CRITICALEYE

Planning for Success in China

*China remains a tough market to get right. Criticaleye speaks to **Matthew White,** Partner for China Advisory Services at BDO, and **Barbara Woodward,** Britain's Ambassador to China, to find out how management teams can set-up and grow their business in the world's second largest economy*

Is China's economy slowing down?

Matthew White: China has been through a huge amount of growth over the last 25-30 years. I've seen 11.5 per cent growth but now it's down at 7.4 per cent, and that's not bad. They're moving from that fast growth situation to concentrating on the quality of growth, looking more at how they can drive it on a sustainable basis.

Has it become easier for foreign companies to do business in China?

The country now has a slightly younger Government and what we've seen, and what has been reported to us, is that it's more internationally focused than the previous leadership. There's a lot more openness in terms of how they approach trade and that helps from an export and investment point of view.

For the latest five-year plan, the Government defined 'priority sectors', they are: agribusiness, pharmaceuticals, medical devices, renewable energy, clean technology, IT and electric vehicles.

What that means is if you operate in one of those sectors you're actively being encouraged to move into China, and the Government is offering support and help to do that. ▸

How should UK companies approach market entry?

Once you've decided to move into China, one of the biggest decisions is how you're going to establish a presence there. There are a number of different formats: the simplest is a straight agency arrangement, but that's relatively high risk because you don't have much control over things such as people on the ground.

Alternatively, a representative office is inexpensive to set up. However, it doesn't have a proper legal standing, so you wouldn't be able to engage in contracts. Businesses can use it to do some market research and find out if this is the right place and jurisdiction for them.

There are other restrictions for representative offices. You can't employ people directly, so you have to go through an agency. There's also a limit on the number of foreigners you can appoint; you can only bring four Westerners in.

What if they're ready to do more than just test the market?

Entering via a joint venture (JV) agreement will give you more control than a representative office and certainly more than an agent. There are two opportunities here: you can enter into an equity or a cooperative JV.

Equity is very much driven by your percentage of the shareholding; your voting rights will correspond directly with your stake.

A cooperative will be governed by the JV agreement. A lot of care and thought needs to go into it so that, when disputes arise, you know how to manage them – set down as much as you can in writing so that you always know how to come to an agreement.

With any JV, it's important that you understand your partner. That means before joining with them, make sure that you're aligned in terms of the business, but also understand what the exit will look like. Any exit needs to be done gracefully; making sure that you part on good terms is really important.

Companies that go into China with their own IP tend to set-up a wholly foreign-owned enterprise, what Westerners know as a limited company type structure. The most common types are: wholly foreign-owned enterprises for service, manufacturing and trading companies.

They are deemed to be legal person/proper entities, so they can engage from a contract point of view and, from a foreign exchange point of view, get currency in and out slightly easier than other vehicles.

How important is it to get your location right?

It is something that we always get asked about. People say: 'I want to go to China,' and we have to point out that it is a relatively large place and they need to really consider where they might go and for what reasons. Consumer behaviours across the country are different, so researching the local market is essential.

You also have to consider the different tiers of cities. Your strategy will be very different depending on the tier you're looking to enter into, because it will impact the infrastructure available and your cost base. There are also city clusters which share some common characteristics. ▶

THE UK/CHINA RELATIONSHIP

"I remain optimistic about the Chinese economy. I know that might seem slightly counter-factual as we look at the GDP growth rate dipping, but we've all been concerned that it might be over-heating.

We've seen strong overall growth in trade and investment with China, doubling exports in the past five years. We have also seen foreign direct investment (FDI) from China increase 85 per cent year-on-year in the same period. As a result, the UK is now the most attractive European partner for FDI from China, overtaking Germany.

So the question is, where do we go from here? For a long while, we've chided ourselves for the fact that British businesses appear to be doing less well in China than German companies. Part of that is the balance of openness in the Chinese economy, it is more open to manufacturing cooperation and imports than it is to the service sector.

That said, we have important opportunities in the next couple of years to address that and work in fast growing sectors in China, like healthcare and IT. We'll extend our network to more of the 160 plus cities with populations over one million and reduce trade barriers and increase transparency.

With China taking on the Chairmanship of the G20 Summit in 2016 we'll be working to further open up the international rules-based trading system."

Barbara Woodward
Her Majesty's Ambassador
People's Republic of China

It's really important to understand the differences because when it comes down to regulation, although the tax regime, for example, is exactly the same across China, interpretations will differ between provinces and cities.

Do leaders underestimate how different customer expectations will be?

The size and scale of China is such that the tastes don't just vary from the West, they vary within China as well. Therefore, making sure that your product or your offering is tailored to that marketplace is vital.

An example of that was Starbucks. When they entered China, they didn't try and sell lattes, they sold different types of green tea. It's the same model but it was green tea rather than coffee. Similarly, McDonald's didn't go in and sell beef burgers, it opted for pork which is very popular.

CRITICALEYE COMMENT

"The playing field for a fast-growth company that wants to consider itself as truly global is becomingly increasingly competitive and complex. When expanding internationally, the stakeholder base becomes more diverse and this means you need to really understand your customers, employees, suppliers and regulatory environment. It's clear that the make-up of the executive teams must reflect this diversity, otherwise they will struggle to navigate different market conditions and will not perform at the highest level. This can't be overstated for a market as fundamental as China."

Andrew Minton
Executive Director
Criticaleye

What do foreign companies need to know about the regulatory environment?

Every entity is subject to at least seven authorities, ranging from the state administration for foreign exchange to the state tax, local tax, customs and environmental regulators.

The tax rules are the same across China. However, there are very different interpretations locally and therefore it's really important that you get advice on the ground and that your adviser has a relationship with the local tax office. Communication with the designated tax officer is important.

The Government is moving towards a more Western approach to tax planning. They have just announced a process where you get pre-approval of planning. So, if you have a tax structure and you want to make sure it works, there is now an approval process that you can go through.

Is it becoming easier to get cash out of China?

We hear about the difficulties of getting cash out of China. That's still true to a certain extent, but it's starting to ease up.

From talking to some of the banks, there appear to be schemes that allow you to get cash out of China. Currently, companies outside of Shanghai Free Trade Zone (FTZ) can only make foreign exchange settlements with regard to "actual needs" as determined by the State Administration of Foreign Exchange, and have to go through a tedious procedure on a case-by-case basis.

However, under the new Notice, foreign invested enterprises (FIEs) registered in the Shanghai FTZ are allowed to make foreign exchange capital account settlements at their own discretion. This is restricted in a number of situations but, significantly simplifies the settlement procedure, increases the efficiency of investing and trading activities and enables FIEs to better manage and avoid foreign exchange risks.

How important is China as a trading partner for Britain?

The recent figures show that China is now the UK's fourth biggest trading partner. However, this is mainly driven by imports, so we need to export more to improve the overall relationship.

Doing business in China is not difficult, it's just different. If UK companies get their planning right, and make sure that their strategy is relevant, there are some great opportunities. ■

This article is based on a Criticaleye Discussion Group which explored the opportunities and challenges businesses face in China. Find out more here

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