



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

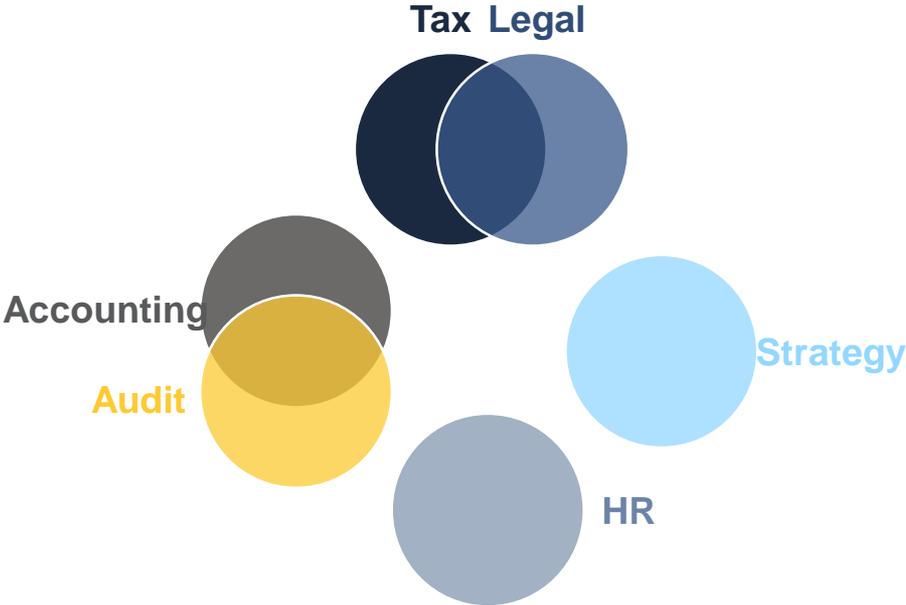
80+ Countries served by our professional services

24 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.**

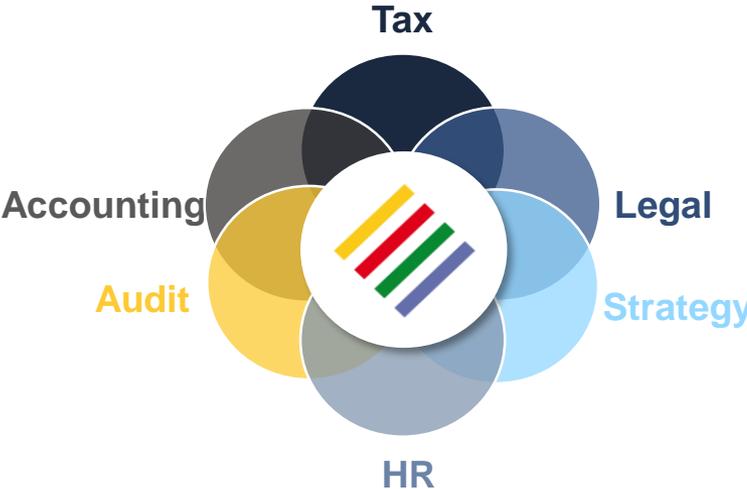


Assisting clients every step of the way

Traditional model



Dezan Shira & Associates Pan-Asia



China's **economy** in a nutshell



A few key milestones



The Chinese 'economic miracle'

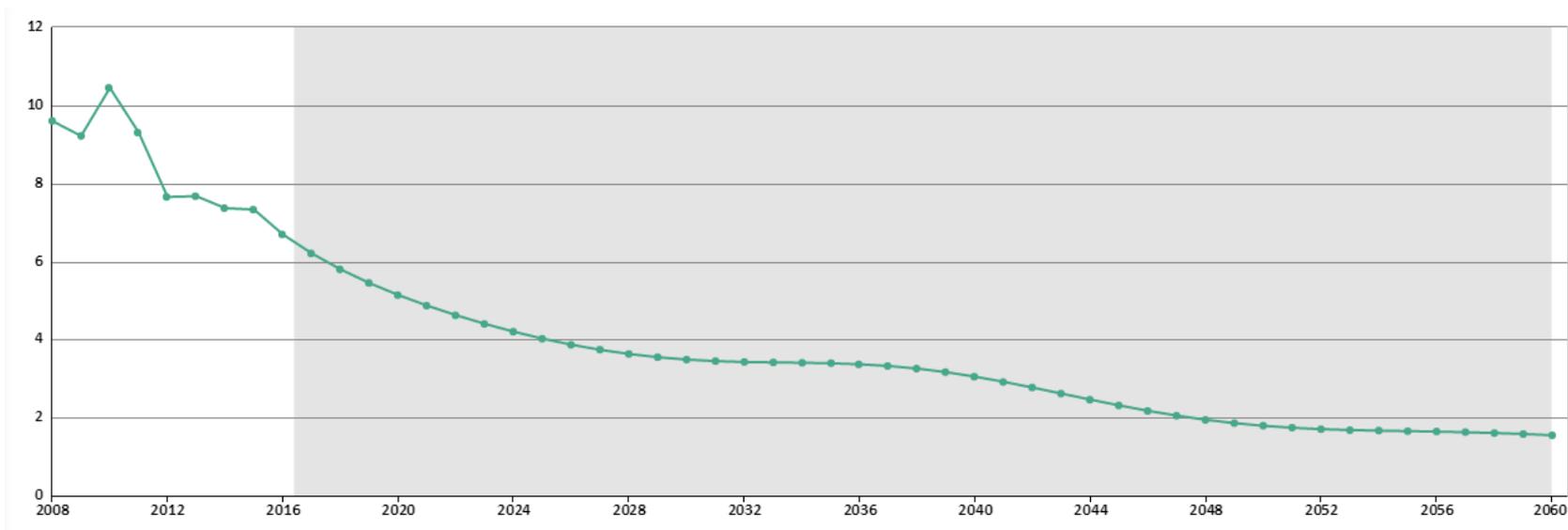
GDP per capita (current US\$), China 1960-2016



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

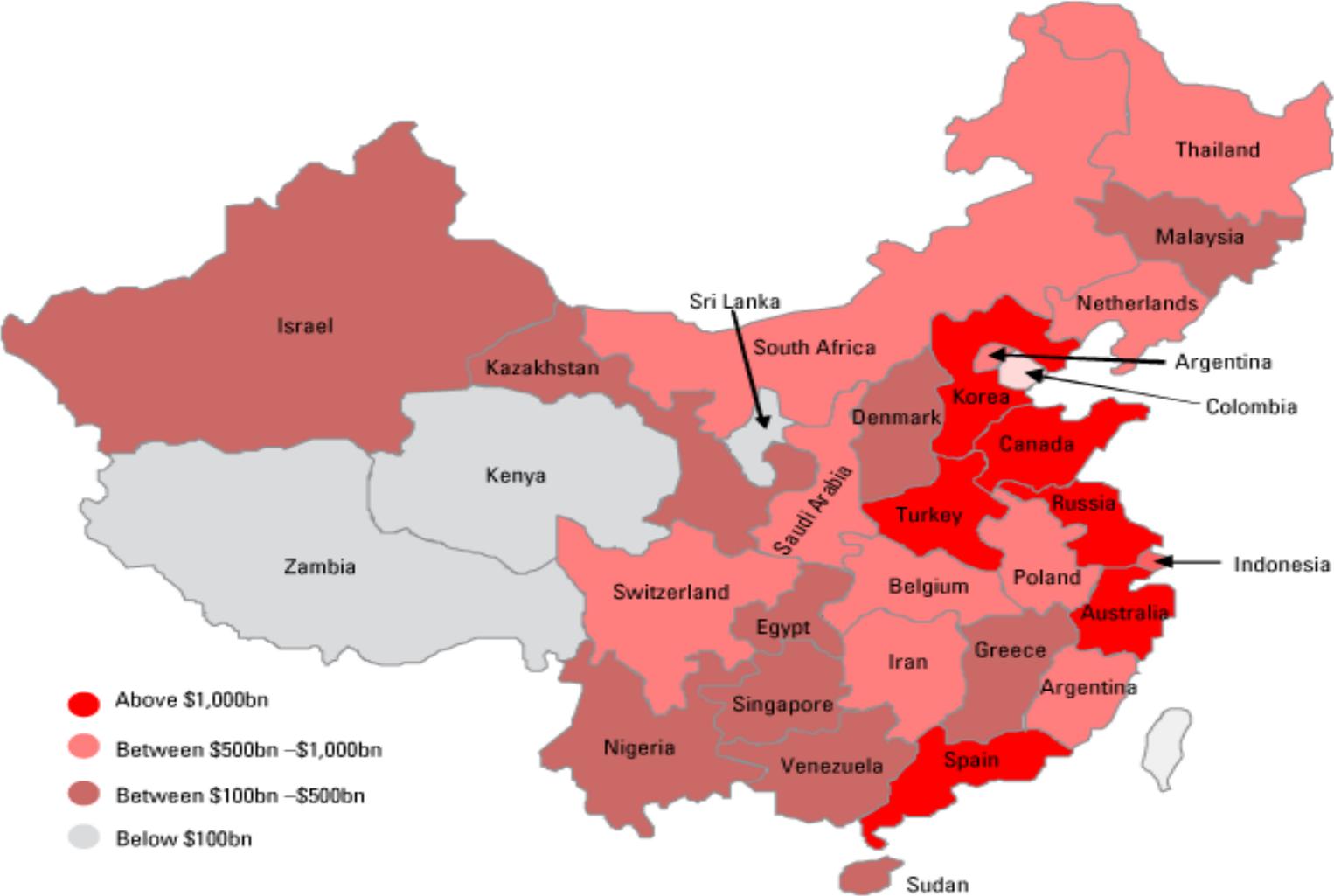


1978-2016: 10% economic growth yearly on average

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)

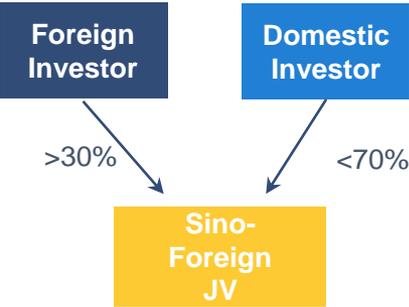
- ✓ Nursing homes
- ✓ Vocational training
- ✓ R&D centers
- ✓ Development of energy saving technologies
- ✓ Highway freight forwarding
- ✓ Manufacturing of clothing
- ✓ Operation of new energy power stations
- ✓ Operation of fitness centers
- ✓ Venture capital enterprises
- ✓ Manufacturing of VR/AR tech

→ 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

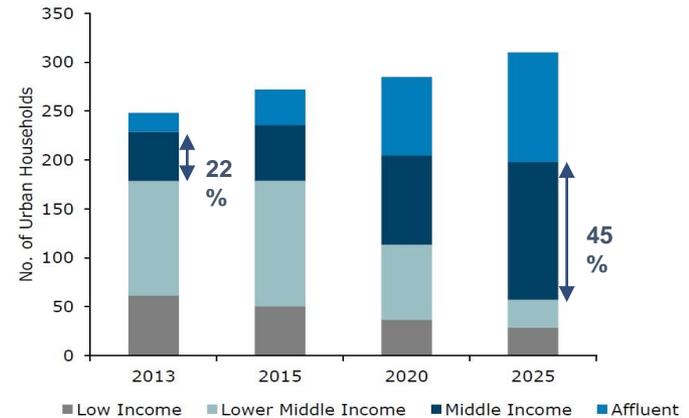


Opportunities: Rising disposable income

Disposable income per capita, 2006-2018



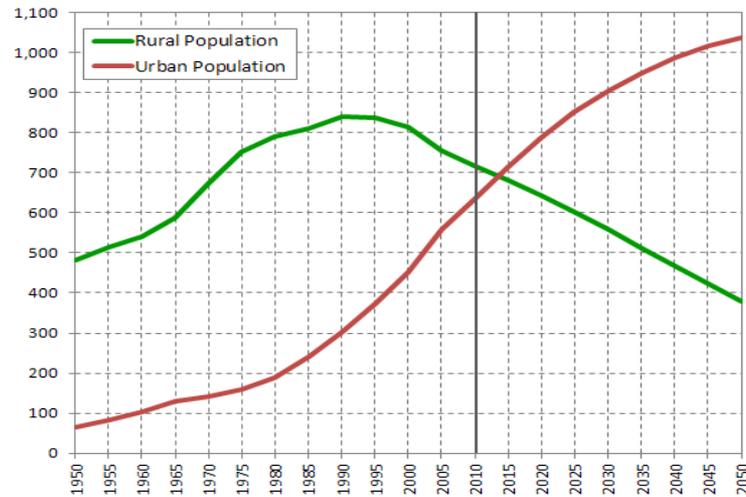
Urban Households by Income



- 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

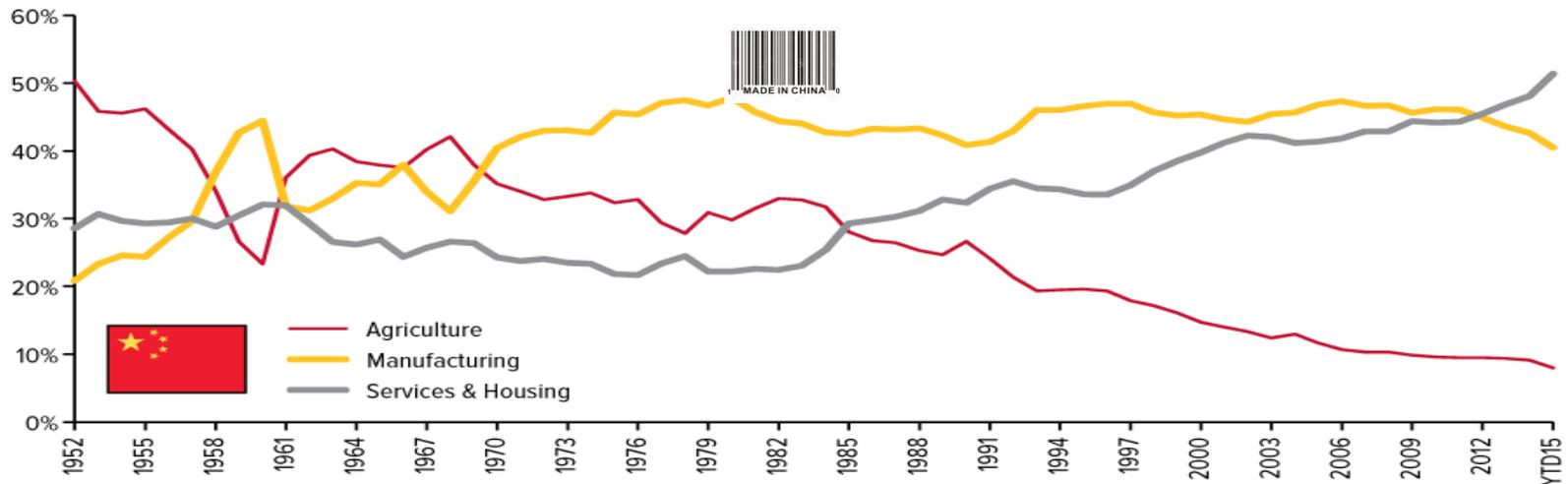
Rural vs urban population, China 1950-2050



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

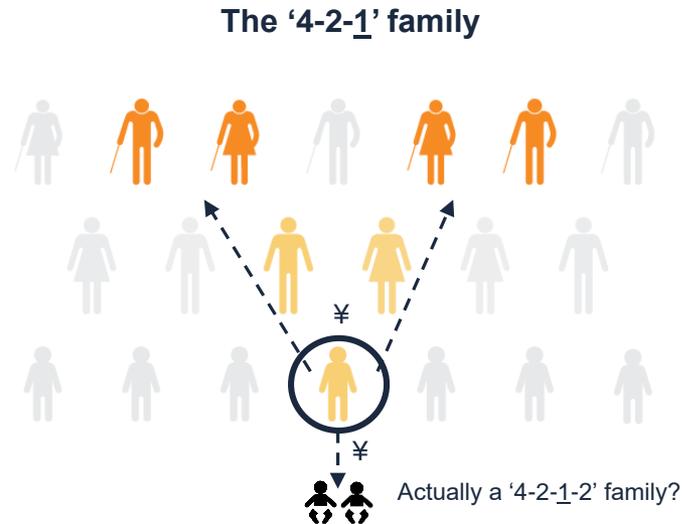
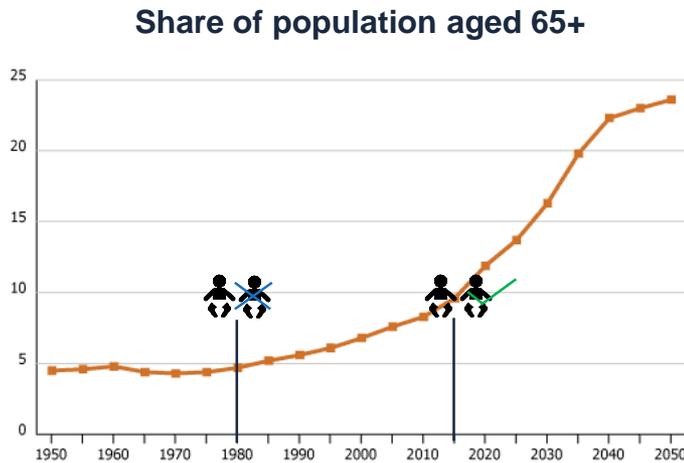
Opportunities: China is now a service economy

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.

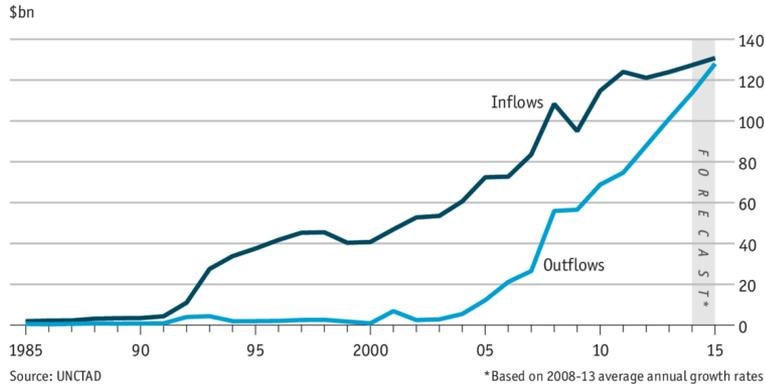
Opportunities: Aging population (healthcare), baby boom on the way



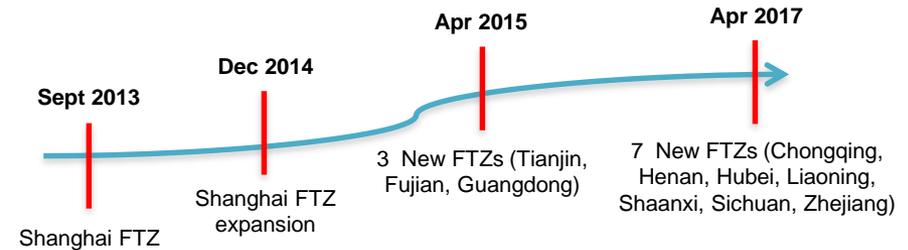
- One Child Policy (1980). Abolished in 2015
- Today: about 10% of the Chinese population is aged 65+. 2050: 25%
- 2016: 18.5 million babies born. 17.5-21 million in the next 5 years.
- 2017: baby products market= RMB 60.7 billion (9.2% growth)

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

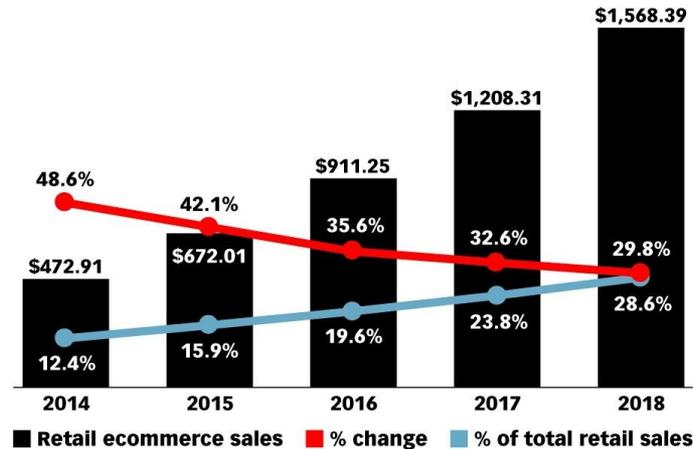


Business is located abroad
Product may be imported on a per-order basis

- 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

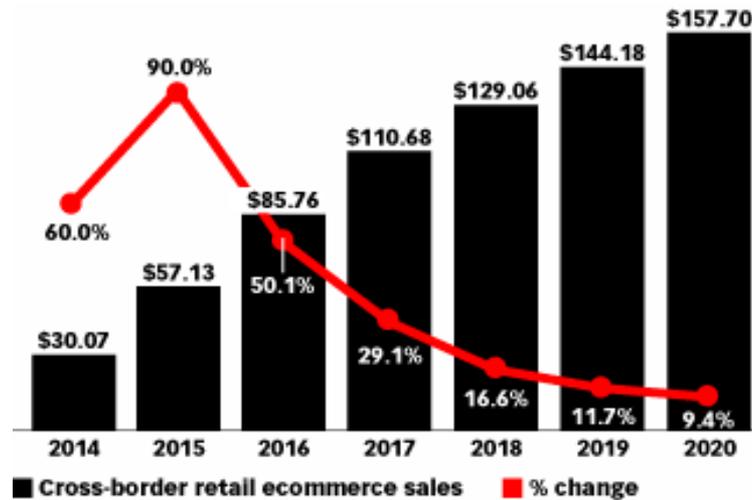
Domestic e-commerce sales, billion



- “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

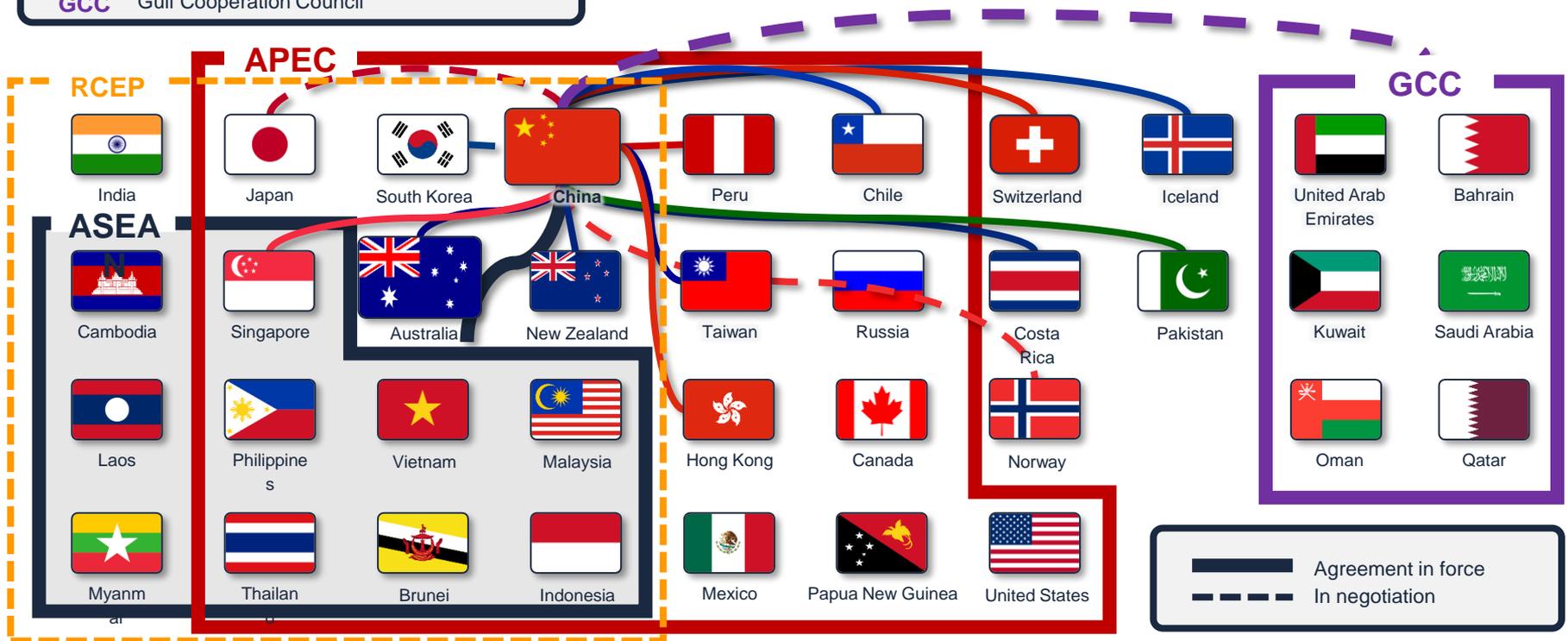
- USD 129 billion in cross-border retail e-commerce sales this year (less than 10% of domestic).
- Tmall Global and JD Worldwide only attract a fraction of the traffic as their domestic equivalents.
- Easier model to set up, but much smaller opportunities.

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)

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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

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



Lorena Miera Ruiz

Senior Associate,
International Business Advisory

Email: 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



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