



**DEZAN SHIRA & ASSOCIATES**

Your Partner for Growth in Asia

# Doing Business in China: Opportunities and Challenges

Lorena Miera Ruiz

International Business Advisory | Senior Associate

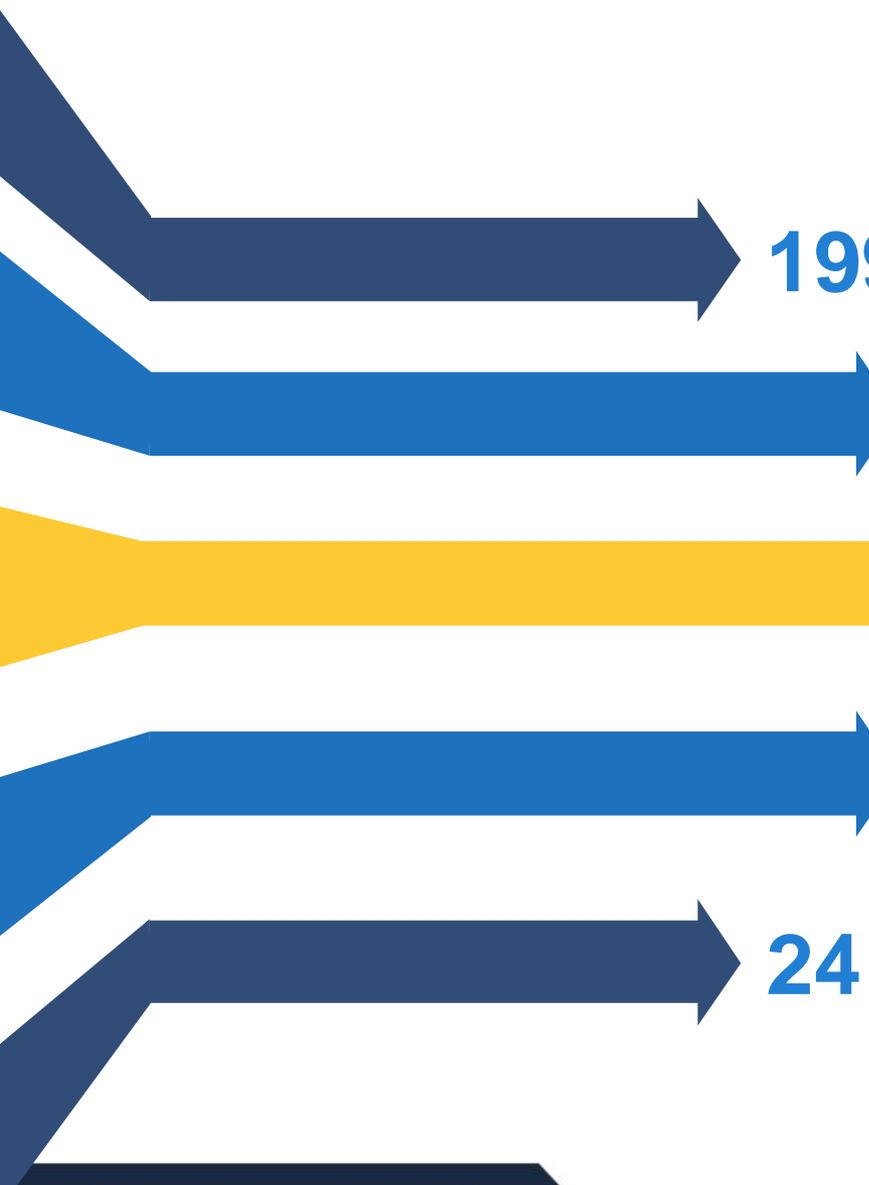
May 31, 2019



**Who are we?**



# Numbers



**1992**

Dezan Shira's establishment

**300+**

Our team of legal, tax, accounting and audit professionals

**2000+**

Multinational clients that have already chosen us

**80+**

Countries served by our professional services

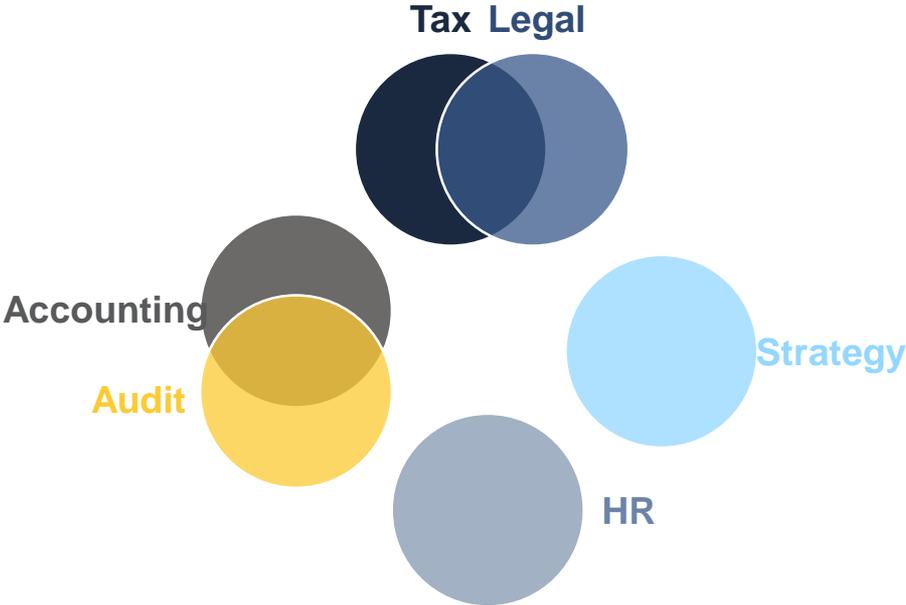
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Our offices in **China, India, Vietnam, Singapore**, liaison offices in **Italy, the United States and Germany**, and alliance offices in **Indonesia, Malaysia, the Philippines, and Thailand.**

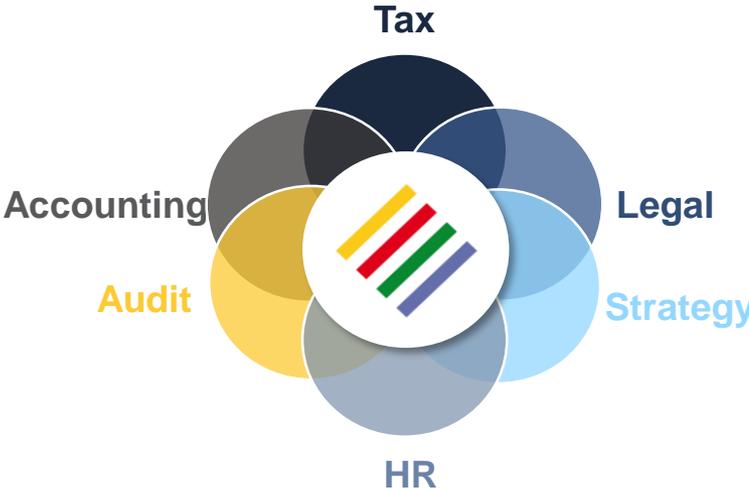


# Assisting clients every step of the way

## Traditional model



## Dezan Shira & Associates Pan-Asia



China's **economy** in a  
nutshell



# A few key milestones



# The Chinese 'economic miracle'

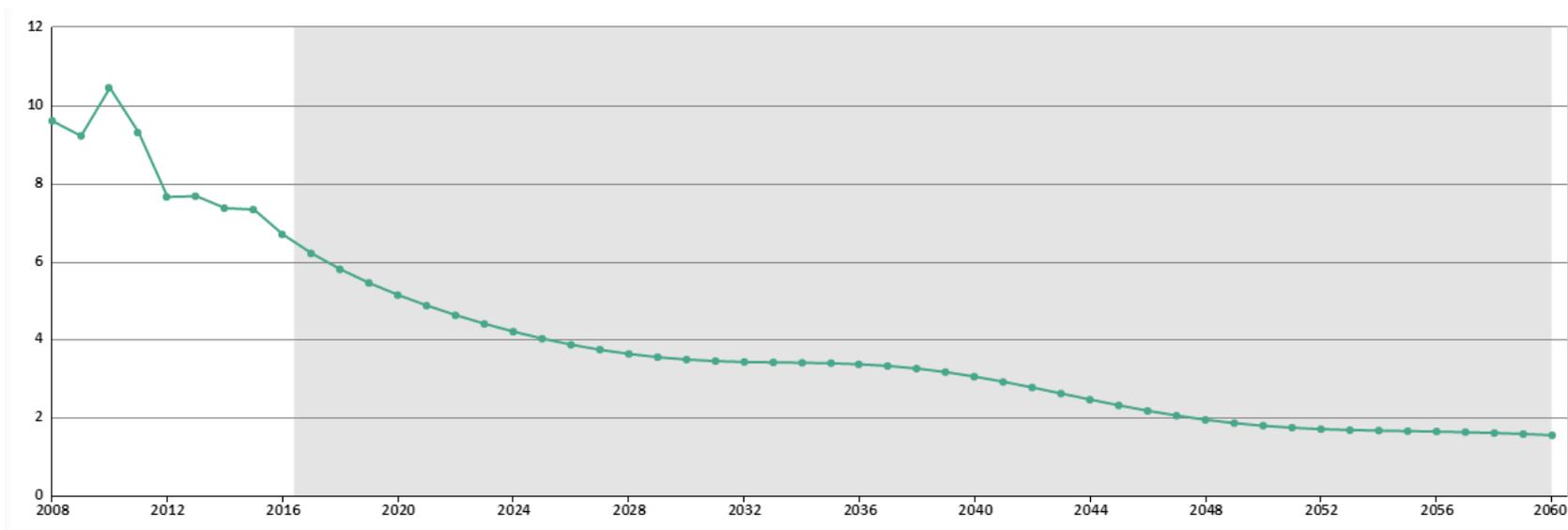
## GDP per capita (current US\$), China 1960-2016



Chinese GDP per capita: US\$ 156 (1978) → US\$ 8,123 (2016)  
500 million people were lifted out of poverty

# The 'new normal'

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

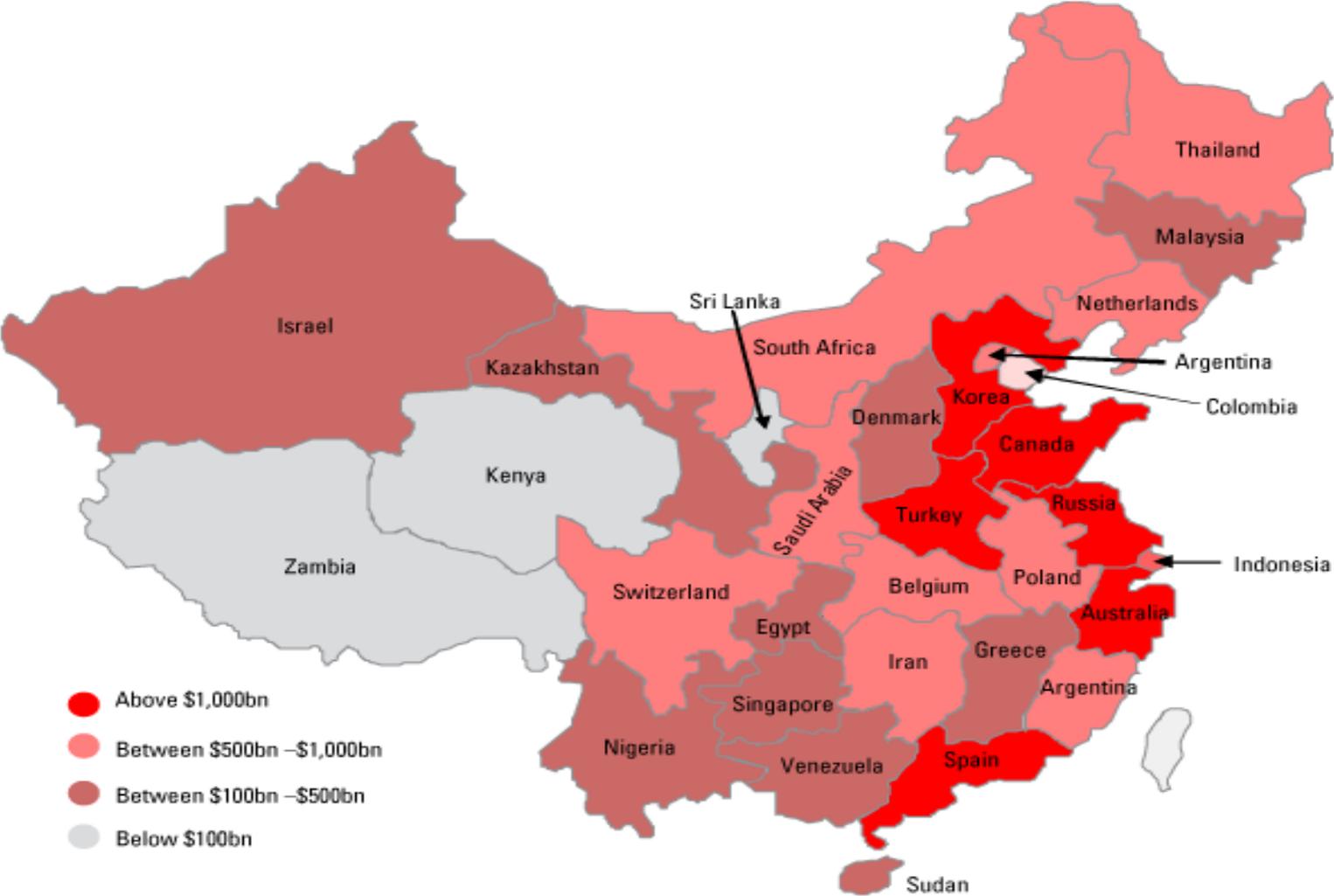


1978-2016: 10% economic growth yearly on average

2016-2040: 3% - 7% (6.7% in 2016, 6.9% in 2017)

USA: 1.6% (2016), 2.3% (2017)

# China's GDP put into perspective



# What to expect in 2019?

- Slower economic growth. Increasing gap between wealthier cities/provinces and poorer cities/provinces.
- Higher government social spending, with increased effort to mitigate pollution and poverty.
- Lower spending on property and infrastructure as government tries to reduce public debt.
- Lower net exports affected by trade war with USA, especially tech goods. Opportunities for other economies.
- Hot industries to look out for this year:
  - Electronic vehicles: China becoming biggest consumer and producer of EVs, USD 50b in government subsidies by 2020
  - Pharmaceuticals: better access to drugs thanks to health reform plan, urbanization and rising incomes, aging population
  - Financial services: opening up to FDI (esp. wealth management, securities), higher competition, better access to products through technology
- Still hot: e-commerce, F&B, private education, cleantech, aerospace, tourism, entertainment, etc.

# China's **Foreign Direct Investment** Environment



# A Negative List & An Encouraged List (Catalogue of Foreign Investment)

Encouraged List  
(updated in 2019)

A unified Negative List  
(updated December, 2018)

## Encouraged

These are promoted by the government but in some cases may still need a JV

## Permitted

Most sectors fall within this category – no special treatment

## Restricted

Normally limits on JV partner; requirements on international partner

## Prohibited

Sectors that are sensitive or illegal and foreign investment is banned

- FDI with 100% ownership permitted;
- Preferential policies

*No special requirements for investment*

- FDI alongside a Chinese investor

- No FDI permitted

# Can I do it in China?

## Catalogue of Industries for Guiding Foreign Investment (reviewed version 2018/19)

### “Prohibited” (28)

- × Commercial fishing
- × Manufacturing of weapons and ammunition
- × Wholesale and retail of tobacco
- × Compulsory education
- × Postal companies
- × Editing and publishing of books and newspapers
- × News agencies and internet news services
- × Radio and TV stations
- × Movie production

→ No FDI permitted

### “Restricted” (151)

- ± Manufacturing of automobile vehicles
- ± Insurance
- ± Securities, futures
- ± Banks
- ± Telecommunications
- ± Oil and gas exploration
- ± Medical institutions
- ± Pre-school and higher education
- ± Railway and waterway transport

→ FDI alongside a Chinese investor

### “Encouraged” (402)

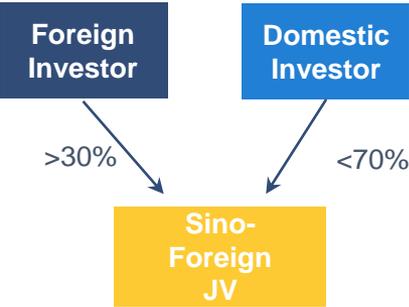
- ✓ Nursing homes
- ✓ Vocational training
- ✓ R&D centers
- ✓ Development of energy saving technologies
- ✓ Highway freight forwarding
- ✓ Manufacturing of clothing
- ✓ Operation of new energy power stations
- ✓ Operation of fitness centers
- ✓ Venture capital enterprises
- ✓ Manufacturing of VR/AR tech

→ FDI with 100% ownership permitted

# The most popular legal entity structures

Depending on industry restrictions and business objectives...

## The Sino-Foreign JV



## The Representative Office



## The WFOE



# Challenges



# Common challenges: Protecting your IP

## First to file system - 'Trademark squatting'

→ Will you pay or sue?



Tesla.cn  
Teslamotors.cn



## Surfing on your brand recognition - Local derivatives

→ Will you get sued?

新百伦领跑

新百伦



## Outright fraud – Fakes

→ How do you prevent it?



# Common challenges: Underestimating costs

## **Lengthy and expensive to set up a company**

→ Lengthy and costly incorporation process; registered capital.

## **Expensive to maintain a company**

→ Compliance: bookkeeping, financial reporting, tax filing, annual audit + traditional expenses (increasingly costly).

## **Lengthy and expensive to close down a company**

→ Lengthy deregistration procedures, especially the tax clearance (audit).

## **Unwise to keep a 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 some 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: Human resources management

Disgruntled employees are litigious:

- Difficult to reason with when negotiating termination.
- Ask for high severance pay.
- Are aggressive, issue threats.
- Can grab the company chops and other sensitive material for bargaining power.

Chinese labor law is very strict and highly protective of employees:

- Arbitration courts usually side with the employee as opposed to the employer.
- Burden of proof is systematically on the employer.
- Important to remain compliant as being in the wrong can become very costly.

# Common challenges: Understanding the local 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 my products?
- How do I differentiate myself?



# Challenges for Australian Companies

- “Australian businesses are usually inhibited by comparatively slow internal decision-making, which means that by the time they reach the market, opportunities are not as fresh and the market is more saturated.”
- “Australian investors entering the Chinese market are often surprised about how different the regulatory and business environments are from Australia, and can sometimes adopt an overly domestic-mindset, making them ill-equipped for the Chinese market.”

# Opportunities

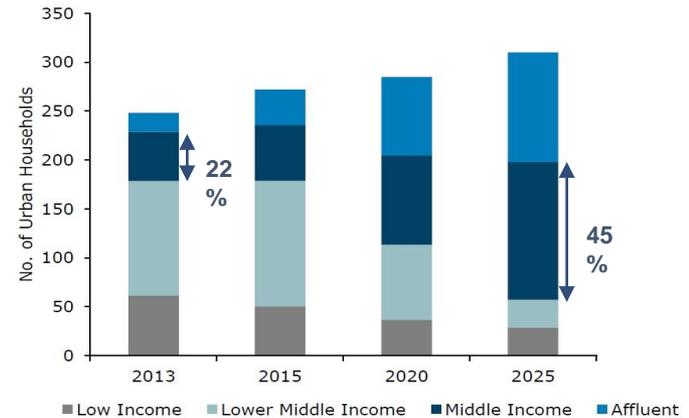


# Opportunities: Rising disposable income

Disposable income per capita, 2006-2018



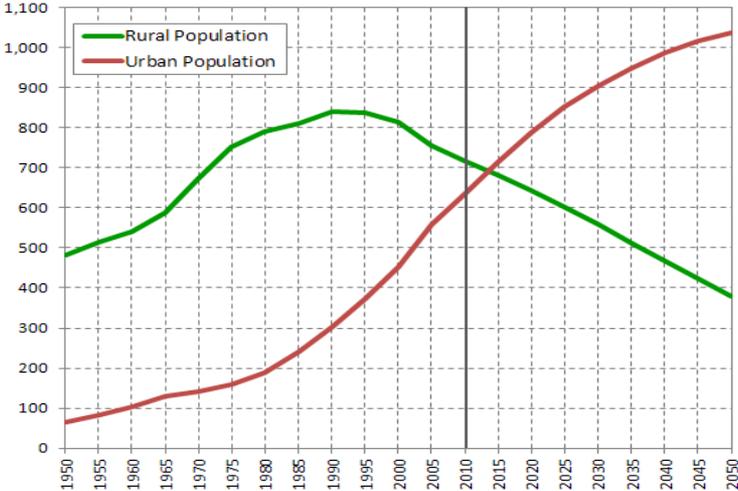
Urban Households by Income



- 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: Urbanization

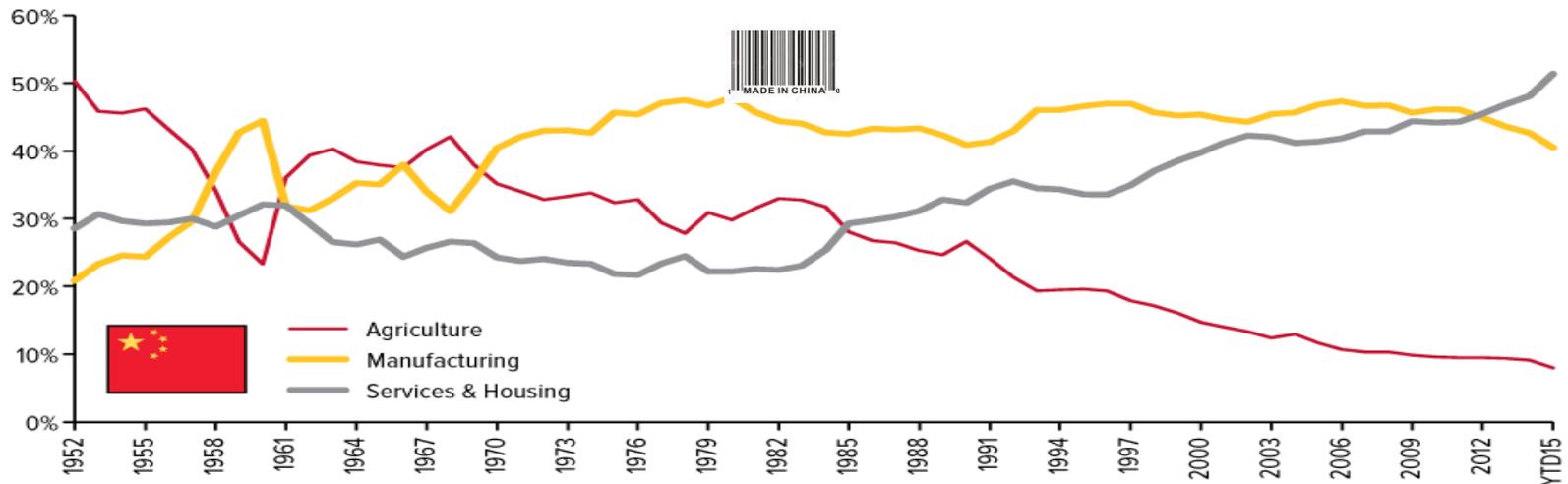
## Rural vs urban population, China 1950-2050



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

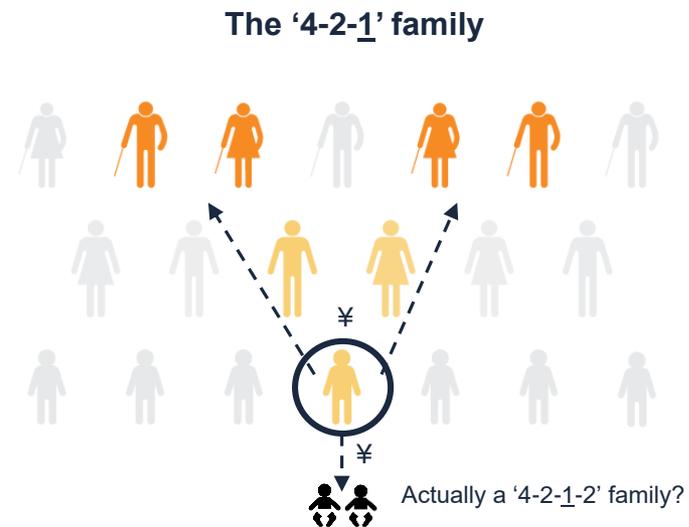
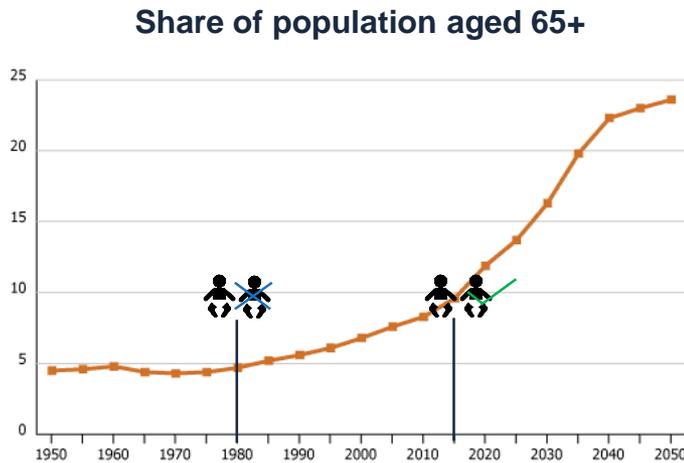
# Opportunities: China is now a service economy

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.

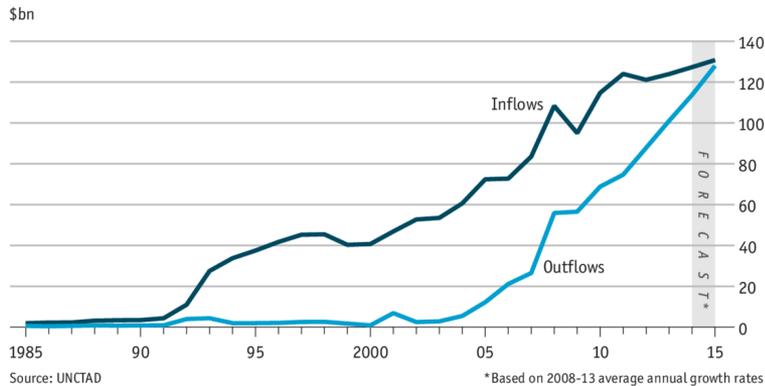
# Opportunities: Aging population (healthcare), baby boom on the way



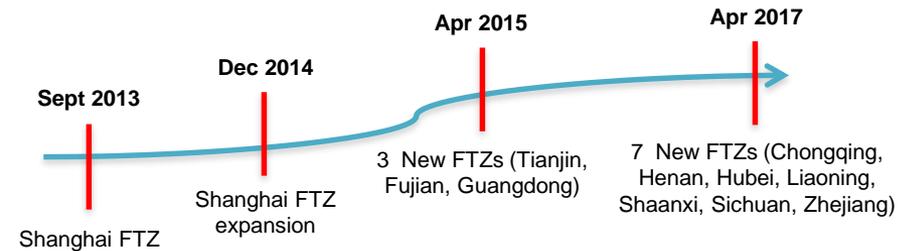
- One Child Policy (1980). Abolished in 2015
- Today: about 10% of the Chinese population is aged 65+. 2050: 25%
- 2016: 18.5 million babies born. 17.5-21 million in the next 5 years.
- 2017: baby products market= RMB 60.7 billion (9.2% growth)

# Opportunities: FTZs and opening up

## China's FDI, 1985-2015



## China's free trade zones (FTZ)



- Gradual opening up of China's industries to FDI. Quick rise in FDI inflows since the early 1990s.
- Becoming easier and faster to complete company incorporation procedures. Taxation system simplified.
- Free trade zones act as testing ground for liberalization of FDI:
  - ✓ Reduced restrictions on FDI
  - ✓ Leaner and more accommodating company incorporation process
  - ✓ Bonded zones advantageous for cross-border trade (delayed payment of import VAT and duties)

# 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

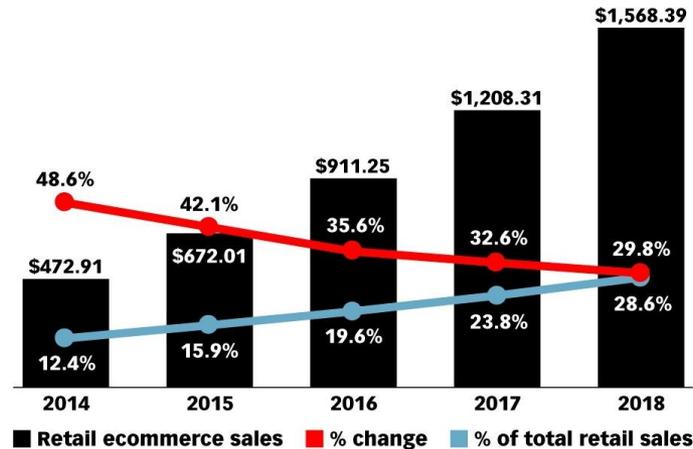


Business is located abroad  
Product may be imported on a per-order basis

- 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: domestic e-commerce

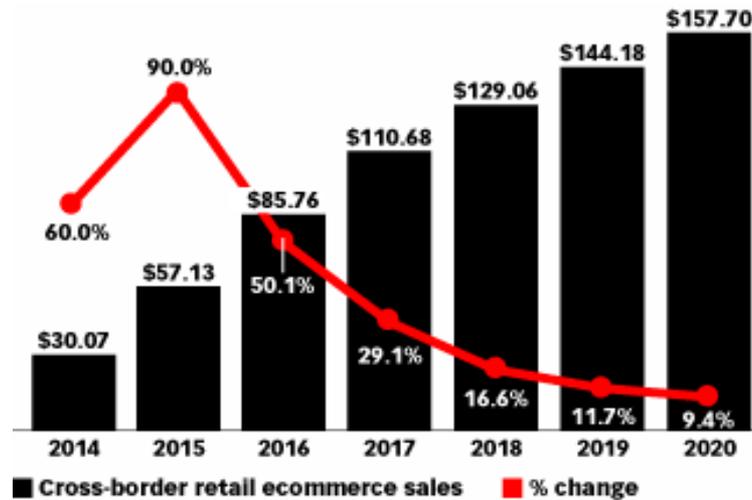
Domestic e-commerce sales, billion



- “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 this year (nearly 30% of retail sales).
- USA (2018): USD 462 billion; 9% of retail sales.
- Impossible to sell well in China consumer markets without an online sales strategy.

# Opportunities: cross-border e-commerce

Cross-border retail e-commerce sales, billion



天猫国际  
TMALL GLOBAL

京东全球购  
JD Worldwide

考拉海购  
KAOLA.com

唯品会  
vip.com  
全球精选 正品特卖

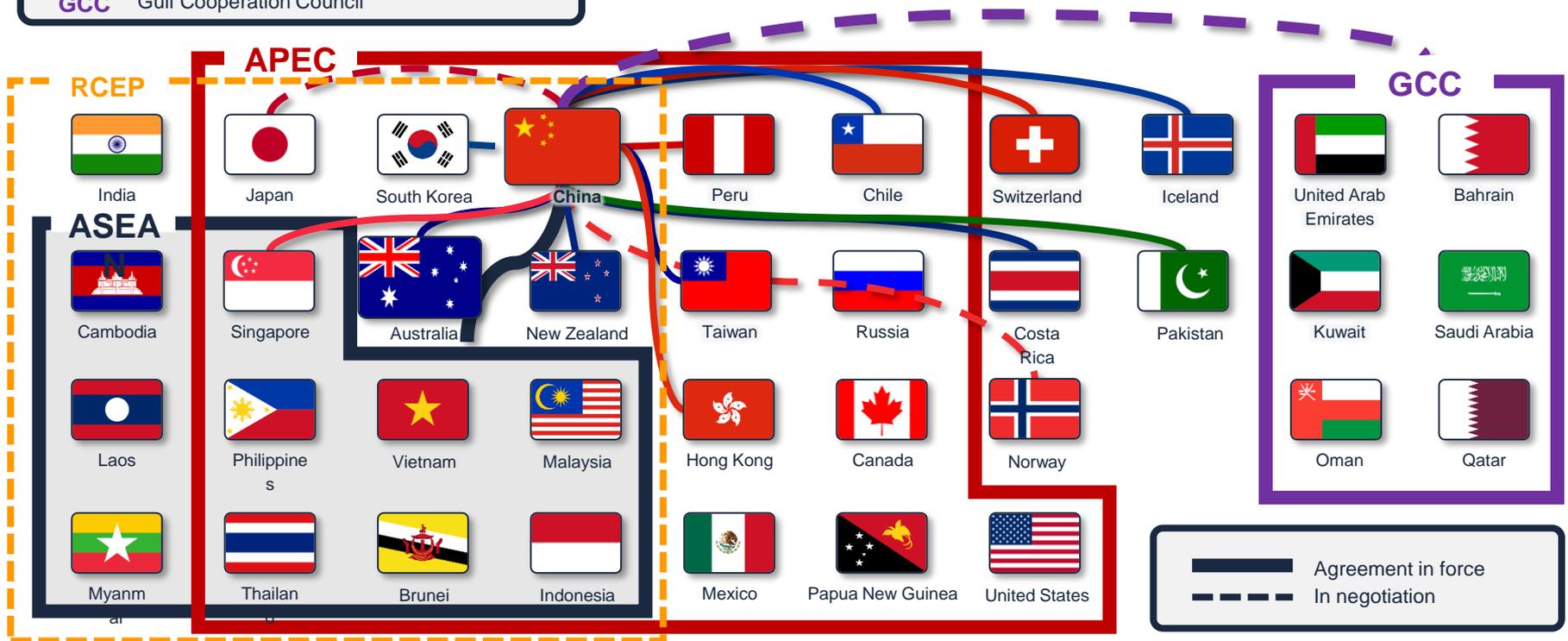
- USD 129 billion in cross-border retail e-commerce sales this year (less than 10% of domestic).
- Tmall Global and JD Worldwide only attract a fraction of the traffic as their domestic equivalents.
- Easier model to set up, but much smaller opportunities.

Opportunities for  
**Australian** companies



# China Free Trade Agreement (FTA) Network as of May 2019

**ASEAN** Association of Southeast Asian Nations  
**APEC** Asia-Pacific Economic Cooperation  
**RCEP** Regional Comprehensive Economic Partnership  
**GCC** Gulf Cooperation Council



## Products benefiting from ChAFTA

Key Highlights of Trade in Goods under ChAFTA			
Commodity	Date of tariff elimination	Old tariff	Value of Australian exports to China in 2016 (US\$)
Coking coal	December 20, 2015	3%	4.38 billion
Hearing aids & implantable medical devices	December 20, 2015	4%	65.6 million
Pharmaceuticals, vitamins & health products	January 1, 2019	3-10%	565.8 million
Wine	January 1, 2019	14-20%	389.3 million
Opals (worked)	January 1, 2019	8% (individual) 35% (on related jewelry)	2.3 million (including other precious stones)
Whisky	January 1, 2019	10%	746,836
Beef	January 1, 2024	12-25%	505.7 million
Dairy	January 1, 2026	10-19%	531.8 million

Source: Austrade, China-Australia Free Trade Agreement Quick Guide Series (2016)

Graphic © Asia Briefing Ltd.

# Opportunities in the Service Industries



Financial Services and Investment



Agricultural Products and Processed Food



Elderly Care



Tourism



Education

# Resources for the Asia Investor



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## Paul Dwyer

Director, International Tax and Transfer Pricing  
Head of the Australian Desk

Email: [paul.dwyer@dezshira.com](mailto:paul.dwyer@dezshira.com)

Tel.: (+86) 21 6358 8686 ext. 6185



## Lorena Miera Ruiz

Senior Associate,  
International Business Advisory

Email: [lorena.miera@dezshira.com](mailto:lorena.miera@dezshira.com)

Tel.: (+86) 21 6358 8686 ext. 6214



# DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia



- Dezan Shira & Associates Offices
- Dezan Shira Asian Alliance Members

## Global Offices

### CHINA

Beijing  
beijing@dezshira.com

Hangzhou  
hangzhou@dezshira.com

Shenzhen  
shenzhen@dezshira.com

Dalian  
dalian@dezshira.com

Ningbo  
ningbo@dezshira.com

Suzhou  
suzhou@dezshira.com

Dongguan  
dongguan@dezshira.com

Qingdao  
qingdao@dezshira.com

Tianjin  
tianjin@dezshira.com

Guangzhou  
guangzhou@dezshira.com

Shanghai  
shanghai@dezshira.com

Zhongshan  
zhongshan@dezshira.com

### HONG KONG

hongkong@dezshira.com

### INDONESIA

indonesia@dezshira.com

### SINGAPORE

singapore@dezshira.com

### INDIA

Delhi  
delhi@dezshira.com

Mumbai  
mumbai@dezshira.com

### VIETNAM

Hanoi  
hanoi@dezshira.com

Ho Chi Minh City  
hcmc@dezshira.com

### DEZAN SHIRA ASIAN ALLIANCE MEMBERS

Malaysia  
malaysia@dezshira.com

The Philippines  
philippines@dezshira.com

Thailand  
thailand@dezshira.com

### DEZAN SHIRA LIAISON OFFICES

Germany  
germandesk@dezshira.com

Italy  
italiandesk@dezshira.com

United States  
usa@dezshira.com



For more information, please visit [www.dezshira.com](http://www.dezshira.com)



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