forecasts to ensure a decent level of comfort throughout the duration of your stay.

Bring power adapters: China operates on a 220V/50HZ system. Chinese sockets are similar to those found in the US.

Keep in mind that internet access is restricted: You will experience restricted access on certain foreign websites and apps. This includes Google, Gmail, Google Maps, Wikipedia App, Facebook, YouTube and Twitter. However, some paid subscriptions to Virtual Private Networks (VPNs) can allow smooth access.
Arrange travel insurance:
It’s better to be safe than sorry, so you should arrange travel insurance before your trip to China. Ideally, make sure your travel insurance covers international hospitals where staff speak English, visits to which can be very expensive if self-funded.

Remember the time difference:
The whole of mainland China is under one time zone - China Standard Time, CST (GMT+8) - all year round. CST is 7 hours ahead of British Summer Time (BST). This is important to keep in mind when calling business partners or your prospective hosts in China.

Schedule a jet-lag recovery period: Given the time difference, it is a good idea to allow for some time to acclimatise.

Have emergency contact information prepared: This could be choosing personal contact, or your CBBC relationship or project manager if you have one.

Arrange an interpreter: As English is not widely spoken in China, arranging an interpreter may be useful. CBBC can arrange this for you.

Bring plenty of business cards:
Exchanging business cards is a frequent activity when conducting business in China. It is recommended to print double-sided English/Chinese cards, and hand them to your Chinese counterparts with both hands.

Research Chinese local customs/practices: You will impress your guest if you familiarise yourself with some of the more nuanced traditions of the cities you will be visiting (e.g. in Guangdong, it is customary to wash bowls and cutlery yourself before eating – this is typical even in very clean restaurants as well).

Locate the closest embassy/consulate: Keep the embassy’s contact details on hand in case you encounter a situation that requires consular support. The UK has a presence in the following locations:

- Beijing (British Embassy):
  +86 (0)10 5192 4000
- Shanghai (Consulate-General):
  +86 (0)21 3279 2000
- Guangzhou (Consulate-General):
  +86 (0)20 8314 3000
- Chongqing (Consulate-General):
  +86 (0)23 6369 1400/6369 1500
- Wuhan (Consulate-General):
  +86 (0)27 8577 0989 (valid until the end of 2015)
Once in China: Practical Issues

**Taxis:** Have the address of your hotel and destination written/printed in Chinese characters (汉字). Taxi drivers will usually not be able to understand English writing or Romanised Chinese written with the Latin alphabet (also known as pinyin). Note that it is very difficult to get a taxi on rainy days and during rush hour, and big Chinese cities can get very congested at these times. Never take unlicensed taxis (known as “black taxis” in reference to their being illegal rather than their colour). Always ask to use the meter.

**Account for irregular travel times:** Whether travelling within a large city or cross-country, it is a good idea to account for delays and longer than usual travel times. This is especially true in cities such as Beijing or Shanghai where traffic can increase transit times considerably. Generally speaking, the trains in China run on time, but planes are often delayed. The high-speed rail network (with an average speed of 200 km/h) is a fast, comfortable and reliable choice.

**Road safety:** Crossing the road can be precarious for someone unfamiliar with Chinese traffic laws and how they are applied. Cars do not have to stop at zebra crossings, and they are allowed to turn right through red lights even if there is a green man at the pedestrian crossing. Many roads have cycle and motorcycle lanes, in which traffic rules are rarely fully adhered to. Be careful, and when in doubt, follow a local.

**ATMs:** Unlike in the UK, you will receive your cash first, and then the card. Do not leave without both!

**Give your hosts ‘face’ at all times:** ‘Saving face’ is one of the most important aspects of Chinese culture. Even inadvertently causing your host/business partners to lose face – e.g. by showing them up or correcting them in front of their peers - can be disastrous for your relationship with them, even if they do not show embarrassment at the time.

**Physical contact:** Although shaking hands has become the norm for business greetings in China, it is often deemed unnecessary on social occasions. Avoid physical contact such as hugs and back patting, particularly of the opposite sex.

**Speak slowly and clearly:** English will not be your counterparts’ first language. Speaking slowly and in a simple (but not patronising) manner will help ensure that you convey your message effectively. Try also to limit using British humour or sarcasm as Chinese people will likely find this strange or rude.

**Avoid taboo subjects:** It is unwise to bring up politically sensitive subjects such as Taiwan or South China Sea island sovereignty, Tibet or Xinjiang secessionist movements, official bribery, human rights or jokes of an adult nature.

**Business card etiquette:** Always give and receive business cards with both hands and a short bow. When receiving a business card, do not put it immediately in your pocket, as this may be portrayed as flippant. Take a moment to inspect it and then place it gently in your pocket or portfolio.

**Business negotiations can be drawn out considerably longer than in the West**
Once in China: Hospitality & Dining

Chinese food is shared: In most situations, food is ordered for the whole table for everyone to share. It would be considered very odd to keep the tastiest dishes to yourself (this rule does not apply when eating Western food).

Chopsticks: Be aware that many restaurants do not have Western-style cutlery. Some visitors choose to bring their own.

Do not be alarmed by drinking: Drinking alcohol is common at business dinners in China, as alcohol is thought to show an individual’s ‘true face’. If you do not wish to drink, make this clear to your host before dining (be prepared to hold your ground). The traditional Chinese liquor is Baijiu, though beer also very common.

Guests eat first: Your host may insist that you, as the guest, be the first to try each dish.

Expect your host to offer you excessive amounts of food: It is considered hospitable to invite your guest to eat to excess. But they will understand that everyone has their limits.

Arguing to pay the bill: At the end of the meal, Chinese people will usually fight over paying the bill. This is done to demonstrate their generosity.

If invited to a private dinner, bring a gift: Gift giving is part of Chinese culture, including at business meetings. If invited to somebody’s home for dinner, bring something for the host (some fruit, for example, will suffice). Ideally, any gift should be presented in a gift box or a gift bag. Do not be disappointed if your host does not immediately open it and comment on its attractiveness/practicality. It is common for them to do so in private later to avoid looking greedy.

Avoid gifts that bear negative connotations: Items which may raise eyebrows include: clocks (=death), cards written in red ink (=sever relations) or books (=losing). Very expensive items may also cause your hosts to worry about how others would perceive the nature of your business relationship. This latter is especially important in the light of recent anti-bribery campaigns.

Basic Mandarin

The written language is uniform throughout China but, as in other countries, Chinese dialects vary from region to region. The standard language, Putonghua (often called Mandarin), is similar to the Beijing dialect and is spoken by most people across the country. This is the language of business and if you would like to learn some Chinese, Putonghua is the one to study. There are numerous free-to-access websites designed to help you learn Putonghua, and some simple phrases are below.
<table>
<thead>
<tr>
<th>English Phrase</th>
<th>Pinyin (Romanised Chinese)</th>
<th>Phonetic Pronunciation</th>
<th>Chinese Characters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hello</td>
<td>Ni hao</td>
<td>Nee how</td>
<td>你好</td>
</tr>
<tr>
<td>How are you?</td>
<td>Ni hao ma?</td>
<td>Nee how ma?</td>
<td>你好吗？</td>
</tr>
<tr>
<td>Goodbye</td>
<td>Zaijian</td>
<td>Sigh jyen</td>
<td>再见</td>
</tr>
<tr>
<td>Thank you</td>
<td>Xiexie</td>
<td>Share share</td>
<td>谢谢</td>
</tr>
<tr>
<td>You’re welcome</td>
<td>Bukeqi</td>
<td>Boo ke chee</td>
<td>不客气</td>
</tr>
<tr>
<td>Sorry</td>
<td>Duibuqi</td>
<td>Dway boo chee</td>
<td>对不起</td>
</tr>
<tr>
<td>No problem (it’s okay)</td>
<td>Mei guanxi</td>
<td>May gwan shee</td>
<td>没关系</td>
</tr>
<tr>
<td>I would like to go to...</td>
<td>Wo xiang qu...</td>
<td>Wor sheang choo</td>
<td>我想去</td>
</tr>
<tr>
<td>Hotel</td>
<td>Jiudian</td>
<td>Jeew Dyen</td>
<td>酒店</td>
</tr>
<tr>
<td>How much is...</td>
<td>Duo shao qian</td>
<td>Dwo shao chee-yen</td>
<td>多少钱</td>
</tr>
<tr>
<td>Too expensive</td>
<td>Tai guile</td>
<td>Tie gway-la</td>
<td>太贵了</td>
</tr>
<tr>
<td>Toilet</td>
<td>Cesuo</td>
<td>Tsir swor</td>
<td>厕所</td>
</tr>
</tbody>
</table>
3. Incorporation & Operating Businesses in China

This chapter is designed to provide an introduction and some practical considerations for companies thinking about setting up and operating a business in China.

The first section on incorporation is designed to get companies asking themselves the right questions about their business needs, and how that will affect the type of legal entity required.

The second section aims to give an idea of the taxes required for starting and then operating a company in China, including those additional expenses which you would not normally associate with variable costs.

The third section is on considerations which should be made when leasing office space or industrial facilities for your China business, including an indication of average rents, and some practical items to consider when going into rental contract negotiations.

In the fourth and fifth sections we discuss how businesses can market their products and services, including some considerations for digital marketing, with a view to establishing and growing a client base in the market.

The sixth section covers practical considerations for the business of hiring and firing, including information on wages, things to look out for in local labour laws, and also what options there are in the case of a dispute with your employees.

Lastly, three case studies are provided to illustrate some of the pitfalls international companies can fall into in China, and how to circumvent them during your own market entry journey.
3.1 Setting up China Operations

The Questions that Determine your Business Model

When entering the Chinese market, companies should consider a few key questions in order to find out which type of entity suits their operations best. Below please see a series of questions that all companies should ask themselves.

1. Purpose
   What are you looking to do in China – export or import products, manufacture, or provide services?

2. Customers
   Where are your customers – in China or overseas?

3. Suppliers
   Where are your suppliers?

4. Function
   What would be the functions / activities of your China entity?

5. Payment
   Your customers will settle your invoice from which company – the China one or the overseas one?

6. Location
   In which city in China are you looking to locate your company? Are there any specific municipal or district regulations and policies?

7. Employees
   Are you looking to hire any employees in China? If yes, how many are local / foreign employees?

8. Activities
   What activities would these employees be performing?
Business Models

Based on the answers to the above questions you can decide which type of entity suits you best.

Buying Structure for Export

Enterprises that are looking to source in China for export overseas are advised to establish a Hong Kong company rather than establishing a trading facility in mainland China due to VAT issues.

By founding a Hong Kong company you will enjoy significant tax and operational benefits. Profits can be structured tax free or at a low rate of 16.5%.

Furthermore, you will be able to sell directly from Hong Kong to worldwide clients without involving your headquarters, and without goods burdening your warehouse. As a result, you can offer lower FOB Asia prices. In addition, you do not require bank credit since your clients would open a transferable Letter of Credit. This frees up your capital and improves cash flow.

Selling Structure for Importing into China

For companies that are looking to sell into the Chinese market, a Limited Liability Company (LLC) in the form of a Wholly Foreign Owned Enterprise (of a Foreign Invested Commercial Enterprise) would be required, especially if you are planning to sell into RMB to your customers. This type of LLC is a limited liability company wholly owned by the foreign investor(s). It allows foreign investors to manufacture, process, assemble, trade, distribute or deliver services in China. Setting up an LLC does not necessarily mean that you can engage in any sort of activity, as may be the case in the West and certainly in Hong Kong. It can only be operated within the scope of business as approved by the authorities, and on the business licence.

Providing Services in China

When providing any type of service in mainland China the issue of whether to establish a Limited Consulting Company comes down to whether the customers in China require you to have a Limited Company in China and / or require you to invoice them in RMB. Should you need to invoice them in RMB for the services being provided, then it would be necessary to establish a Limited Consulting Company. Should it be possible to invoice in a foreign currency then an alternative could be to open the consulting company in Hong Kong. In addition, with the internationalisation of the RMB, it is also possible to invoice in RMB from a Hong Kong company, but the China company must be authorised to remit RMB overseas.

Manufacturing in China

If manufacturing in China, you need to establish a Limited Manufacturing Company. For this, you are required to rent a factory space as a registered address. The local Administration of Industry and Commerce (AIC) will check the factory in person before registering the company.

In addition, a manufacturing WFOE is required to obtain approval from the Environmental Protection Bureau and a full report on the estimated environmental impact of the factory issued by a qualified agent is required. This is intended to ensure compliance with specific environmental norms. The Bureau will require information about the raw materials used, the machinery and equipment, and the consumption and safe disposal of toxic products. Therefore, you will need to engage a local qualified agent to do an Environmental Assessment Report.

According to some local regulations, it may also be necessary to provide a Feasibility Report by a local qualified agent.
Hong Kong as a Holding Company for a China Company

Whether you establish a Representative Office, Joint Venture or Limited Company in mainland China, a Hong Kong company can be used as a holding or as a trading company for transactions dealing with the mainland China entity.

The Hong Kong holding company is fully liable for the China investment and protects your existing company. Also, dividends received by your Hong Kong Holding Company are tax free, but incur a 5% withholding tax in China compared to 10%-20% in other countries, and can be used for further investment.

If you are planning on establishing a Joint Venture in China, we recommend that you first set up the Joint Venture with your Chinese partner in Hong Kong as it would be based on Hong Kong law. Additionally it would be much easier to exit this Joint Venture in the future and it would be advantageous to receive your dividends from China in Hong Kong due to the favourable Hong Kong tax laws. From this Hong Kong Joint Venture, you can then establish a Wholly Foreign Owned Enterprise in mainland China (based on one shareholder which is your Hong Kong Joint Venture).

Types of Entities:

Limited Companies

A Limited Liability Company is an independent PRC legal entity and is legally responsible for all its activities. This includes the following below:

- **Wholly Foreign Owned Enterprise (WFOE)** – owned solely by a foreign investor(s) e.g.:
  - Management Consulting Company
  - Information Technology
  - Recruitment
  - Architecture and Design
  - Logistics
  - Restaurants
- **Foreign Invested Commercial Enterprise (FICE)** – is a WFOE which handles import and export functions e.g.:
  - Wholesale Trading
  - Retail Trading
  - E-commerce Trading
  - Manufacturing
- **Domestically Invested Enterprise (DIE)** – owned solely by mainland Chinese investor(s)
- **Joint Venture (JV)** – owned by a foreign investor and a mainland Chinese investor
- **Foreign Invested Partnerships (FiPs)** – foreign companies and individuals are permitted amongst themselves or in partnership with China (domestic individuals or entities) to directly establish foreign invested partnerships
A Representative Office (RO) is not an independent PRC legal entity, but rather a type of liaison office with a limited range of authorised activities. The parent company of the RO is legally responsible for its activities. An RO can only be invested in by an overseas corporate entity and this entity is required to have existed for over two years.

ROs are prohibited from engaging in directly operational business activities and must operate according to local market conditions, for example through market research, liaison activities or local procurement.

Representative Offices have long been the favoured type of entity for foreign enterprises wishing to conduct business in China. Recently however, Chinese authorities have started enforcing further restrictions on ROs and are investigating them more intensely. If the foreign investor is not 100% within the operational parameters of an RO, it would be highly recommended to avoid such a structure. Additionally, the requirements are now such that ROs are no longer the cheapest and easiest form of entering the market, as restrictions on WFOEs ease.
Incubators

If business trips to China are proving to be financially onerous or time-consuming, there are other methods to have someone represent you in China without incorporating a company locally. A short- to medium-term option is to use a business incubator service, allowing you to have a year-round representative on the ground.

As is the case with ROs, staff working in business incubators may not conduct business activities which generate revenue in China, and may not issue Chinese invoices using their own name. Incubators are therefore popular with companies “testing the water”, carrying out market research on their prospective Chinese clients, promoting their UK business, or carrying out sourcing or quality control activities.

Considerations

Registered Capital

ROs must be funded by the parent company, but they do not have any further requirements in terms of registered capital.

For LLCs, there are no official requirements in terms of minimum investment and statutory schedule, but local authorities require your business model to be feasible and to have a reasonable cash investment. There is a great deal of confusion over the term “Minimum Registered Capital”. The term is used by local governments as a guideline only, and the LLC needs funding via its registered capital until it is able to support itself from its own cashflow.

Registered Office Space

ROs are not subject to any requirements in terms of office space.

An LLC must have office space prior to registration, and the company address must be situated in a commercial building. Additionally, you are required to provide various rental and real estate certificates and contracts. In terms of size, there is no official requirement. The tax bureau will check office premises before issuing General VAT taxpayer status (a specific status that allows companies to issue VAT invoices and offset them against their output VAT), making sure that you are actually operating out of China. It is therefore advisable to have at least three or four workstations in the office.

CBBC Launchpad is an example of a business incubator, through which UK companies can have their own representative working for them in China, with their own space in one of CBBC’s 13 offices. More details about CBBC Launchpad can be found at: www.cbbc.org/services/launchpad/
that allows companies to issue VAT invoices and offset them against their output VAT), making sure that you are actually operating out of China. It is therefore advisable to have at least three or four workstations in the office.

**Tax Requirements**

Since an RO is not allowed to have any profits, its tax duty is based on its expenses. The presumed profit rate is no less than 15%. The Enterprise Income Tax payable on this amount is 25%. Business Tax for ROs that issue service invoices is 5% and due monthly.

LLCs pay Enterprise Income Tax of 25%, due quarterly. They also pay VAT. Assuming an LLC has a turnover of over RMB 800,000, it is eligible to obtain the aforementioned General VAT taxpayer status. The VAT rate is 17% on tangible goods and 6% on most services. The LLC can offset Input VAT against Output VAT. VAT is due monthly.

You are further required to pay various surtaxes, for example the Education Surtax (3%) or the Urban Maintenance Surtax (1-7%, depending on the region). Lastly, Stamp Tax is required, though it is relatively minimal. Employees must pay individual income tax monthly.

**Accounting Requirements**

A LLC and a RO are now required to produce all financial management reports. A LLC may offset its expenses against its revenue as is typical in any LLC.

A RO may not offset its expenses, but rather must treat its expenses as profit.

**Payroll Requirements**

An RO is not allowed to handle its own payroll. It must hire a Chinese third party agency both to hire employees and to hire the payroll. For LLCs, however, there are no specific requirements regarding payroll.

**Timeframe**

An RO is set up within two months. Setting up an LLC takes between six and nine months, not including for instance the time it takes to conduct the Due Diligence and to set up contracts with Chinese partners.

**Due Diligence**

Because of the complexity and opacity of Chinese market structures and enterprises, conducting Due Diligence is of great importance for foreign investors who wish to partner with a Chinese company through a Joint Venture.

Due Diligence is not as straightforward in China as it is in Western countries, and you may face several obstacles, such as language, lack of documentation or the organisation of reluctant Chinese partners.

**Conclusion**

In recent years, the circumstances for companies wishing to enter the Chinese market have changed considerably. Representative Offices are no longer the cheapest and easiest way to set up operations, and WFOEs and other types of LLCs have become more attractive.

There are many different factors that should be taken into consideration, but generally, a Limited Liability Company offers good flexibility at reasonable cost. When partnering with Chinese companies, foreign investors should be aware of differences between the Chinese investment environment and that of their domestic market.

This section was written for CBBC by professional services specialists and CBBC member company Koehler Group.

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3.2 Tax System & Unseen Costs

The Chinese tax system has changed rapidly over the past few years, in line with the pace of economic development. The charts below summarise key taxation information for business cycles that are typically relevant to foreign companies conducting business in China.

Stage 1: Company Registration

Company registration in China is a complex procedure, involving nine to 12 government authorities, and can take several months. If pre-approval is needed for certain industries, it may take an additional month or longer. The main taxes related to company registration are stamp duties.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Items</th>
<th>Tax rate</th>
<th>Remark</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stamp Duty</td>
<td>Permits and licences</td>
<td>RMB 5 / per licence</td>
<td>Stamp duties are paid when agreements are signed. The contract’s total value is used for tax calculations. The applicable tax rate depends on different contract categories.</td>
<td>For a company that signs an office leasing contract, with monthly rental of RMB 100,000, for a leasing period of 24 months, the stamp duty payable when the contract is signed is: RMB 100,000<em>24 months</em>0.1%= RMB 2,400</td>
</tr>
<tr>
<td></td>
<td>Property leasing contract</td>
<td>0.1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Registered capital</td>
<td>0.05%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Stage 2: Employee Recruitment

Tax relating to employees is Individual Income Tax, which is borne by the employees but withheld by their employer. Additionally, social welfare and housing fund costs are related to the employment of staff.

If your job applicant is asking for a net salary, you need to add up the individual income tax, social welfare and housing fund to work out the total cost. For a local employee, the employee payable part is approximately 32% of the gross salary and the employer payable part is 44% of the gross salary. If the gross salary is more than three times the local average monthly salary (e.g. more than RMB 19,389 in Beijing) then the social welfare base shall be that amount.

For example, for a monthly net salary of RMB 8,000, the social welfare and housing fund by both employee and employer shall be approximately RMB 7,190, and the Individual Income Tax shall be approximately RMB 431. Therefore, total cost for hiring this employee shall be RMB 15,621.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Items</th>
<th>Tax rate</th>
<th>Remark</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual Income Tax (IIT)</td>
<td>Employee</td>
<td>3% - 45%</td>
<td>7 progressive rates</td>
<td>If an expatriate employee’s monthly gross salary is RMB 35,000/month, and social insurance is RMB 1,980, his/her IIT payable is: Taxable Income = Gross Salary – Social Insurance – Taxable Threshold</td>
</tr>
<tr>
<td></td>
<td>Freelancer/Part-time</td>
<td>20% - 40%</td>
<td>Applicable to those providing services as an individual without an employment relationship with the service recipient party.</td>
<td>*(RMB35,000-RMB1,980-4,800)*25%-1,005=RMB6,049</td>
</tr>
</tbody>
</table>
**Stage 3: Purchasing Goods & Services**

Taxes relating to the purchasing of goods and services consist mainly of VAT, China Customs Duty and Consumption Tax. VAT relating to purchases can be utilised to offset Output VAT levied on sales, and is not charged in the income statement. Any other taxes will be part of the inventory or service costs and will go under the profit and loss categories.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Items</th>
<th>Tax rate</th>
<th>Remark</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Input Value-added Tax (VAT)</td>
<td>Purchase of goods within China</td>
<td>3% for small scale vendors (sales volume under RMB 800,000), 17% for general scale vendors (sales volume over RMB 800,000).</td>
<td>For general taxpayers, the input VAT can be utilised to offset output VAT. Small-scale taxpayers are not able to do this due to the PRC’s laws.</td>
<td>If a company purchases goods from a supplier, and receives a VAT invoice, and the total invoice amount is RMB 20,000, then Input VAT shall be RMB 2,905 (RMB 20,000/(1+17%)*17%). This can be utilised to offset against its Output VAT.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>For a consulting service fee to be paid to a UK vendor who provided services in China, if the contract amount is RMB 100,000 including VAT:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Withholding VAT is RMB 5,660 (RMB 100,000/(1+6%)*6%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Withholding Corporate Income Tax is RMB 9,434 (RMB 100,000/(1+6%)*10%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>The withholding surcharge is RMB 679 (RMB 100,000/(1+6%)*6%*12%).</td>
</tr>
<tr>
<td>Withholding VAT / Business Tax (BT)</td>
<td>Purchase of service within China</td>
<td>3% for small scale vendors 6% for general scale vendors.</td>
<td>When a Chinese company purchases services from an overseas vendor, it is responsible for withholding taxes for the service payment.</td>
<td>The net amount to be paid to the UK vendor is RMB 84,227 (RMB 100,000- RMB 5,660- RMB 9,434- RMB 679).</td>
</tr>
<tr>
<td>Withholding Corporate Income Tax (CIT)</td>
<td>Purchase of overseas service</td>
<td>5-6%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Purchase of overseas service provided in China</td>
<td>10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Import VAT</td>
<td>Purchase consumption goods abroad/domestic</td>
<td>Dependent on the import goods category or import item’s code.</td>
<td>Import VAT and customs duty are to be collected by China Customs. Import VAT can be utilised to offset output VAT by general taxpayers.</td>
<td>A Chinese company importing a car from a UK company, if the car’s Freight On Board (FOB) price is RMB 600,000, and overseas freight cost is RMB 50,000, then:</td>
</tr>
<tr>
<td></td>
<td>Import goods</td>
<td></td>
<td>Consumption Tax is RMB 30,000 (RMB 600,000*5%).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Import goods</td>
<td></td>
<td>Custom Duty is RMB 65,000 ((RMB 600,000+RMB 50,000)*10%).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Purchase consumption goods abroad/domestic</td>
<td></td>
<td>Import VAT is RMB 126,650 ((RMB 600,000 + RMB 50,000 + RMB 30,000 + RMB 65,000)*17%).</td>
<td></td>
</tr>
</tbody>
</table>
Stage 4: Sales Taxes

Taxes relating to sales are mainly comprised of Output VAT, which can be offset by Input VAT purchases. Other taxes should be recorded in the sales tax and surcharges, in the profit and loss categories.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Items</th>
<th>Tax rate</th>
<th>Remark</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output VAT</td>
<td>Consulting Services</td>
<td>6%</td>
<td>For general taxpayers</td>
<td>Assume a company selling milk with a gross income of RMB 11,700 including</td>
</tr>
<tr>
<td></td>
<td>Selling other goods</td>
<td>17%</td>
<td>VAT payable = Output VAT - Input VAT</td>
<td>Output VAT of RMB 300 when it purchases raw materials.</td>
</tr>
<tr>
<td></td>
<td>Transportation service</td>
<td>11%</td>
<td>For small-scale taxpayers</td>
<td>a) If it is a general taxpayer, the Output VAT is RMB 1,700</td>
</tr>
<tr>
<td></td>
<td>Selling audiovisual products, agriculture</td>
<td>13%</td>
<td>VAT payable = Output VAT</td>
<td>(11,700/1.17*17%), VAT payable is RMB 1,400 (1,700–300), surcharges</td>
</tr>
<tr>
<td></td>
<td>products</td>
<td></td>
<td></td>
<td>are RMB 168 (1,400*12%).</td>
</tr>
<tr>
<td></td>
<td>Small-scale taxpayer</td>
<td>3%</td>
<td>China is trying to convert all BT into</td>
<td>Surcharge can be up to 12% of the taxed amount.</td>
</tr>
<tr>
<td></td>
<td>Movable property leasing, education,</td>
<td>5%</td>
<td>VAT, and is currently undergoing changes</td>
<td>For a restaurant that received a restaurant service fee of RMB</td>
</tr>
<tr>
<td></td>
<td>commission fee</td>
<td></td>
<td>under Chinese taxation law.</td>
<td>800,000, BT payable is RMB 40,000 (RMB 800,000*5%), and surcharges</td>
</tr>
<tr>
<td></td>
<td>Surcharge of VAT/BT</td>
<td>7%</td>
<td>Industry relevant VAT/BT surcharges are</td>
<td>are RMB 4,800 (RMB 40,000*12%).</td>
</tr>
<tr>
<td></td>
<td>Surcharge of VAT/BT</td>
<td>3%</td>
<td>also in place. A taxpayer is then required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Surcharge of VAT/BT</td>
<td>2%</td>
<td>to pay such surtaxes at applicable rates.</td>
<td></td>
</tr>
</tbody>
</table>
**Stage 5: Profits**

If there is a profit after all the costs and expenses are deducted from the sales, then Corporate Income Tax is charged at 25%. Under certain circumstances, the Corporate Income Tax Rate may be lowered to 10% or 15%.

<table>
<thead>
<tr>
<th>Tax Items</th>
<th>Tax rate</th>
<th>Remark</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Income Tax (CIT)</td>
<td></td>
<td>Paid on quarterly basis, then after the year end, the company can check and adjust the whole year's filing.</td>
<td>If a general taxpayer makes a quarterly profit in Q2 of RMB 500,000, its CIT payable is RMB 125,000 (RMB 500,000*25%).</td>
</tr>
<tr>
<td>Normal company (Over RMB 300,000 profit before taxation)</td>
<td>25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small-profit company (under RMB 300,000 profit before taxation)</td>
<td>10 or 15%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Unforeseen Costs

When conducting business in China, besides the above taxes, attention should be paid to potential unforeseen costs that may occur. Common unforeseen costs are outlined below.

a) Late interest penalties and one-time fines on underpaid tax / tax evasion: the late interest penalty rate is 0.5% per day of the underpaid tax amount; one-time fines may range from 50% to 500% of the underpaid tax amount.

b) Employment Termination Compensation: to dismiss an employee within the labour contract period, for reasons not the employee’s fault, the employer is required to pay termination compensation which is generally “N” times the employee’s monthly gross salary, where “N” refers to his/her years with the company. If the monthly salary is higher than three times the prior year’s local average monthly salary (e.g. RMB 19,389 in Beijing for the year 2014), then the monthly salary shall be capped at three times (e.g. RMB 19,389).

c) Other Non-compliance Implications: for example, missing the deadline for submitting annual checks to government authorities, hiring expatriates without legal work permits, importing goods without reporting to SAFE. There are strict supervision measures and punishment regulations for such cases.

d) Bad Debt: account receivables or prepayments to suppliers may become bad debt if the credit of the customers or vendors is not verified in advance. Legal costs will also be incurred from lawsuits. Bad debt may not be deducted before tax if not accepted by the tax authority, causing unnecessary Corporate Income Tax Burden at 25% of the bad debt.

e) Intellectual Property Disputes: there are a lot of specific laws to protect intellectual property (IP) in China. It is vital to register your rights at the very beginning when conducting business in China due to the “first to file” principle under Chinese law. Otherwise, there may be legal costs for IP disputes and/or loss of sales revenue and reputational risk.

Disclaimer

Please note that this is intended as a brief introduction for beginners without a background in Chinese taxation. It is not intended to be a comprehensive and accurate tax framework. Any decision made about business in China should be made in consultation with Chinese tax professionals.
3.3 Renting Commercial & Industrial Premises

Office rents vary across different cities in China, but the most expensive average rent can be found in the biggest cities.

It is generally the case that multinational companies and their headquarters prefer setting up their first office in China in tier 1 cities due to the proximity to their customers and suppliers as well as to available talent.
Most cities across China have been exhibiting an over-supply in the office market in 2015, a trend expected to continue into 2016. Therefore key cities including Beijing, Shanghai and Guangzhou are facing downward pressure in rent prices, although some CBDs saw moderate growth. The Shenzhen office market, however, has been outperforming other cities with strong rental market growth potential. Companies will continue to relocate, consolidate, upgrade premises and seek cost saving opportunities as their business requirements change and new business districts mature. In the tier 2 cities, driven by strong demand from local companies in finance/insurance and Technology, Media and Telecommunications sectors, high quality office buildings in the CBD areas have remained sought-after.

### Office Rents and Vacancy Rates in Major Cities

<table>
<thead>
<tr>
<th>City</th>
<th>Rent/Price</th>
<th>Vacancy Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>373 / 4%</td>
<td>118 / 23%</td>
</tr>
<tr>
<td>Xi’an</td>
<td>118 / 18%</td>
<td>124 / 20%</td>
</tr>
<tr>
<td>Tianjin</td>
<td>124 / 20%</td>
<td>113 / 7%</td>
</tr>
<tr>
<td>Chengdu</td>
<td>123 / 37%</td>
<td>125 / 29%</td>
</tr>
<tr>
<td>Hangzhou</td>
<td>143 / 17%</td>
<td>143 / 17%</td>
</tr>
<tr>
<td>Wuhan</td>
<td>125 / 29%</td>
<td>126 / 13%</td>
</tr>
<tr>
<td>Chongqing</td>
<td>93 / 38%</td>
<td>110 / 40%</td>
</tr>
<tr>
<td>Dalian</td>
<td>113 / 7%</td>
<td>126 / 13%</td>
</tr>
<tr>
<td>Qingdao</td>
<td>126 / 13%</td>
<td>274 / 5%</td>
</tr>
<tr>
<td>Shanghai</td>
<td>274 / 5%</td>
<td>274 / 5%</td>
</tr>
<tr>
<td>Nanjing</td>
<td>125 / 12%</td>
<td>125 / 12%</td>
</tr>
<tr>
<td>Shenyang</td>
<td>118 / 23%</td>
<td>118 / 23%</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>238 / 5%</td>
<td>238 / 5%</td>
</tr>
<tr>
<td>Guangzhou</td>
<td>165 / 11%</td>
<td>165 / 11%</td>
</tr>
</tbody>
</table>

**Unit:** RMB/sqm/month  
% refers to vacancy rate

**Note:**  
Tier 1 cities have significant populations with higher levels of disposable income over the national average. Tier 1 cities are also marked by developed infrastructure and transportation links. Tier 1.5 cities are those cities maturing quickly and narrowing the development gap over Tier 2 and 3 cities. Tier 2 cities are often defined as the provincial capitals and special administrative cities.
### Finding an Office

There is no official office classification in China but office buildings are generally grouped as:

<table>
<thead>
<tr>
<th>Type</th>
<th>Definition</th>
</tr>
</thead>
</table>
| **Serviced Office / Virtual Office** | Fully equipped and managed by a facility management company, which then rents individual offices or floors to other companies. Often found in the business districts of large cities, and usually best suited to companies who are new entrants or only require a business presence in the city.  
Reputable serviced offices in Shanghai include Regus and SERVCORP. The average cost in the core CBD is estimated as RMB 5,500-7,500/workstation/month. |
| **Premium Grade-A**       | Very modern and centrally located with top quality finishes; highly flexible layouts; generously raised floors; very spacious and well-decorated lobbies and circulation areas; advanced climate-control systems; service zones for passenger and goods deliveries; international management and full backup power supplies; single landlord.  
Reputable locations in Shanghai include the Shanghai Tower, Corporate Avenue and Plaza 66.  
Typical floor area: over 2,000 sq m (Gross Floor Area, GFA)  
Average rent in Shanghai ranges from RMB 12-15/sq m/day. |
| **Grade-A**               | Modern with high-quality finishes; flexible layouts; large floor plates; decorated lobbies and circulation areas; effective central air-conditioning; good lift services zoned for passengers and goods deliveries; single landlord.  
Reputable locations in Shanghai include Westgate Tower, Henderson 688 and Raffles City.  
Typical floor area: 1,500-2,000 sq m (GFA)  
Average in Shanghai ranges from RMB 9-11/sq m/day. |
| **Grade-B**               | Ordinary design; good quality finishes; flexible layouts; average-size floor plates; adequate lobbies; central or free-standing air-conditioning; adequate lift services; good management; strata-title ownership or single landlord.  
Typical floor area: 1,000-1,500 sq m (GFA)  
Average rent in Shanghai ranges from RMB 5-8/sq m/day. |
| **Grade-C**               | Plain with basic finishes; less flexible layouts; small floor plates; basic lobbies; no central air-conditioning; barely adequate or inadequate lift services; minimal to average management and no parking facilities; strata-title ownership.  
Typical floor plate: <1,000 sq m (GFA)  
Average in Shanghai ranges from RMB 2-4/sq m/day. |
Start Early to Get the Best Terms

The process of negotiating a lease (new lease, relocation or renewal) may take three to six months, depending on the size of the transaction. Due to the rapidly changing economic and policy environment, the market conditions may change materially during this period of time; therefore, starting the process early is crucial.

Signing an Office Lease

The variances in the documentation and approval process may be significant between different regions, cities and sub-markets. There is often also a huge disparity in the experience of landlords and legal teams across China in handling office leases, so having a clear understanding of what should be in a lease for office premises is essential for protecting tenants’ interests. We present a summary of some of the major terms that should be in an office lease below, and a qualified advisor is essential to ensure the key commercial terms, lease flexibility and technical provisions are covered to mitigate tenant risks:

### General

- **Lease Terms:** 3-5 years
- **Rental Basis:**
  - Shanghai: RMB /sq m / day
  - Other cities: RMB / sq m / mth
- **Management Fee Basis:** RMB / sq m / month (gross area)
- **Measurements:**
  - On Gross sq m
  - Grade A efficiency benchmark min. 70%

### Negotiable Terms

- Expansion / termination rights
- Rent
- Holdover clause
- Renewal provisions
- Reinstatement and dilapidations
- Signage / Building naming rights
- Rent-free / Fit-out period
- Property management fees
- Car parking
- Security deposit
- Sublease and assignment rights

### Handover Provisions

- Integrated Ceilings
- Lighting
- Various HVAC systems
- Various finished floors
- Painted walls

### General Commercial Terms

- **Renew Cap:** 15-25%
- **Deposit:** 3 months’ gross rental + management fees
- **Fit-out / Free Rent Period:** 3 months’ rent fee for a 3 year contract
The variances in the documentation and approval process may be significant between different regions, cities and sub-markets

Industrial Leasing

Occupation of industrial land is currently at high levels, leaving most of the country’s major industrial zones with little land available for sale to developers. Coupled with the government’s supply side policies restricting the release of agricultural land available for industrial development, the last few years have witnessed a steady rise in the price of both industrial land and buildings in most of China’s industrial zones.

Historically, most major investors were interested in built-to-suit industrial developments, but they are increasingly looking at selling the land and leaseback strategies. This might be attributed to China’s lack of freehold interest in property where only land-use rights (similar to a leasehold interest) are given to both domestic and overseas investors for periods of 20-50 years for industrial use. While these land-use rights are renewable, the lack of precedent and a clear system for renewal is prompting many uncertain investors to release their capital through sale and leaseback arrangements. Therefore land-use terms are coming to an end.

Major international investors such as Ascendas, Mapletree, Prologis, GLP and Goodman are seeking to build significant logistics and high tech industrial portfolios in zones such as Pudong in Shanghai, Binhai in Tianjin and Yantian in Shenzhen. At the moment, rental prices for prime industrial and logistics facilities located in China’s coastal cities such as Beijing, Shanghai and Shenzhen range from RMB 30 to RMB 50 per sq m per month with gross returnable yields ranging between 7.0% and 8.0%.

Industrial Property Site Selection

Industrial properties may be divided into three primary classifications:

- Manufacturing: Used for the conversion, fabrication and/or assembly of raw or partly wrought materials into products/goods
- Warehouse / Distribution Centre: Primarily used for the storage and/or distribution of materials, goods and merchandise
- Flex: An industrial building designed to allow its occupants the flexibility of alternative uses of the space, usually in an industrial park setting. Specialised flex building uses include R&D, storage, offices, laboratories, data/call centres, and service centre/showrooms

Typical characteristics of the different types of industrial properties are described below:

<table>
<thead>
<tr>
<th>Type</th>
<th>Average size (sq m)</th>
<th>Rent (RMB/sq m/mth)</th>
<th>Management fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Flex</td>
<td>5,000</td>
<td>Tier 1: 95-120</td>
<td>Approx. 10% of rent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tier 2: 60-80</td>
<td></td>
</tr>
<tr>
<td>Warehouse</td>
<td>10,000</td>
<td>Tier 1: 40-50</td>
<td>Approx. 5% of rent</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tier 2: 20-30</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>15,000</td>
<td>Tier 1: 20-40</td>
<td>Approx. 5% of rent</td>
</tr>
</tbody>
</table>
**Development Zone Types**

Industrial zones in China are generally categorised into two types. The first type are primarily used for manufacturing and include the Economic and Technological Development Zones (ETDZs), High and New Technological Development Zones (HIDZs) and Export Processing Zones (EPZs). The second type, Free Trade Zones, are more focused on logistics services, trade and exports.

<table>
<thead>
<tr>
<th>Development zone</th>
<th>Description</th>
<th>First approval year</th>
</tr>
</thead>
</table>
| Economic and Technological Development Zones (ETDZs) | • Originally established as part of the Chinese economic reform  
• Offering preferential tax policy to attract Foreign Direct Investment (FDI)  
• Mainly located in knowledge- and technology-intensive developed cities  
• Promoting the development of high-technology  
• Additional preferential policies for Sino-foreign joint ventures | 1984                |
| High-tech Industrial Development Zones (HIDZs) | • Set up by the central government solely to serve the export industry  
• Companies in the zone are exempted from export quota and licence controls | 1988                |
| Export Processing Zones (EPZs)         | • Tax refunds on exports, import duty exemption and lower VAT rates  
• Export processing, entrepot trading, logistics and bonded warehousing  
• Adopt a “negative list” for investment management  
• Simplified foreign trade supervision procedures  
• Promote financial system reform to realise RMB capital account convertibility | 2000                |
| Free Trade Zones (FTZs)                |                                                                                                                                                                                                                                                                                                                                            | 1990                |
| China Pilot Free Trade Zones           |                                                                                                                                                                                                                                                                                                                                            | 2013                |
Lease contracts will vary according to project, location, zone type and tenant requirements.

**Signing an Industrial Lease**

The below items should give tenants a framework for industrial lease contracts in mainland China. However lease contracts will vary according to project, location, zone type and tenant requirements. Potential tenants should carry out sufficient research and may consider hiring a reputable real estate consultancy firm to verify the commercial terms and ensure the strongest negotiation position possible. Furthermore, employing an experienced real estate lawyer can be useful to verify the legality and enforceability of the contract terms.

### General

| Lease Terms: | • 3-5 years  
• 10 years for built to suit premises |
|-----------|--------|
| Rental Basis: | • Shanghai: RMB / sq m / day  
• Other cities: RMB / sq m / mth |
| Management Fee Basis: | RMB / sq m / month (gross area) |
| Measurements: | • On gross sq m  
• Single-floor factory efficiency benchmark approx. 90%  
• Site coverage benchmark approx. 40-60%  
• Plot ratio benchmark >0.8 |

### Negotiable Terms

| • Use and occupancy  
• Infrastructure and facilities  
• Renewal right  
• Rent  
• Holdover clause  
• Renewal provisions  
• Reinstatement and dilapidations  
• Rent-free / fit-out period  
• Property management fees  
• Car parking  
• Access to building  
• Legal fees and government fees  
• Security deposit  
• Sublease and assignment rights |

### General Commercial Terms

- Renew Cap: 10-15% after three years
- Deposit: 3-6 months’ gross rental + management fees
- Fit-out / Free Rent Period: 3-6 months’ rent fee for a 3-6 year contract

### Handover Provisions

Generally, premises are handed over in bare shell condition at an agreed handover date stated in the lease.

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This section as written for CBBC by property management and investment consultants, and CBBC member company Knight Frank.

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3.4 Marketing in China

When entering the Chinese market, the first step for many companies is to consult your legal representatives and seek professional financial advice. These are important and practical first steps to establish your business. At the same time, however, to run a business successfully it’s crucial to consider how you are going to cement your market position and grow.

This guide comprises two elements. The first considers your brand strategy and the second looks at your practical communication activities.

Understanding your Brand Value in the Chinese Market

Research conducted by CWA in China for British SMEs has shown the Chinese perception of a British brand is that it stands for quality, reliability, tradition, prestige and that it is assured and trustworthy.

Instead of buying fake and copycat brands, the Chinese middle classes are increasingly pursuing quality, originality and personality. A well-designed British brand not only requires knowledge about the look and feel of the product, but more importantly it needs a strategic position and vision. Don’t be mistaken into thinking only consumers have preconceptions about “Britishness”. Chinese businesses too have ideas of what British companies are like when looking for suppliers and partners.

Step 1: Positioning – Don’t sell yourself too cheaply

Even if you are a value brand domestically, you should reconsider how you position yourself in China, because if you go head to head with Chinese competitors on price, it’s unlikely you’ll win.

So what are the value adding attributes of your brand compared to your competitors in China and in the UK? Are they your product quality, brand heritage, industrial experience or specialist knowledge? Or are they your professional and dedicated workforce and extensive dealer network? Or perhaps even a combination of these?

How your customers or clients see you and think about you will be based on your unique selling points. Extensive market research is essential in establishing your position and building awareness of your brand in a crowded market.

Step 2: Developing a trustworthy and convincing brand story

Once you have decided on your positioning, it’s time to communicate to your audience. A brand story which is less formal and dry than a traditional vision and mission statement can be your differentiator. By telling the audience about who you are, on what your brand heritage is based and what makes your product and service range unique, you can create immediate
The Chinese perception of a British brand is that it stands for quality, reliability, tradition, prestige and that it is assured and trustworthy.

Internal Communication

Expanding into the Chinese market is not a decision you have taken lightly. At the very least the cultural differences will be felt by everyone in the company. Are they prepared for this new market? What are employees’ attitudes towards this move? Do they have an open mind to the challenges they will face in operations, finance, production, legal, and every other aspect of the business? Will they embrace these challenges or will they wish you had never looked at the Chinese market in the first place?

You may think this is the responsibility of management and HR but internal communication is perhaps the most powerful tool at your disposal. Try things like organising a creative and energising workshop for your employees to ‘experience’ China; or even to mimic a ‘best and worst case scenario’ to help everyone see for themselves and understand how their respective functions will be impacted. It is also important to communicate the possibilities your expansion into China could present to individuals and to the company as a whole.

Always keep your mind open to creativity. The key is to engage employees to get them on board, so that they can support the company’s decision and deliver what is necessary to operate and succeed in the Chinese market. And this is the first part of your communications plan.
Channel Communication

The second part of your communication plan addresses the external organisations that you need to help you deliver your products and services to your customers in China. Regardless of whether you run a B2B or a B2C business model, these organisations include such as your dealer/distributor network, your professional advisors and sales or promotional agencies.

The ultimate goal of your channels is to generate profit and to achieve this goal your channels will need your support. For instance, it is essential you provide your dealers/distributors with sufficient product knowledge and even training if necessary, so they will be able to deliver the best customer service. For agents who promote your brand, make sure you provide them with the most up-to-date materials on a regular basis, e.g. your social media agency needs to be constantly given information in order to produce content for new posts.

Remember, in order to get your channels on side and to create synergy throughout your operation, good communication is crucially important.

End-customer communication (if applicable)

One must keep in mind that what the end-customer needs should sit at the root of your marketing plan. To communicate with the end-customer efficiently, we suggest three steps:

Step 1: Research – identify the need and the spending behaviour

Like every culture, China has its unique cultural values and ideology. There are countless examples of the way this creates a divergence between Chinese consumer behaviour and needs and those we’re used to in the West. Therefore, carrying out comprehensive research to identify the spending behaviour and need of your target is a critical first step.

Step 2: Choosing suitable media

After you have conducted your research, you should be able to establish a certain level of local knowledge. At this stage you should have a good understanding of your target customers’ behaviour in terms of what they like, what they need, where they normally shop and how they make their purchases. With all the information you have gathered, now is the time to choose the most suitable media to reach your target, because each different target group has different media preferences. There are no general rules so it is essential you have access to the full marketing mix so you can target appropriately.

Step 3: Building localised content

When entering the Chinese market, breaking the language barrier is essential. This doesn’t only mean translation of the brand name, but also an appropriate translation. Due to the fact that Chinese is a language that allows different words to share the same pronunciation, when translating your brand name into Chinese, always choose the best word which alludes to your brand’s message. For example, the Chinese name of Swedish furniture brand IKEA is “Yi Jia (宜家)”, which means “good for the home”, while Coca Cola’s Chinese name is “Ke Kou Ke Le (可口可乐)”, which refers to “tasty and joyful”.

However, please remember to add some elements to which Chinese customers can relate. HSBC, the global banking group, achieved this quite simply with its TV commercials by stressing ‘localisation’ as the key message.

Finally, when communicating with end-customers, your content should always be consistent with channel communication – never let your end-customers feel that you are a premium brand while telling your channels that you are a value brand.

The information herein has been provided by CBBC member CWA. CWA is a Creative Agency that thinks of clever ideas to help companies communicate with people inside and outside their organization, then helps to implement those ideas.

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A clear understanding of what Chinese internet users expect from your brand and what you aim to achieve is vital when planning your digital marketing strategy. Many assume that they will be successful by simply replicating tactics in other markets – pushing out the same websites, search and social campaigns but translated into Chinese can be a costly and all too frequent mistake. Investing a little extra in your Chinese strategy and taking time to understand the market more fully will pay dividends in the medium and long term.

**Domains and Hosting**

A fundamental decision is the type of domain your website is on; if you have a company presence in China it can be tempting to apply for a .cn domain name, but it’s not always the best choice. A .cn domain is seen as being local – if your brand is trading on its Western-ness then it is usually advisable to go with the more international .com. Chinese internet users are very familiar with .com domains and, importantly, you will not be penalised by Baidu and other leading search engines for using one.

The best location to host the site will depend on your company status (a local company presence is required to legally host in mainland China), the content of your site (banned content can see a site taken down or, if hosted outside China, blocked) and technical concerns. Hong Kong is often a good hosting location for Western companies, but always check with a company that has hosting expertise to ensure you are getting the required visibility, speed and performance in all targeted regions of China.

**Web Design**

Differences between Chinese and Western web design have narrowed in recent years, but they do still exist. Avoid overly minimal designs that require users to drill down through lots of pages to find any information; a flatter site structure that presents a useful amount of content in a clear, concise manner is usually the better choice. It is good practice to clearly explain who you are and what you offer on the landing page – particularly as a foreign company with an unfamiliar brand.

Getting the opinions of Chinese users on site design and content before promotion begins is strongly recommended. Does the navigation make sense? Does the design look right? Is the content clear and does it answer all of their questions? What needs to be added or taken away? Getting these things in place will lead to lower website bounce rates and better conversion rates.

**Trust Factors**

Whether you are a B2B or B2C business, being able to generate trust in your online presence is of vital importance. Chinese customers need to feel secure in dealing with you, and a few trade association logos that they do not recognise are unlikely to cut it. Ultimately, the best way of putting users’ minds at ease is to tell them exactly who you are and make it easy for them get in touch with you.

Even if you do not have a physical presence in China, an office representation service that comes with a local telephone number and first-point-of-contact customer liaison is an effective, affordable way of building trust. Similarly, being available via the QQ instant messaging service is recommended.

**Social Media**

All of the popular Western social media sites – Facebook, Twitter and YouTube – are blocked in China. In their place, sites like WeChat and Weibo offer feature-rich networking services to huge numbers of Chinese internet users.

There is scope for most businesses to increase brand awareness and generate a following, sales and enquiries with the aid of social media. Whether it is through the use of popular key opinion leaders (invaluable when entering a new market or launching a new
product/service), driving engagement through WeChat competitions or e-vouchers, or leading discussion on Weibo, it is likely there is a suitable social strategy for your company.

The best social media strategy for you will depend on who you are (Is your brand well-known or a new name in China?) and what you aim to achieve. Big, well-known brands can use a more pull-oriented strategy, relying on latent interest from potential customers who will search for the brand and be drawn in through various marketing channels, whereas lesser-known brands need to create awareness and interest via a push strategy.

Make sure that your accounts are active (less time between posts) and that you interact with any engagement from users or other brands – there is often the opportunity for some cross-promotion, and established Chinese accounts may welcome the association with a Western brand that isn’t a direct competitor.

Whichever strategy you use, being a source of useful information and engaging with the conversation rather than just attempting to overtly sell is always recommended. Users will typically respond well to interesting, informative and fun posts, but limiting sales posts to events such as product launches and special discount/offers can also work well.

Search

With over 650 million Chinese internet users, there are huge gains to be had from being ranked on the popular Chinese search engines. Like Google, leading local search engine Baidu offers both natural and pay-per-click results and you can successfully optimise your Chinese-language site for both.

Powerful analytics tools such as Baidu Tongji (Baidu’s equivalent of Google Analytics) are available to help you keep on top of on-site visitor behaviour and ensure that your website traffic is being properly converted to sales and enquiries. Unlike Google Analytics, Baidu Tongji still provides detailed breakdowns of visitor keyword usage; a useful tool when managing your SEO and PPC campaigns.

This guide was written for CBBC by member company Backbone IT Group. As web development & digital marketing specialists established in China for 15 years, they help companies effectively reach their target market online.

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Enquiries: enquiries@backboneitgroup.com
China is a highly regulated and employee-friendly jurisdiction from an employment law perspective. The key pieces of legislation that govern employment law in China are the PRC Labor Law, the PRC Labor Contract Law and the PRC Social Insurance Law. The laws cover a range of topics including formation, performance, contract revisions and terminations. They apply to all employers that are based in the territory of the PRC and to all employees with whom they establish an employment relationship.

This section aims to give a non-exhaustive snapshot view of the PRC employment legislation. As such, only the key issues and those which are of particular interest at the time of writing will be covered.

### Employment Contracts

Employers are required to enter into a written employment contract with their employees within the first month of employment. There are three types of employment contract: fixed term, open-ended and project-based. In the absence of an employment contract, a de facto employment relationship may be held to exist by an arbitration tribunal, provided that certain statutory requirements are satisfied. Failure to enter into an employment contract can result in the employer being required to pay twice the normal salary for every month during which the contract was not provided, or the employee being deemed to have entered into an open-ended labour contract.

### Wages

Wages under Chinese law are generally calculated on a time basis or on a piece-rate basis and can also include rewards and allowances. In paying wages to employees, Labor Law states that employers should adhere to a number of ‘principles’. Two principles to watch out for include:

- Payments should be no less than the statutory minimum standard according to the type of work undertaken
- ‘Equal pay for equal work’ – where the quality and quantity of work produced by employees is similar, the remuneration provided to employees should also be similar. Wages should not differ on account of gender

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**Chinese Employees’ Salaries**

Recruiting carried out a survey in 2014 to report on the average monthly salaries of white-collar workers in some of China’s biggest cities. This data shows that the biggest and most developed coastal cities often have the highest average wages. Of course wages vary depending on experience, industry sector and degree of speciality.

While Chinese salaries usually remain far lower than those in the West, the national average annual wage has seen near double digit growth among urban employees since 2004, according to China’s National Bureau of Statistics.
Public Holidays

Under PRC laws, employees are entitled to 11 statutory public holidays per year, analogous with Bank Holidays in the UK. The Gregorian calendar dates vary each year as most Chinese holiday dates are based on the lunar calendar:

- **New Year’s Day** – 1st January
- **Spring Festival (or ‘Chinese New Year’)** – 3 days usually in late January or early February
- **Tomb Sweeping Festival** – 4th or 5th April
- **Labor Day** – 1st May
- **Dragon Boat Festival** – 1 day in early June
- **Mid-Autumn Festival** – 1 day in September
- **National Day** – 1st October, 2nd October and 3rd October

It must be noted that generally if there is a three-day holiday, such as the Spring Festival or National Day, the government will declare a seven-day ‘Golden Week’. However citizens are usually required to work some of the weekend(s) either side to make up the other four days. There is a certain amount of discretion on behalf of the employer as to how to apply these regulations.

Annual Leave

According to the Provision on Paid Annual Leave of the PRC, the number of days of annual leave shall be calculated on the basis of accumulated working years of the employee (including the working years with his/her former employers).

In reality these are statutory minimums, and employers may decide to allow more annual leave depending on internal regulations and concerns of staff motivation, etc.

Other common forms of paid leave can include:

- **Sick pay**: an employer should provide an employee with sick pay equating to at least 80% of the local minimum wage whilst the employee is on sick leave. However, local rules provide for different enforcement standards.

<table>
<thead>
<tr>
<th>Accumulated Working Years</th>
<th>Annual Leave</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between 1 and 10 years</td>
<td>5 days</td>
</tr>
<tr>
<td>Between 10 and 20 years</td>
<td>10 days</td>
</tr>
<tr>
<td>Over 20 years</td>
<td>15 days</td>
</tr>
</tbody>
</table>

- **Maternity leave**: female employees are entitled to at least 98 days of fully-paid maternity leave, and an additional 15 days if the employee experiences a difficult delivery. Due to the one-child policy it is still relatively rare for urban households to have more than one child.
- **Other**: including marriage leave, paternity leave and bereavement leave.
Social Insurance and Housing Fund

Under the Social Insurance Law of the PRC, employees are required to participate in a social insurance scheme and a housing fund scheme, with the contributions being made by both employees and employers. Social insurance includes pension, medical, unemployment, maternity and work-related injury insurance. Employers are obliged to withhold the employee contributions from their salaries and pay them into the relevant schemes. The amount payable is a function of the employee’s salary.

Individual Income Tax (IIT)

Anyone domiciled in China will be subject to IIT on their worldwide income. Generally, PRC residents will be regarded as domiciled in China. Whether foreign nationals are subject to IIT depends on whether they are domiciled in China, the length of time they have resided in China if non-domiciled, and the source of their income.

Remuneration income is taxable for IIT at progressive rates, as below:

<table>
<thead>
<tr>
<th>Bracket</th>
<th>Monthly taxable income (RMB)</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Up to 1,500</td>
<td>3%</td>
</tr>
<tr>
<td>2</td>
<td>1,501 to 4,500</td>
<td>10%</td>
</tr>
<tr>
<td>3</td>
<td>4,501 to 9,000</td>
<td>20%</td>
</tr>
<tr>
<td>4</td>
<td>9,001 to 35,000</td>
<td>25%</td>
</tr>
<tr>
<td>5</td>
<td>35,001 to 55,000</td>
<td>30%</td>
</tr>
<tr>
<td>6</td>
<td>55,001 to 80,000</td>
<td>35%</td>
</tr>
<tr>
<td>7</td>
<td>Above 80,000</td>
<td>45%</td>
</tr>
</tbody>
</table>

IIT brackets are calculated based on gross monthly remuneration less a standard monthly deduction and less other items exempt from IIT (such as statutory social insurance contributions made by employers and employees). The standard monthly deduction is RMB 3,500 for local employees and RMB 4,800 for expatriate employees.
Termination & Severance Pay

There are limited statutory grounds allowing employers to unilaterally terminate employment contracts. If an employee challenges a unilateral termination in arbitration or court as being unlawful, employers often have difficulty in producing evidence to the satisfaction of the arbitrator or judge to support the grounds for termination. Arbitrators and judges have a wide discretion in such cases which causes uncertainty for employers in terms of whether a unilateral termination can be successfully defended. As a result, many employers choose to avoid unilateral terminations and instead mutually terminate employment contracts.

Arbitration proceedings and litigation relating to unlawful termination have been increasing, as employees are becoming increasingly assertive of their rights (there is also no cost for an employee to file for labour arbitration). The typical remedy for unlawful termination is reinstatement of employment or double severance pay. An employee can also claim unpaid wages for the interim period.

Since 2008, statutory severance payments are usually one month’s average wages (including base pay, bonus and allowances) over the 12 months preceding the termination date (the “Average Monthly Income”) multiplied with the service years with the company. The Average Monthly Income is subject to a statutory monthly cap (currently three times the local average wage, which varies regionally). The total severance payment is subject to a further cap of 12 months.

Immigration and Employment of Expatriates in China

Non-PRC nationals, residents of Hong Kong, Taiwan and Macau and PRC nationals with permanent foreign residency are all classed as foreign nationals for employment purposes. Generally, foreign nationals work in China in one of the following three ways:

- **Secondment**: the foreign national is employed by a foreign entity and seconded to work at a PRC entity in China
- **Dual employment**: the foreign national is simultaneously employed offshore by a non-PRC entity and by a PRC entity
- **PRC employment**: the foreign national is employed directly by a PRC entity

Under all three of the above options, a foreign national working in China must obtain the necessary visa and work permits. In the cases of dual employment and direct PRC employment, the employee must obtain a work permit before commencing work in the PRC. Work permits can only be granted if the employee is in possession of a Z visa (work visa) before entering China. It is also possible to enter China for short stints via frequent business trips with certain limitations. For example, each stay should be no more than 90 days, the foreigner should not get any pay in China, and the activity should be limited to business liaison rather than generating any direct profit.

Employee Transfers

Under the PRC labour laws, there is no automatic transfer of employment and employees must give their prior consent to the transfer. If consent is not provided, the employee(s) will remain an employee of their old employer.

If an employee does consent to a transfer, his/her contract of employment with their old employer must be formally terminated by mutual agreement. Following this, a new written employment contract must be entered into between the employee and the new employer, in accordance with the PRC Labor Contract Law.
Labour disputes, which are not subject to arbitration or litigation fees, can often last one to two years.

If the transfer is due to non-personal reasons of the employee, the new employer will be required, under the PRC laws, to recognise the employee’s years of service with their old employer for the purposes of calculating annual leave, sick leave and severance payments (unless the old employer paid the applicable severance payment at the time of the transfer, in which case the employee’s service with the old employer need not be recognised for the purposes of calculating their severance, annual leave and sick leave entitlements).

The statute of limitation for labour disputes is one year, which begins to run from the day on which the claimant knows or should have known of the infringement of their rights. One exception to this rule is that the statute of limitation for claims of arrears of pay during employment will not start to run until the employment is terminated.

The information herein has been provided by CBBC members Bird & Bird. Bird & Bird is an international law firm, with a specialty in strategic commercial issues.

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Company Formation: Getting in the Way of Growth

Poor Planning when Entering Market Caused Family LED Maker to Miss Big Orders

One of the most significant developments in global business in the past few years has been the shift from “Made in China” to “Sell to China” as firms cater to a large and growing economy. Thousands of foreign companies have rushed to get a foot in the door and then scale up their operations.

In a recent example, a European family-owned producer and supplier of environmentally friendly and energy efficient LED lighting products for large venues was looking to take advantage of the commercial and industrial property boom across the country.

Be Careful to Avoid the Wrong Steps to Market Entry

Setting up a local operation was part of this company’s strategic plan to get closer to local clients, first by establishing a Wholly Foreign Owned Enterprise (WFOE) to seal smaller deals before rolling out local manufacturing capabilities to capture large orders.

The company took on board some local employees who were tasked with building the local operation, and one of these early employees recommended a small, one-person consultancy that apparently specialised in company formation to handle the administrative side of the process. Seeking to move quickly to capture emerging opportunities, the company approved the recommendation and left the consultant to it. He duly registered a WFOE with only the permitted business scope of a trading company. And so with the help of a local distributor, orders came in soon after and the business began taking off.

Within six months the company had built up good relations with bigger clients and bigger orders were coming in. In order to meet these new demands, the client needed to manufacture locally. But even though deals were on the table, the company was stuck in a bureaucratic nightmare: the consultant had failed to prepare any of the necessary elements to help the company grow quickly. It transpired that he had only registered the company and nothing else; there was no local bank account, no customs licences, no registration with the local tax bureau – nothing. Not only was the company unable even to provide the buyers with a VAT invoice for their purchase but they also did not have permission to start manufacturing locally in time to meet the orders. The company eventually lost out on a major tender.

In ordinary circumstances this loss would be bad enough, but the company had always planned to scale up quickly and establish a local factory to meet demand. Unfortunately the desire to move quickly to enter China and to control expenditure by taking on a small consultant would prove very costly. Not only was the consultant understaffed and unable to complete crucial administrative tasks but more importantly he was unable to plan out the longer term development of the company and so registered a scope of business that would severely restrict activity.

“When entering China, companies need to clearly consider the type of business they want to register based on their plans for the market and their scope of business.”
When entering China companies need to clearly consider the type of business they want to register based on their plans for the market and their scope of business; it can take months to get permission to change any of this and sometimes it’s quicker to start all over from scratch. Executives at foreign companies charged with launching operations in China are usually too focused on winning business and are not equipped to deal with company formation. That’s why it pays to work with an experienced partner who can plan for the future and prevent unnecessary additional costs in the long run.

Accounting: When the Numbers Don’t Add Up

Messy Accounting Practices Could have Cost Family Textile Firm Millions

In 2013 a mid-sized family textile business that had been sourcing almost all of its products from China for many years decided to set up operations locally. Business was good, with clients in more than 50 countries, and growing demand meant that it made sense to have a local team to strike better deals and improve efficiency. The company considered several locations before settling on an office in scenic Hangzhou, once the pre-eminent imperial holiday retreat and now the capital of Zhejiang, a thriving manufacturing province on China’s east coast.

Struggling with the Numbers

The company decided that it wanted to control all aspects of the China operation and set about hiring people to take care of key tasks. One of the main hires was an in-house accountant who had several years’ work experience with a foreign company, which in theory meant that she would be able to prepare accounts in accordance with the requirements of HQ. But almost immediately after starting work the accountant took it upon herself to make records based on her personal preferences – there was no attempt to set up a formal accounting system or produce a matching chart for the company’s accounts, nor did she communicate with the group accounting team for guidance.

In addition to not standardising its accounting procedures, the company also had nobody on their local team who understood how to handle VAT tax refunds for export deals. Three months after the office was opened the company sent a shipment to Europe without even knowing what percentage of a VAT refund it could get or even how to claim for it. This lack of basic organisation extended to other areas as well. The company kept a small number of popular products in the office to show to clients but had no system in place to manage inventory.

Straightening out the Paperwork

Such disorganised internal accounting and inventory management created uncertainty and unnecessary paperwork in HQ and was costing the company money. Finally, the company hired external international accounting specialists, who sent a small team to their office to conduct a comprehensive internal audit. They looked at the accounting books and export transactions, spoke with different people in the office, and had several conference calls with HQ. In the end the China office’s internal accounting books were converted into a management report in a format that could be accepted and understood by HQ under IFRS standards.

A simple inventory control method was developed to help monitor inventory levels on a daily basis. And the international accounting consultants’ tax team reviewed all export related documentation for 2013 and started to arrange a VAT tax refund with the local tax authority. After straightening out the back office functions, the company successfully claimed a VAT tax refund amounting to USD 1.5 million for all their export sales in the previous year.
HR & Payroll: Unsupervised Executive Creates Havoc

Rogue GM Severely Undermined British Trading Firm’s Operations

Over the past decade an increasing number of foreign companies that source from China have opted to establish a local presence, or agent, to secure better quality products and improve their supply chains. One such company, a British trading firm founded in the 1980s that deals mostly with clients in Europe and the US, opened a local office 10 years ago and set about building a global purchasing team. For the task they recruited an experienced Chinese national as General Manager, who steadily set about building up an operation with 20 employees.

One-Man Show Creates Room for Suspicious Activity

After reviewing the company’s accounts and contracts and spending time in the local office, the Managing Director was still not able to make sense of what was going wrong in China and so reached out to specialised HR and payroll consultants for help. After a full internal audit, a number of serious problems were uncovered that had had a significant financial impact on the company and could have resulted in damaging legal issues as well. First, the China office had 20 people on the payroll but there were only 18 employees in the office. Two people had left the company but their names were still on the payroll and they were still drawing a “salary”. It turned out that the Chinese GM’s wife was the company’s accounting manager and HR manager, which put her in a position to cover her tracks; she was also deliberately underpaying social insurance contributions for some employees, which was not only fraudulent behaviour but exposed the employer to legal action when an employee was fired. As for the uncompetitive pricing of the company, detailed analysis of suspicious transactions revealed that the Chinese GM was fulfilling orders to the client from his personal business at inflated prices in order to create higher profit margins for himself.

Supervision Can Be Outsourced to a Trusted Third Party

Entrusting your China business to a single partner or senior employee with little or no managerial oversight is a huge risk, as this company discovered. The Chinese GM was able to get away with these practices for so long because he had directly hired everybody in the local office without any oversight from HQ. This also prevented anyone from spotting the potential conflict of interest between accounting and HR departments, which should be managed separately. In China, where labour laws strongly protect employees, there can be no shortcuts; all employees should sign a full legal contract and be issued with an official company handbook, while social insurance should be paid based on the full amount of salary, stipulated in the employment contract. Finally, for companies that are operating a Chinese business remotely, it makes sense to hire a third-party service provider to handle or check payments and company accounts to prevent business from being conducted under the table and losing the business money.

This section was written for CBBC by China market entry, tax, accounting and HR specialist member company Orangefield Group.

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This chapter is designed to help companies trading with and operating in China to understand some of the challenges of the business environment, and to prepare to mitigate risks to their business interests.

The first section on due diligence covers the key discipline of making sure your Chinese partners are who they say they are, and that they can fulfil obligations which are part of your business relationship.

The second section aims to provide an introduction to necessary precautions when entering into contractual relationships, including using Non-Disclosure Agreements, as well as best practices and things to note when drafting other forms of commercial contracts.

The third section is about your options for recourse if the relationship with your Chinese clients or partners breaks down, including formal litigation, and also the alternative dispute resolution methods available, such as international and domestic arbitration and mediation.

In the fourth section we discuss the challenges of managing cybersecurity for companies operating internationally, and what companies doing business in China can do to mitigate risks to their assets.

The fifth section covers the impact to the business environment of changes in China’s approach to corporate corruption and bribery, as well as how the UK Bribery Act affects you in China. We discuss how UK companies can take steps to ensure compliance in their own supply chain, and how to promote a strong record as a competitive advantage.

In section six we aim to help UK companies understand how registration of intellectual property (IP) rights is of the utmost importance for companies planning to do business in China now or in the future, and the necessary steps which can be taken to obtain various forms of rights.

The seventh section provides an introduction to the various options for enforcing registered IP rights in China, including the use of the courts, but also the quicker and lower cost options for administrative enforcement, including the use of customs.

Lastly, the final section covers the rapid rise of Chinese e-commerce and the new challenges which have arisen for UK brand owners wanting to minimise the appearance of counterfeit goods online, including a basic guide to using Alibaba’s AliProtect and TaoProtect mechanisms for reporting IP-infringing product listings.
Due diligence ("DD") is the most important part of the work you do in preparing to work with a Chinese company. It is more important than having well-drafted contracts in place. And it is more important than creating a good relationship with your Chinese counterparty. This is not to say those are unimportant, just that DD is more important.

DD is the technical term for the process of getting to know the details of a company or person that you intend to do business with, and is most commonly used when one company is planning on buying another company. The prospective purchaser carries out DD on the target to make sure it is worth buying.

DD is also carried out by companies on potential business partners, to make sure they really can do what they claim to be able to do, and that they will be an asset to the business, not a liability. Below, we discuss both types of DD.

DD on Business Partners

Many manufacturing companies are eager to find good business partners in China, whether for distribution of their products there, for manufacturing for export, or for processing trade. Overseas service providers also wish to find partners in China, whether for marketing, licensing of their services, or outsourcing.

Some questions you should ask:

- Is the business a genuine business? Obtain a copy of their business licence and, if possible, check with the local Administration for Industry and Commerce bureau on the legitimacy of the Chinese business.
- Is the business a real manufacturer or distributor? You will often find you are actually dealing with a middleman. You need to see a copy of their business licence and make sure the company name is the right one. Do not ever go by the made-up English name of the Chinese company. Only the Chinese-character name of a company has legal effect: the translated names are meaningless and should not be used on contracts except as defined terms.
- Does the Chinese entity need or have an international quality accreditation? Obtain a copy and check with the relevant organisation.
- What reputation does the Chinese company have? In particular, will it protect your intellectual property?

The last point is particularly important and is really a subject in itself. If you intend to engage with China in any way, either by selling your products there or sourcing them, you should have an IP protection strategy in place, not just a few clauses in a contract.

DD Disciplines and How to Budget

DD is carried out in various disciplines – financial DD (done by accounting firms), legal DD (done by law firms), tax (which can be done by either), personal (done by investigation firms), anti-criminal risk (done by a combination of all the above), environmental (done by environmental agencies together with law firms), and various others. Not all of these are necessary, but usually legal DD is considered to be a bare minimum, and the law firm conducting the work might recommend other forms of DD during the process. It is worth noting that although the concept of DD has been hijacked to some extent by the service providers named above, a manufacturer with a limited budget can do a certain amount of the work itself. The idea is, after all, simply to find out as much as you can about the proposed partner so that you can make an informed decision about whether to work with that partner, and if you do, how to reduce risk.

Many companies are dimly aware that DD is important, but these days budget pressures mean that they need to prioritise how they spend their service provider money, and that does not always include detailed DD. It is very
common now for companies to ask hopefully for diligence to cover “just the big ticket issues” or “solutions, not problems”. While this attitude is understandable, it is also unwise. There is no way for your service providers to know what the big ticket items are until they have done thorough investigations, which in China take time and money to do. When they have dug deep into the company, then they are in a position to identify the most important problems. It is also not possible for there to be a legal “solution” to every legal problem that appears. You should be asking the service provider not to solve every problem (which usually means explaining it away in the hope of getting paid quickly) but instead to be explaining the significance of the risk, so you can decide whether to accept that risk or not.

If you want to cut legal costs, cut them in other areas. There is no need to pay your lawyers to negotiate every clause of the contracts you will be using, as in any case those are likely to be unenforceable if a dispute arises. Similarly, do not place so much faith in your relationship building. Some companies spend more on flying back and forth to China and attending meetings, conferences and dinners than they do on the nuts and bolts work. If you have a tight budget, spend your money wisely.

“ If you have a tight budget, spend your money wisely ”
DD on the Target of an Acquisition

If you are acquiring a business, your due diligence needs to be more thorough than if you are just vetting a business partner. Yes, Chinese companies can have limited liability, so in theory, you, the overseas investor, can take comfort from the corporate veil. But that veil will not hold in place if the liability is criminal, and it will not protect you from negative press arising from breaches by your subsidiary.

Legal due diligence in China should cover these areas:

- Financial information; loan documents; debt; receivables. Look for the registered capital/total investment, actual capital contributions verified by a CPA, and the yearly examination certificates. In addition, check for foreign exchange registration if the target is foreign invested, and make sure any overseas loans have been registered properly.
- Anti-corruption compliance
- Intellectual property and any other intangibles
- Land and buildings; title to tangible assets; construction approvals
- Insurance
  - Material business contracts. Look for transactions that are not concluded on an arm’s length basis
- Environmental compliance
- Litigation and arbitration, potential disputes
- Government permits and approvals for operation – some types of business require industry specific approvals
- Labour law compliance – employment contracts, welfare and social insurance
- Corporate structure – branches, subs, affiliates
- Government subsidies
- Tax – especially evidence of preferential treatment
- Government approvals for establishment (look for operation term, correct name, and especially the business scope which determines what type of business the company can do. It may have been operating outside its scope of business for years).
Timing

Due diligence takes longer in China than in many other countries, especially if the seller is a pure domestic enterprise. There is no guarantee that the seller will hire lawyers to coordinate data provision, and it is also possible that at first no-one will pay close attention to your DD requests. It is unlikely that the seller will provide a virtual data room, and if it does, it is likely that few of the documents you need are actually there.

It is therefore fair to assume that lawyers will need to travel to the premises of the target and extract documents by talking to relatively junior staff who know where they are and have been authorised to release them. This all takes time.

After the process of data collection has ended, lawyers can prepare a due diligence report, and you can go through it, working out what the more serious issues are and how they can be resolved. The report ought to offer a “way out” of resolvable problems – and should of course highlight any issues that simply cannot be resolved. In all cases there should be ways to minimise risk, even if risk cannot be eliminated.

Linking with the Purchase Contract

There is no compulsory legal provision specifying a duty to disclose by the seller, and there are no specific provisions in law relating to the constructive knowledge of the seller, which means that you depend on what you have learned during due diligence and also on the drafting of your contract to try to shift the risk onto the seller. You do this by requiring the seller to make legally binding representations or warranties in the purchase contract. Bear in mind that these may not be enforceable – if you try to sue the client for breach of warranty, you might not get any compensation even if you win. The purpose of these representations and warranties is to force the seller to think long and hard about each statement you are asking him to make – and quite often this results in revisiting the DD process, because the seller will now take more of a lead role in due diligence, and consequently new facts or documents may be revealed.

The information herein has been provided by CBBC member DLA Piper. DLA Piper is a global law firm with lawyers in the Americas, Asia Pacific, Europe and the Middle East.

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Nicolas Groffman, Partner
Importance of Financial Due Diligence

Importance of Financial Due Diligence

Thorough Financial Due Diligence can provide informative and comprehensive insights during M&A transactions, by identifying drivers for synergies and risks on investment return. It can also help in potential business partner selection.

Based on understanding the target company’s business, financial performance is reviewed pursuant to applicable accounting principles, and accordingly a normalised operating result and financial status is reconciled to reflect the business truthfully.

Special Attention Areas for Financial Due Diligence

• **Deal structure:** An effective deal structure is critical to successfully implement M&A deals. Asset deals and equity deals have distinguished advantages and concerns, and should be considered together with legal and tax implications.

• **Internal control:** Absence of functional internal control can lead to restrained control on the business, inefficient operations and inaccurate financial reporting. Such issues can result in a lack of separation of duties, unclear job descriptions, use of personal bank accounts for company matters, or incomplete documentation.

• **Financial reporting:** Manual bookkeeping and adoption of unsuitable accounting policies are commonly seen in a target company, especially for startups, resulting in misreported financial accounts.

• **Related party transactions:** Assets may be transferred to a related-party applicable to lower tax rates or tax preferences. Pricing strategies for transactions between related-parties may deviate from the market benchmark or those with third parties, allowing them to fluctuate within different products/service lines or time periods.

• **Contingent liabilities and off-balance sheet items:** Unrecorded or under-accrued warranty, depreciation or other expenses imply underestimation of liabilities. On top of that, mutual guarantees, mortgages, lease commitments and potential taxation need to be considered for their contingent impact.

• **Taxation:** Practices incompliant with local tax law and regulations can lead to potential tax liabilities and penalties, which may be borne by the buyer side after the M&A transaction. Therefore, identification and assessment of the impact of tax risk is necessary to be clarified during the Financial Due Diligence process.

This section was written for CBBC by member and CPA network HLB International.

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This section deals with signing contracts in the People’s Republic of China and is aimed at foreign companies or subsidiaries of foreign companies in China. If you are signing a contract with a Chinese supplier or an outsourcing company, there are specific issues you need to be aware of to ensure your contract works. And while many say that good relationships are more important than legally binding contracts, you can be sure that a relationship by itself will not protect you if your business arrangements do not go according to plan.

Governing Law, Language and Dispute Resolution Clauses

When we talk about enforceability of a contract, we mean the ability to rely on the terms of the contract in a dispute. If the contract does not satisfy some very basic form requirements, then what you have is not an enforceable contract, but a wish list of how the parties hope they will behave.

There are various options for governing law and dispute resolution. The text below sets out the rules in very general terms only; there are exceptions to all of these:

- If one of the parties to a contract is foreign, then you may use foreign law to govern the contract (unless it is a joint venture contract, in which case it has to be governed by Chinese law).
- If both parties are Chinese (and that includes China-based wholly-owned subsidiaries of foreign companies) then they generally cannot use foreign law, unless the contract is going to be performed outside China.
- If the contract provides for disputes to be adjudicated in a foreign court, then generally they cannot be enforced against a Chinese company (unless it has assets overseas). If however the contract provides for arbitration overseas, instead of court adjudication, then the arbitration award can usually be enforced (with difficulty) in China. The arbitration needs to satisfy various requirements too numerous to set out here.
- The language of the contract is also important. Contrary to common belief, it is not always mandatory to have the contract written in Chinese, even if it is governed by Chinese law. However, preparing the contract in Chinese as well as English reduces the risk of disputes arising because it increases the likelihood that senior management at the Chinese company will actually read the contract carefully.

NDAs & IP Protection

If you will engage in outsourcing work, you probably need to share at least some of your secrets with the Chinese counterparty, so you should have that counterparty sign an NDA (Non-Disclosure Agreement). This needs to go further than simple non-disclosure of information.

If the contract does not satisfy some very basic form requirements, then what you have is not an enforceable contract.
Your goal is not to trap the counterparty into breaching the agreement by cunning drafting. Your goal is to set out clearly what it is you want the Chinese counterparty to avoid. You need to show you have considered their business model and understand it, and you also need to make sure they understand exactly what you mean.

- Assume the Chinese manufacturer will be sorely tempted to “cut out the middleman.” To them, the middleman may be you, the overseas patent-holder, not the honest manufacturer doing all the hard work. If you do not have a good personal relationship with the counterparty, it will try to go direct to the end-buyers. Your NDA needs to address this.

- The most likely breach of confidentiality is disclosure of your secrets by the counterparty to a related party. Chinese businesses often have many affiliates and manufacturing is often done through an arrangement of other subcontractors. The NDA must try to control information within that network, otherwise the Chinese counterparty will think that as long as it does not disclose to companies outside the network it is still complying with your requirements.

- Disclosure in itself is not harmful. It only hurts you if the Chinese manufacturer makes use of your secrets to compete with you or to damage your brand. To avoid this, you need to cover use of the confidential information, and set out first what the counterparty CAN do. Anything else is forbidden. Then, give some examples of what they CANNOT do – as practically as possible, using industry language, not legal terms. This is where brusque Chinese drafting becomes very important, as it is vital the message gets across to the counterparty. Business people justifiably switch off when presented with legal language that attempts to cover every situation in one long sentence, whatever language it is written in.

The subject of IP protection is a huge one and goes way beyond the scope of this tip-sheet. At the most basic level: register your trade marks in China before you start talking to any Chinese companies, or you will find that someone else has helpfully registered them for you, and then you will have to pay them off. China is a strictly first-come, first-served regime, so complaining to the trademark bureau that they had no right to register it will not usually work unless you are Pepsi (because that is a world famous brand) or you can prove they were in bad faith.

Engaging Third Party Service Providers

If you have a subsidiary in China that will be engaging third party service providers, it is important to have more than one senior officer in that subsidiary responsible for concluding such contracts. Authorisation of engaging third party service providers should be executed according to an authorised signatory list.

Such contracts should be divided according to value – so that budgeted items which are below a certain figure (e.g. RMB 1 million) and within budget can be approved by two “B” signatories (lower ranking managers). Unbudgeted items or items that are over that figure, or are out of budget, should only be approved by one “A” signatory and one “B” signatory.

Application of Company Chop

If you are dealing with a Chinese company, ideally you would want the company chop (stamp) to be affixed to the contract, as well as a signature from the legal representative. This makes it much more difficult for the counterparty to challenge the validity of the contract at a later date.

Note that there are many different types of chop used by companies in China, which is why we specify above the importance of the company chop. Many Chinese companies (including Chinese subsidiaries of international companies) have some or all of the following, even though most are not required by law.
Assume the Chinese manufacturer will be sorely tempted to “cut out the middleman”

<table>
<thead>
<tr>
<th>Seal/Chop</th>
<th>Purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Chop / 公司章</td>
<td>• All government correspondences</td>
</tr>
<tr>
<td></td>
<td>• Used for any official documents</td>
</tr>
<tr>
<td></td>
<td>• All other external correspondences</td>
</tr>
<tr>
<td></td>
<td>• Certification of all official company documents</td>
</tr>
<tr>
<td></td>
<td>• Transacting banking business (loans)</td>
</tr>
<tr>
<td>Contract Chop / 合同专用章</td>
<td>• All agreements and contracts</td>
</tr>
<tr>
<td>Legal Representative Chop / 法人章</td>
<td>• Cheque issuance (together with</td>
</tr>
<tr>
<td></td>
<td>• Finance – Cheque Chop</td>
</tr>
<tr>
<td></td>
<td>• Employment contract</td>
</tr>
<tr>
<td>Finance – Company Finance Chop (oval shape, for documents) / 财务专用章</td>
<td>• Documents for insurance and bank confirmation</td>
</tr>
<tr>
<td>Customs Declaration Chop</td>
<td>• Used for any documents required for imports and exports (seldom used)</td>
</tr>
<tr>
<td>Amendment Chop</td>
<td>• Amending the terms and clauses of contracts</td>
</tr>
<tr>
<td>Finance – Tax invoice (province)</td>
<td>• Purchase and issue invoices pertaining to services served, e.g. towing services and rental income</td>
</tr>
<tr>
<td>Finance – Company Finance Chop (square shape, for cheque issuance)</td>
<td>• Cheque issuance (together with Legal Representative Chop)</td>
</tr>
<tr>
<td></td>
<td>• Verification of bank deposits</td>
</tr>
<tr>
<td></td>
<td>• Payments of bank charges</td>
</tr>
<tr>
<td></td>
<td>• Withdrawal from staff housing fund at the request of staff</td>
</tr>
<tr>
<td>HR Chop</td>
<td>• Matters related to individual employees</td>
</tr>
</tbody>
</table>

Other chops that entities might hold include the following:
• Cash Payment Chop / 现金付讫章
• Bank Payment Chop / 银行付讫章
• Invoice Chop / 发票专用章
If you have a subsidiary in China, then it is important to ensure that the company chops are kept secure. Typically, a well-run company in China would have a mandatory guide for the use of all chops. It is important to:

- Set out clearly what the approval requirements are for use of each chop (e.g. does it need approval from an overseas manager, or the CFO of the onshore Chinese entity, or both?)
- State clearly who is responsible for looking after the chop, and who is that person’s back-up

**Company Name**

A surprising number of contracts are concluded between international companies and Chinese companies where the Chinese company has been insufficiently identified because its Chinese name has not been used. Transliterating the name into Hanyu Pinyin, or translating the name into English, is not sufficient to identify a Chinese company unequivocally. The Chinese language name, in Chinese characters, must be used, preferably together with the company number. Contracts, however well drafted, are no substitute for the following:

- A good understanding of the business and the standing of the counterparty that you are going to sign the contract with
- A good personal relationship between your managers and the managers of the counterparty

However, a well drafted contract in place is necessary to minimise risk of a dispute. At the very least, it helps both parties focus their minds on the issues that are of importance to each side, and the negotiations can often reveal unexpected assumptions by each side which only come to light when clauses are read carefully. The contract should also provide legal protection to the parties if one or the other breaches, and ultimately enable the non-breaching party to achieve compensation or restitution.

The information herein has been provided by CBBC member DLA Piper. DLA Piper is a global law firm with lawyers in the Americas, Asia Pacific, Europe and the Middle East.

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Nicolas Groffman, Partner
Despite careful planning and thorough due diligence, one cannot rule out the possibility of becoming embroiled in commercial disputes with Chinese business partners. However, advance preparation can assist in resolving disputes in the unfortunate event they do arise.

### Options for Resolving Commercial Disputes

Commercial disputes in China can be resolved in a number of ways:

**Administrative Action**

Depending on the type of dispute in question, several government departments and agencies in China can assist parties to resolve commercial disputes. A common example is action taken against intellectual property infringement by the State Administration of Industry and Commerce (SAIC) and its local offices. The SAIC is empowered to conduct investigations and raids, and to impose penalties and sanctions.

This route can provide a low-cost and effective means of resolving intellectual property disputes, in particular when the complainant has a strong and clear case.

**Consultation and Mediation**

**Consultation**

Consultation is an informal means of dispute resolution in China. It is common for contracting parties to meet to discuss their respective positions prior to escalating their disputes to formal litigation or arbitration. This is often seen as a “cooling off” period for the parties to communicate and to attempt to preserve an otherwise mutually beneficial relationship. Subject to the parties’ agreement, a neutral third party can be appointed to act as a facilitator for the discussions. Even though the consultation is intended to be casual and informal in nature, its results can be made to be legally binding if this is expressly stipulated in the parties’ agreement.

**Mediation**

The idea of mediation is that the contracting parties in dispute voluntarily present their respective cases to a trained and impartial third party (mediator) who assists in making suggestions to resolve the issues in dispute. It is non-binding and confidential in nature which promotes communication between the parties and may also help to preserve their business relationship. Mediation can also result in pragmatic settlement terms beyond the legal remedies which a court is entitled to grant.

**Judicial Mediation**

Pursuant to the PRC Civil Procedure Law, a Chinese court will require parties to attempt mediation with a judge (as both mediator and adjudicator) during the early stage of the litigation proceedings. If mediation fails, the parties will then need to argue their respective case with the same judge. In the event that a settlement agreement can be reached at the conclusion of the mediation, it becomes legally binding and can be enforced by the court.
**Arbitration**

Arbitration of China-related disputes can be divided into domestic arbitration and international arbitration. The respective rules and procedures can be very different and once again care must be taken in selecting the most appropriate forum.

**Domestic**

Onshore arbitration is conducted by Chinese arbitration commissions established under the PRC Arbitration Law. There are now more than 200 arbitral commissions in the country. The China International Economic and Trade Arbitration Commission (CIETAC) and the Beijing Arbitration Commission (BAC) are well-known and established commissions which can handle both domestic and international commercial disputes.

One of the shortcomings of domestic arbitration in China is that the Chinese courts have supervisory jurisdiction over any disputes relating to an arbitral award issued within the jurisdiction. Further, the choice of arbitrators is usually restricted to a relatively local tribunal which often constitutes a significant concern for foreign parties. The position has improved recently in that CIETAC have allowed parties to appoint arbitrators who are not on their official panel, subject to their final approval. Cases tend to be determined by reference to documentary evidence and it is uncommon for oral evidence to be given or witnesses cross-examined.

**International**

Foreign investors naturally prefer to turn to international arbitration for resolving their commercial disputes in China, as some of the weaknesses associated with domestic arbitration can then be avoided. The Hong Kong International Arbitration Centre (HKIAC), the Singapore International Arbitration Centre (SIAC) and the International Chamber of Commerce (ICC) are all well-established and experienced in handling disputes involving Chinese parties.

Another issue is that in general, Chinese arbitration commissions do not have powers to grant interim measures in order to preserve property or evidence during the arbitral process. Although the latest CIETAC arbitration rules now allow its tribunals to grant interim remedies prior to commencement of arbitral proceedings (for example an injunction), they still lack the power to order conservatory measures (such as preservation of evidence and assets of a defendant for future enforcement purposes), applications for which must be transferred to a competent court for ruling.

One practical issue is that, as stated above, only “foreign-related” disputes maybe legitimately arbitrated outside China pursuant to Chinese law. It is also common during contract negotiations for Chinese parties to be unwilling to arbitrate overseas. Hong Kong often serves as a compromise given that it is a common law system commensurate with international standards yet based in China.

**Litigation**

There are four levels of courts in China and each has its specified jurisdiction: Basic-level People’s Courts, Intermediate People’s Courts, Higher People’s Courts, and the Supreme People’s Court, which is the highest judicial body in China and has appellate powers over all the lower courts. Contractual disputes which involve foreign elements (for example the contracting party or subject matter of the commercial contract is foreign) are usually heard by the Intermediate People’s Courts.

![Bird & Bird Office](image-url)
Mandarin Chinese is the official language in litigation proceedings and foreign litigants are required to use interpreters at their own cost. Any party which is dissatisfied with the decision of the court of first instance may appeal once to the court immediately above.

**Arbitration vs Litigation in China**

For most foreign parties, arbitration (whether domestic or international) is a better option than litigation for resolving disputes in China. The advantages include the finality of an arbitral award and arbitral rules and processes which are usually more transparent than litigation. Although China continues to reform its civil litigation system, significant concerns remain over substandard adjudication, bias and local protectionism.

**Dispute Resolution and Governing Law Clauses**

**Onshore vs Offshore**

Litigation in China can be a frustrating experience for foreign parties because of the language, bureaucracy and unfamiliar legal procedures involved. It also limits a foreign party’s choice of legal representative as only PRC qualified lawyers can appear in the local courts.

It is important to bear in mind that mainland China does not enforce foreign judgments, except in the few instances where there is a reciprocal treaty with that foreign jurisdiction. Enforcement of an arbitration award in China will face fewer obstacles given China is a party to the New York Convention, of which most countries are member states. In general, arbitration in China tends to be the preferred option for resolving China-related disputes.

Whichever option is preferred, it is always of crucial importance to seek legal advice and communicate clearly with counterparties during contract negotiations.

Governing law clauses may appear to be routine provisions. However, they play a critical role when disputes arise. A good governing law clause promotes certainty in deciding the enforceability and validity of a contract, which may become invalid if the contract is illegal under Chinese law.

In China, commercial contracts which are not “foreign-related” must be governed by Chinese law, and disputes resolved (whether by litigation or arbitration) within China. A contract may be considered as “foreign-related” if any of the following apply:

- One of the contracting parties is incorporated offshore or is a non-PRC citizen
- The subject matter is or will be at least partly outside the jurisdiction
- There are other legal features concerning “the occurrence, modification or termination of civil rights and obligations” outside the jurisdiction
- There are other circumstances indicating that the business relationship between the contracting parties is foreign-related

Chinese law will still apply to certain “foreign-related” contracts, including where the subject matter involves land and share ownership, employment issues and insolvency. Significantly, a contract between a Wholly Foreign Owned Enterprise (WFOE) and a Chinese party will not be “foreign-related”.

**Drafting Tips**

For the sake of certainty and clarity, the dispute resolution and governing law clauses should be drafted in simple wording. Prior to drafting or agreeing to such a clause, always refer to the latest version of the relevant legislation or rules to confirm its validity and application.

In summary, there is no hard and fast rule in respect of dispute resolution and governing law clauses in relation to Chinese contracts. Each case should be reviewed in accordance with its specific circumstances, taking into consideration factors such as the location of the parties’ assets and the type of remedies to be sought.

However, advance preparation can assist in resolving disputes in the unfortunate event they do arise.
Offshore Security and Cross-border Enforcement

Asset Tracing and Recovery

China has signed mutual legal assistance treaties with over 50 countries including the United Kingdom, which can assist in asset tracing and recovery in China. Upon receipt of an official request from a requesting country, the relevant Chinese court will examine the supporting documents to ensure that the request does not violate the legal principles of China. If the request is considered to be detrimental to the sovereignty, security or public interest of the country, the Chinese court is entitled to refuse such request.

Recovery procedures can include investigations by the relevant government authorities to identify, restrain and seize assets within the jurisdiction. Since time is of the essence, it is common that parties also engage private local investigators to speed up the process. In the event that assets can be identified, Chinese courts will arrange for the return of assets in accordance with the procedures stipulated under the relevant bilateral treaties or international conventions.

Enforcement of Foreign Judgments/Arbitral Awards in Local Courts

Enforcement of foreign judgments is mainly accomplished in accordance with international agreements signed by China or the principle of reciprocity, provided that the foreign judgment does not violate state sovereignty, security or public interest.

There are, however, relatively few agreements and since, for example, there is no such agreement between China and the UK, it is not possible to enforce a UK court judgment in China. The only option in those circumstances is then for either party to submit the case to a Chinese court to be re-litigated, which means the foreign judgment will then be of limited significance or influence.

In light of the above, arbitration has become a preferred option for foreign investors as China and most other countries in the world are party to the New York Convention, so foreign arbitral awards should not be rejected by a Chinese court for enforcement. In practice, the geographical location and status of the Chinese party and its assets can still have a significant role to play. Enforcement is usually easier in major cities such as Beijing and Shanghai.

Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters between Hong Kong and China

In July 2006 Hong Kong and China entered into a special arrangement for mutual recognition and enforcement of monetary judgments. This applies to commercial contracts which contain an exclusive choice of jurisdiction in either Hong Kong or mainland China and which are entered into after 1 August 2008. The arrangement has significant implications for foreign investors as it further expands the choice of jurisdiction for contracting parties, taking into account the geographical proximity between Hong Kong and the mainland. It also saves the time and expense which would be required to bring parallel enforcement proceedings in China. More importantly, a Chinese court is required to give effect to the relevant Hong Kong judgment and cannot simply ignore it.

Protective / Injunctive measures

Travel Bans

In the event that foreign nationals in China become involved in a commercial and/or civil dispute and the case is submitted to a Chinese court, the Chinese government has the power to prohibit the foreign party from leaving the country until the resolution of the dispute and his/her travel documents may be detained.

If a foreign national is suspected of having engaged in any criminal acts, the police can exercise their power of detention for 24 hours for interrogation. If a travel ban is imposed by the Chinese government, such decisions will be notified to the relevant Embassy or Consulate. Any detainee has the right to
appoint a legal representative, who must be a qualified PRC lawyer.

Any person who is subject to a travel ban in China is advised to inform the relevant Embassy or Consulate for assistance without delay.

_Prohibition Orders to Preserve Property and Evidence_

If there is a likelihood that a losing party will not comply with an execution order granted by a Chinese court at the conclusion of civil proceedings, the winning party can apply to the court for a preservation order to freeze that party’s assets. Such an order may be granted by the court prior to the commencement of court proceedings or arbitration if it can be shown that irreparable damages to the subject’s property may occur without immediate preservation.

The applicant is generally required to provide a security (effectively a bond) upon the application for a preservation order, failing which the application will be dismissed.

Prior to commencement of a civil action or arbitration in China, the potential plaintiff can also apply to the Chinese court to preserve evidence on the basis that such information or materials may be destroyed or altered.

_Review of Government Authorities’ Sanctions or Decisions_

In general there are two ways to challenge a sanction or decision made by PRC authorities: administrative review and administrative proceedings.

Administrative review is an internal check conducted by the legal offices of the administrative body which carried out the relevant act. This covers a range of issues including physical detention, freezing and seizure of assets, and suspension of a business licence. The review will usually be conducted in the form of a paper trial and be processed within 30 days upon request. A complainant should usually first apply for administrative review before resorting to administrative proceedings.

Although this option saves time and cost, in practice it has proved ineffective in reversing government decisions.

An alternative is to submit a complaint to a Chinese court for determination. The procedures involved are similar to those for a normal civil matter. One point to note is that the court will not accept cases involving national defence and foreign affairs, or an administrative regulation or order that has a binding effect on the general public.

The information herein has been provided by CBBC members Bird & Bird. Bird & Bird is an international law firm, with a specialty in strategic commercial issues.

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In recent years businesses have become increasingly dependent on digital technologies and connectivity for everyday business functioning; the cloud, social media, email, mobile systems and other digital technologies underpin information sharing and communication between international offices, partners, suppliers and customers. This is a global phenomenon, but particularly true for British businesses with offices, partners and suppliers spread across Britain and China.

Alongside dependence on digital infrastructure a threat to businesses has emerged in the form of malicious code (such as viruses and Trojans), phishing scams, and other cyber-attacks which can disrupt business and significantly harm business assets, reputation and intellectual property. Threats can be targeted, or untargeted, and stem from several malicious motivations, including data and IP theft, sabotage and data destruction. Threats may materialise from assorted actors: cyber-criminals, competitors (corporate espionage), foreign intelligence services (state sponsored attacks), hackers and ‘hacktivists’. A large number of studies have also revealed that internal employees are one of the greatest sources of threats to information assets.

The report also revealed the extent of cyber threats to business:\(^3\):

- 55% of large businesses and 33% of small businesses were attacked by an unauthorised outsider.
- 73% of large businesses and 45% of small businesses suffered from infection by viruses or malicious software.
- 38% of large businesses and 16% of small businesses were hit by denial of service attacks.
- 24% of large businesses and 12% of small businesses detected that outsiders had successfully penetrated their network.
- 16% of large businesses and 4% of small businesses know that outsiders have stolen their intellectual property or confidential data.
- 58% of large businesses and 22% of small businesses suffered staff-related security breaches.
Failure to protect against, and manage, the associated risks can prove costly. A report commissioned by the Department for Business Innovation and Skills\(^1\) showed that 81\% of large businesses and 60\% of small businesses experienced a security breach in 2013. The median number of breaches was 16 for large businesses and six for small businesses. The typical cost to large businesses of its worst security breach of the year ranged from GBP 600,000 to GBP 1.15 million, while it ranged from GBP 65,000 to GBP 115,000 for small businesses. However, it is important to recognise that most businesses keep their worst security incidents hidden from the public, making them difficult to track.

While threats seem largely directed towards larger businesses, smaller businesses may be unaware of a security threat because they are generally inadequately armed with the necessary IT security and infrastructure to detect the intrusions. This is an issue for the entire business supply chain as cyber criminals may gain access to data from small businesses and penetrate the whole supply chain.

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China Cyber Threats

China is considered to have some of the most sophisticated threats in terms of corporate cyber-attacks and malicious activity. Reports show that 41% of all the cyber-attacks in the world in 2012 originated within China, and many Chinese and foreign companies are concerned about data security. An American Chamber of Commerce survey found that 36% of businesses operating in China believe that the risk of unauthorised access to data in China operations is increasing, and 23% of businesses have had propriety data or trade secrets breached or stolen.

Part of the problem is that Chinese regulations and policies on cyber threats are still embryonic. This means that British businesses engaged in international operations in China and other higher risk countries are vulnerable and thus ought to have heightened awareness of potential threats and have strategies in place to build cyber resilience.

Lack of Awareness of Cyber Threats

Following a flurry of high-profile incidents in recent years, including data leaks, hacking and IP theft, governments and business groups have raised the profile of cyber threats as an international concern. Despite this, awareness, particularly managerial awareness at the business level, remains low. The Economist Intelligence Unit highlighted complacency as a main business shortcoming – with only one in five managers rating cyber security as a key area in which their business will invest over the next three years. The reason for this was a lack of awareness of the potential threats. Other reports show that 7% of the worst security breaches were partly caused by senior management giving insufficient attention to security. This is a concern, as many British businesses operating in China may not even be aware of the threat or that their information may be compromised.

Study of British Businesses in China

Dr Karanasios and Dr Voss from the University of Leeds and Dr Papageorgadis from the University of Liverpool are currently undertaking a study to better understand current levels of awareness, practices and experiences of British businesses in dealing with cyber threats in China. Their research aims to augment understanding of the cyber threat readiness of British businesses in China through in-depth interviews with managers and a large-scale survey of businesses with British and China offices. Preliminary results have revealed a lack of awareness by most businesses involved in Britain-China business operations, especially small businesses. There is also a mix of experiences of cyberattacks, from viruses, loss of information, suffering from partners being hacked and being deceived into making payments.

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3 www.wired.co.uk/news/archive/2013-04/24/akamai-state-of-the-internet
5 www.economistinsights.com/sites/default/files/Cisco_Connecting%20the%20dots_ExecSummary_English%20v3_0.pdf
Managers have mixed views around doing business in China, some are actively concerned:

“Very concerned, and our clients our very concerned as well”

“Moderately concerned, I’d see it (China) as higher risk than some of the places we do business in...it’s mainly around hacking and making a concerted effort to get into my system without me realising”

While other businesses generally accept that is part of doing business in China:

“It doesn’t actually concern me as such; I think I just accept it”

A range of practices are used to ameliorate threats, such as common use of firewalls and other IT security, to more protective measures such as putting in place strict information security policies. For instance, a manager explained that, due to concerns around cyber threats that it is common for employees to receive a clean/blank mobile work device (e.g. iPad, laptop, smartphone) when working/visiting China offices to avoid sensitive information being lost; once they leave all data on the device is deleted to avoid returning to the UK with potential threats.

Larger businesses, especially those with long-term international experience tend to be more aware and better prepared for cyber threats. A manager from a leading international consulting business commented:

“[We are] incredibly concerned...because we are quite informed, even though we have a very sophisticated IT security, we are aware of the risks”

Despite this, one of the key concerns for businesses is be aware that information assets have been compromised:

“One of the key challenges is understanding the ‘unknown unknown’. Understanding those compromises which they do not detect and they do not know what is going on”
Countermeasures: Moving Towards Cyber Resilience

Trying to reduce the threat level to zero is unrealistic and will have an impact on business flexibility. For example, those companies that are using ‘clean’ laptops and restrict corporate email access in China or outside the office suffer if, for instance, the team cannot go back to important files during sales meetings to check data; or employees cannot quickly email back to HQ to get input mid-negotiation; or even save the notes from meetings and copy them over to their home computers to work on out of hours.

However, threats can be minimised at relatively low cost with education of employees, and there are several steps British businesses operating in China can take to build cyber resilience. Several guides have been developed to help businesses secure information assets and develop ‘cyber hygiene’. A common theme across the best practice literature is that guarding against threats involves a three pronged active defence, which includes people, policies and technology. If any one of these chains is weak it leaves a business vulnerable to cyber threats. For instance, solutions that rely solely on technology will become outdated. Likewise, the most robust processes and policies are ineffective if decoupled from actual staff practices.

- **People:** involves ensuring employees at all levels are aware of the threats and that they comply with information security policies (including avoiding pirated software, and accepting software and anti-virus updates); that internal illicit behaviour can be monitored, controlled and sanctioned; and that employees are stewards for protecting business information and important passwords.

- **Technology:** involves ensuring all security systems are up to date and good ‘cyber-hygiene’ practices are followed such as security systems being patched and passwords not being weak. More advanced practices may include ensuring mobile devices (e.g. tablets) do not contain sensitive information and cannot be used to gain access to core systems. Likewise, it may be prudent to store only non-sensitive data on internal servers in China. Smaller businesses without expertise in cyber security could consider cloud solutions.
• **Policies:** focus on ensuring that data access is controlled (only providing access to sensitive data for people that need it, i.e. different security levels for different people) and that inadvertent lapses are reduced by having policies and procedures in place around patching systems and sharing of data. Processes should be developed to quantify cyber threats, in order to support managers to make clear strategic decisions.

The long-term trend in cyber hygiene is that physical proximity is less of a focus. Hackers are comfortable operating across global networks, and while on the ground security protocol will remain important, the global technology and communications processes are becoming increasingly central.

In the case of China a key measure is to work with your supply chain and partners to build resilience (‘herd immunity’) and strengthen each other – ensure that the absence of your suppliers’ cyber strategy does not become an information security issue for your business.

This section was written for CBBC by our members the Universities of Leeds and Liverpool. It was authored by Drs Karanasios (Leeds), Voss (Leeds), and Papageorgiadis (Liverpool).

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Impact on the Business Environment

While the international movement to eradicate corruption has been gaining momentum for some time now, President Xi has since assuming office in 2012 spearheaded a significant anti-bribery campaign in China. The primary focus started with corrupt officials – the Communist Party’s discipline inspection agencies reported that Xi’s battle against “Tigers and Flies” resulted in over 180,000 government officials being “disciplined” in 2013 alone.

The anti-corruption campaign has not stopped with public officials, extending also to bribery in the private sector (“commercial bribery”), particularly in key areas such as pharmaceuticals, food production, construction and media. Furthermore, high profile scandals involving multi-national corporations have also demonstrated that no quarter is being given to either non-Chinese nationals or global corporations.

Xi’s campaign is having a profound impact on business conduct in China, and not only in the more obviously affected sectors such as hospitality and luxury gifts. Government officials are proving hesitant to make potentially risky decisions such as the approval of new investment and procurement projects. Bank of America Merrill Lynch has estimated that the campaign may have cost the economy more than USD 100 billion in 2014 alone as a result.

Being able to demonstrate that you and your company have a zero tolerance policy on corruption and a fully embedded compliance programme is opening up opportunities in place of the corporate hospitality or gifts of old.

The Chinese Regime – Impact on Your Business

In China there is no unified code, as yet, covering bribery and corruption. Instead there are a collection of laws – primarily contained in the Criminal Code and the Anti Unfair Competition Law – which make up the Chinese anti-bribery and corruption regulatory framework. Coupled with the fact that several Chinese regulatory agencies enforce China’s anti-corruption laws, such as the Public Security Bureau (PSB) and the State Administration of Industry and Commerce (SAIC), understanding and complying with your obligations under the Chinese law can be frustrating, particularly given what is at stake for both you and your company.

There are three main categories of offence: bribery of public officials (“official bribery”), commercial bribery and bribery of foreign public officials. The penalties imposed depend on (i) who is being bribed and (ii) the amount of the bribe. Given the elevated position of Chinese government officials and Party cadres, official bribery is perhaps unsurprisingly treated more severely than commercial bribery, with harsher penalties being imposed (unlimited fines and up to life in prison for non-government personnel). Crucially, what constitutes a public official is broadly defined: it could include, for example, an employee of a State Owned Enterprise.

Such is the importance of the current anti-graft drive to China that it is accelerating the formulation and implementation of new anti-bribery laws, so that “officials dare not, cannot and do not want to be corrupt”. We do
It is insufficient to merely pay lip service to anti-bribery and corruption obligations; your compliance procedures must become embedded in your business culture.

Conducting Business Across Borders

This extraterritorial effect of the anti-bribery regimes of the UK and other jurisdictions, including China, means that a business – and its management – may find itself open to prosecution in several jurisdictions for the same corrupt act, regardless of where it took place. This is why, having been found guilty in China (and fined USD 500 million), a prominent UK pharmaceutical company now finds itself under investigation by the Serious Fraud Office in the UK and possibly faces prosecution under the Bribery Act for the corrupt acts of its agents carried out in China.

Similarly, Chinese companies operating abroad and/or with Western stakeholders must take account of their international compliance obligations. Given the international pressure to combat corruption, coupled with the fact that a company’s clients, customers and other stakeholders may be automatically held liable for its corrupt acts, there is a significant commercial and reputational advantage to fostering a zero tolerance policy on corruption.

Effective Compliance

In the light of the above, it is imperative that businesses operating across borders are fully aware of and compliant with all jurisdictions’ regimes to which they are subject. If and when an allegation of corruption is made, a business’s first, perhaps only, line of defence will be to demonstrate that it has an adequate compliance programme in place. This can only be accomplished by ensuring that all relevant staff are made aware of their compliance obligations via strong, up-to-date procedures backed up by effective training.

Moreover, as mentioned above, the UK Bribery Act represents the gold standard in anti-corruption. Adherence to the Bribery Act and the business culture it instills will go beyond compliance issues to offer an improvement in their bottom line: China will look to do business with those who demonstrate the highest regard for tackling corruption.
Key Principles of Effective Compliance

It is insufficient to merely pay lip service to anti-bribery and corruption obligations; your compliance procedures must become embedded in your business culture. The UK Ministry of Justice (MoJ) has issued practical guidance as to what would constitute “adequate procedures” for the purposes of the Bribery Act. Given the Act’s status as the global benchmark in anti-corruption, the MoJ’s guidance also constitutes sound advice for any business seeking to maximise its compliance and minimise its risk profile. The MoJ lists six key principles:

- **Proportionate procedures:** procedures should be proportionate to the bribery risks faced by your business and to the nature, scale and complexity of its activities. They must also be clear, practical, accessible, effectively implemented and enforced. This would include, for example, having your procedural, training and associated materials in a language understood by each relevant member of your workforce.

- **Top level commitment:** top level management (such as the board of directors or owners of your business) must make it clear they are committed to preventing bribery by persons associated with your business. It is imperative that this top level commitment comes from boards of both the parent company and, crucially, its local affiliate.

- **Risk assessment:** assess the nature and extent of your business’s exposure to potential external and internal bribery risks. This assessment should be periodic, informed and documented.

- **Due diligence:** apply due diligence procedures, taking a proportionate and risk based approach, in respect of persons who perform or will perform services for your business or on its behalf, as a means of both assessing risk and mitigating identified bribery risks.

- **Communication:** you should seek to ensure that your business’s anti-bribery procedures are embedded and understood through internal and external communication, including training, that is proportionate to the risks faced. Training may not necessarily be limited to your own employees: where necessary third parties, such as agents or a JV partner, should also be provided with anti-bribery training. Training enables you to identify and address bribery risks and enforces your business’s commitment to applying its compliance programme and preventing corruption. To be effective this training should be communicated in a language understood by each participant, be readily accessible and continuous as well as regularly monitored and evaluated.

- **Monitoring and review:** you should continually monitor and review your business’s anti-bribery procedures and make improvements where necessary.

More information and an up-to-date discussion on China-UK anti-bribery compliance is available in the ChinaSure-CBBC webinar (https://youtube/KWpb_TpJaWw).

The information herein has been provided by CBBC member ChinaSure. ChinaSure exists to help companies of all sizes achieve a practical and effective cross-jurisdictional compliance programme, with legal support from HBJ Gateley and JunZēJun Law Firm.

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Intellectual property (IP) rights are a frequent source of concern for companies doing business in China. Most people are aware that intellectual property rights give rise to legal monopolies that can be very powerful in commercial situations. If you are doing business in China or plan to do so, it therefore is important to know how to use, register and enforce the intellectual property rights that are relevant to your activities there.

China has modern, comprehensive IP laws that generally match international standards; and it is party to important international agreements such as the Patent Cooperation Treaty (PCT), Paris Convention, Madrid Protocol and TRIPS. Many cities in China moreover have sophisticated legal markets that can provide high-quality advice and services; standards of education in IP matters in some cases are extremely advanced; and judicial functions are discharged efficiently and at lower cost in many Chinese locations than is possible in Europe.

At the same time there are pitfalls for the unwary. This section seeks to provide some key information that should help to prevent accidents and upsets at a basic level, although of course it can never substitute for specific legal and strategy advice that is tailored to the needs of a particular company.

**Who Owns the Rights?**

It is a common, and largely correct, assumption that subject to certain exceptions the first to file an intellectual property application wins the right to ownership. China, like most other countries, has a “first to file” and “absolute novelty” system for invention patents (protecting inventions), utility models (protecting lower-level technological developments) and registered designs / design patents (protecting the look of a product). This means that it is usually necessary to consider your filing strategy for China at an early stage in the development of a product, perhaps even some years before you are ready to take the product to China (whether to manufacture or market it there).

Unlike the UK, China also has a first to file trade mark system. So here too you ought to file for trade mark registration at an early stage, or run the risk of suffering trade mark “hijacking” or “squatting”. Trade mark squatters can be particularly troublesome and costly to deal with, so it is often strongly desirable to arrange an effective trade mark strategy in China in plenty of time before any product launch or marketing effort commences.

Registered intellectual property rights are territorial. Thus a patent or registered design granted in the UK has no effect in China (although it could be used to prevent importation
of a product made in China into the UK); and a Chinese patent or other registered intellectual property right provides protection in mainland China only. Separate registration therefore is required in Hong Kong and Macau; and in contrast to Europe there are no regional intellectual property treaties in Asia covering Chinese-speaking jurisdictions.

**Trade Marks**

A trade mark is a sign, logo, or symbol that allows customers to distinguish the goods or services of one producer or supplier from those of another. A wide range of signs can be registered as a trade mark provided that they are capable of graphical representation. Examples include words, letters, numerals, shapes and colours and combinations of these things. It is advisable to register word trade marks in both English and in Chinese. Furthermore it is essential that any translation of a trade mark into Chinese is prepared by an advisor with good experience of the Chinese trade mark system, as there have been numerous cases of the value of a trade mark being diminished by an inaccurate or inappropriate translation.

The initial term of trade mark protection in China is 10 years but a registration can be renewed indefinitely at 10-year intervals thereafter.

**Invention Patents**

Invention patents provide protection for a product or process which has practical application.

To be patentable an invention must be novel. This means that it must not have been made public anywhere in the world, in any language, in any form (such as in a printed document, an electronic disclosure, an oral disclosure or by use) before the patent application is filed.

The invention must also be inventive. This means that the invention must not be obvious in view of information that was publically available before the patent application was filed.

Chinese invention patents provide protection for a maximum period of 20 years from the application date, subject to the payment of annual fees. Before a Chinese patent can be granted the application is subjected to an examination by the State Intellectual Property Office (SIPO) to ensure that the invention satisfies the requirements for patentability. As a result of this process it can usually take several years to obtain an enforceable, granted patent.

**Utility Model Patents**

Utility model protection is often an extremely useful form of protection in China that is used very little by UK companies. Utility model protection is available for products that have practical application, but not for processes, chemicals or biotechnology developments.

A utility model must meet the same requirement for novelty as an invention patent; but the inventiveness hurdle in contrast is set at a significantly lower level. As a result, utility models are particularly useful if you wish to obtain protection for an improvement to an existing product, or a relatively simple invention.

Utility models provide monopoly protection for a maximum of 10 years subject to the payment of the necessary fees.

The validity of a utility model application is not examined in detail before the utility model is granted. This means that a utility model can be granted in a matter of months after filing, thus offering a quick, simple and cheap means of protecting various types of technical product in China.

**Design Patents**

Chinese design patents are very much like registered designs in Europe. Thus they protect the visual appearance of a product, such as its shape, pattern or colour or any combination of these. Chinese design patents provide protection of a maximum of 10 years and are usually granted in less than
a year. Due to new legislation, design patent protection terms will soon be extended to 15 years.

**Filing an Application for Registered Intellectual Property**

Timing is extremely important when filing an application for registered intellectual property, particularly for patents, utility models and design patents.

**Invention Patents & Utility Models**

For an invention devised in the UK, typically a UK company will file a UK patent application first. This needs to be done before there has been any public or other non-confidential disclosure of the invention, and often means that the patent application is filed at an early stage of the development of a product. After filing the UK application the applicant has 12 months in which to file applications in other countries. At this point, he/she has the option to file national applications in each country of interest or to file a PCT patent application. Filing a PCT application at this stage is the most popular route for many applicants.

There is no such thing as an "international patent". Rather, a PCT application provides the option of obtaining patent protection at a later date in the vast majority of economically significant countries, including China. Hence the PCT option creates time to decide which countries are important to the business.
In more detail, within 30 months after the filing of the patent application in the UK it is necessary to convert the PCT application into national patent applications in the countries of interest. At this point a patent application can be filed in China. The 20 year patent term runs from the date on which the PCT application was filed (i.e. no more than 12 months after the initial UK filing date), although it is not possible to enforce the patent until after it has been granted.

Alternatively, a Chinese patent application can be directly filed within 12 months after the filing of the initial UK application. This can be advantageous if the applicant wishes to obtain more rapid grant of the Chinese patent application but it does bring significant costs.

It is also possible to file a Chinese utility model application based on a UK patent application or a PCT application. The option to convert a PCT application into a utility model could be advantageous if, from the information received after filing of the PCT application, it appears difficult to obtain a granted invention patent.

There is however a route to filing both an invention patent application and a utility model application in China, involving arranging the filing of both applications on the same day within 12 months after the UK
filing date. The utility model patent normally then should issue within a few months of filing; it will then be possible to enforce the utility model to prevent infringement. This can be particularly beneficial if there is a serious risk of infringement occurring before the patent application is likely to be granted.

It is not allowable to have both a granted Chinese patent and a granted Chinese utility model for the same invention. Therefore once the patent application has been granted the utility model can be allowed to lapse. By this strategy you achieve the right to enforce your intellectual property rights quickly by virtue of the utility model and also obtain protection for the longer period of time provided by a patent.

The patent filing strategy will need to be slightly different if you employ staff in China or collaborate with a Chinese company and the invention you wish to protect was devised in China. In this situation it is necessary to file the first patent application in China or to obtain clearance from SIPO to file abroad.

**Design Patents**

An application for a design patent can be filed directly at SIPO or may be based on a design registration filed in another country, provided that the application in China is filed within six months after the filing in the other country.

**Trade Marks**

For trade mark filing purposes products and services are classified into product and service classes. It therefore is necessary to identify all the products and services for which your trade mark will be used (or potentially will be used).

Normally we recommend that prior to filing a trade or service mark application a search is conducted to check that the mark in question has not already been registered by a third party.

You should give careful consideration to choosing a Chinese trade mark equivalent to your English language trade mark because the meaning and also the sound, tone and even the look of Chinese characters used in a trade mark can affect a brand’s reputation. Trade marks can be registered through a direct national filing route, or through the international (Madrid Protocol) system. Using the Madrid Protocol the application in China is based either on a trade mark application or registration in your home country.

As noted China has a “first to file” trade mark law. This means that you may not be able to register your trade mark in China if someone else has already registered a similar mark. It is important that you register your trade marks before you enter the market in China to reduce the risks of your mark being “hijacked” and registered by someone else first.

**Assistance Obtaining Registered Intellectual Property**

A foreign company with a legal presence in China can apply directly to the Chinese authorities to obtain patent, utility model, design or trade mark registration, although this is not generally recommended. Foreign companies without a legal address in China need to file via a registered Chinese patent or trade mark attorney. You may, of course, instruct a Chinese patent or trade mark attorney directly. However, most European patent or trade mark attorneys can recommend Chinese patent attorneys that they trust and have already conducted due diligence on. Additionally, not only can they help you ensure that you satisfy all necessary national requirements; they can also provide assistance to help you realise a consistent intellectual property strategy around the world.

This guide was written for CBBC by Patent and Trade Mark Attorney firm and CBBC member Poter Clarkson LLP.

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There are three main formal routes for intellectual property (IP) enforcement in China, as follows:

1. Administrative (including Customs)
2. Civil
3. Criminal

This section provides a brief overview of how IPR is enforced in China, but does not replace the need to seek qualified advice in relation to any specific IP matters.

It goes without saying that enforcement is only available where you own applicable IP rights in China (most forms of IP require registration), and you are not able to directly enforce UK IP rights in China. A separate section of this guide provides information on registration of IP.

**Administrative Enforcement**

Administrative enforcement is one of the most common forms of IP enforcement in China, as it provides for a quick, low-cost remedy that does not require representation by a law firm or any action in court.

*State Administration of Industry and Commerce*

China’s laws empower various government agencies with jurisdiction to enforce IP rights. For example, in relation to trade marks, false advertising and trade dress infringement, authority is given to the State Administration of Industry and Commerce (SAIC) and its local AIC branches.

If an IP owner discovers an infringing act, such as infringing products being sold at a retail outlet, stored in a warehouse or produced at a factory, they bring a case to the nearest AIC branch. Note that an investigation to establish the location of infringement must be done by the IP owner – the AIC will not investigate general information of infringing goods in the market; they will only respond to a specific complaint.

The AIC do not require complex formalities or evidence in order to act, and often need only:

- Copies of the IP right concerned (such as trade mark certificates)
- A Power of Attorney (scanned copy is often sufficient)
- A brief written submission with the case facts

Samples of the infringing items are usually not required for a case of exact counterfeiting, but are required if the trade marks or packaging are not identical and require comparison.

The AIC officers will often act promptly, sometimes within the same day, if the case is urgent (for example, if there are goods which may be shipped imminently).
The AIC officials will conduct an on-site inspection of the target premises, and have powers to seize all suspected infringing items, including finished and semi-finished goods, packaging and tools such as moulds.

Unlike police, the AIC do not have powers of search or arrest, but the suspected infringer is simply required by law to cooperate with their investigation. The AIC officials may seize sales records and other electronic or physical records. However, generally their enforcement is based on physical articles at the scene.

The AIC officials may allow the IP owner’s representative to attend the raid, although this is not stipulated in law and in some locations the AIC will refuse to allow the IP owner’s representative to attend. The AIC will normally provide a record of the seized goods to the IP owner’s representative.

If the scale of infringement discovered is obviously large, the AIC may transfer the case to the Public Security Bureau (PSB, or police) for criminal prosecution (see the section on Criminal Enforcement below).

The AIC will later interrogate the responsible person, determine infringement and, after around two to three months, will issue a Punishment Decision that typically includes:

- An order to cease infringement
- Forfeiture and destruction of the seized items
- A fine based on the turnover of the infringing goods. Generally fines are low, just a few hundred or thousand pounds
- On the IP owner’s request, the AIC will usually provide a copy of the Punishment Decision

The IP owner is sometimes allowed to witness destruction of the goods, but this is not a right. Generally the AIC will destroy all confiscated goods in their warehouses in batches.

The fine issued by the administrative authorities such as the AIC is retained by the national treasury, and if the IP owner seeks compensation, they can use the administrative decision to file a separate civil suit.

While the above describes the enforcement process of the AIC for infringement of trade marks and trade dress etc, similar principles broadly apply to other administrative bodies that have jurisdiction over patents (the Intellectual Property Office), copyright (the National Copyright Administration) and quality and labelling standards (the Administration of Quality Supervision, Inspection and Quarantine), the latter body having some overlapping jurisdiction with the AIC as they can also enforce against acts of counterfeiting.

It should be noted however that the Intellectual Property Office’s (IPO) system for administrative enforcement of patents is somewhat weak, as there is no seizure of infringing items, only samples, and no fines are issued, only a decision of infringement. Except for relatively small and minor cases which may be suitable for the IPO system, patent owners tend to prefer to bring cases to the civil courts.

**Customs Route**

Chinese Customs are another source of administrative enforcement, albeit with a special jurisdiction over goods both entering and exiting China. Like other administrative enforcement bodies, Chinese Customs have independent powers to handle cases without recourse to the judicial system, although in certain situations a case must be brought to the courts (see below).

An IP owner must first record their IP rights with Customs on a national database, which must also include a contact person in China – either an agent or the IP owner’s own local representative. The IP owner must also keep an up to date “whitelist” of any companies authorised to export their products, which they manage on Customs’ database via a password-protected portal.

If the IP owner seeks compensation, they can use the administrative decision to file a separate civil suit.
It is recommended to provide training for Customs officers at certain key ports. This training should avoid detailed technical information and instead provide the officers with very simple indicators (for example “our products are never shipped mixed with competitors’ products”). Experienced IP agents can organise training sessions.

Over 95% of cases are discovered by Customs from random inspections, and involve goods exiting, not entering China.

When Customs find suspected infringing goods, they will notify the IP owner who has three working days to request its detention or release. Customs will not send samples or spend time on detailed photographs, so it is essential to have a local contact person who can conduct verification.

If the IP owner wishes to detain the goods, they are required to place a cash bond, up to a maximum of RMB 100,000 (approx. GBP 10,000) with Customs for the duration of the case, but a bank guarantee can be arranged for IP owners who have a large volume of cases.

Where the value of a case meets the threshold for criminal prosecution, a Customs case can be transferred to the PSB for prosecution.

After detention, Customs will conduct an investigation against the shipper, order the goods to be confiscated, and issue a small fine, which may be no more than a few hundred pounds. This fine is submitted to the national treasury and there is no provision for compensation to the IP owner. On conclusion of a case, the IP owner must pay storage costs before the bond is refunded. The confiscated goods will either be destroyed or, if they have resale value, by law can be re-sold provided that the infringing IPR (such as trade marks) are removed.

Customs will not share shipping documents with the IP owner. Where a case is relatively large scale, the IP owner may consider threatening civil proceedings against the shipper to demand disclosure of the other parties, and may also demand that the shipper pay storage costs.

Customs officials only have powers to handle straightforward cases of counterfeiting and piracy. For cases involving patents or non-identical infringement, Customs will require the IP owner to file a suit in the courts in 50 days. Therefore Customs border protection measures for IPR are most simple and effective for dealing with counterfeit goods rather than more complex types of IP infringement.
Administrative enforcement is one of the most common forms of IP enforcement in China

**Administrative Enforcement** *(e.g. Trade Marks and Patents)*

1. **IP owner investigates and gathers evidence**

2. **IP owner or agent brings complaint to administrative authorities (e.g. AIC for trade marks and passing off, IPO for patents)**

3. **Admin authority will conduct inspection of site and seize samples, infringing goods, tools and documents. IP owner usually may attend**

   **IPO inspection for patent infringement will only consist of taking samples, but the IPO may agree to seize inventory on payment of a bond. IP owner usually may NOT attend**

4. **Administrative authority will question alleged infringer, issue a penalty decision including fine and confiscation of goods. Copy may be provided to IP owner, but not always**

   **IPO will hold a mediation hearing between the parties and if infringement is determined, will issue a decision and order to stop. No seizure of infringing goods is made**

5. **Seized items will be destroyed in batches by authorities**

   **For IPO, no seizure of goods, so surrender of infringing goods is on voluntary basis**

   **If IP owner wants to claim compensation, the administrative decision can be used to file a separate civil suit**

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**Timeline:**
- **for AIC, an urgent inspection may be carried, but typically it takes 1 week. For IPO, may be 2-3 weeks**
- **Can be 2-4 months after inspection**
Civil Litigation

Civil litigation of IP infringement through China’s courts is becoming increasingly common, with over 100,000 IP cases concluded by China’s courts in 2014.

The Chinese court system can be characterised as relatively procedurally simple and fast.

Since there is no evidence discovery process imposed by the court, the plaintiff must gather as much relevant evidence as they can themselves and have it notarised by a domestic public notary. An experienced corporate investigator or law firm should be engaged for this.

Judges in China prefer to deal with cases in a quick and practical manner and will actively encourage the parties to settle, which may result in an enforceable mediation decision issued by the court. This can be useful if the IP owner wants to conclude the case and obtain monetary compensation with as little time and cost as possible. Alternatively, if the parties cannot reach a result by mediation, the judge will issue a final decision.

The law provides for preliminary orders such as interim injunctions, “Evidence Preservation Orders” (i.e. a court search order) and “Asset Preservation Orders” (an asset freeze). In reality, preliminary injunctions are very rarely issued. Evidence and asset preservation orders can be more straightforward to obtain but require payment of a cash bond, set by the court. Asset preservation orders, which freeze the defendant’s bank account, can be a useful tactic to force negotiations and ensure that the plaintiff can secure some of the defendant’s assets for recovery.

Courts generally do not engage in a detailed analysis of compensation to the plaintiff. Most commonly, judges will rely on “statutory damages”, which means a discretionary range of damages that the judge can award in the absence of a clear evidentiary basis. For an overview of what damages to expect, you may consult the CIELA database (www.cieła.com.cn) which compiles information on all published IP cases. For example, the average damages awarded for trade mark infringement is RMB 129,000 (approx. £13,000). However, with the statutory damages level in the recently amended Trade Mark Law significantly increased, it is likely that averages will be raised.
Enforcement of court decisions in China is weak, and plaintiffs may find that they have to spend further costs on procedures to try to compel the defendant to comply. This is another reason why it is often preferable for the parties to reach a voluntary settlement.

Due to the relative speed and low cost of civil litigation for straightforward cases, many IP owners use the courts as an add-on to an administrative action (see above) where the facts of infringement have already been established and the only issue is one of the compensation amount to be paid. Such cases may conclude within four to six months or more quickly if the parties settle.

However, some types of case may involve the trial of one or more substantive and complex issues, for example, passing off a product’s trade dress, or patent infringement. Such cases can be very time consuming and costly to prepare and carry out. Such cases may take over a year to obtain a decision or settlement. As an alternative to litigation, warning letters threatening action and requesting undertakings can be effective in stopping smaller or less determined infringers, but IP owners should not expect an infringer to pay compensation or hand over infringing goods only on the basis of a letter.

**Criminal Prosecution**

China’s Criminal Code provides offences for various types of IP infringement, including the sale of counterfeit or shoddy goods, certain types of copyright piracy and theft of trade secrets. Criminal sanctions are not available for patent infringement, passing off or non-identical trade mark infringement. China’s PSB have jurisdiction to investigate suspected IP crimes.

A criminal offence can be established where a case has exceeded a minimum threshold of economic value – for trade mark counterfeiting this is:

- **For a manufacturer:** the amount from illegal business turnover is no less than RMB 50,000 (i.e. the total value of goods sold and unsold) or the amount of illegal earnings (i.e. goods sold) is no less than RMB 30,000
- **For a seller:** the thresholds are RMB 150,000 illegal turnover (goods sold or unsold) or RMB 50,000 illegal earnings (for goods sold)

The value of the sold infringing products shall be calculated at the actual sales price as shown in the evidence obtained from the criminal investigation. The value of unsold goods is calculated by marked or average price, or if this cannot be determined, the average market price of the genuine goods. In general, it is easier to request the PSB to bring a criminal prosecution where the valuation of the case is clearly over the threshold, especially in parts of China outside of major cities where the PSB may be less experienced with IP cases.

Many IP-related criminal cases are not launched by the PSB initially, but through seizures made by administrative authorities such as the AIC (note those sections above). This is because the PSB do not prioritise IP crimes and they can be slow to investigate. By contrast, an IP owner can arrange a raid with the AIC very quickly and if the case is clearly above the threshold for a criminal offence, the AIC can be requested to transfer the case to the PSB immediately.

Criminal enforcement is the most powerful of the enforcement routes as the PSB have powers to detain suspects, interrogate and search for physical and electronic evidence.

Following a PSB investigation, a case is brought to the Public Prosecutor who will review the case, issue arrest warrants and indict the suspects for trial. The IP owner will be required to provide a statement verifying that suspect goods are counterfeit.

While the IP owner is not required to engage a lawyer to represent them as the victim, it is generally advisable for the IP owner to do so to see that the case proceeds smoothly.

"A criminal offence can be established where a case has exceeded a minimum threshold of economic value"
Sentences for IP crimes are typically a monetary fine of a few thousand pounds and a suspended sentence. For large scale and serious crimes, there may be a custodial sentence imposed of up to seven years, although such a high sentence is rare.

A criminal case will generally take six to 12 months from the start of a PSB investigation to the issuing of a sentence, while it can take 12 to 24 months in some protective jurisdictions.

**IPR Investigations**

It should be noted that for all the above enforcement routes (except for ex-officio actions by Customs), the IP owner is expected to conduct most of the investigation work to identify the infringing activity and the involved parties. The enforcement authorities rarely conduct lengthy investigations on their own initiative. Therefore much of the success of the above enforcement relies on IP owners investigating and preparing cases themselves before bringing them to law enforcement authorities or the courts.

As the investigation industry is not regulated in China, it is advisable for IP owners to arrange investigations through their lawyer.

This section was written for CBBC by intellectual property specialised law firm and CBBC member company Rouse & Co. International LLP.

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Counterfeit Goods & Misleading References to Trade Marks in Chinese E-commerce

Infringers are always looking for the most effective ways of taking advantage of strong brands via the internet and e-commerce marketplaces. This section will outline some of the main issues in this area, as well as best practices for protecting your brands online.

- **IP/trade mark abuse:** These infringements often take the form of unauthorised parties using brand and product names to sell their own, entirely different products, with the aim of misleading buyers. Logos and copyrighted material are also used to further mislead consumers.

- **Counterfeits & imitation goods:** The products are not genuine, but the results are all too real: lost sales and tarnished brand image. Some copies in China can be virtually identical to genuine products, and in many cases consumers are unable to determine whether products are original or copies. In addition to lost sales and brand damage, the production of imitation goods often involves poor working conditions for employees, child labour and environmental pollution.

- **Traffic diversion:** To maximise online sales, brands need to be skilled at driving traffic to their own online sales channels. The use of traffic diversion to mislead buyers by piggybacking on well-known brands to sell other products, including counterfeit goods, is increasingly widespread. Customers are misled throughout the buying process from search engines, marketplaces and on social media by using search words that specifically match your brand and your products.

- **Parallel imports:** Goods produced by the brand owner or another party with a valid licence are exported to a country with the brand owner’s permission; but are then imported to another country without the brand owner’s permission. The term ‘parallel imports’ comes from the fact that the imports are carried out outside or in parallel with the normal distribution channel. Parallel imports mostly occur because of the price differences between jurisdictions, and professionals have imported large quantities of goods into mainland China from Hong Kong in particular.

Diversified E-commerce Channels

The e-commerce trend originally started with web stores, but now involves a number of different channels and platforms. Sales are also made via channels that were not originally intended for sales.

- **Web stores:** Web stores are sites run by the sellers themselves, in which they integrate payment solutions and other operational functions. There are web stores for specific brands, but also stores with a wide variety of brands. To reach their buyers, sellers need to drive traffic to their site and do this by creating high brand awareness, search engine optimisation and different kinds of advertising. Web store owners also advertise on market places and in social media.

- **Online market places:** Online market places currently represent the largest sales channels, and are also where the highest levels of infringement take place. Alibaba Group is the owner of some of the most famous ones in China, such as Alibaba.com, Taobao, 1688.com, AliExpress and Tmall. Other market places include Paipai, Makepolo and Gongchang. eBay and Amazon are examples of major market places in other parts of the world. Sellers, either companies or private individuals, use the market places as an advertising space to reach their buyers. Some market places offer brand owners ‘flagship stores’ that are certified as distributors of genuine products.

- **Social media:** Social media has seen an incredible development over the past 10 years in China, particularly local platforms but also some global service providers. Sina
Weibo, the Chinese equivalent to Twitter is extremely popular, while Renren and WeChat for mobile devices are China’s answer to Facebook. Communication is at the very heart of social media, but an extremely high level of sales is generated or takes place through social media as well.

- **App stores and m-commerce:** With the rapidly growing popularity of mobile devices in China, an increasingly wide variety of products have become available for purchase via in-app sales. Major app stores in China include Wandoujia, Zhushou360 and Chinese iTunes. The main type of infringement on app stores is brand abuse, whereby a developer uses the brand in such a way that more people buy its products in the belief that they have been developed by the brand owner.

**Minimising Counterfeit Sales**

To make sure you are prepared to enforce your rights to your brand online, as with enforcing IP in China generally, the first important step is to register your IP. Most online platforms and websites will request proof of IP ownership and will have the right to ignore your requests to remove links to counterfeit products if your IP is not registered properly.

Irrespective of the level of infringement you are affected by, or whether you carry out the work yourself or using a provider, online brand protection has three phases: tracking, analysis and enforcement.

- **Tracking:** It is straightforward to visit an online marketplace and find counterfeit products listed under your own brand name. However, it is not uncommon to have brands with more than 10,000 listings on individual marketplaces, which can make the process of finding all infringing listings incredibly time-consuming. Furthermore, as soon as you’ve found one listing, another emerges. Fortunately, there are automated monitoring tools, or ‘technical solutions’, that can help you to isolate new listings in focus areas. Some systems concentrate on key marketplaces and social media, while others cover all of the ones that need to be monitored.

- **Analysis:** Most of the work analysing sales in the different channels is carried out manually. Logo and image recognition tools can help, as well as alert systems that react when there are any signs of infringement. However, to make sure the analysis is completely accurate, a final manual analysis needs to be carried out. There are a number of different factors or metrics that raise red flags when products have a high probability of being counterfeit. The most common factor is price.
If a price is too good to be true, it normally is. Identification can also be made by analysing product images that can show if the logo is not genuine and if there are any other details that are different from the original products.

**Enforcement:** Work on enforcement differs depending on the channels and the organisations, but the basic premise is the same. If you want to request infringement sales to be taken down, you need brand registrations and also business registrations. If you have this documentation, you can apply to be given the authority to request the content on many sites to be taken down. On sites like Alibaba.com and Taobao, reporting is done within their web-based IP protecting systems. On other sites, reports are made by email.

**AliProtect: Alibaba.com, AliExpress, 1688.com**

AliProtect is a reporting system, where the brand owner can monitor and handle take-downs of IP infringing products on Alibaba.com, AliExpress and 1688.com. It is an effective channel that is easy to control. AliProtect is available in English. Registration is required first (which is free):

- **Step 1:** The brand owner registers an account at AliProtect, providing information such as company name, email, name, address, telephone number, etc.
- **Step 2:** The brand owner registers and uploads the IP rights it wishes to protect, such as trade mark, invention patent, utility model patent, design patent or copyright. It is only at this stage that you need to upload proof of identity in the form of a business incorporation certificate or certificate of incorporation.
- **Step 3:** AliProtect will then process the application, which normally takes three working days. After this the brand owner will receive an email to say whether the verification was successful.

When AliProtect has approved your application, you can start to submit IP infringement complaints immediately. You do this in AliProtect, under the IPR Complaint section. When you want to submit a complaint, there are two alternative routes you can take:

- **Option 1:** You can carry out searches directly within AliProtect, and select which you want report.
- **Option 2:** You can paste the links to the listings you believe contain infringements; links that you have found directly on the normal website.

When you submit a complaint, you need to specify the registration you are using as protection and the kind of infringement you believe has taken place.

After you have completed the report in its entirety, you will probably have to wait three to seven working days until Alibaba has analysed and taken any action against the seller.

If Alibaba accepts your report, you will find this result under the History menu option. If it does not accept your report, you will receive an email, which explains why the complaint cannot be handled.

Alibaba always contacts the seller. If the seller knows that they have made an infringement, they will probably accept the take-down. Sometimes the seller will provide counter-notification to prove they are not infringing the IP rights, which Alibaba then investigates. Based on this information, Alibaba makes a decision, but as long as you have the IP rights and it is an actual infringement, the listing will usually be taken down.
**TaoProtect: Tmall, Taobao**

TaoProtect is the reporting system for Tmall and Taobao, where the brand owner can monitor and handle take-downs. It is an effective channel that is easy to control. TaoProtect became available in English in July 2015. Registration is required first:

- **Step 1:** The brand owner registers an account at TaoProtect, providing information such as company name, email, name, address, telephone number, etc. Unlike Alibaba.com, the brand owner has to upload proof of identity in Step 1, in the form of a business licence or certificate of incorporation.

- **Step 2:** The brand owner registers and uploads the rights it wishes to protect, such as trade mark, invention patent, utility model patent, design patent or copyright.

- TaoProtect will now validate your proof of IPR, which normally takes two working days.

When TaoProtect has approved your application, you will be able to report infringements. You do this in TaoProtect, under the File Complaint section. When you make the report, you can paste the links to the alleged infringements in question; links that you have found directly on the website.

When you fill in the complaint form, you need to specify the IP rights you are using as protection and the kind of infringement you believe has taken place.

After you have completed the report in its entirety, you will usually have to wait approximately seven to 10 working days until Taobao has analysed and taken any action against the seller.

If Taobao accepts your report, you will find this result under the complaint filing history. If they do not accept your report, you will receive an email, which explains why they have not accepted it.

As with AliProtect, the seller is always contacted, and may file a counter-notification to deny IP infringement. This is then shared with the rights owner, to respond again before a decision is made about taking down the relevant link(s).

**Taking a Strategic Approach**

A brand is often considered to be a company’s largest and most important asset. Incredibly rapid online development has significantly increased the need to protect the brand, and the sales it generates. There are now an endless number of infringers who have sales channels available to them, which they can use to reach a global market. Protecting your brand requires a Brand Protection Strategy, in which you decide what needs to be done to achieve the maximum return on investment. A simple analysis for most brands will probably show that the cost of managing brand protection is much lower than the cost of lost sales and damage to the brand. It is also incredibly important to act in time. The longer you wait before taking action, the higher the risk of damage. If you do not have a well-established Brand Protection Strategy, the brand will face difficulties, particularly in terms of knowing which channels to check, and how to carry out the enforcement and analysis. This is particularly true for the Chinese sites.

**AliProtect is a reporting system, where the brand owner can monitor and handle take-downs of IP infringing products on Alibaba.com, AliExpress and 1688.com**

This guide was written for CBBC by online brand protection specialist and member company Yellow Brand Protection.

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In September 2014, CBBC and Alibaba Group signed a Memorandum of Understanding (MoU) to reinforce and promote intellectual property (IP) in Chinese e-commerce.

Under the provisions of the MoU, CBBC has been helping UK companies to understand and better utilise Alibaba’s notice-and-take-down mechanisms, in order to address the issue of infringing product listings found on platforms such as Alibaba.com, Taobao and Tmall.

A strategic aim of the MoU is to reinforce the processes Alibaba uses to protect IP from a systemic standpoint. Through quarterly roundtables, UK companies are also able to benefit from Alibaba’s detailed explanations of how current systems work, and the opportunity to propose changes or new initiatives Alibaba could adopt to protect brands’ IP.

Some new initiatives initiated by Alibaba include the ‘good faith take-down mechanism’, which is a new scheme for IP rights owners to register for certain privileged protection; and the ‘dynamic recognition system’, which is designed to prevent the reappearance of infringing vendors, whose online stores have previously been removed, under new pseudonyms.

Baroness Neville-Rolfe, UK Minister for Intellectual Property, said of the MoU: “This historic enforcement agreement builds on the important steps that Alibaba has already taken to increase business and consumer confidence, and sets an example that I hope other businesses will follow.”

For more information and to become an MoU stakeholder, please contact CBBC’s IP lead directly: Michael.Ryan@cbbc.org.cn
The China-Britain Business Council (CBBC) is the leading organisation helping UK companies grow and develop their business in China. Our mission is to help UK companies of all sizes and sectors, whether new entrants or established operations, access the full potential of the fastest growing market in the world.

We deliver a range of practical services in the UK and in China, including: advice and consultancy, market research, business match-making and partner introductions, conferences, briefings, trade missions and exhibitions, and the CBBC Launchpad business incubation service.

CBBC has specific programmes on the Chinese Consumer, China Outbound, Business Issues and Intellectual Property, as well as sector specific initiatives.

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