

Helpful Hints for Doing Business in China

China represents a land of opportunities and remains the second largest foreign direct investment recipient in the world. Accession to the WTO is further integrating China into the global economy and trading system. However, doing business in China has been a struggle for foreign business executives, which in turn creates a major barrier for companies hoping to profit from this huge emerging market. Foreign companies should understand the obstacles and the need to form alliances.

China's regulatory framework, decision-making processes, trading system and business culture make it a confusing and complex place in which to do business. It represents an unique environment not only different from the business environment in the developed OECD countries but significantly different also from the business environment of other emerging markets.

Regulatory Framework

Major regulatory constraints remain on foreign investment in China (many of which have been addressed by WTO accession protocol with a phase-out of such restrictions). Foreign investment is classified into four categories in which investment is either encouraged, permitted, restricted or prohibited. There are restrictions on form of establishment, equity stakes, and geographic restrictions in certain industries. There is a two-tier tax system, national and provincial, which by its nature is complicated.

Decision-Making Processes

There are no clear lines of authority from the centre to the province and then from the province to the municipal level. Decisions are often made only when consensus has been arrived at.

Trading System

Most of China's major enterprises are State Owned Enterprises (SOEs), but the level of government that owns the enterprise varies. Some SOEs are owned by municipalities, some by provincial governments, or by the various national level ministries. One level of SOE is even on an administrative par with the national ministries, for example, the China National Aviation Industry Corp.

The hierarchy within a Chinese organisation is complicated. It is often difficult to identify who makes the final decision. Thus, foreign companies will have to treat everybody with equal respect and be prepared to present their business plans to many different people at varying levels of authority.

Business Culture

Foreign companies doing business in China face and will continue to face challenges due to the complex business culture, which is very different even from other Far Eastern countries.

Doing business with the private sector is entirely different from doing business with the public sector. There are also huge regional variations in business culture across the country.

Foreign companies who engage in relationships with Chinese partners often find it difficult to adjust to the Chinese business environment: the Chinese are willing to bend a few rules in order to get things done. Many rules and regulations in China are not strictly enforced and are subject to personal interpretation to make room for exceptions. People with *guanxi*, as we will discuss later, can circumvent government regulations for their own benefits.

This flexibility has both advantages and disadvantages. On the one hand, the flexibility is conducive to doing business. On the other hand, foreign companies are baffled over the extent to which the Chinese are willing to be flexible on some matters but not on others. Those who have the access to *guanxi* and connection in the government praise such flexibility whilst others who have suffered because of the flexibility denounce it.

Another important part of Chinese behaviour that may affect foreign companies doing business in China is that the Chinese individuals behave very differently in a group from as an individual. When in a group, the Chinese are less flexible and not straight-forward. The group atmosphere usually makes the Chinese more cautious, less open and inflexible. Foreigners need to develop personal relationships with Chinese individuals that go beyond the business relationship, exploiting non-business opportunities to overcome the difficulties.

Keep in mind that over-learning and adaptation could be counter-productive. To develop a balanced adaptation to business culture in China, foreign companies will need assistance from experienced advisers, who can help investors avoid many mistakes that other foreign businesses have made in China in the past.

Entry Vehicles

It is of high importance to foreign companies taking a serious look at the China market to understand what the available entry vehicles are, and in particular whether to set up local production or to sell to this market through exporting products. Several options are available, and which to select depends greatly upon the size, strategic objectives, consumers, and product mix of the company.

It is critical to collect information for market research. Though sometimes you can expect to obtain information from the government, information is a precious commodity in China because it is much less widely available and is commonly linked with *guanxi*, which we are to address below. Obtaining valuable business information requires the cultivation of relationships and personal interaction with the Chinese. After the market research has been accomplished and you are sure that there is a market for your products or services, you can then prepare a normal commercial transaction.

Many foreign companies may prefer a phased-in approach to doing business in China, from direct export to setting up a representative office and then to local production.

You can export your products without being produced locally, most commonly through a local middleman (distributor). There are currently several major SOEs that operate monopolistic national distribution networks for grains, cigarette etc. Such a company might be an option for foreign company that needs nationwide coverage. However, these networks are generally inefficient and might be costly in the long run.

Problems associated with the distribution in China, cost implications, and tariffs prevent companies from relying purely on export. Even after China's accession to the WTO, when

tariffs have been reduced for many products, local production may still mean significantly lower prices for your products.

A representative office is a bridge to serve local market better. Establishing a representative office in China before investing allows the company to become more familiar with the market, and get a better picture of what the market for their products and services are, and what the customers want. It will also allow the company to promote awareness of its brand name and start to establish a guanxi network. Perhaps most importantly, this will allow the company to get a much better idea of the local business practices and regulatory framework.

Setting up either a joint venture (JV) or a wholly owned foreign enterprise (WOFE) is the next step.

In most cases, establishing a JV is cheaper than a WOFE. On top of that, the foreign company can make the most of the local partner's sales channels and government relationships. Domestic companies, especially those well-connected, can be very helpful in dealing with government relationships and bureaucracy. With the exception of a few industries that are classified as prohibited and restricted categories, it is always advisable for the foreigner to be the majority partner in the JV, as they can exercise control over the company.

However, the history of JV in China, like other emerging markets, is not good. It is often the case that either the Chinese partner, the foreign partner, or both, come to the JV with different business objectives. This is due mainly to culture differences between the two partners. This inevitably leads to JV failure.

The WOFE is currently the most popular structure for foreign investment in China. This is due to both the increased legal acceptance and the high failure rate for joint ventures. Nearly four years after China's joining the WTO, almost all restrictions on WOFE's participation in various economic sectors have been lifted.

The main advantage of establishing a WOFE is that the foreign company can operate freely without having to cooperate with a domestic partner, whilst the obvious disadvantage is lack of access to existing sales channels, local knowledge, and help in government relationships.

Here are some tips on doing business in China.

- If you have local knowledge, don't be afraid to go alone. Set up a WOFE.
- When you have to set up a JV, you need to pay considerable time in planning and conducting a thorough due diligence on your partner, including cultural due diligence. An exit strategy should be embedded in the JV agreement.
- Start small and grow as your revenue grows or as you gain a better understanding of the market.
- Be prepared for the differences in culture and business norms.
- A bit of understanding of the Chinese language and history are positively received by the Chinese, and therefore helpful to doing business in China.
- Use of an experienced advisor is highly recommended. The retention of professional assistance may also lead to an early exposure of unidentified business risks.

As operations start, you will find that guanxi is the centre of your concerns to do business successfully in China.

Don't Forget Guanxi



If you get stuck in the lengthy approval process, or want to move your business faster, then you need a guanxi network.

Guanxi refers to a particular kind of social networking based on shared experiences and mutual obligations. In its simplest and purest forms, guanxi can mean friendship, trust and willingness to help each other. Chinese prefer to do business with people they know, have connection or guanxi with. Guanxi is the key to successfully doing business there. In the Chinese context, you have to establish a personal rapport before you start talking about business.

Foreign companies should develop good relationship with the Chinese and have access to various guanxi networks in China to ensure their success. To start your network, there is no better way than to hire good local staff. Overseas Chinese with western education background are often best candidates if they have the right business background.

Alternatively, you can turn to certain professional firms who operate a good guanxi network. Law firms, accounting firms, and some consulting firms can normally perform a public relations and lobbying role helping move your business around.

Guanxi often has a financial component. The exchange of gifts is at the heart of building and maintaining guanxi. This may qualify as bribery in the West, where corporate gifts must comply with certain regulations. However, distinguishing between a normal guanxi transaction and corruption in the Chinese context is a sticky and highly challenging task. The best way for a foreigner to avoid this problem is to simply avoid guanxi transactions that involve significant financial components.

Keep in mind that guanxi is built over time on trust and commitment. A rule of thumb is that, the more you give the more you get. Developing and maintaining guanxi network in China should be considered an investment. Better understanding through more communication is the most important to develop and strengthen your guanxi with the Chinese.

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