

Break Through the Chinese Wall

**- Legal and practical guidelines
for establishing a company in China**

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About the book

“Break Through the Chinese Wall” is an accessible handbook which provides an introduction to the fundamental rules, regulations and common practices related to establishing and running a business in China. The handbook provides answers to the most frequently asked questions from our clients.

The handbook has been jointly written by Capital Associates and NCO China. Capital Associates is a Chinese law firm specialised in providing commercial legal services and assistance to foreign companies investing in and trading with China. NCO China is a consulting firm that offers corporate services with regard to the establishment of an enterprise in China, Hong Kong etc., and provides accounting, tax and HR services to foreign investors in China. Both Capital Associates and NCO China serve a variety of clients; from large multinational companies to small and medium sized enterprises.

China’s rapid development means that regulations and practices are constantly changing. The handbook is meant to be an introduction to the current laws and practices in China. Updates and further information regarding the subjects covered by the handbook can be obtained from our offices or websites. Please refer to the contact information in the back of the book.

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Considerations before entering the Chinese market

China has exhibited stunning economic growth since it initiated its first economic reforms, and opened its market to the outside world over 30 years ago. In this period, China doubled its economy several times, exhibited high growth in international trade (China overtook Germany in 2010 as the largest exporting country in the world) and has been a main contributor to global economic growth. This year the Chinese economy has become the world's second-largest economy.

Introduction to China's economy

Chinese reforms have focused on industrialization and market liberalization. In 1994, state owned enterprises represented 82% of value added wealth in the industrial sector. By 2005 this number had decreased to 41%. Similarly, the number of employees working in state owned enterprises declined from 80 to 40 millions during the same period. Due to these developments and China's gradual opening-up to foreign investment, the Chinese economy can now be categorized into three different sectors; the state-owned sector, the private sector and the foreign-owned sector.

State-owned enterprises dominate the primary sector (e.g. raw materials, steel, and petrochemical), the utilities sector (e.g. transportation, communication and electricity) and the banking sector. As state-owned enterprises have easy access to financing, they represent a large proportion of capital-intensive and heavy industries in China.

Private enterprises are mainly small companies doing business in the service, trading and light manufacturing industries. Since these companies do not have the same access to financing as state-owned

enterprises, the growth in the private sector is driven by higher employment.

Foreign owned enterprises were initially concentrated in high technology sectors that utilize cheap labor to re-export or sell goods to the Chinese market. China is a country abundant in labor but limited in raw materials. Because raw materials are imported globally and shipped to China for processing, China has earned the reputation of being the "factory" of the world.

Due to large surpluses in China's trade balance in recent years, China has lowered its demands for foreign financing. At the same time, the Chinese government has shifted its requirements with regard to foreign direct investment. The Chinese government now focuses on attracting foreign investments that can bring new technology and know-how to China so that China can become an independent producer of high technology products.

Priority is also given to foreign investments that protect the environment and lead to more efficient use of natural resources. Furthermore, greater foreign investment is encouraged in China's remote west and the northeast rust belt which currently lags behind the coastal regions with regard to the amount of foreign investment received.

Characteristics of the Chinese market

China is a large country with much diversity within its borders. With a population exceeding 1.3 billion people, China is best described as a mixture of different cultures, ethnic minorities and languages. The level of economic development varies tremendously from East to West, as does the average per capita income from one province to another.

Despite the enormous opportunities in China, most foreign investors will agree that succeeding is easier said than done. The Chinese market and the mechanisms behind it are unlike the markets in most western countries. Foreign investors should not expect that transferring existing business solutions and strategies from their country to China will work out just like that. Instead, thorough preparations, hard work and persistence is required to achieve results in the Chinese market.

As you read the following chapters, you will understand that entering the Chinese market will often involve complications and various degrees of uncertainty and risk. Some difficulties can be avoided by being proactive and performing due diligence, while other issues must be dealt with when they occur. China is notorious for its inefficient bureaucracy and obscure rules and regulations. However, it is also well known for its many alternative ways to get around difficulties.

Business success in China will depend on how prepared you are when making an investment in China. In the following chapters we will provide some general advice which may prove useful to you when you enter the Chinese market.

Collect information and gain experience

Collecting information is essential to making the right decisions:

- Use contacts in your existing business network to gather key information and first-hand knowledge and experience from China.
- Spend some time in China and visit different locations to make local contacts there. Information gathered from local sources such as foreign enterprises, embassies, government officials, local business life, etc. often provides a good basis for making

the right decisions on how and where to make your investment in China.

- Do not underestimate the value of your initial efforts to establish personal relationships in China. Personal relations are very important in Chinese business life, both in the short and long term perspective.

Alone or with a Chinese partner?

Carefully consider the benefits from entering the Chinese market with a Chinese partner. The Chinese market is booming with private companies interested in expanding their business operations on the basis of foreign invested capital, advanced technologies and/or management expertise.

A partnership with a Chinese enterprise may give you a head-start in terms of overcoming start-up difficulties, working up necessary distribution networks, attaining vital market information and getting an early grip of the Chinese market.

On the other hand, a partnership may also jeopardise your investment, if you do not choose your Chinese partner carefully. See the chapter “Establishing an enterprise in China” for further information on when to choose a partnership with a Chinese partner.

Support from headquarters

Many foreign investments in China fail due to lack of support from the board and management of the parent/home company.

Before starting out in China, make sure your home company is prepared and able to provide the support needed for the new Chinese enterprise to succeed. Select management and key employees

carefully, allow the management sufficient decision-making power, be prepared to take risks and accept losses, assess developments continuously, and be ready to make quick decisions.

Start out small and learn from your experiences

To most foreign investors, China is still a new and untried market. Allowing your business in China to grow gradually is often the best way to avoid overspending and disappointment.

Start out with small and well-known projects; make an effort to find the right employees; establish or join a local business network; make sure local suppliers meet the quality standards you set out; be patient and learn about the Chinese way of doing things.

With a sound and efficient organization in place, you will have a good foundation for expanding your Chinese business operations.

Useful links

Help and advice when establishing a FIE in China

- www.capitallaw.cc
Capital Associates' website.
- www.ncochina.com
NCO China's website.

Government and organizations

- <http://english.gov.cn/index.htm>
The official website of the Chinese central government.
- www.ebeijing.gov.cn
Official website of the Beijing Municipal Government.
- www.shanghai.gov.cn
Official website of the Shanghai Municipal People's Government.
- www.china.org.cn
Government portal site to China that offers broad access to news about China.
- www.fdi.gov.cn
Website of the Chinese Ministry of Commerce directed to foreign investors. The site comprises government news and information about investment directions, economy, statistics and law.
- <http://english.mofcom.gov.cn/>
Official website of the Chinese Ministry of Commerce.

- www.chinainvest.com.cn
China International Electronic Commerce Centre's website. Contains investment news and information about investment projects in China.
- www.tdctrade.com
Hong Kong Trade Development Council's website. Provides information about CEPA.
- www.tid.gov.hk/english/cepa/
Website of Hong Kong Trade and Industry Department. Provides full text documents on all CEPA agreements and annexes.
- www.adb.org
Website of the Asian Development Bank.

Other sources of information about China

- www.transparency.org
Website of Transparency International, a coalition against corruption.
- www.hoover.org/publications/clm
Website of the Hoover Institution of Stanford University. Provides information about China's leadership politics and its foreign and domestic policies.
- www.chinaeconomicreview.com
China Economic Review is a monthly magazine published in Hong Kong covering business, finance and economics in China.
- www.worldbank.org/transitionnewsletter
World Bank newsletters on developing economies.

- www.cia.gov/library/publications/the-world-factbook/
U.S. CIA World fact book.
- www.expatsinchina.com
A guide for foreigners living in China.

Logistics

- www.maps-of-china.com
Maps of Chinese cities, provinces and regions in the principal areas of China.
- www.primecargo.com
Website of the international transportation and freight forwarding company Primecargo.
- www.dsv.com
A transportation company that offers end-to-end transport and logistics solutions.

News in English

- www.chinadaily.cn
Website of China Daily, the Chinese government's official mouthpiece.
- www.scmp.com
Website of South China Morning Post, which is a little less censored than China Daily.
- www.shanghaidaily.com
Website of the local Shanghai newspaper
- <http://english.peopledaily.com.cn>.

Chambers of commerce

- www.amcham-china.org.cn
The American Chamber of Commerce in China.
- www.europeanchamber.com.cn
The European Chamber of Commerce in China.
- www.pek.britcham.org
The British Chamber of Commerce in China.
- www.ccifc.org/
The French Chamber of Commerce in China.
- www.dccc.com.cn
The Danish Chamber of Commerce in China.
- www.swedishchamber.com.cn
The Swedish Chamber of Commerce in China.

Abbreviations

AIC	Administration of Industry and Commerce
AMEA	Anti-Monopoly Law Enforcement Agency
ASBE	Accounting Standards for Business Enterprises
BLTB	Beijing Local Tax Bureau
CAS	Chinese Accounting Standards
CBRC	China Banking Regulatory Commission
CCPIT	China Council for the Promotion of International Trade
CEPA	Closer Economic Partnership Arrangement
CIETAC	China International Economic and Trade Arbitration Commission
CJV	Contractual or Cooperative Joint Venture
CO (CEPA)	Certificate of Hong Kong Origin (CEPA)
COFCOM	Commission of Commerce
CPA	Certified Public Accountant
CSRC	China Securities Regulatory Commission
DTT	Double Taxation Treaty
EJV	Equity Joint Venture
EPZ	Export Processing Zones
FESCO	Foreign Enterprise Service Corporation
FIE	Foreign Investment Entity
FIP	Foreign Invested Partnership
FR	Factory Registration with TID (CEPA)
HKTDC	Hong Kong Trade Development Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LoI	Letter of Intent
MII	Ministry of Information Industries
MOFCOM	Ministry of Commerce
MOLSS	Ministry of Labour and Social Security
NDRC	National Development and Reform Commission
NPC	National People's Congress

PBOC	People's Bank of China
PRC	People's Republic of China
RMB	Renminbi
RO	Representative Office
ROOs	Rules of Origin (CEPA)
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SAR	Special Administrative Region (Hong Kong and Macau)
SAT	State Administration for Taxation
SIPO	State Intellectual Property Office of the PRC
TID	Hong Kong Trade and Industry Department
TRIPs	Trade-Related Aspects of Intellectual Property Rights (agreement under WTO)
WFOE	Wholly Foreign Owned Enterprise
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

References

We have found inspiration for the handbook on the websites listed under “Useful links”. In addition, various materials from events and presentations together with “Danmarks Nationalbank, Quarterly Review 1, 2009” have been used.

Last, but not least, we have drawn on the long experience of Capital Associates and NCO China in advising clients.

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