Exporting goods, services and technology to the Chinese market

Are you ready for China? - Report 3

www.eusmecentre.org.cn

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Introduction to the EU SME Centre diagnostic kit

To help European SMEs entering the Chinese market to make an informed decision, the EU SME Centre has published a series of diagnostic business tools entitled *Are you ready for China?*. Four reports introducing different aspects of market entry are accompanied by an online quiz tailored to help entrepreneurs check their level of readiness regarding the market and pointing them towards further resources to improve their understanding of less well-known business areas. The series is designed to work as a step-by-step introduction to the Chinese business environment, allowing SMEs to gauge their preparedness in doing business in China.

This report, *Exporting goods, services and technology to the Chinese market*, is the third in the series of four, aimed at helping EU SMEs understand and ideally enter the China market. In it, we take a closer look at import regulations and processes for goods, services and technology as well as the necessary documents, associated costs and best practices. The report also offers a variety of case study examples, practical recommendations and references for further information.

Online quiz - *Gauging your readiness*: An electronic learning module to help you assess your knowledge of the Chinese business environment.

Report 1 - *Is China on your radar?*: A general introduction to China's macroeconomic framework and what it means for European SMEs, including specific opportunities by industry sector.

Report 2 - *Ways to enter the Chinese market*: An overview of different modes of entering the Chinese market, from exporting to investing, from joint ventures to wholly foreign-owned enterprises.

Report 3 - *Exporting goods, services and technology to the Chinese market*: A closer look at import regulations and processes, including practical tips and best practices.

Report 4 - *Knowing your partners in China*: A concise guide to due diligence in China. From verifying a company's administrative and legal standing to checklists for visits to the partner's premises, it covers all areas basic due diligence is concerned with.

To find out more, please visit www.eusmecentre.org.cn/content/diagnostic-kit

1. Exporting goods, services and technology to the Chinese market

The third report of the EU SME Centre diagnostic kit, *Exporting goods, services and technology to the Chinese market*, provides practical guidelines to export your goods, services or transfer technology to China.

Exporting refers to the shipment of goods, provision of services or transfer of technology across national borders. The seller of the goods, services or technology is the “exporter”, who is based in the country of export (in our case, one of the Member States of the European Union), and sells his product to the overseas buyer or consumer (who, in our case, is based in China). Exporting is a process which needs to be diligently researched and planned.

Exporting of goods to China always involves engagement of a company which has the right to operate import/export activities stated in its business licence. Such a company has to be registered in China. Therefore, the term “importer” in Chinese trade terminology usually refers to the China-registered company possessing an import/export licence. Such a company can be a buyer and thus importer in the general sense, but most often it is only a intermediary assisting with the import (bringing the goods across the border and facilitating international payment).

2. Goods

China is currently the world’s second largest economy and the EU’s second largest trading partner behind the U.S.. The export of goods from the EU to China reached EUR 136.2 billion in 2011, a 20% increase from 2010. These exports consist mostly of industrial products, transportation equipment, miscellaneous manufactured goods, luxury products, medicine, cosmetics and chemicals. As the fastest growing market for European exports, vast potential for the export of goods manufactured by European small and medium-sized enterprises (SMEs) exists in the Chinese market.

2.1. Process for exporting your goods to China

Determine what category your product falls into

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Apply for any required import licences or quotas with the Chinese Ministry of Commerce

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Make sure your product meets the relevant Chinese standards

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Apply for a China Compulsory Certification (CCC) mark, if required

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Make sure your product meets all labelling and packaging requirements, if any

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Affix relevant labels to products before arrival in Chinese port

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Have all required paperwork ready (licences, quota licences, etc.) to present to customs for inspection at the Chinese port

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Be ready for Chinese customs to take a sample of your product for inspection and to hold your products until all inspections are completed (if applicable)

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Pay relevant customs taxes and fees

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Products are released by customs and successfully imported into China

Your first step is to determine what category your goods for export fall into. China's Ministry of Commerce (MOFCOM) regulates the import of foreign goods. According to the New Foreign Trade Law, which came into effect in April 2004, goods are classified into the following categories, depending on how helpful they are for the Chinese government's economic targets.

The Chinese government classifies goods into three categories:

Free imports

Restricted imports (under licence, quota, tariff-rate quota management)

Prohibited imports

2.2. Free imports

Freely importable goods are the least regulated category of goods and, in most cases, can be imported into China without restriction. However, selected items require an automatic import licence which is granted to all companies who apply. The licence enables the Chinese government to monitor the imported amounts of certain products. For a sample list of goods that require this automatic licence, please see the appendix. The list is jointly updated by MOFCOM and The General Administration of Customs (GAC) on a regular basis.

2.3. Restricted imports

For the purposes of this report, 'restricted imports' refers to imports where the importer must apply for and obtain an import licence, a quota import licence, a tariff quota licence or any combination of these.

According to Chinese legislation, only goods under quantitative restriction by way of quotas and goods under restriction by way of necessary licences are considered 'restricted'. Goods under tariff-rate quotas are not considered 'restricted'.

Import licence

Although China has been reducing the amount of paperwork required for imports since joining the WTO, an importer must receive approval in the form of an import licence from MOFCOM before importing certain goods. Obtaining the proper registration and licence is the responsibility of the importer.

Documentation required to obtain an import licence include an application for issuance of an import licence, the business licence of the importer and other documents required for specific types of restricted goods under the licence system. It is important to verify whether your product requires an import licence prior to shipping the product. If goods are imported without the required import licence, Chinese customs authorities may confiscate the goods. Examples for goods restricted by way of import licence are steel, wool and natural rubber. For a sample list of goods that require this licence, please see the appendix. The list is updated on a regular basis.

Import quotas

What is an import quota?

An import quota is the maximum amount of foreign goods that can be imported into a country in a given period of time. It is a type of trade restriction that limits the foreign supply of goods available in the market, which raises the market price of the goods.

Some goods are regulated under a quota management, which means that China will only allow a certain quantity of these goods to enter its borders each year. In this case the importer will have to apply for a relevant import quota licence prior to importing goods to China. Example products are crude oil, pesticides and tobacco. For a sample list of goods subject to import quota, please see the appendix.

Tariff-rate quota management

In order to import goods under tariff-rate quota management, in addition to an import licence, an import quota must also be obtained. Goods under tariff-rate quota management include, amongst others, grain, sugar, cotton and vegetable oil. For a sample list of goods under tariff-rate quota management, please see the appendix. The list is updated on a regular basis.

2.4. Prohibited imports

Some goods are prohibited from import into China for national security or health and environmental reasons. It is unlikely your good will be on this list. Prohibited imports include weapons, ammunition, explosives and illicit drugs. For a sample list of prohibited imports, please see the appendix.

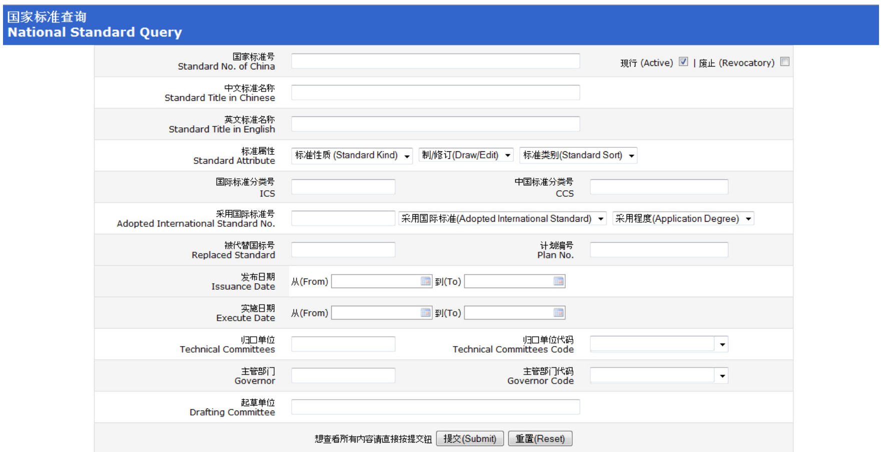
2.5. Standards

Once you have confirmed the import category your goods fall into and have researched the necessary paperwork, you will need to ensure that your product meets the corresponding Chinese standards. Although some Chinese standards correlate with European or international standards, meeting a corresponding European or international standard does not mean that you will automatically meet the Chinese standard.

There are four levels of standards in China: national standards, professional standards, local standards and enterprise standards. Only national standards, or GB (guobiao) standards are mandatory. The rest are considered voluntary. Standard levels are hierarchical; meeting the highest existing standard for your product means that you will automatically meet all lower-level standards. However, some products may require compliance with national and professional standards, since those standards sometimes regulate different aspects of the product.

National standards

- Administered nationally by the Standardization Administration of China (SAC) and consistent across China;
- 15% of national standards are mandatory; these are prefixed with a "GB";
- The SAC has a database of more than 27,000 national standards, which can be searched in English: www.sac.gov.cn/SACSearch/outlinetemplet/gjbzcx.jsp



Professional standards

- Also referred to as industry or sector standards;
- Developed and applied when no national GB standard applies;
- Are administered by various ministries;
- Can be searched in Chinese:

  www.cssn.net.cn/pages/nv_search/index.jsp

Local standards

- Also referred to as provincial standards;
- Developed when neither national nor professional standards apply;
- Administered by the China Inspection and Quarantine Service (CIQ);
- Designated with either "DB + *" (mandatory) or "DB + */T" (voluntary).

Enterprise standards

- Developed and used by companies when other high-level standards are not available;
- Never mandatory.

2.6. China Compulsory Certification (CCC)

The China Compulsory Certification, or CCC, mark is China's national safety and quality mark. It is a compulsory safety mark that must be obtained before certain products can be imported and sold in China. The mark takes the form of a physical sticker that is applied to individual products as a label. Implemented in May 2002, it is required for approximately 20% of European exports to China. The CCC mark is administered by the Certification and Accreditation Administration (CNCA) and the China Quality Certification Centre (CQC).

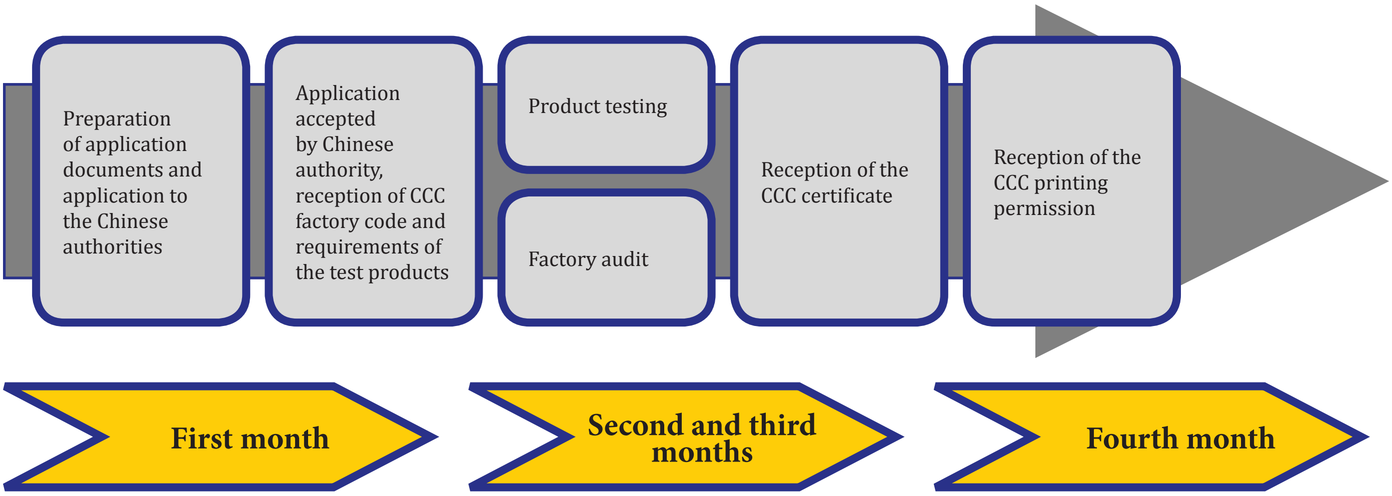
The CNCA publishes an online catalogue of CCC mandatory products, which are grouped into 23 categories and span 254 products. The CNCA and CQC will periodically make amendments to this list, so it is important that you use the most recent version when checking if your product is listed. CCC mandatory products include, amongst others, household and small electrical appliances, motor vehicles, latex products, medical devices and IT products. For a full list of CCC mandatory products, please see the appendix.

If a CCC certification is required, we highly recommend European companies work with an experienced Chinese third-party consultant, contractor or partner to obtain the approval. This helps with language, culture, as well as distance barriers and can significantly speed up the process.

While slightly cumbersome, the certification process is fairly straightforward and can be completed in four to six months. Costs start at EUR 3,500 and can range upwards significantly, depending on the specific product. Once CCC certification is granted, it is valid for five years but must be renewed annually. The unauthorised supply, sale, or import of products listed in the CCC catalogue may result in product confiscation at the border and a penalty fee ranging from EUR 6,000 to 25,000.

CCC mark certification process

- Application: Submission of application and supporting materials to CNCA;
- Testing: Submission of product to CQC laboratory in China for testing;
- Factory inspection: Inspection of factory and manufacturing facilities by CQC;
- Evaluation: Approval of CCC certificate or failure and retesting;
- Product marking: Marking of product and packaging with the approved CCC mark;
- Annual follow-up factory inspections: Manufacturing facilities need to be inspected every 12-18 months. Costs for follow-up inspections are much lower than the initial inspection.



2.7. Other industry standards

In addition to GB standards and the CCC mark, numerous government agencies in China issue industry-specific standards or testing requirements for products under their jurisdiction. For example, the export of medical devices, cosmetics, and food must also receive approval by the State Food and Drug Administration (SFDA) before import into China. For industry standards, please reference specific industry guidelines for your product.

2.8. Labelling

All products entering China require some amount of labelling, usually in Chinese. Labels are administered by China Inspection and Quarantine (CIQ). It is best to get approval from CIQ, receive the labels, and attach them to your product before it arrives in a Chinese port. For first-time exporters the process of labelling and customs clearance can be quite an ordeal. Being consistent and always using the same port as entry point into China will make the process easier with time. For more information on labelling requirements, please see the website of the General Administration of Quality Supervision, Inspection and Quarantine of the P.R.C. at http://english.aqsiq.gov.cn/.

The costs associated with obtaining a Chinese label can vary significantly. Customs charges are calculated as a percentage of the value of the imported product. Fees include product inspection, quarantine and label verification.

There are both mandatory and voluntary labelling guidelines in China:

Mandatory labelling

- For some products, both English and Chinese labels are required;
- Labelling requirements vary by industry:
- **Food and beverages**

- Labels must contain information on the ingredients, composition of each ingredient, weight and volume, and the address of the manufacturer and local distributor.

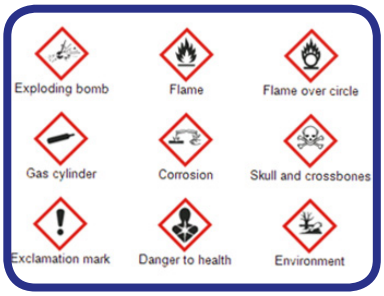
- **Cosmetics**

- Labels can be attached to the product or provided in a separate booklet. Labels must contain information on ingredients, amount of the ingredient, and the name and address of the manufacturer and the local distributor.

- **Electronics**

- Labels must fulfil the energy label and the restricted use of hazardous substances (RoHS) label requirements;
- For energy label requirements, please see: www.eusmecentre.org.cn/content/energy-efficiency-label-guideline
- For RoHS label requirements, please see: www.eusmecentre.org.cn/content/rohs-label

- **Chemicals**



- Imported chemicals and products containing chemicals must be classified, labelled and packaged according to the globally harmonised system of classification and labelling of chemicals (GHS) as adopted by the UN.

Voluntary labelling

- China's voluntary labels are designed to indicate that a product is safe and environmentally friendly. They generally only benefit domestic companies; only large multinational companies have acquired voluntary labels. For more information, please see:

  www.eusmecentre.org.cn/content/voluntary-labelling-china

2.9. Packaging

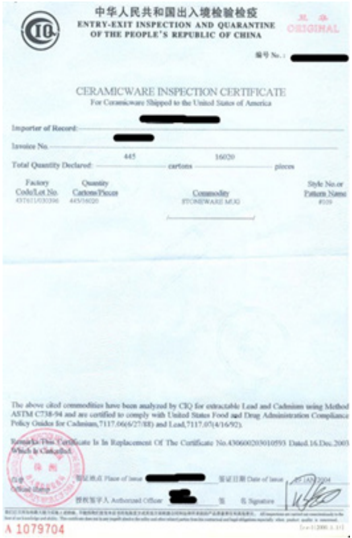
In addition to standards and labelling, there are various packaging requirements for goods exported to China. Depending on the specific product, packaging requirements are administered by different government bodies and can vary greatly. For packaging laws and standards, please see the packaging regulations of your specific industry:

www.worldpackaging.org/packaging-regulations/default.asp

2.10. Entry-exit commodity inspection and customs

The General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ) is the administrative and enforcement body for quality control, measurement, inspection of import and export commodities, entry-exit health quarantine, entry-exit animal quarantine, certification and standardisation in China. The *Catalogue of Import-Export Commodities Subject to Compulsory Inspection* *and Quarantine* lists the types of commodities requiring entry-exit inspection and quarantine. It also covers how the inspections will be carried out.

Once goods pass the entry-exit commodity inspection process, a certificate will be awarded from AQSIQ.


中华人民共和国出入境检验检疫
ENTRY-EXIT INSPECTION AND QUARANTINE
OF THE PEOPLE'S REPUBLIC OF CHINA
ORIGINAL
编号 No.: [redacted]

CERAMICWARE INSPECTION CERTIFICATE
For Ceramicware Shipped to the United States of America

Importer of Record: [redacted]
Invoice No. [redacted]
Total Quantity Declared: 445 cartons 16020 pieces

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Once your goods arrive at the Chinese port or other point of entry, they will need to clear Chinese customs inspection. Your Chinese importer (for example your agent or distributor) will be responsible for putting together the documents you need and provide them to the Chinese customs agent. The approval process for these documents should be started long in advance of your product's arrival in China, to ensure smooth passage through customs and on to the final destination of your goods.

Required customs documentation varies from product to product, but standard procedures include:

- Quota certificate/import licence inspection (if applicable);
- Customs registration;
- Commodity inspection;
- Customs declaration;
- Submission of documents (certificates or origin, sales contracts, bills of lading, commercial invoices, packing lists, etc.);
- Examination;
- Payment of taxes and fees.

2.11. Relevant taxes and fees for the import of goods

Many taxes and fees are associated with exporting goods to China. Several common ones are listed below:

Customs duty

- For customs duty purposes, the taxable value of an imported good is its cost, insurance and freight (CIF) price, which includes the normal transaction price of the goods, plus the cost of packing, freight, insurance, and seller's commission;
- China customs is in charge of assessing the customs duty of all imports;
- China customs uses a valuation database that lists the values of various imports based on international market prices, foreign market prices and domestic prices;

- Typically, customs officers will accept the importer's price. However, if the reported value is too far out of line with the database, the customs officer will estimate the value of the goods based on China's customs rules and regulations for tax calculation purposes.
- To look up tariff rates, please search for your product by HS code at the China customs website:

  http://english.customs.gov.cn/publish/portal191/

Value-added taxes (VAT)

- VAT is levied on the sales and import of goods as well as processing, repair and replacement services;
- VAT is levied after the tariff and incorporates the value of the tariff;
- VAT is collected regularly on imports at the point of entry into China;
- The basic VAT rate is 17%, but a lower rate of 13% applies to the following goods (amongst others): food and edible vegetable oil, drinking water, heating, natural gas, coal gas, liquefied petroleum gas, books, newspapers, magazines, animal feed, chemical fertilizer, pesticides, agricultural machinery and agricultural plastic sheeting.
- The importer may enjoy tax exemption for the import of certain goods identified in relevant regulations. For example, the import of devices for the use in scientific research and teaching might be exempted.

Consumption tax

- 14 categories of goods are subject to consumption tax, which may be calculated based on the price and/or amount of the imported goods respectively or collectively depending on the specific legal regulations.
- The rate of the consumption tax calculated based on price is between 1% and 56% when entering China.
- Goods subject to consumption tax include: tobacco, liquor, cosmetics, precious jewellery and precious jade and stones, firecrackers and fireworks, refined oil products, motor vehicle tires, motorcycles, small motor vehicles, golfing equipment, high-grade watches, yachts, disposable wooden chopsticks, real wood flooring.

2.12. Case studies

Case study: CS Wines

European winemaker establishes successful import business in China:

- CEO first came to China with only samples and the ambition to enter the market;
- Extensive market research revealed a large consumer group in China for their product, affordable standard wines of good quality;
- Opened a WOFE in Beijing and Shanghai, with 25 local employees and a retail store in Beijing;
- Ensures that all customs documentation for each wine shipment is received by CIQ before the arrival of the product:
    - Certificate of origin and health certificate, packing list, invoice, sales contract, customs authorisation, declaration papers;
    - Three to six bottles of wine are usually impounded;
    - Certification can take up to one month;
- Purchased their own insurance policy for the storage warehouse;
- Routinely ensures that all licences, contracts and documents are accurate and up-to-date.

To access the full case study on CS Wines, please visit our website.

www.eusmecentre.org.cn/content/cs-wines-–-importing-wine-china

Case study: Linet

Czech manufacturer of medical beds decides to expand its export business to China:

- According to market research, China has a large and growing market for high-grade medical beds;
- As a veteran in international trade, Linet decided to export its products to China;
- The company won a contract to provide USD 2.4 million worth of medical beds to the Ministry of Health;
- Standards and conformity certificates for medical beds took between 8 and 18 months to obtain, costing EUR 12,000 to 16,000 for each product;
- Assigned a local Chinese distribution company to sell its medical beds in China;
- Due to unsatisfactory sales results, Linet signed a contract with another local distribution agent to sell its beds in China;
- Linet is currently negotiating with two other distributors in Hangzhou and Hong Kong;
- Finding the right Chinese agent and building a trusting relationship is key for distributing products to certain industries.

To access the full case study on Linet, please visit our website.

www.eusmecentre.org.cn/content/linet-–-exporting-medical-beds-china

Case study: Müller Textil

A German-based manufacturer of hi-tech functional fabrics decides to enter the Chinese market:

- The company followed two of its key customers to China in 2006;
- Management decided to target Chinese manufacturers in the automotive and consumer industry, the same industries it targets in its home market;
- After extensive market research, chose to use an experienced market consultant to help establish a WOFE in the Langfang Economic and Technical Development Zone in Hebei province, which is close to an airport, a port in Tianjin and its two key customers;
- Raw materials are imported from Europe and processed in China;
- In the beginning, nearly 60% of Müller's output in China was exported overseas, exempting them of the 10% import duty on raw materials and allowing for a lower VAT;
- IPR is protected through difficult to copy machinery, production know-how and building trust in employee relationships;
- Employee turnover is high in China and Müller works hard to retain staff;
- Sales are managed through a locally trained team of Chinese employees;
- Müller China has been profitable since its establishment in 2006.

To access the full case study on German Biogas, please visit our website.

www.eusmecentre.org.cn/content/mueller-textil-–-leader-functional-textiles-crossing-over-china

3. Services

According to the *General Agreement on Trade in Services* under the WTO framework, trade in services, which is also called import of services herein, is defined as the supply of a service:

1. from the territory of one Member State into the territory of any other Member State;
2. in the territory of one Member State to the service consumer of any other Member State;
3. by a service supplier of one Member State, through commercial presence in the territory of any other Member State;
4. by a service supplier of one Member State, through presence of natural persons of a Member State in the territory of any other Member State.

Since joining the WTO in 2001, China has gradually opened up its service industries to foreign businesses, especially the banking, insurance, securities, telecommunications and logistics sectors. Services in these sectors are urgently needed in China due to its rapid economic growth. Requiring large investments, high expertise and advanced technology, Western companies and professionals often offer stronger services in these industries than their Chinese counterparts.

China's service imports have grown rapidly in the last few years. By 2010, China had become the third largest importer of services in the world. China's yearly trade in services has seen an annual growth rate of about 11%, and is projected to reach EUR 450 billion by 2015.

3.1. Process for exporting your services to China

Determine what category your services fall into

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Decide how to enter the market: direct vs. indirect entry

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Meet relevant guidelines

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Pay relevant taxes and fees

For the purpose of this report we divide export of services to China into direct market entry covering investment (point 3., above) and indirect market entry covering all the rest.

1. **Direct market entry – requires more resources but provides full market access**

- Open an office on the ground in China through establishing a foreign-invested enterprise (FIE) and provide services as you would in other places where you have an office. FIEs are subject to all laws, regulations and taxes as laid forth by the Chinese government.
- For more information on FIEs and options for which type to establish, please see the second report of the EU SME diagnostic kit, *Ways to enter the Chinese market*, and the guideline *Establishment of a foreign-invested enterprise in China*:

www.eusmecentre.org.cn/content/ways-enter-chinese-market

www.eusmecentre.org.cn/content/establishment-foreign-invested-enterprise-china

2. **Indirect market entry – requires fewer resources but provides only limited market access**

- Export your services to China without setting up an office on the ground;
- Once an agreement is reached with a Chinese client, you can send consultants to China on a short-term basis if necessary;
- Works best if you are seeking to build a customer base in China for services that you provide in Europe, for example travel services;
- Does not work well for services that you would like to provide on-the-ground in China, because Chinese business culture values face-to-face meetings and personal interactions;
- One option for providing services without a permanent establishment in China is to offer them online. Basic resources required to sell your services online in China:
  - Chinese website;
  - Chinese language communication abilities, either in-house or contracted;
  - Flexibility to take calls and virtual meetings in China time;
  - Ability to accept international payments via credit card or wire transfer;
  - Ability to send employees to China on a short-term basis.

3.2. Services allowed for investment

Many types of services are approved for provision in China. In the 12th Five-Year Plan (FYP) the Ministry of Commerce (MOFCOM) released a blueprint for the development of the service trade industry. Jointly drafted by MOFCOM and 33 other ministries and organisations, the plan calls for further development of services in 30 sectors, including tourism, transportation, construction, consulting, finance and technology. In 2010, education-related travel services were the largest foreign service export to China, valued at EUR 3.4 billion. The second largest category of service exports to China was other personal travel services, valued at EUR 466 million, followed by business services (such as financial, insurance, professional and technical services) valued at EUR 195 million.

Foreign investment in China is currently governed by the *Catalogue for Guiding Foreign Investment in Industries*. Industry sectors are classified as:

1. Encouraged;
2. Permitted;
3. Restricted;
4. Prohibited.

3.3. Service industries encouraged and permitted for investment

- Permitted services are all remaining services which are not included in the *Investment Catalogue* or other special regulations;
- Services in encouraged and permitted industries are allowed to be provided in China;
- Government approval for investment in the 'encouraged' and 'permitted' categories is usually granted automatically;

- Encouraged industries generally bring new or advanced technology to China, increase product quality and efficiency, or conserve resources and protect the environment;
- Some service activities in the following industries are encouraged and permitted: transportation, manufacturing, education, culture, art, radio, film and television. For a sample list, please see the appendix.

3.4. Service industries restricted for investment

- Investments in restricted industries face stricter scrutiny from the government and require higher levels of approval;
- Industries may be classified as restricted for a variety of reasons, including when China does not stand to gain new technology, if the industry has an adverse effect on the environment, or if the industry is highly regulated by the State Council;
- Although not impossible, services in restricted industries are much more difficult to export to China;
- In order to enter restricted industries, China may require foreign companies to establish a joint venture with a Chinese partner;
- Some service activities in the following industries are restricted: banking and insurance, real estate and high-end property, medical institutions and certain areas of telecommunications. For a more exhaustive list, please see the appendix.

3.5. Service industries prohibited for investment

- Services in prohibited industries are completely off limits to foreign investors;
- These industries are prohibited because the Chinese government has deemed that their import might harm national security, the public, health or the environment, or lead to loss of Chinese intellectual property;
- Prohibited service industries include: postal services, future trading, social research and the publication of books, magazines and newspapers. For a sample list, please see the appendix.

3.6. Relevant taxes and fees for the import of services

According to Chinese tax laws and regulations, all service companies that have obtained income in China or have consumers that are located in China are subject to Chinese taxes, unless exempted expressly by Chinese regulations. These taxes vary depending on your industry, income, place of service and business model.

Direct market entry and establishment of an FIE to provide services

- Subject to all taxes applicable to an FIE:
  - Enterprise income tax: 25% (rate for SMEs under Chinese law is 20%);
  - Individual income tax: 3% to 45%;
  - Business tax: usually 3% or 5%;
  - VAT pilot tax: 3%, 6%, 11%, or 17%
  - Other applicable taxes and fees as regulated by Chinese government ministries, depending on industry and locality.

For more information on taxes and fees in connection with the import of services, please see the EU SME Centre guideline *China enterprise income tax*:

www.eusmecentre.org.cn/content/guideline-china-enterprise-income-tax

Indirect market entry, no office on the ground

- Unless exempted expressly by Chinese laws and regulations, a foreign service provider is subject to business tax (BT), which is generally 3% or 5% for the income derived from provision of services to Chinese service receivers, as well as surtaxes like city construction and maintenance tax, education surcharge and local education surcharge. These additional surcharges total 5.3%, 5.5% or 5.6%, depending on the place of the service provision.
- Please see a specific service industry business tax table below:

Taxable item	Business tax rate
Communications and transportation, construction, post and telecommunications	3%
Finance and insurance, other services, transfer of intangible assets, transfer of immovable property	5%
Entertainment	5% - 20%

Reform of service industry taxation

Since January 1 2012, a pilot reform regarding the collection of VAT in lieu of business tax in the transportation and parts of modern services industries has been implemented progressively in China. Where a foreign service provider provides such services to a Chinese entity or individual, it is subject to VAT for the income derived from the services instead of business tax, as long as certain conditions are met. For detailed information, please refer to the EU SME Centre report *Tax liability for non-resident enterprises engaging in service provision*:

www.eusmecentre.org.cn/content/tax-liability-non-resident-enterprises-engaging-service-provision

Tax treaties

A foreign service provider is subject to enterprise income tax at the rate of 10% of the deemed taxable income, calculated based on the income derived from the service provided. However, the enterprise income tax a foreign service provider is required to pay in China may be mitigated by tax treaties. Tax treaties are signed between countries with the goal of reducing double taxation, eliminating tax evasion and encouraging cross-border trade efficiency. To research your specific tax requirements, please refer to your home country's tax treaty with China (if available).

3.7. Case studies

Case study: APCO

EU and U.S.-based communications consultancy decides to enter the Chinese market:

- As a first step, consulted the Catalogue for Guiding Foreign Investment in Industries to make sure that its services were permitted for import;
- Conducted extensive market research to confirm market demand for communications consulting services;
- Researched channels for entering China and decided to establish a wholly foreign-owned enterprise (WOFE) in Beijing, Shanghai and Guangzhou:
    - Joint-ventures are not required for communications consulting;
    - WOFEs offer much greater brand and business control;
- Submitted all required documents and registered RMB 100,000 as capital, as is required of consulting WOFEs in China;
- Has been operating successfully in China since 1998.

Case study: Export of travel services

Italian-based travel agency decides to enter the Chinese market:

- Conducted market research and found that Chinese demand for travel services to Italy was concentrated among high-income office workers in first tier cities;
- Researched channels for entering China and decided to choose indirect market entry:
    - Established Chinese website hosted outside of China to sell travel services online;
    - Indirect market entry required much less investment and taxes;
- Developed extensive marketing materials targeted at Chinese consumers;
- Used search engine optimisation to ensure website was prominent in key word searches;
- Communicates with potential clients via email and phone;
- Uses PayPal as online payment method;
- Only pays 5% business tax on services provided to China-based consumers.

Case study: Export of educational services

Italy-based college professor teaches for a semester at university in Beijing:

- Participated in short-term exchange programme for foreign professors to teach in China, while still being paid from home university in Italy;
- Arranged through faculty exchange programme between universities;
- Enters China on a business visa (F), which is much easier to obtain than a work visa (Z);
- Professor works in China for five months providing educational services;
- Because the professor was in China for less than six months and no permanent establishment under the bilateral tax treaty between China and Italy was constituted, no additional Chinese taxes are required beyond the standard business tax of 5% and relevant surtaxes.

4. Technology

Many European SMEs are considering entering the Chinese market. If your company's business is based on valuable intellectual property, you may consider exporting your technology to China. There are many reasons to enter the Chinese market: access to growing Chinese demand, establishment of R&D facilities, engagement in cooperative development, access to a skilled work force, access to a large number of suppliers, or the development of long-term partnerships with Chinese businesses. One way to get a foothold in China is to license or transfer ownership of your key technology and designs to Chinese subsidiaries of European firms, joint venture partners, or Chinese manufacturing and service companies. One of the challenges facing European companies using this way to enter China is devising creative solutions to minimise the risk to their IP associated with technology transfers.

What is a technology transfer?

A technology transfer is the process of transferring patent rights (ownership of patent), rights to apply for patents, licences for the exploitation of patents (patent licence), technological know-how, technical secrets, as well as the provision of technical services and technology transfers in other forms.

4.1. Process for transferring your technology to China

Make sure your technology is registered and protected in your home market

Register and protect your technology in China

Find out what category your technology falls into

Decide between licensing and ownership transfer

Find a Chinese partner

Negotiate a technology transfer contract

Different types of technology transfers:

Licensing

- Common practice; includes patents, designs, technical secrets and know-how.

Ownership transfer

- Uncommon practice; generally not recommended due to IP risk.

Technology transfers are not limited to high technology. Many companies manufacture low technology, consumer, or industrial products and designs in China through a manufacturing contract. No matter what level of technology, all companies that transfer technology to China face the same risks of IP infringement.

What is patent licensing?

Based on the exclusive rights conferred by a patent, licensing is a permission granted by the patent owner to another party to use the patented invention on agreed terms and conditions (including, for example, the payment of royalties), while the patent owner continues to retain ownership of the patent. Licensing not only creates an income source for the patent owner, but also establishes a sound legal framework for the transfer of technology.

Different ways to export your technology to China:

1. Licensing the technology to an unrelated Chinese company

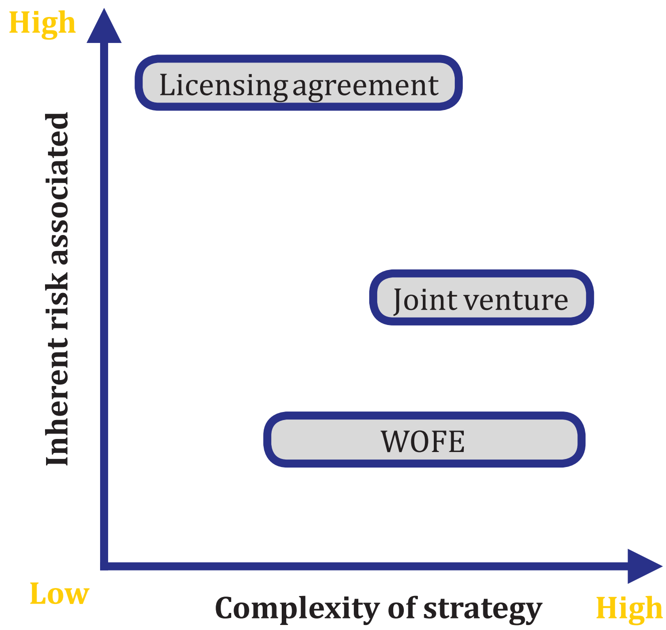
- When licensing to unrelated Chinese companies, you generally have the least control over your IP. However, you can use a "modular strategy", i.e., using different Chinese suppliers to source different components of your product, so that no single Chinese supplier will be able to duplicate your product.
- You can also use a phased implementation of your licensing contract to test out your Chinese partner before transferring additional technology. Both of these strategies are widely used by many European companies.

2. Setting up a joint venture (JV)

- In some industries, Chinese law requires foreign companies to establish a JV in order to transfer technology to a Chinese partner. Please see the Foreign Investment Catalogue published by the National Development and Reform Commission (NDRC, http://en.ndrc.gov.cn) to see if you will be required to do this. In addition to the Investment Catalogue, the requirement to set up JV can result from other legislation and regulations as well.
- Although it will be difficult to use a modular or phased approach with your Chinese JV partner, it is still important to take steps to protect your IP. Many European companies keep critical design and IP components overseas, or held in a separate wholly foreign-owned enterprise (WOFE).
- A Chinese JV partner's local contacts and distribution network is valuable in a sales and distribution role.

3. Setting up a WOFE

- If a WOFE is permitted in your industry, it will give you the greatest amount of control over your IP.
- In WOFEs, IP risk should be managed by preventing leaks by employees and business partners.
- Use of confidentiality agreements and non-compete agreements is important.



4.2. Technology approved for import

In China, the Ministry of Commerce (MOFCOM) regulates the import of technology. Technology imports are divided into three categories:

- Freely importable;
- Restricted;
- Prohibited.

The Ministry of Commerce publishes lists of technologies prohibited and restricted for import and updates them on a regular basis. Technology that is not included in the restricted or prohibited lists is freely importable. Aside from a few sectors deemed harmful to national security or national interests, most technology falls within the freely importable category.

Freely importable technology can be imported directly without prior approval, although the importer should register the technology import-export contract with MOFCOM. Registration can be started online at http://fwmys.mofcom.gov.cn, but will have to be finished on-site at MOFCOM. Since a registration certificate is needed to be able to carry out foreign exchange, banking, customs, tax and other import-related issues, it is highly advised as a practical matter.

4.3. Restricted technology

MOFCOM's import catalogue currently lists around 100 technologies that are restricted for import. The rationale of the Chinese government for restricting the import of these technologies is:

- They are likely to endanger national security;
- They are likely to have a negative effect on public moral and public interests;
- They are likely to cause harm to the health of human beings, animals and plants;
- They are likely to damage the environment.

A listing on the restricted catalogue does not make the technology impossible to import, just more difficult. In order to import from this list of restricted technology, an import licence must first be obtained from MOFCOM. A contract for the import of restricted technology is only legally effective after an import licence is obtained.

Applications for import licences for restricted technology must be submitted to the competent branch of MOFCOM at provincial level. Once the application is submitted, MOFCOM will review the trade and technical aspects of the application. They are required to make a decision within 30 working days on whether or not to approve the application.

Factors considered by MOFCOM when reviewing an application for an import licence:

- Whether the import complies with China's foreign trade policies and external trade obligations;
- Whether the import promotes the development of foreign economic cooperation;
- Whether the import endangers national security or threatens the public interest;
- Whether the import endangers lives and the health of the people;
- Whether the import damages the ecological environment;
- Whether the import complies with state industrial policies and economic development strategies, accelerates technological development and progress, and supports the economic and technology rights and interests of the state.

If MOFCOM approves the application, MOFCOM has ten working days to review the authenticity of the import contract before making a final decision on whether to issue an import licence. The importer is additionally required to complete an online registration of the contract once the import licence is granted.

Updates must be registered with MOFCOM for approval or filing if:

- Substantive modifications to the contract require an application for a new import licence;
- A contract is terminated.

For a sample list of technology restricted for import, please see the appendix.

4.4. Prohibited technology

MOFCOM's import catalogue currently lists around 10 categories of technology that are prohibited from import into China. Examples include technologies relating to non-ferrous metal processing, chemical engineering and petrochemical production. For a sample list of technology prohibited from import into China, please see the appendix.

4.5. Technology transfer contract

In order to import your technology into China, you will need to enter into a technology transfer contract with a Chinese partner. Technology transfer contracts are contracts that involve the import of technology, and include contracts for

- Transfer of patent rights;
- Transfer of the right to apply for patent;
- Transfer of technological know-how;
- Licence for exploitation of patents.

All of them need to be in written form.

Process and content of a technology transfer contract

1. **File for IPR protection:** Make sure you have filed for the appropriate IPR protection of the technology in question (patent, trademark, copyright, etc.) both within China and your home country before entering into technology transfer negotiations. For more information, please contact the China IPR

SME Helpdesk at www.china-iprhelpdesk.eu.

2. **Confirm technology is legally importable into China:** Consult MOFCOM's catalogues of restricted and prohibited technology to see if your technology is freely importable into China. If it falls into the category of restricted technology, make sure you have applied for and received an import licence from the relevant Chinese government bodies.

3. **Select a Chinese partner (if needed):** Conduct due diligence and carry out a comprehensive and thorough check of potential Chinese partners, as well as local industrial policies and laws. It is important to be aware that a top motivation for many Chinese companies in a technology transfer is to obtain foreign technology and know-how. This is a commonly accepted industry fact. Therefore, choosing the right Chinese partner is paramount as a first step to protecting your IP in a technology transfer. The ideal partner will be complementary, but not well-positioned to directly compete with your business. For information on selecting a Chinese partner, please see the the fourth report of the EU SME Centre diagnostic kit, *Knowing your partners in China*.

   www.eusmecentre.org.cn/content/knowing-your-partners-china

4. **Negotiate a technology transfer agreement:** The purpose of a technology transfer contract is to protect your IP. The structure of your technology transfer contract is critical to effectively protecting your IP. It is recommended that companies use IP licences with their Chinese partners; in addition to establishing each party's rights, the IP licence ensures that the technology transferred is documented in case issues arise later on.

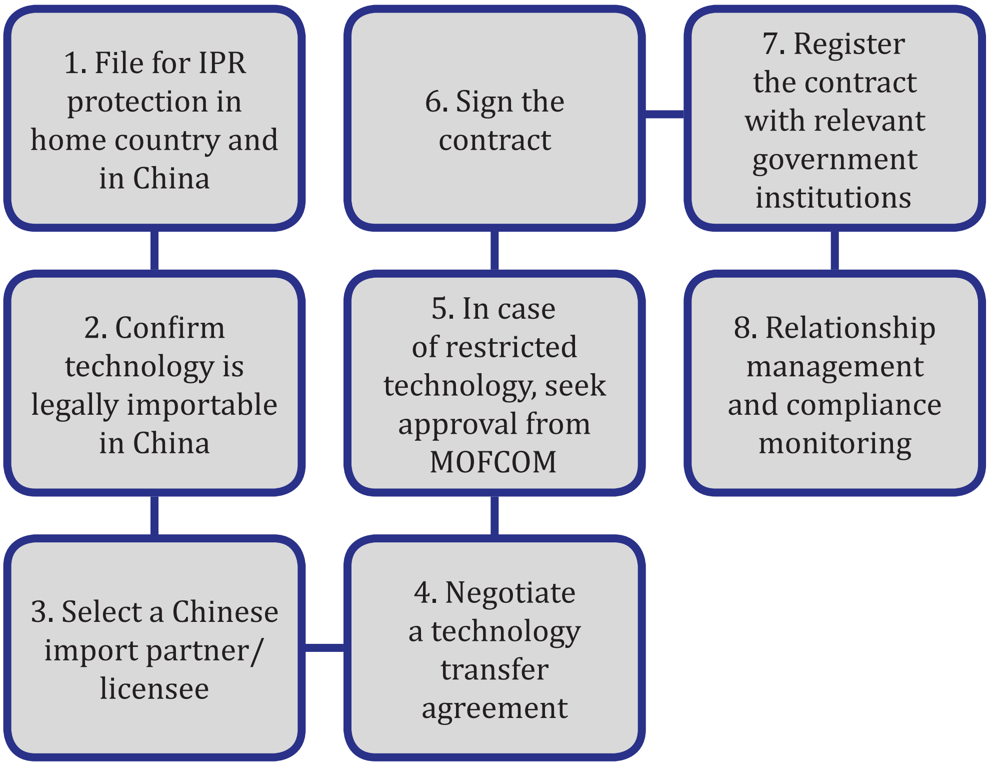
   The contract should clearly define and document the technology in question, establish each party's rights and include specific clauses for improvement and confidentiality. Some important topics that should be covered in a technology transfer contract include:

   - Define technology and rights – clearly define in writing with your partner the specific technology in question, and the rights each party has. Define in detail the recipient of the transfer, who may use the technology, and how.
   - When possible, license technology to Chinese partners instead of transferring ownership rights. Make sure that the sharing of information and technology through documents, drawings and oral communications is clearly recorded and covered by the agreement.
   - Improvements - one of the most negotiated clauses of a technology transfer agreement is the creation of improvements and the ownership of improvements made by the Chinese partner.
     - Unless specified in the contract, commissioned IP belongs to the commissioned party. That means that if your Chinese partner develops improvements on top of your technology, they will, by default, own the IP rights to those improvements, and in practice be able to copy and use your transferred technology freely. In addition, under Chinese law, a Chinese partner is legally allowed to make improvements to transferred technology and use the improvements. For these reasons, it can be very risky to transfer or license your technology to a Chinese partner, and special attention should be paid to the improvement clause in your technology transfer contract to provide legal protection for your IP.
   - Confidentiality – it is very important to include strong confidentiality provisions in the technology transfer contract. Depending on the amount of employees involved in the process of the technology transfer, you may even want to consider having employees sign individual confidentiality agreements.
   - Non-competition agreements – make sure to restrict the jurisdiction of your partner to markets that you are not currently operating in, to avoid unnecessary competition.
   - Reverse engineering – reverse engineering is permitted under Chinese law and not considered a

theft of trade secrets. To maintain the security of your IP, the technology transfer contract should include a provision that prohibits your Chinese partner from engaging in reverse engineering.

- Technical training and personnel – if applicable, specify the conditions under which technical training of employees will occur.
- Limitations – specify that the Chinese party cannot sell the technology to third parties without authorisation. To the extent possible, limit the amount of sub-licences given.
- Price, payment and taxes – specify the value of the contract, how payments will be made and who will be responsible for taxes in each market.
- Delivery terms and packaging - Specify how the technology will be packaged and delivered to your Chinese partner as well as a timeline for delivery.
- Termination – include a clause for the termination of the agreement beforehand and a timeline for the end of the contract. The agreement can always be amended and modified in the future.

5. **In case of restricted technology, seek approval from relevant branch of MOFCOM.**
6. **Sign the contract:** The contract for freely importable technology is only valid if signed by both parties. In case of restricted technology, the contract only becomes effective when the technology import licence is issued.
7. **Register the contract:** The contract must be registered with the competent branch of MOFCOM within 60 days of its signing, or within 60 days after the initial base amount of commission can be claimed in case the payment is made on commission basis, in order to practically perform your contract.
8. **Management and compliance:** Remain in regular communication with your partner to manage the partnership and ensure compliance. Successful agreements are managed by both sides. Good contract management will ensure sound and profitable collaboration.



4.6. Relevant taxes and fees for the transfer of technology

There are certain taxes and fees owed by both parties that enter into a technology transfer agreement.

Chinese party – for any transfer or licence of IP, the Chinese party must register its tax obligation with the relevant Chinese tax bureau within 30 days of signing the contract. They must present the signed contract, in addition to all other required documentation, to the tax authorities. Only after registration can the Chinese party pay taxes on behalf of the foreign party. If the contract is a licence, the Chinese party must file for taxes on behalf of the foreign party before each payment. Tax registration is essential if a contract includes payment of more than USD 30,000 (around EUR 23,000), as it is impossible for a foreign party to receive such payments without a tax certificate.

Foreign party – under Chinese tax law, if the foreign party does not have an establishment in China, technology transfers are usually taxed at a rate of 20% on the gross sales price. In some cases, with the right approvals, income may be taxed at 10% or less, or even be fully exempt.

Below is a case study illustrating the successful export of technology from a foreign party to China.

Case study: Export of technology

A European manufacturer of indoor air filters decides to enter the growing market of environmental consumer appliances in China. The air filters use proprietary purification mechanisms which are protected by patents in Europe. Previous to entering the Chinese market, the European manufacturer registered the same patent in China. Looking to reduce manufacturing costs while protecting its IP at the same time, the European manufacturer decides to use a modular strategy involving the use of different Chinese suppliers to source different components of the air purifier so that no single supplier can reproduce the final product. One supplier will manufacture the purifier shell and another supplier will manufacture the replaceable filter. However, the proprietary technology that differentiates this air purifier will be manufactured and shipped from Europe. Final assembly takes place at the European manufacturer's wholly foreign-owned enterprise (WOFE) in China. All employees are required to sign confidentiality agreements, an inventor assignment and a reward agreement, which provides that all inventions created by the employee are owned by the European manufacturer. The product development manager is required to sign a non-compete agreement. The WOFE provides periodic trainings to employees on IP protection.

5. Import contracts

Once you have selected a Chinese partner who will import your goods to China, it is necessary to negotiate an import contract. While the specific content of the contract will depend on the goods to be exported, it is important to have a clear and binding contract in place whenever exporting goods to China. The importer does not necessarily need to be a buyer.

5.1. Fundamentals of a sales and purchase contract

A sales and purchase contract is the most basic and most common form of an import contract. If you are looking to export your products to a Chinese importer, you will need to negotiate and agree upon a sales and purchase contract. A foreign company that carefully negotiates a sales and purchase contract along with fair or favourable dispute resolution mechanisms will greatly reduce the risks of exporting to China.

Important components of a sales and purchase contract:

- Selection of legal jurisdiction – according to China's contract law, when a foreign party enters into a sales and purchase contract with a Chinese party, they have the choice to decide whether Chinese law or foreign law will govern the contract. Although European companies would usually prefer the laws of their home country, the Chinese party is usually reluctant to agree.
- Clear definition of buyer and seller – clearly define which parties are bound by the contract.
- Contract product – give a detailed description of the product to be exported, so there is no confusion about the product in question.

- Quantity – the quantity, as well as the unit of measurement of the goods to be exported, should be specified.
- Quality enforcement – many disputes in sales and purchase contracts arise as a result of product quality issues. To manage these issues, a well-developed and agreed upon system for product inspection should be put into place. For product inspections, the standards and specifications of the product can be included in the sales and purchase contract. Quality maintenance systems can include the following:
    - A sample of the product to be inspected with the contract;
    - Pre-shipment of the product for inspection;
    - Inspection at the port by the Chinese importer;
    - Inspection at the final destination by the Chinese importer;
    - In case of dispute, a final binding inspection by a neutral third party designated by both parties in advance.
- Price and payment method – define the price for the goods and whether the Chinese party will pay in RMB, Euros, or another currency. Keep in mind the appreciation trend of the RMB against the Euro when calculating payment. A payment process and timeline should also be included in the contract. In addition, it is also wise to include a list of who will be responsible for what costs associated with the contract and transfer of the goods (port charges, tariffs, import-export fees, taxes, storage, etc.).
    - Letters of credit as a form of payment:
        - Letters of credit are often used by European businesses exporting to China. Only letters of credit from well-established Chinese banks should be accepted.
        - With letters of credit, it is possible to receive advance payments for sales and purchase contracts even before the product is delivered. The usual amount of an advance payment is 10% to 20% of the total value of the contract.

What is a letter of credit?

A letter of credit is a promise to pay that is issued from the Chinese buyer's bank to the European exporter. The letter guarantees that as long as the European exporter provides its goods to the Chinese buyer as agreed upon, it will be paid. Even if the Chinese buyer ultimately fails to pay the European exporter, its Chinese bank will still pay the full amount. Letters of credit are commonly used in large international transactions to lower the risk of the seller.

- Confidentiality - if you are exporting products that contain intellectual property - such as copyrights or a trademarks – you should include a confidentiality clause in the sales and purchase contract to protect the IP of your products. Nonetheless, registration of all IPR is highly recommended.
- Delivery – provide a specific delivery schedule, delivery port and destination for the shipment in the contract. Will partial shipments be allowed?
- Time of effectiveness – indicate when the contract will become effective and when it will be terminated.
- Insurance – who will be responsible for the insurance of the goods during transport? After shipping and delivery?
- Liability for breach of contract – include a clear liability clause for the breach of the contract, including what actions will be taken if a contract is breached and how dispute settlement will be reached.

- Dispute settlement – if a dispute arises, there are generally two ways to solve it, either through litigation or arbitration. Under the Arbitration Law of the People's Republic of China, the parties in conflict must agree on one method to solve a dispute, either litigation or arbitration, they cannot chose both. If no agreement on arbitration is made, litigation will automatically be resorted to.
  - Litigation
    - Typically lengthy and expensive. A lawsuit involving an international sale and purchase contract can take more than a year to resolve.
    - Trade secrets and IP may be leaked due to the public nature of some law suits.
    - According to Chinese law, litigation brought against a Chinese legal entity usually has to be resolved where the defendant is registered.
  - Arbitration
    - The contract parties are free to choose the arbitration institution. It is possible to select an international arbitral body to ensure neutrality.
    - Simpler procedure leads to a faster decision.
    - Arbitration is the predominant dispute resolution mechanism for sales and purchase contracts in China.
    - Arbitration can take place in a third country that is neither China nor your home country.
    - The decision of arbitration is binding and legally enforceable in China, even if it is made outside the country, as long as the place where arbitration took place is a member country of the Convention on the Recognition and Enforcement of Foreign Arbitration Awards, i.e., the New York Convention.

6. Foreign exchange controls and limitations

Foreign exchange is the buying and selling of currencies and is inherent in international transactions. In import contracts with your Chinese partner, you will have to specify what currency you would like to receive payment in. Typically, European companies would prefer to receive payment in Euro for products and services. However, Chinese importers will prefer to pay in RMB. Foreign exchange risk enters into the question anytime one currency is converted into another.

Ways to control foreign exchange risk:

- Ask for all transactions in Euro or the currency of your home country;
- Develop a strategy to manage foreign exchange risk.

Sometimes Chinese partners are reluctant to pay for transactions in your home currency because the process for acquiring foreign exchange in China is typically cumbersome and highly restrictive. As regulated by the State Administration of Foreign Exchange (SAFE), foreign exchange can only be purchased from certain banks for certain amounts. There are also multiple regulations on the use and holding of foreign currency.

7. Distribution channels

There are several distribution channels in China available to foreign exporters. Each channel varies in complexity and risk, and is suited for the distribution of different types and volumes of products. Specific product, sector, and industry regulations and distribution goals should be considered when selecting a distribution channel for China.

Available distribution channels

7.1. Online platforms

Selling in China using online platforms has grown rapidly in the last ten years. Spurred by the advent of third-party platforms like Taobao and user-friendly online payment systems, Chinese consumers have become more at ease with purchasing products online. E-commerce is a readily available distribution channel to access the Chinese market. Distribution through online platforms allows for the promotion of goods to a vast market, spread across a large geographic area, for relatively little cost.

There are four different methods for a foreign business to distribute its products online to Chinese consumers:

- Standalone website outside of China;
- Standalone website in China;
- Third-party platform outside of China;
- Third-party platform inside China.

For more information on online selling, please see the EU SME Centre report *Selling online in China*:

www.eusmecentre.org.cn/content/selling-online-china

7.2. Local partners

A popular way to sell products in China is through using a local partner, such as a distributor or an agent.

- An agent is a company's direct representative on the ground, and is paid a commission.

- A distributor buys your products and then sells them to customers through a third party. Their income comes from the difference between the buying and selling price.

For small and medium-sized enterprises, using a well-known agent or distributor is one of the easiest ways to sell their products in China. Local Chinese agents possess the knowledge, contacts and distribution networks to promote your products and can help overcome language and cultural barriers.

In addition, sales and distribution agents can assist with tracking policy and regulatory updates, collect market data, and respond to new developments in an efficient manner.

However, finding a dedicated, reliable, professional and credible agent or distributor can be a challenge. An agent could be a manufacturer who is in a similar field or an import-export company that has well established connections and an extensive network of suppliers.

Criteria for a good agent or distributor:

- Knowledge of your product/service and its market;
- Good references and previous experience;
- Language skills including English, Mandarin, Cantonese and relevant local dialects;
- Strong network and geographical coverage;
- Support team, staff, sub-agents;
- Soft skills and sales experience;
- Ability to work with incentives (i.e., commission-based and subject to customer's payment first);
- Strong work ethic, such as the ability to prepare and submit reports and marketing plans, conduct training, work with limited marketing budgets, translate documents, travel, respect the professional image of the company, and be transparent about any potential conflict of interest.

For more information on local partners, please see report 2 of the EU SME Centre diagnostic kit, *Ways to enter the Chinese market*:

www.eusmecentre.org.cn/content/ways-enter-chinese-market

7.3. Franchising

Franchising is a method of distributing products or services. At least two levels of people are involved in a franchise system: (1) the franchisor, who lends his trademark or trade name and a business system; and (2) the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. The McDonald's business model is an example of franchising.

When considering franchising in China, you should be aware of China's legal framework for commercial franchises. In February 2007, China's State Council published the revised Regulation on Administration of Commercial Franchise. These regulations apply to both domestic and foreign franchisors who engage in commercial franchising in China.

Franchise requirements

Below a list of the most important requirements for franchise businesses:

- Only enterprises may engage in franchising as franchisors;
- A franchisor must own a developed business that can provide long-term commitment, technology support, business training and other services;
- A franchisor must have former experience in terms of ownership and operation of at least two outlets for at least one year before he/she can establish his/her own franchise in China;

- In order to act as franchisee, a foreign company must first establish a foreign-invested enterprise in China.

For more information on franchising, please see report 2 of the EU SME Centre diagnostic kit, *Ways to enter the Chinese market*:

www.eusmecentre.org.cn/content/ways-enter-chinese-market

7.4. Foreign-invested enterprises and representative offices

The establishment of a foreign-invested enterprise gives foreign companies more control over the distribution of their product and the management of their brand. Depending on the product and industry, the process of setting up a foreign-invested enterprise can be relatively simple, or extremely complicated and time-consuming. It is important to first research Chinese regulations in your industry to learn what laws and regulations govern foreign-invested enterprises.

Types of foreign-invested enterprises:

- Wholly foreign-owned enterprise (WFOE, commonly known as WOFE);
- Equity joint venture (EJV);
- Cooperative joint venture (CJV);
- Foreign-invested partnership (FIP);
- Representative office (RO).

For more information on these types of foreign-invested enterprises, please also see the second report of the EU SME Centre diagnostic kit, *Ways to enter the Chinese market*, as well as the guideline *Establishment of a foreign-invested enterprise in China*:

www.eusmecentre.org.cn/content/ways-enter-chinese-market

www.eusmecentre.org.cn/content/establishment-foreign-invested-enterprise-china

Wholly foreign-owned enterprises (WOFE)

- An independent limited liability corporation registered with foreign capital under the laws of China;
- The most common form of foreign-invested enterprise in China today;
- Allows a foreign company to establish an office and own stock without a Chinese partner;
- Offers complete control over the business;
- Establishment process can be difficult and time-consuming;
- Appropriate structure for companies whose main activities in China are to manufacture and sell products, or provide services such as research and development or business consultancy.

Equity joint ventures (EJV)

- A limited liability corporation established between a foreign company (or companies) and a Chinese company;
- Jointly held operations, ownership, risk and reward;
- Foreign investor must generally hold at least 25% of the registered capital (exceptions exist);
- Profit is distributed in the form of dividend to the parties in accordance with equity contributions;
- Preferred form of foreign-invested enterprise by Chinese government and business.

Cooperative joint ventures (CJV)

- Established through the partnership between a Chinese organisation and a foreign enterprise, organisation or individual;
- Can be an incorporated arrangement with a limited liability corporation or a contractual cooperation agreement;
- Ownership of profit and losses is usually not shared based on equity contributions, but based on the contractual agreement;
- Provides more flexibility regarding profit sharing and risk management.

Representative offices (RO)

- Not a legal entity, but rather a liaison office for a foreign company in China;
- Prohibited to engage in profit making activities on behalf of its foreign headquarters;
- Not a viable choice for product distribution in China.

For more information on the establishment of a representative office, please also see the EU SME Centre report *Establishment and operation of a representative office in China*:

www.eusmecentre.org.cn/content/establishment-and-operation-representative-office-china

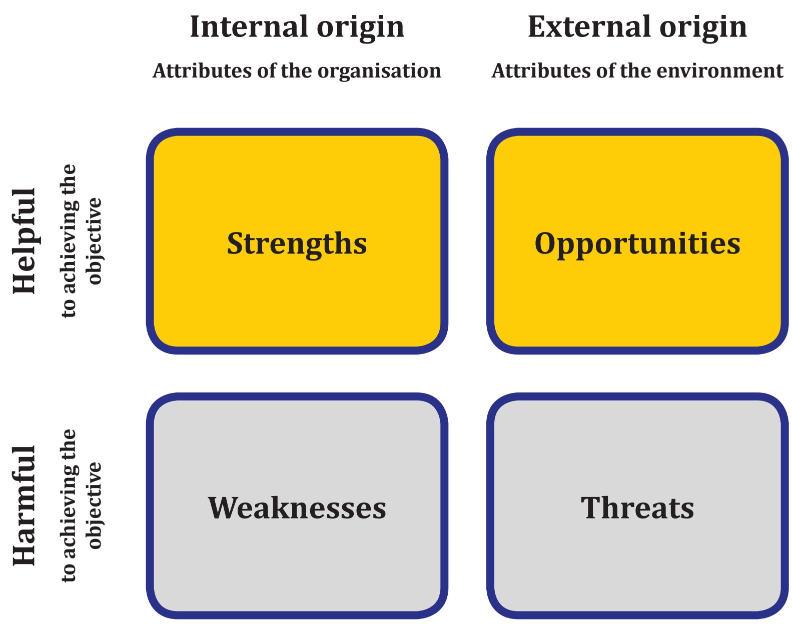
8. Recommendations on how to enter the Chinese market

Before you enter the Chinese market, it is recommended that you develop a comprehensive strategy that addresses:

- What you stand to gain by entering the Chinese market;
- What China stands to gain through your entry;
- What risks you are likely to face; and
- How to manage potential risks.

Below, we include several questions in the form of a SWOT analysis to help you determine the strengths, weaknesses, opportunities and threats you may face. The following questions may be helpful in determining what strategy to employ, what potential opportunities exist, and what risks are likely to be faced. By honestly and comprehensively discussing these and other topics, it is possible to create a more refined strategy that will lead to a higher probability of success.

SWOT analysis



Strengths and weaknesses

- What is your current level of brand recognition in your home market? In China?
- How capable is your organisation of adapting structure and/or current practices to fit the China business environment?
- Is your current staff able to manage a transition into China (workload capacity, cultural/language challenges)?
- What is your current competitive advantage (cost, quality, market permeation, customer service, etc.) and is this transferrable to China?
- Does your current customer base have a presence in China, and if so, can these relationships be leveraged to aid in gaining traction?
- What other strengths and weaknesses exist in your organisation that need to be addressed while developing a China entry strategy?

Opportunities

- What level of demand for your product currently exists in China?
- Does your market offering coincide with current political agendas in either your home market or China?
- Is there potential for technological advancements to strengthen your position?
- What does your current target consumer group look like? In what ways is it likely to change?
- What is your prime motivation for entering the China market?

Threats

- How will fluctuations in the local and global economy affect your market position in China?
- Do you have a strategy to protect your IP (patents, trademarks, copyrights and trade secrets)?
- What challenges have your competitors faced, and how have they managed them?
- Do you have a strategy to manage foreign exchange risk?
- What assumptions are you making regarding your motivations for entering China, and how can you confirm/disprove them?

9. Appendices

9.1. Key policy and legislation update

- 2004 – New Foreign Trade Law issued by the Chinese Ministry of Commerce (MOFCOM);
- 2007 – MOFCOM's revised Catalogue of Technologies Prohibited and Restricted from Import;
- Measures for the Administration of Prohibited and Restricted Import of Technologies

  http://english.mofcom.gov.cn/aarticle/policyrelease/announcement/200903/20090306128144.html
- Foreign Exchange Control Regulations of the People's Republic of China;
- 2011 - Catalogue for the Guidance of Foreign Investment Industries;
- 2007 - Regulation on Administration of Commercial Franchise from the State Council;
- The 12th Five-Year Plan;
- Enterprise Income Law of the People's Republic of China;
- The Catalogue of Import-Export Commodities Subject to Compulsory Inspection and Quarantine.

9.2. Goods subject to automatic import licence

Goods subject to automatic import licence (for reference only)		
Poultry	Crude oil	Vegetable oil
Processed oil	Waster paper	Alumina
Tobacco	Chemical fertilizer	Cellulose diacetate filament tow
Copper ore and concentrates	Copper	Coal
Aluminium	Mechanic and electrical products	Iron ore
Steel		

MOFCOM's catalogues for goods subject to automatic import licence can be found online (in Chinese):

- Announcement [2012] No. 94 of the Ministry of Commerce and the General Administration of Custums - List of Goods Subject to Automatic Import Licensing Management in 2013, issued on the date of 10 December, 2012

  www.mofcom.gov.cn/article/b/c/201212/20121208496384.shtml

9.3. Goods subject to import licence

Goods subject to import licence (for reference only)		
Specific used chemical and electrical products	Ozone-depleting substances	

MOFCOM's catalogues for goods subject to import licence can be found online (in Chinese):

- Announcement [2012] No. 98 of the Ministry of Commerce and the General Administration of Customs and the General Administration of Quality Supervision, Inspection and Quarantine – List of Goods Subject to Import License Management in 2013, issued on the date of 27 December, 2012

  www.mofcom.gov.cn/article/b/c/201212/20121208502201.shtml

9.4. Goods subject to import quota

Managing government body	Goods under import quota (for reference only)
NDRC	Natural rubber

There is currently only one product subject to import quota. Details can be found online (in Chinese):

- Announcement [2002] No. 5 of the National Development and Reform Commission – Detail Rules for the Import Quota Allocation for Natural Rubber in 2003, issued on the date of 30 September, 2002

  www.sdpc.gov.cn/zcfb/zcfbgg/gg2003/t20050614_7471.htm

9.5. Goods subject to tariff-rate quota management

Goods under tariff-rate quota management (for reference only)		
Grain	Chemical fertilizer	Vegetable oil
Cotton	Sugar	

MOFCOM's catalogues for goods subject to tariff-rate quota management can be found online (in Chinese):

- Announcement [2012] No. 60 of the Ministry of Commerce and the General Administration of Customs – Announcement on the Implementing Rules on Import Tariff Quota of Wool and Wool Top in 2013, issued on the date of 25 September, 2012

  www.mofcom.gov.cn/article/b/e/201209/20120908362131.shtml

- Announcement [2012] No. 59 of the Ministry of Commerce – Announcement on Detailed Rules for the Application and allocation of Import Tariff Quotas of Sugar in 2013, issued on the date of 25 September, 2012

  www.mofcom.gov.cn/article/b/e/201209/20120908362118.shtml

- Announcement No. 61 [2012] of the Ministry of Commerce - Announcement on Total Import Tariff Quota of Chemical Fertilizer, Quota Allocation Principles and relevant Procedures in 2013, issued on the date of 10 October, 2012

  www.mofcom.gov.cn/article/b/e/201210/20121008376628.shtml

- Announcement [2012] No. 25 of the National Development and Reform Commission and the Ministry of Commerce - Announcement on the Re-allocation of Tariff-rate Quotas for Import of Agricultural Products in 2012, issued on the date of 14 August, 2012

  www.mofcom.gov.cn/article/b/e/201208/20120808295312.shtml

- Announcement [2012] No.35 of the National Development and Reform Commission - Quantity of Tariff Quotas for Import of General Grains and Cotton, Application Conditions and Allocation Principles, issued on the date of 26 September, 2012

  www.sdpc.gov.cn/zcfb/zcfbgg/2012gg/t20121008_508641.htm

- Announcement [2005] No. 93 of the Ministry of Commerce - Abolishment Import Tariff Quota and Import State Trading Management of Soya Bean Oil and Palm Oil and Rapeseed Oil for applying Automatic Licensing Management, issued on the date of 7 December, 2005

  www.mofcom.gov.cn/article/b/e/200512/20051201000816.shtml

9.6. Goods prohibited from import

Prohibited imports (for reference only)		
Arms	Lethal poisons	Old/used garments
Ammunition	Illicit Drugs	Explosives
Disease-carrying animals and plants	Food items containing certain food coloring and additives deemed harmful to human health	Printed matter, magnetic media, films or photographs which are deemed detrimental to the political, economic, cultural and moral interests of China
Foods, medicine and other articles coming from disease-stricken areas		

MOFCOM's catalogues for prohibited imports can be found online (in Chinese):

- Announcement [2001] No. 37 of the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China and the General Administration of Customs of the People's Republic of China and the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China - List of Prohibited Import Goods, the second batch, effective on the date of 1 January, 2002

  www.mofcom.gov.cn/article/b/c/200404/20040400210013.shtml

- Announcement [2001] No. 36 of the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China and the General Administration of Customs of the People's Republic of China and the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China - List of Prohibited Import Goods, the third batch, effective on the date of 1 January, 2002

  www.mofcom.gov.cn/article/b/c/200404/20040400209990.shtml

- Announcement [2002] No. 25 of the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China and the General Administration of Customs of the People's Republic of China and the General Administration of Quality Supervision, Inspection and Quarantine of the People's Republic of China - List of Prohibited Import Goods, the fourth and fifth batches, effective on the date of 15 August, 2002

  www.mofcom.gov.cn/article/b/c/200404/20040400205769.shtml

- Announcement [2005] No. 116 of the Ministry of Commerce and the General Administration of Customs and the State Environmental Protection of the People's Republic of China - List of Prohibited Import Goods (the six batch) and List of Prohibited Export Goods (the third batch), effective on the date of 1 January, 2006

  www.mofcom.gov.cn/article/b/c/200602/20060201575919.shtml

9.7. CCC mandatory products

CCC mandatory products (for reference only)		
Electrical wires and cables	Information technology equipment	Fire fighting equipment
Circuit switches and electric devices for protection or connection	Lighting equipment	Safety and home protection products
Low-voltage electrical equipment	Telecommunications equipment	Home décor and remodeling products
Low power motors	Motor vehicles	Safety parts and accessories of vehicles and motorcycles

Electric tools	Safety glass	Toy products
Welding machines	Agricultural machinery	IT products
Household and small electrical appliances	Latex products	
Audio and video equipment	Medical devices	

CNCA's full catalogue for CCC mandatory products can be found here:

www.cnca.gov.cn/cnca/rdht/qzxcprz/rzml/images/20080701/4755.htm

9.8. Service industries encouraged and permitted for investment

Services industries encouraged and permitted for import (for reference only)		
Water conservation technology	Transportation	Scientific research
Certain agriculture, forestry, and animal husbandry	Warehousing	Education, culture, art, radio, film, and television industries
Mining	Real estate for ordinary housing	Foreign funded projects that directly export all of their products
Manufacturing	Sanitation, fitness, and social welfare industries	

Please note that only some activities in these industries are encouraged and permitted.

For more details, please see the *Catalogue for Guiding Foreign Investment in Industries*.

9.9. Service industries restricted for investment

Service industries restricted for import (for reference only)		
Certain agricultural, forestry, animal husbandry and fisheries	Electricity, gas, and water production	Mining of precious metal and certain ores
Wholesale and retail of certain products	Production and distribution of radio and TV programming	Certain manufacturing (tobacco, certain textiles)
Banking and insurance industries	Land surveying	Electricity (adoption of low capacity generator)
Real estate in high end property	Asset certification and appraisal	Certain telecommunications
Public utilities	Other industries restricted by the Chinese government	Certain wholesale and retail trade

Please note that only some activities in these industries are restricted.

For more details, please see the *Catalogue for Guiding Foreign Investment in Industries*.

9.10. Service industries prohibited from investment

Services Industries prohibited for import (for reference only)		
Breeding and growing of precious, high quality breeds of animals	Construction and operation of power grids	Social research
Development of certain types of plant seeds	Air traffic control	Publication of books, magazines, and newspaper
Mining of radioactive materials	Postal Services	

Arms and ammunition manufacturing	Futures trading

Please note that not all activities in these industries are prohibited.

9.11. Technology restricted for import

Industry	Specific technology (for reference only)
Agriculture	Compound microorganism
	Genetically modified organisms application technology
Food manufacturing	Genetic engineering microorganism technology used for fermentation
	Co-production of salt and glauber salt
Textile	Shuttle loom production
	Printing and dyeing technology
Processing of petroleum, coking, processing of nuclear fuel	Sodium cyanide
Manufacture of raw chemical materials and chemical products	Ammonia synthesis catalyst produced in low temperature and low pressure
	Phthisic anhydride production technology
	Ammonium phosphate technology
Manufacture of raw chemical materials and chemical products (cont.)	Diammonium phosphate production technology
	Sulfuric acid production technology
	NPK production technology
	Pigment production technology
	Toluene disproportionation technology
	Packaged process of aromatic extraction
	Packaged process of butadiene extraction in DMF method
	Packaged process of acrylonitrile
	Packaged process of polyester
	Dicarboxylic acids technology
Manufacture of non-metallic mineral products	Continuous drying/ sintering by ceramic roller kiln
	Fully automatic compressing technology for ceramic tile

Smelting and pressing of ferrous metals	Hematite beneficiation Plain steel and general slab continuous casting machine Infrared carbon and sulfur analysis and atomic absorption analysis Plain steel continuous square billet caster Wet-ESP Hot strip mills and steel coil-temper mill Hot slab heating furnace Hot rolled strip slitting line Hot rolled thin gauge strip shearing line Small-sized bar and wire rod production line Flying shear control system of bar-wire mill in start stop mode Basic automation control system of bar-wire mill Cold-drawn pipe Welded pipe units Continuous hot-dip galvanization Heating furnace vaporization cooling Middle and low grade non-oriented electrical steel Middle and low grade cold rolled non-oriented silicon steel
Smelting and pressing of non-ferrous metals	Pre-oxidation of raw ore and concentrate Diasporic bauxite alumina production Electrolysis process for 350kA prebaked aluminum reduction cell Extrusion machine and technology (<1600 ton) Design and manufacturing technology for 350kA prebaked aluminum reduction cell
Manufacture of general purpose machinery	Oil-burning boiler manufacturing Design and manufacturing technology for general butterfly valves (with caliber less than 1040mm) Design and manufacturing technology for general high and middle pressure cast steel valve Design, manufacturing and application technology for conventional centrifuge

Manufacture of special purpose machinery	Packaged technology for EAF automatic control system Fixed-length and rolling cut technology Double-side trimmer (three-eccentricity) technology Small and medium tractor manufacturing technology Seed processing machine technology Feed extruder unit equipment technology Rapid economic die based on RPM& NC technology Design and manufacturing technology for cold punching die Design and manufacturing technology for plastic molding
Manufacture of transport equipment	Automobile engine manufacturing technology
Manufacture of electrical machinery and equipment	Design and manufacturing technology for GIS&GCB Porcelain insulator in wet molding process Small and middle power diesel generators technology and its products Generator manufacturing technology Manufacturing technology for high energy consumption household appliance Battery production equipment and technology F type heavy-duty gas turbine technology Subcritical pressure boiler and its auxiliary equipment (≤ 600MW) CFB technology (<300MW) Transformer and reactor technology System design and investigation technology for converter station
Manufacture of measuring instruments and machinery for cultural activity and office work	Civil used kilowatt meter, water meter and gas meter manufacturing technology One-component gas element analyzer technology Digital and conventional photofinishing equipment manufacturing technology Stenograph (mimeograph) manufacturing technology Paper shearer manufacturing technology Packaged technology for VD automatic control system
Production and distribution of electric power and heat power	Supercritical pressure fossil fired unit technology Design and manufacturing technology for subcritical pressure fossil fired unit Typical wet mode limestone/gypsum wet FGD system technology
Banking industry	Counterfeit deterrent technology specially used for printing RMB

Environment management industry	General electrostatic precipitator and supply power manufacturing technology Power plant limestone-gypsum method and CFB-FGD technology General wastewater treatment technology Municipal solid waste treatment technology (composting method) Large load damping spring isolation technology

9.13. Technology prohibited from import

Prohibited technology (for reference only)		
Production technology for ethoxyabietic amine	Production technology for magnesia-carbon brick	Rear earth metallurgy technology
Production technology for span	Refractory material technology	Lead smelting technology
Production technology for rosin amine	Coking technology	Imperial smelting furnace for smelting copper
Lead printing process technology	Second-hand equipment and supplementary equipment for iron making, steelmaking and steel rolling	Acid making by fume dry scrubbing technology and hot concentrated acid washing technology
Visbreaking technology	Hot-dip galvanizing technology	Gold ore dressing, refining technology
Production technology for pesticide	Bell-type annealing furnace with HPH technology	Single rare earth separation and preparation technology
Production technology for sodium carbonate	Drive control system of mercury converter	Pre-treatment of rare earth concentrate
Aniline technology	Steelmaking technology by cupola furnace	Automotive engine technology
Production technology for sodium cyanide	Hot sintering mineral technology	Lead contained insulating coating technology
Production technology for chromium salt	Production technology for copper oxide mast	Halogenous copper clad panel technology
Formula for petrochemical industrial water treatment chemicals	General CIP process	Automotive freon air conditioning system technology and asbestos friction material production technology
Production technology for phthalic anhydride	Continuous production line of cyanide brass plating	Battery production technology
Drugs packaging technology for scalding wax cork	Production technology for electrolytic aluminium	Freon refrigeration technology

Catalogues for restricted and prohibited imports can be found online (in Chinese):

- List of Technology Subject to Prohibited Import and Restricted Import (Revised, effective since the date of 22 November, 2007

  www.mofcom.gov.cn/article/swfg/swfgbf/200711/20071105200235.shtml

- Announcement [2012] No. 96 of the Ministry of Commerce and the General Administration of Customs- Catalogue of Dual-Use Items and Technologies Subject to Import and Export Licence

Management, effective since the date of 1 January, 2013

www.mofcom.gov.cn/article/b/e/201212/20121208507720.shtml

9.14. Sample questions from the online quiz *Gauging your readiness*

The online quiz *Gauging your readiness,* which accompanies the four reports of the EU SME Centre's diagnostic kit, will help you gauge your knowledge of the Chinese business environment. Here are some sample questions:

- Do you have any evidence that there is a growing demand of your product in China?
- How much do you know about your competitors in China?
- Do you know in which cities you should be selling your product?
- Do you know which distribution channels to use?
- Do you know your customers?
- Have you confirmed that your product can be sold in China?
- Do you know how to find the legal/technical requirements for your product?
- Have you already decided what would be the best way to access the Chinese market?
- How much are you ready to invest upfront?
- Do you understand the possible legal structures in China?
- What do you know about the availability of your required human resources in China?
- Have you found a Chinese partner to distribute your products?
- Do you know how to perform preliminary due diligence in China?
- What are your expectations in terms of time to achieve your goals?
- Do you have previous experience in accessing other markets?
- What is your strategy to protect your intellectual property in China?

To find out more about the online quiz *Gauging your readiness*, please go to

www.eusmecentre.org.cn/quiz

The EU SME Centre assists European SMEs to export to and/or invest in China by providing a comprehensive range of free, hands-on support services including the provision of information, confidential advice, networking events and training. The Centre also acts as a platform facilitating coordination amongst Member State and European public and private sector service providers to SMEs.

The Centre's range of free services cover:

- Business development – provision of market information, business and marketing advice
- Legal – legal information, initial consultations and practical manuals
- Standards – standards and conformity requirements when exporting to China
- HR and training – industry and horizontal training programmes
- Access to a service providers directory and information databases
- Hot-desking – free, temporary office space in the EU SME Centre to explore local business opportunities
- Any other practical support services to EU SMEs wishing to export to or invest in China.

To find out more about our services visit the EU SME Centre website at

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enquiries@eusmecentre.org.cn

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