



**DEZAN SHIRA & ASSOCIATES**

Your Partner for Growth in Asia

# Doing Business in China

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International Business Advisory | French Desk

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*Agenda*

# What are we going to talk about?

1. Quick overview of the macroeconomic environment
2. Foreign investment vehicles
3. Challenges
4. Opportunities



*Section One*

# Who are we?



# An Asia creature with China roots



**1992**

**Establishment**

**300**

**Staff**

**24**

**Offices**

**2,000+**

**Clients**

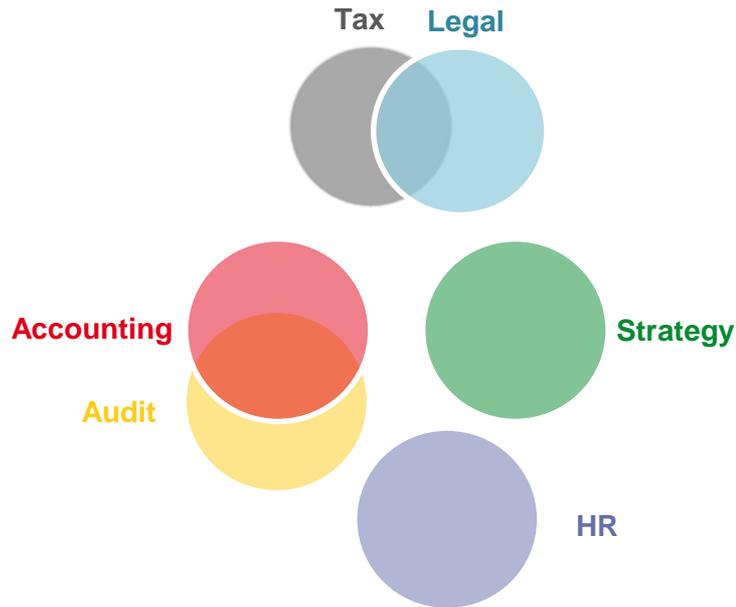
**80+**

**Nationalities  
serviced**

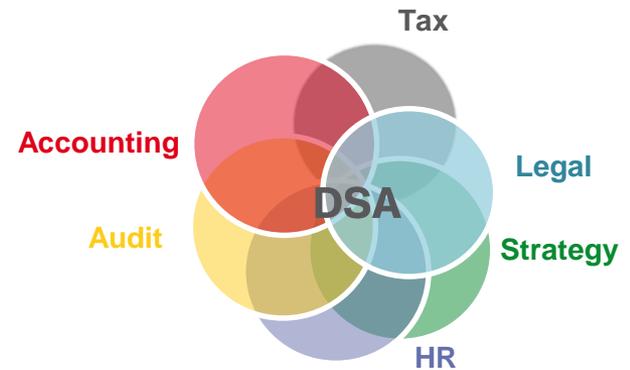


# The 'one-stop shop' model

## FRANCE

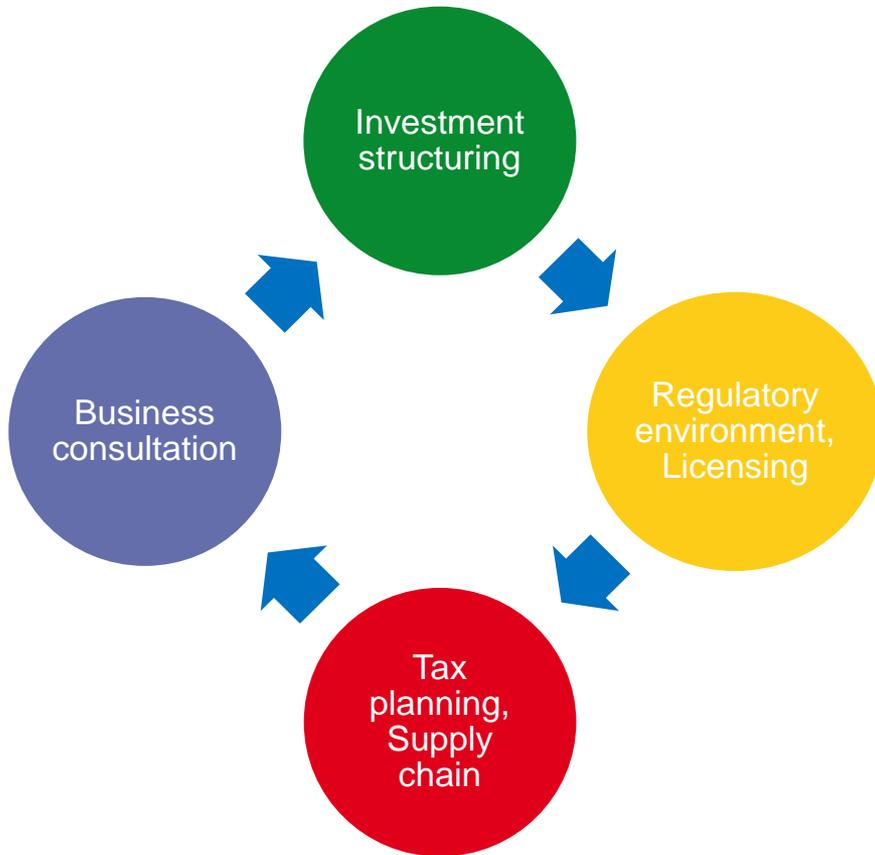


## CHINA

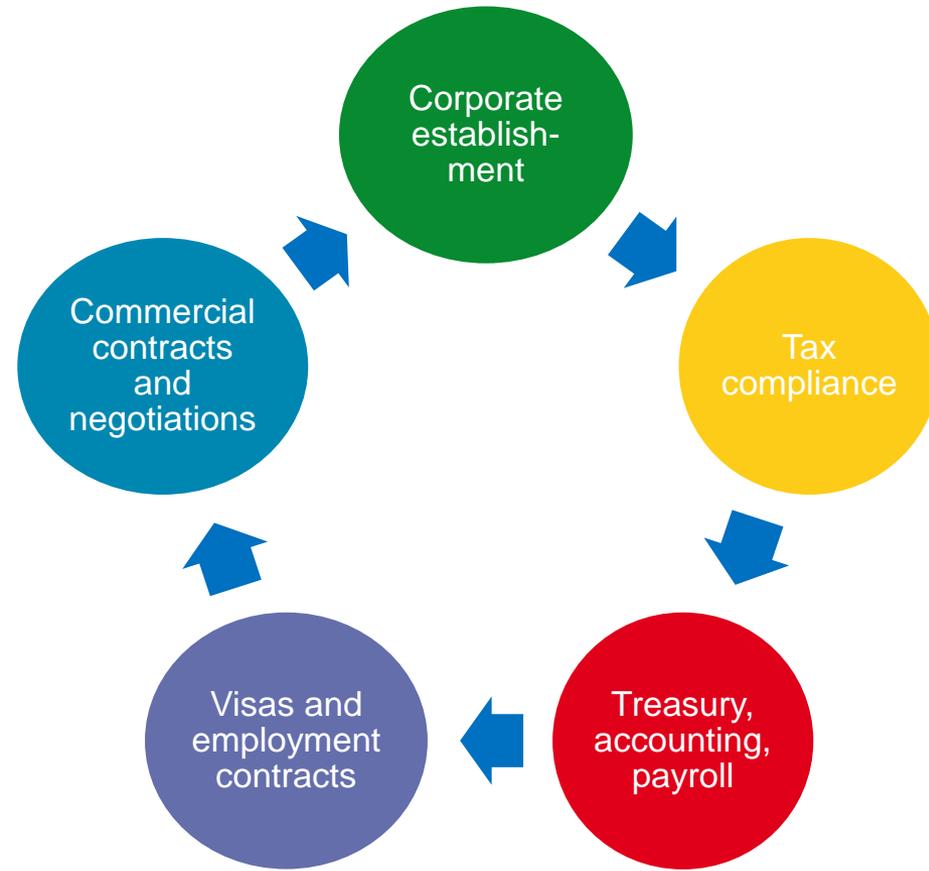


# Assisting clients every step of the way

## Entry Strategy



## Implementation



*Section Two*

# China's economy in a nutshell



# A few key milestones

Establishment of the People's Republic of China

Reform and Opening Up

Admission to the World Trade Organization

Xi Jinping elected as President of the PRC

PRC becomes world's biggest economy in PPP terms

1949

1978

2001

2013

2014



# The Chinese 'economic miracle'

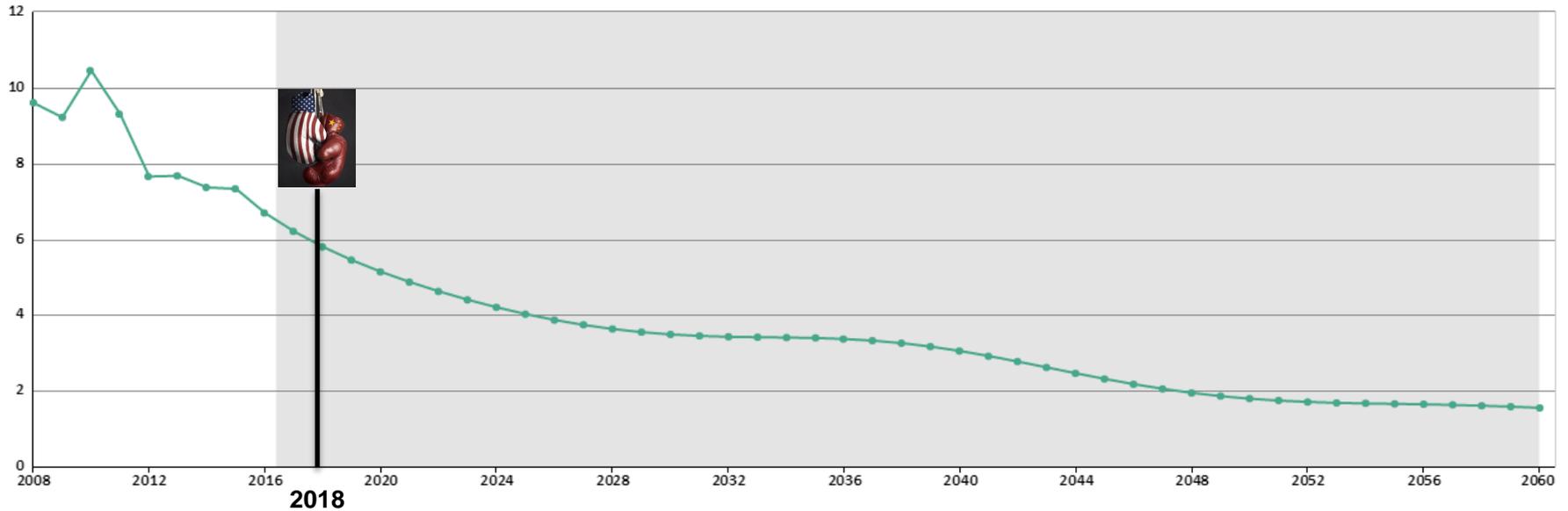
## GDP per capita (current US\$), China 1960-2015



- Chinese GDP per capita: US\$ 155 (1978) → US\$ 7,925 (2016)
- 500 million people were lifted out of poverty

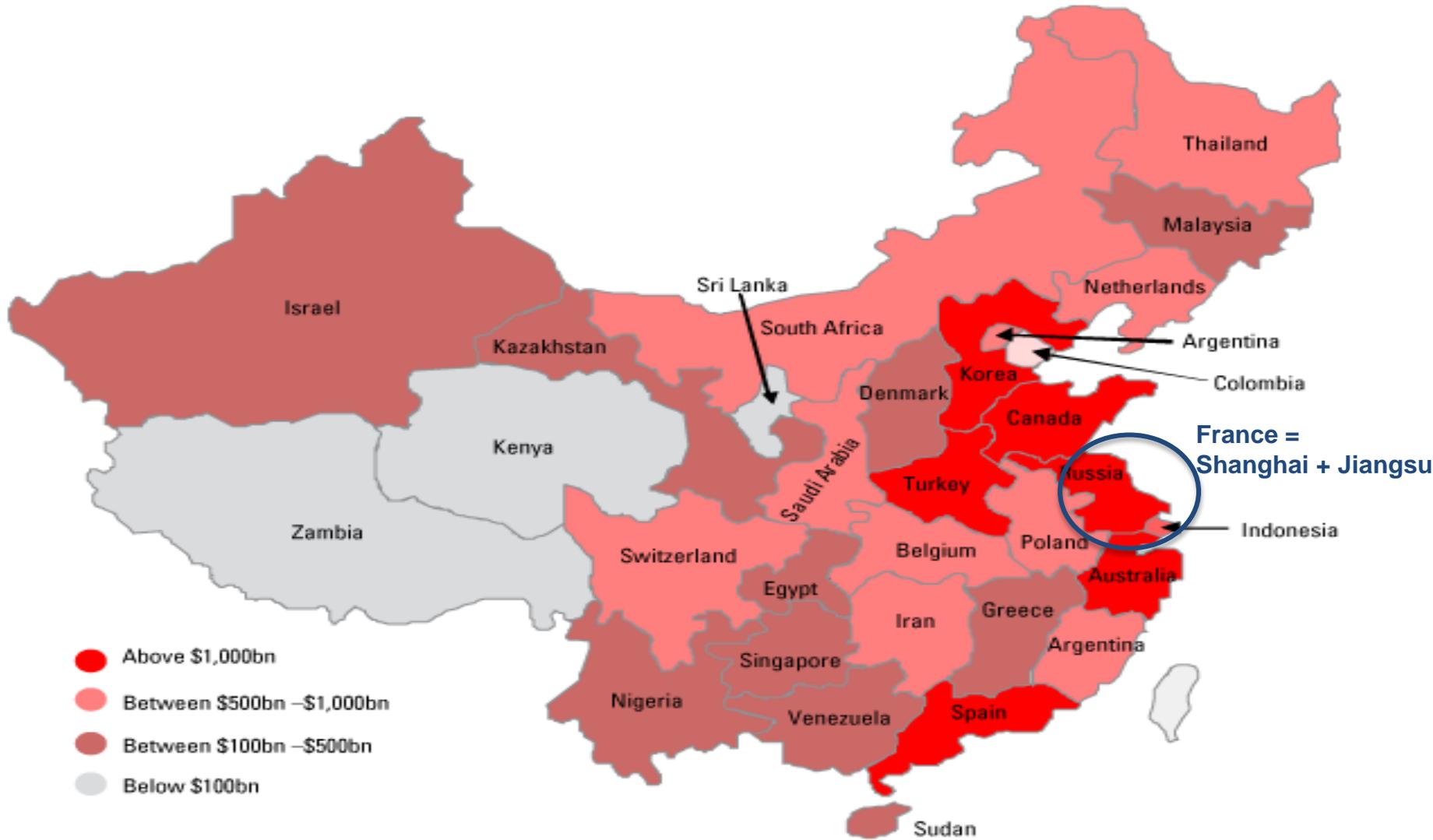
# The 'new normal'

## GDP growth (%), China 2008-2060



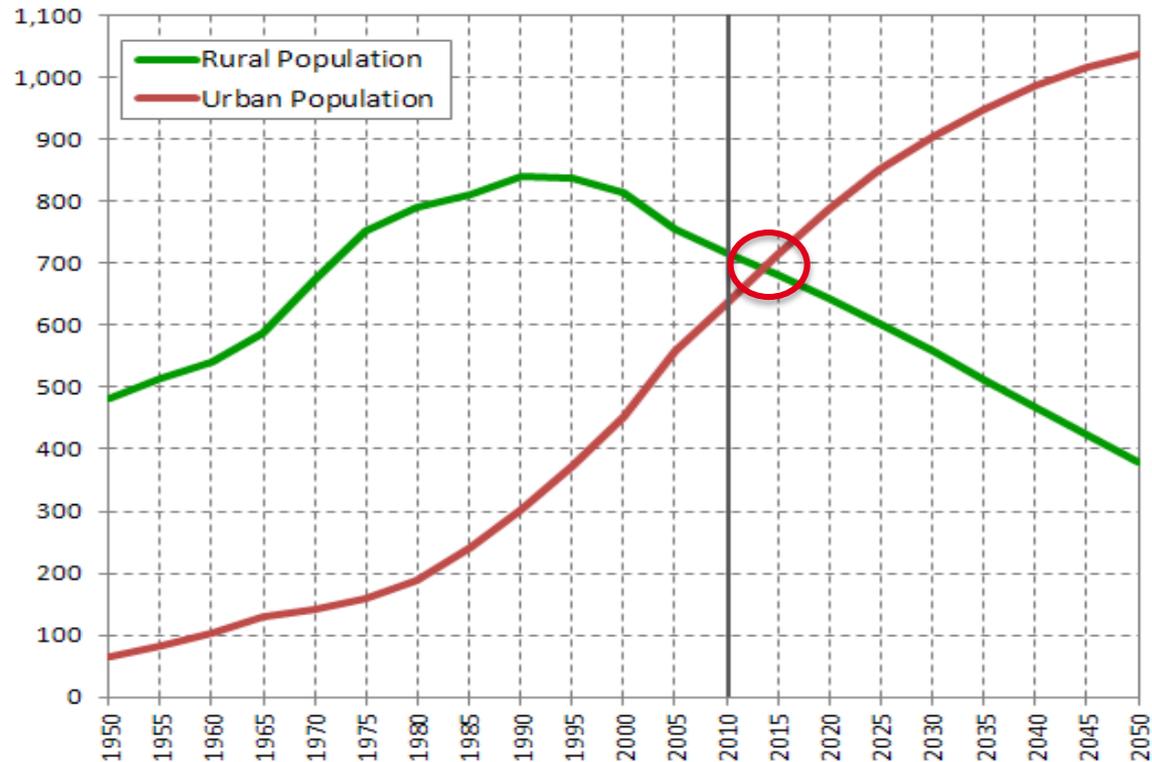
- 1978-2016: 10% economic growth yearly on average
- 2016-2040: 3% - 6% (6.5% in 2017)
- 2040....: <3%?
- France: 1.3% (2016)
- 2018: PRC surpasses US as largest global economy (nominal GDP terms)

# China's GDP put into perspective



# Socioeconomic trend 1: Urbanization

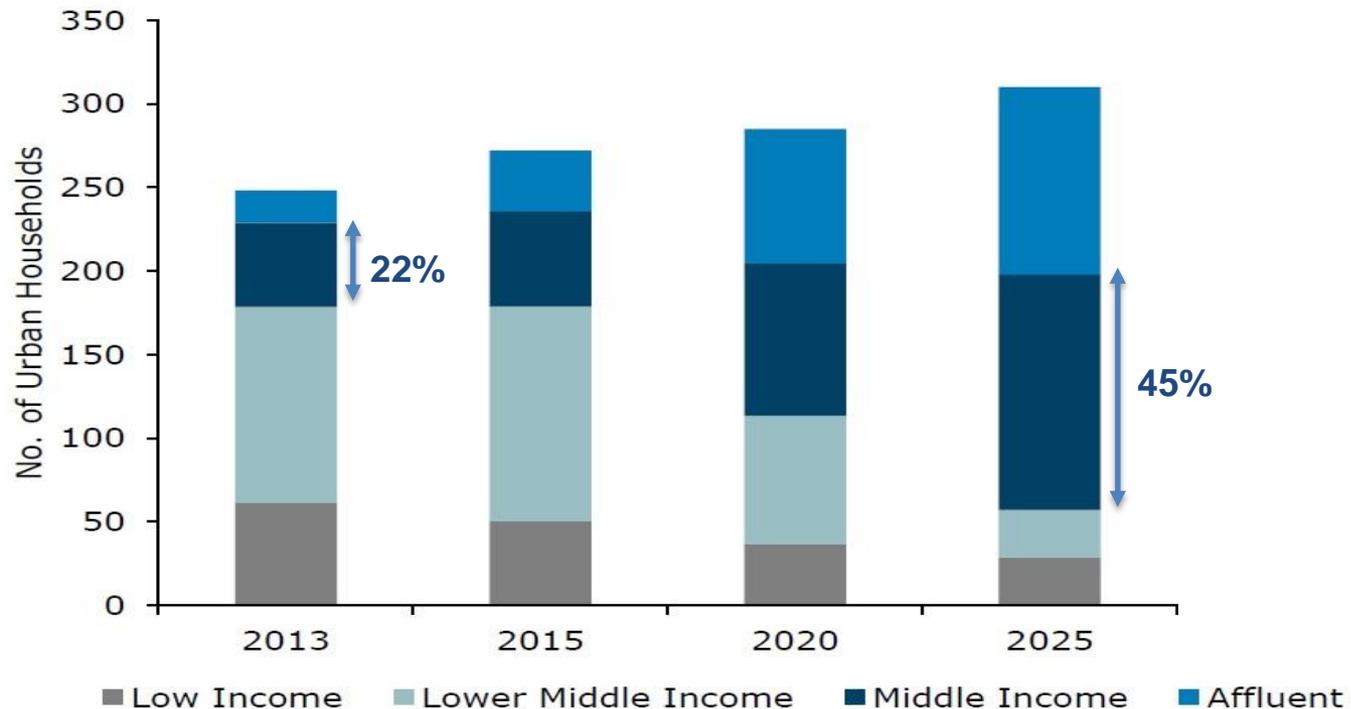
## Rural vs Urban Population, China 1950-2050



- 18% lived in urban areas in 1978
- 50% in 2011
- 60% in 2020?

# Socioeconomic trend 2: Booming middle class

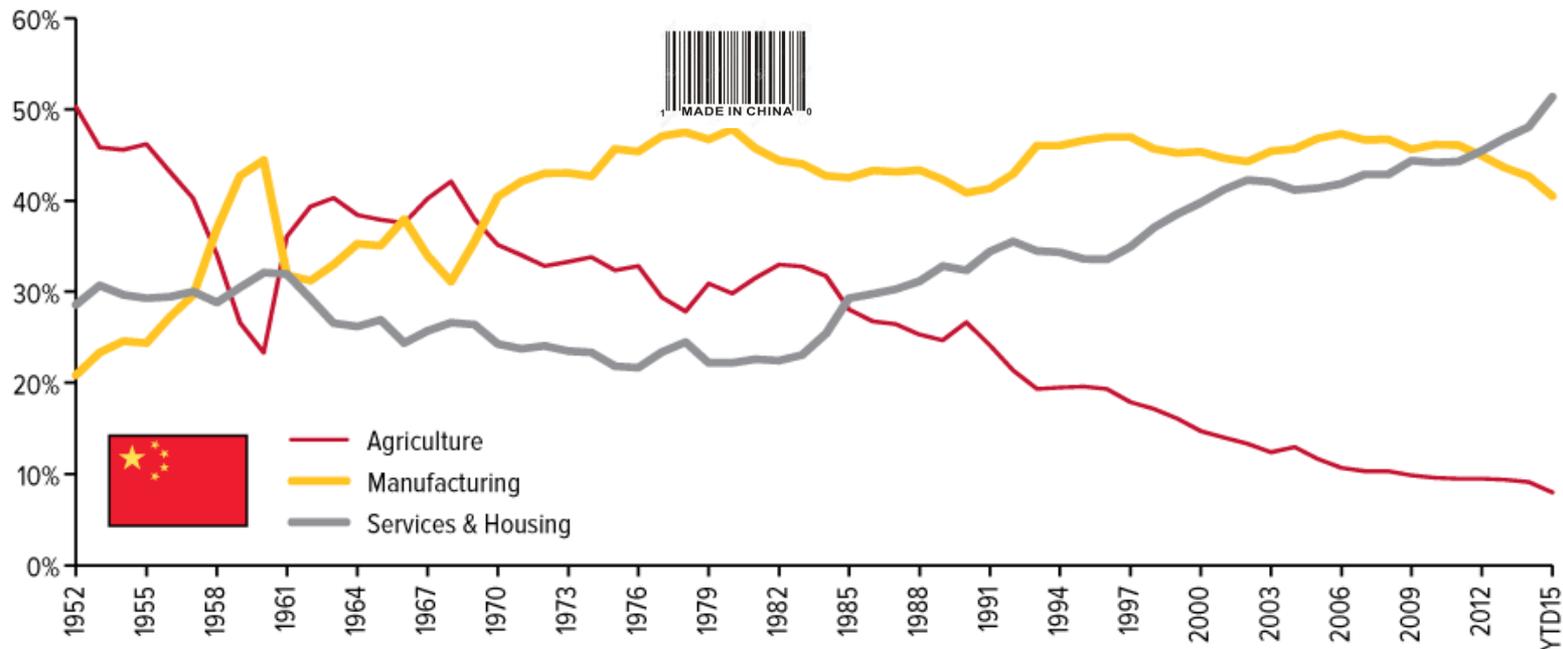
## Urban Households by Income Groups



- 2013: 22% urban class households were considered 'middle class'
- 2025: 45%
- Chinese middle class: high propensity to consume, appetite for high-tech, luxury, services

# Socioeconomic trend 3: Service economy

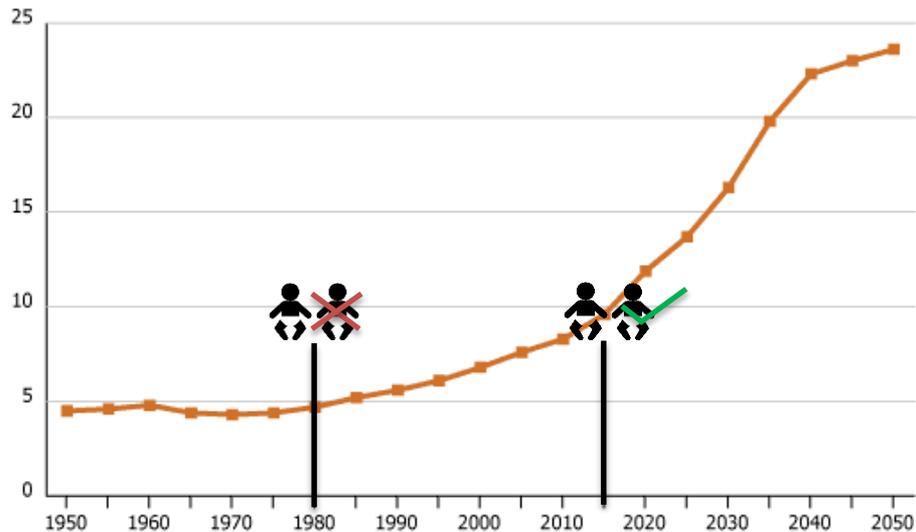
## China's GDP by Sector, 1952-2015



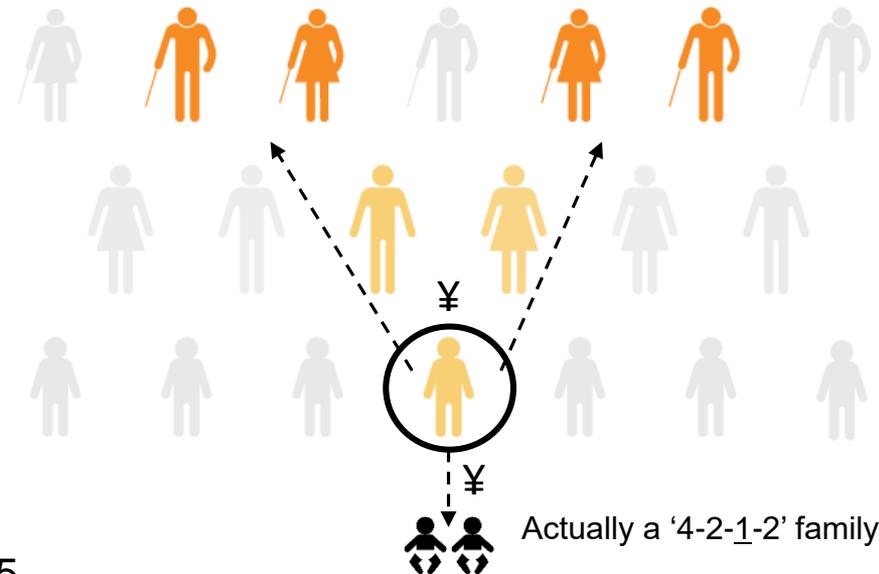
- 1980: “Made in China”: Manufacturing = 50% GDP / Services = 22%
- 2016: “Serviced in China”: Manufacturing = 38% GDP / Services = 57%
- World’s manufacturing hub Vs service-intensive economy driven by domestic consumption

# Socioeconomic trend 4: Aging Society

## Share of Population Aged 65+



## The '4-2-1' family



- One Child Policy (1980). Abolished in 2015
- Today: about 10% of the Chinese population is aged 65+
- 2050: 25%
- Pre-policy generation: Today= 40s-50s; 2040= 60s-70s; 2050= 70s-80s
- The '4-2-1' family: 1 child supports 2 parents and 4 grandparents

# The 13<sup>th</sup> Five-Year Plan (2016-2020)

- **Coordination:** bridge welfare gap between rural and urban areas.
- **Sharing:** prosperity for the masses, not just the elite.
- **Innovation:** encourage entrepreneurship and move up in the value chain.
- **Green Development** and mitigation of environment impact of development.
- **Opening Up:** become supranational power and extend influence (cultural, etc.).



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# The most promising industries

- E-commerce
- Logistics
- Clean technology and green technology
- Private education
- Cloud computing and “big data”
- Health care and elderly care
- High-end manufacturing (robotics)
- High-end machinery
- High-tech agriculture
- Professional wealth management
- Aerospace
- Tourism and travel
- Entertainment, art and culture
- Architecture, landscape architecture
- Food and Beverage

**Coordination**

**Sharing**

**Innovation**

**Green Development**



*Section Three*

# Investment Vehicles



# Can I do it in China?

Catalogue of Industries for Guiding Foreign Investment (2015, revised Dec. 2016)

## NOT IN the 'Negative List'

### "Encouraged"

- ✓ Business consulting
- ✓ Elderly care (not medicalized)
- ✓ Food service (with a license)
- ✓ Production of textiles & garments
- ✓ Sale of machinery
- FDI with 100% ownership permitted

## IN the 'Negative List'

### "Restricted"

- ± Architecture
- ± Education
- ± Automobile production
- ± Finance
- ± Inbound travel agencies
- FDI alongside a domestic investor

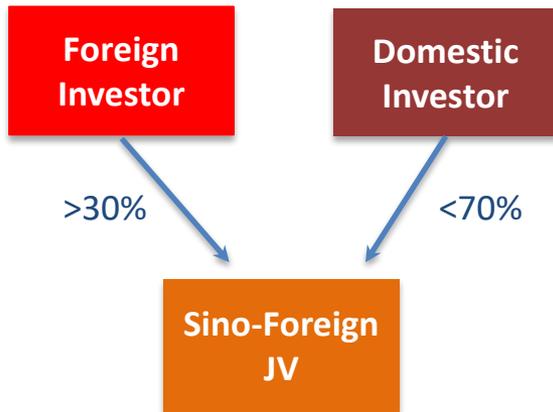
### "Prohibited"

- × Mining
- × Insurance
- × Hospitals
- × Sales of tobacco
- × Press
- No FDI permitted

# The most popular legal structures

Depending on industry restrictions and business objectives...

## The Sino-Foreign JV



## The Representative Office



## The WFOE



# The Sino-Foreign Joint Venture (JV)

JVs unlock access to tremendous opportunities but are difficult to manage in practice.

- When the industry is “restricted” for FDI
- When the learning curve is too steep

## Advantages

- ✓ Invest in restricted industries
- ✓ Utilize existing workforce
- ✓ ----- facilities, assets
- ✓ ----- supplier networks
- ✓ ----- distributor networks
- ✓ ----- relationships, connections

## Limitations

- × Profit sharing, loss of full control
- × Co-management can be difficult
- × Different expectations
- × Different ways of doing business
- × The Chinese party often has the upper hand
- × Deadlock in case of issue -> useless entity -> what happens to assets, IP, etc.?

# The Representative Office (RO)

A branch of the foreign parent in China.

- Legal identity tied to parent, not an independent legal entity in China
- Used to conduct marketing, liaison and quality control activities on behalf of parent

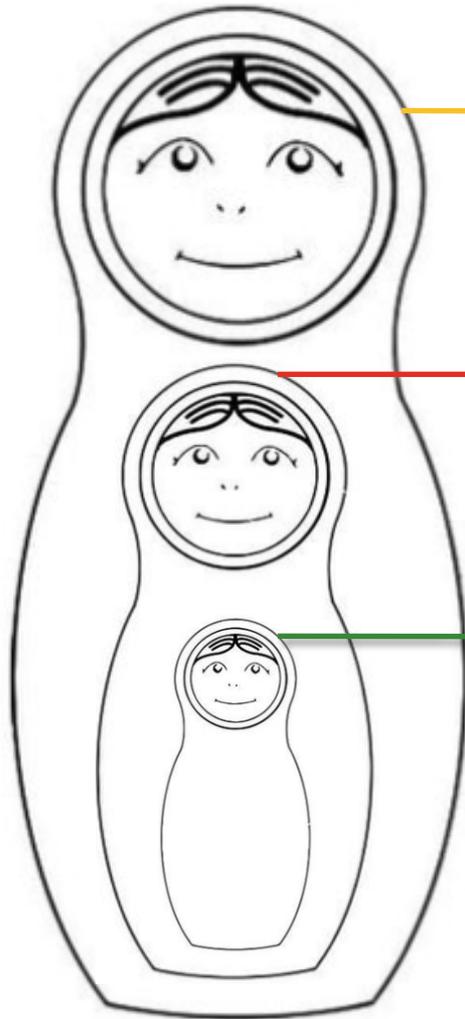
## Advantages

- ✓ Quick to set up (2-3 months)
- ✓ Relatively inexpensive to set up
- ✓ No capital contribution requirement
- ✓ Nice 'foot-in-the-door' structure

## Limitations

- × Extremely limited business scope
- × Cannot issue invoices or generate revenue locally
- × Cannot hire staff directly
- × Restricted number of foreigners
- × Parent must be two years old or more
- × Heavily taxed if expenses are high

# The Wholly Foreign Owned Enterprise (WFOE)



## Manufacturing WFOE

FICE's business scope +

- Manufacture products on Chinese soil

## Trading WFOE/ FICE

Service WFOE's business scope +

- Sell products in China
- Import/export products in/out of China

## Service WFOE

- Sell services in China:
  - Issue invoices
  - Collect revenue

# The Wholly Foreign Owned Enterprise (WFOE)

An independent legal entity over which the foreign shareholder has full ownership and control.

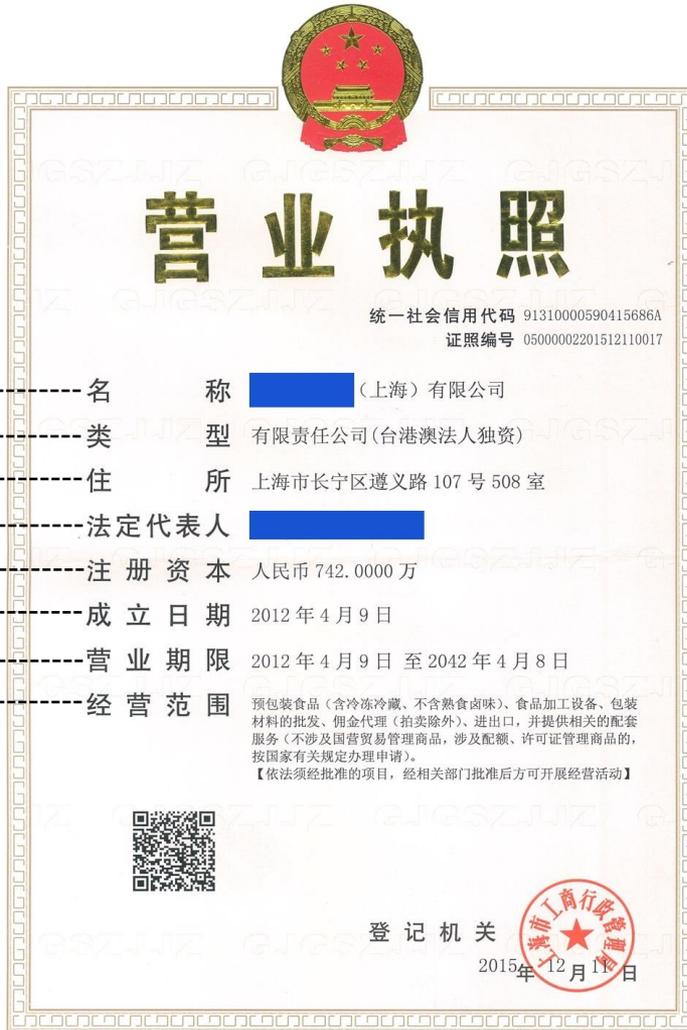
## Advantages

- ✓ Full ownership & control (>JV)
- ✓ Broad business scope (>RO)
- ✓ Issue invoice and collect revenue locally (>RO)
- ✓ Hire staff directly (>RO)

## Limitations

- × 4-7 month incorporation timeline (<RO)
- × Capital injection requirement (<RO)
- × Barred from access to some industries (<JV)

# The business licence



Company name	名称	[Redacted] (上海) 有限公司
Shareholder	类型	有限责任公司(台港澳法人独资)
Registered address	住所	上海市长宁区遵义路 107 号 508 室
Legal representative	法定代表人	[Redacted]
Registered capital	注册资本	人民币 742.0000 万
Date of BL issuance	成立日期	2012 年 4 月 9 日
Business life	营业期限	2012 年 4 月 9 日 至 2042 年 4 月 8 日
Business scope	经营范围	预包装食品(含冷冻冷藏、不含熟食卤味)、食品加工设备、包装材料的批发、佣金代理(拍卖除外)、进出口,并提供相关的配套服务(不涉及国营贸易管理商品,涉及配额、许可证管理商品的,按国家有关规定办理申请)。【依法须经批准的项目,经相关部门批准后方可开展经营活动】

Registered Capital: 742m RMB

Company Type: Limited Liability Company (Trading WFOE)

## **Business Scope:**

Wholesale, import and export, commission agent service (excluding auction) of prepackaged food (including refrigerated and frozen food), food processing equipment and packing material, associated with the provision of affiliated services.

# Additional licenses and permits

- Common to require further licenses to operate in a certain industry.
- Sale of wine in China by a WFOE requires:
  - ✓ Food Business Operation License
  - ✓ Liquor Distribution Licence



*Section Four*

# Challenges



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# Common challenges: underestimating costs

- Long and expensive to set up a company  
→ Lengthy and costly incorporation process; registered capital.
- Expensive to maintain the company  
→ Compliance: bookkeeping, financial reporting, tax filing, annual audit + traditional expenses (increasingly costly).
- Long and expensive to close down the company  
→ Lengthy deregistration procedures, especially the tax clearance (audit).
- Unwise to keep the company 'dormant'  
→ Blacklist; vicious circle.

**Setting up a formal presence in China involves a significant financial commitment.**

**A decision which shouldn't be taken lightly.**

# Common challenges: local business practices

- Local VS foreign firms - not an even playing field:
  - Foreign investors are still denied access to many industries
  - Restricted business scope, additional licensing requirements
  - Foreign investors receive more scrutiny than locals
  - At a disadvantage in the courts
  - Obstacles with moving money around and repatriating profits
- JVs, M&A:
  - Different bookkeeping standards → hidden liabilities
  - Tendency to overvalue assets, undervalue liabilities → valuation surprises
  - Many 'routine' practices (e.g. kick-backs, bribes) locally = fraud in the 'West'
  - Different expectations, different objectives
  - Protecting your brand image
  - Protecting your IP

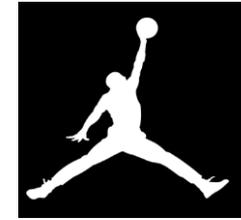
“There is a **small, rocky pathway to China [for foreign investors]** and an autobahn from China to Europe . . .”

Jörg Wuttke, head of the European Chamber of Commerce in China.

# Common challenges: protecting your IP

- First to file system - 'Trademark squatting'

Pay OR sue?



Tesla.cn  
Teslamotors.cn

- Surfing on your brand recognition - Local derivatives

Will you get sued?

- Outright fraud – Fakes

Illegal, but how do you prevent it?

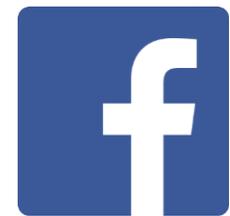
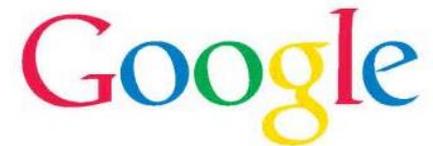
新百伦领跑

新百伦



# Common challenges: understanding the market

- Know thy customer
  - Is there a demand for my product?
  - How do I brand myself so that my products become more appealing?
  - How will my products be purchased / how will I sell them?
  - How do I promote my products and generate brand awareness?
- Know thy competition
  - Is there room for products?
  - How do I differentiate myself?



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# Common challenges: human resources

- Chinese labor law is very strict and highly protective of employees. Arbitration courts usually side with the employee as opposed to the employer.
  - Important to remain compliant as being in the wrong can become very costly.
- Social insurance and housing fund contributions are extremely important for employees.
  - Adds 40% to employment costs for the employer.
- Filing Individual Income Tax (IIT) is the responsibility of the employer.
  - Progressive rate of 0-45%.
- Disgruntled employees:
  - Are litigious.
  - Difficult to reason with when negotiating severance. Ask for high severance pay.
  - Are aggressive, issue threats.
  - Can grab the company chops and other sensitive material for bargaining power.

*Section Five*

# Opportunities



# Opportunities: rising disposable income

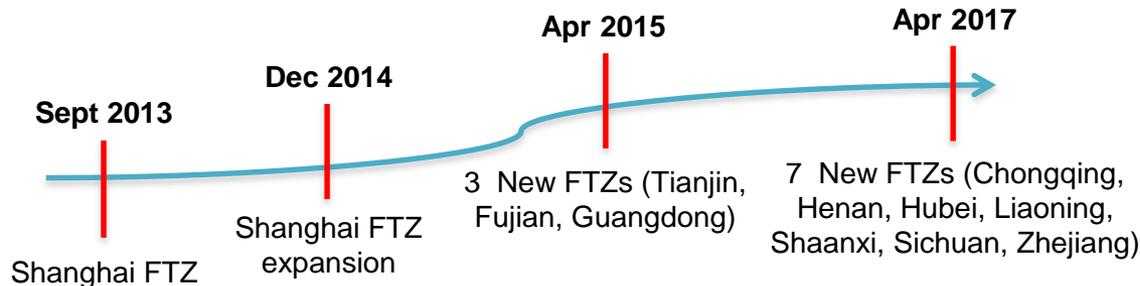
Disposable income per capita, 2006-2018



- Relentless growth in disposable income per capital: nearly 150% growth in last 10 years.
- Consumers have higher willingness to pay and their consumption habits are changing.
- Looking for higher quality, prestige through consumption, more differentiation.
- China is becoming the major consumer market for foreign products (BMW, Apple, LV).

# Opportunities: FTZs and opening up

- Gradual opening of industries to FDI.
- Advantages offered by settling in the Free Trade Zones
  - Reduced market access restrictions on some foreign investment.
  - Faster Administrative and Registration Procedures.
  - Clusters of selected industries (e.g. finance in Lujiazui Shanghai).
  - Cross-border trade in bonded zones: VAT and import duties paid once products leave the zone.



# Opportunities: E-commerce - Cross-border vs domestic



Store has Chinese business license  
Product is stored customs-cleared in Mainland China

- Chinese legal entity required
- Corporate **bank account** within China and Payment received in CNY
- **Trademark** registered in China
- **Warehouse** within China
- **Shipment** and delivery within China

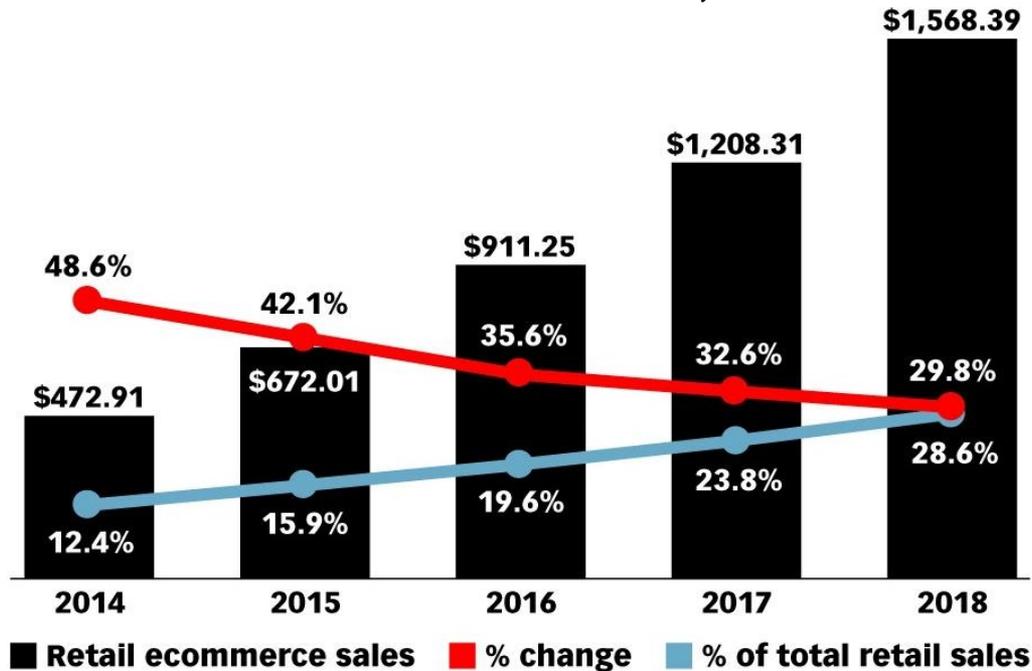


Business is located abroad  
Product may be imported on a per-order basis

- International legal entity
- Home country **bank account** and Payment received in local currency
- **Trademark** registered in home country
- **Warehouse** outside China
- **Shipping** from overseas directly to Chinese consumers

# Opportunities: Local E-commerce

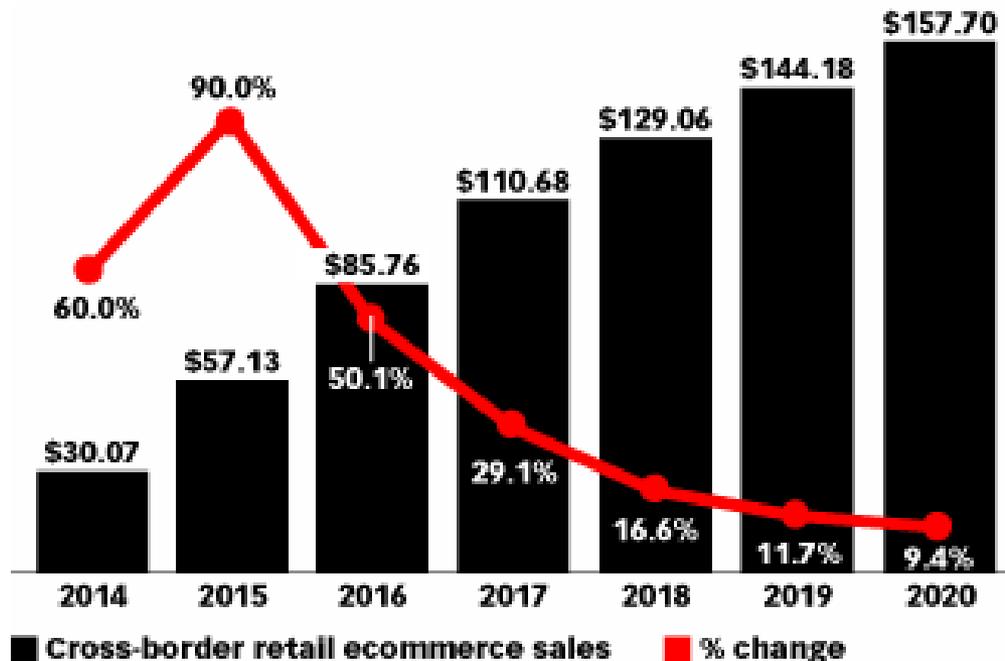
Domestic E-commerce Sales, 2006-2018



- “In other countries, e-commerce is a way of shopping while **in China it is a way of life.**“ Jack Ma
- USD 1.5 trillion in retail e-commerce sales next year (nearly 30% of retail sales).
- France (2016): EUR 70 billion; 9.2% of retail.
- Impossible to sell well in China consumer markets without an online sales strategy.

# Opportunities: Cross-border E-commerce

Cross-Border Retail E-commerce Sales, 2006-2018



天猫国际  
TMALL GLOBAL



京东全球购  
JD Worldwide

- USD 129 billion in cross-border retail e-commerce sales next year (less than 10% of domestic).
- Tmall Global and JD Worldwide only attract a fraction of the traffic as their domestic equivalents.
- Easier model to set up, but much smaller opportunities.

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# Additional Online Resources

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**CHINA BRIEFING**

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# Q&A



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