To help European SMEs make informed decisions when entering the Chinese market, the EU SME Centre has published a series of diagnostic business tools entitled *Are you ready for China?* The four reports introduce different aspects of market entry. These tools are accompanied by an online quiz tailored to help companies check their level of market readiness and point them towards further resources to improve their understanding of lesser-known business areas. The series is designed as a step-by-step introduction to the Chinese business environment, allowing SMEs to gauge their preparedness to do business in China.

*Ways to enter the Chinese market* is second in a series of four reports aimed at helping EU SMEs understand and ultimately enter the China market. It provides an overview of different modes of entering the Chinese market – from exporting to investing, from joint ventures to wholly foreign-owned enterprises. It 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, the report covers all basic areas in which due diligence is concerned.

To find out more, please visit [www.eusmecentre.org.cn/diagnostic](http://www.eusmecentre.org.cn/diagnostic)
1. Preliminary Remarks

China is one of the world’s fastest growing economies, and it continues to attract companies of all types to its markets. The most challenging decisions for companies is how best to enter the China market.

When deciding to do business in China, European SMEs should first conduct market research on the business fields in which the EU SME is interested and are necessary (see Report 1 – Is China on your radar? in this Starter Kit). Second, before take the initiative to enter the market, European SMEs should pay attention to several important elements, including compliance with laws and regulations, the necessity of obtaining protection for intellectual property rights, difficulties resulting from foreign exchange control, the administrative and geographical structure in China and, most importantly, careful selection of business partners (see Report 4 – Knowing your business partner in this Starter Kit).

1.1 Compliance

A lack of a culture of compliance has deep roots in China's long political and legal tradition. In ancient times, people gave more power to the ruling person than to the ruling regulation. Therefore, compliance meant little in such a society. However, once China decided to implement the “opening up policy” in the late 1970s, it began building a modern legal system. It steadily increased government transparency and exercised control over local authorities to ensure that laws and regulations were properly applied. Recent governmental policies and actions against corruption, new anti-monopoly laws and so on, show that the Chinese government has tools to combat unethical business practices and is willing to do so.

Consequently, before doing business in China, it is important to become aware of the laws and regulations that must be followed and any administrative formalities to be completed. This will avoid risky behaviour, such as non-standard business practices; noncompliance could negatively impact your current business activities and future prospects.

1.2 Protection of your Intellectual Property Rights

A prerequisite before entering the market in China is obtaining proper intellectual property right (IPR) protection for your products in China. Without patent, trademark or copyright registration and protection in China, it will not be possible to file complaints with relevant authorities, which could help investigators find the person liable for encroaching on your rights. It will not be possible for plaintiffs to claim damages in court due to the territory characteristics of IPR protection. Registration of your IPR in other jurisdictions does not provide any protection in China. You must register in China unless you already registered through an international procedure.

For further guidance on IPR related issues, the China IPR SME Helpdesk can provide you with free of charge, confidential, business-focused IPR advice. Reach their experts at: http://www.china-iprhelpdesk.eu/

1.3 Foreign Exchange Control

The circulation of foreign currency is strictly controlled across the border and within the territory of the People's Republic of China. Rules related to foreign exchange control can significantly influence the financing of your business from abroad (e.g. time, sources of funding) and also complicate cross-border payments for goods, services and other cash transactions. Therefore, it is necessary to prepare medium- and long-term financial and business plans, as well as calculate more time for payment settlements.
1.4 China, Hong Kong and the Free Trade Zones

Since the Qin Dynasty united the country, China has maintained a centralised framework for most of its history. However, due to China's size, the unified framework has become fractured by numerous local factors. Currently, China is structured as a hierarchy of one central government with many provinces, cities, counties, districts and townships.

Defined as a special administrative region (SAR), Hong Kong reverted to China in 1997 under the principle of “one country, two systems”. Hong Kong enjoys a high degree of autonomy along with executive, legislative and independent judicial powers. However, at the same time, it is still subject to potentially far-reaching political control by the P.R.C. central government. As an example, the Basic Law of Hong Kong is a national law enacted by the National People’s Congress of the People’s Republic of China, and it has the role of constitutional law of Hong Kong.

In 2013 and 2015, new free trade zones – Shanghai, Tianjin, Guangzhou and Fujian – were established as special economic areas within Mainland China. These zones made administrative reforms in the areas of investment, finance, foreign trade and filing supervision to create a more business-friendly environment. Free trade zones are considered pilot projects and should be viewed as indicators of potential future policies implemented for all of China rather than areas with exceptions that are valid forever (see more information in Chapter 11).

Case study: Importance of Protecting your IPR

- An EU textile company (EU company) holds its trademark on textile products, registered and protected in the EU. The EU company signed a manufacturing contract with a Chinese manufacturer to produce bed sheets for export back to the EU for sale.

- The EU company had not filed any trademark registration applications in China, as the products were not sold in the Chinese market. This manufacturing contract was in effect for 10 years, and the EU company decided to explore the Chinese market. However, when filing the trademark registration in China, the company discovered that its trademark had been registered by a company affiliated with the Chinese manufacturer. Even worse, the Chinese manufacturer had been selling exactly the same products for several years, using the China trademark.

- The EU company had two choices: either give up the trademark it had used for so many years with good reputation or negotiate with the Chinese manufacturer to buy back the trademark and retain its IPR. However, the second choice would be very costly.

- Therefore, it is really important to register your IPR before entering the Chinese market; this includes signing distribution contracts, manufacturer contracts, advertising, and so on.

For further guidance on IPR related issues, the China IPR SME Helpdesk can provide you with free of charge, confidential, business-focused IPR advice.

Reach their experts at: [http://www.china-iprhelpdesk.eu/](http://www.china-iprhelpdesk.eu/).
2. Broad Methods of Market Entry

This report will explain the primary methods of entering the China market:

**Direct Exporting**
Direct exporting refers to exporting goods or services from one country to another, directly to the final customer.

**Indirect Exporting (using an intermediary)**
Indirect exporting refers to selling goods to an intermediary based on your target market. The intermediary in turn sells your products to customers. Such intermediaries may include agents, distributors, franchisees and so on.

**Investing Directly**
Investing directly is establishment of a legal entity in another country for the purpose of expanding operations and/or production. Such entities may include wholly foreign-owned enterprises (WFOE, commonly known as WOFE), joint ventures (JV) and partnerships.

* EMC = Export management consultant
While each mode of market entry offers its strengths and weaknesses, most companies develop a gradual approach based on available time and resources and the market responses they receive along the way.

Considerations regarding the entry mode most suitable for your business plan include:

- The size of your firm;
- The nature of your products;
- Previous export experience and expertise;
- Business conditions and regulations in China (both exporting and investment requirements);
- The need for on-the-ground representation (i.e. marketing, after-sales services);
- The need for control of your product and intellectual property rights (IPR) protection;
- The time and resources of your company.

The following sections provide a brief description of each entry mode and their advantages and disadvantages.

*Note: Before exporting your goods, services or technology, make sure that all your IPR are properly registered in China.*
3. Exporting

For companies that wish to do business with China without directly investing in the country, exporting offers the potential for high profit gains but will also require a considerable investment of time.


3.1 Direct Export

**Direct exporting** refers to the shipment of goods or provision of services across borders or transfer of technology from one country to another directly to the end customer. The seller of such goods, services and technology is referred to as an “exporter” who is based in the country of export, whereas the overseas-based buyer is usually referred to as an “importer”.

Exporting of goods to China always involves engagement of a company that has a licence for import/export according to Chinese laws. Such a company has to be registered in China. Therefore, the term “importer” in Chinese trade terminology usually refers to the registered company in China possessing an “import/export licence”. The company can be a buyer and, thus, an importer in the general sense, but most often the company is only a service provider/intermediary assisting with import (bringing goods across the border and facilitating international payment).

Practically speaking, direct export is suitable for unique products of smaller quantity, not requiring a developed distribution network, or for export of services or technology.

Higher gains come from cutting out any middlemen (intermediaries, agents etc.) and avoiding the costs of setting up in China. However, such companies also have the responsibility for doing their own market research and meeting all necessary administrative requirements: ensuring that their goods, services and technology can enter the market, meeting relevant standards and certification requirements, and meeting necessary labelling and licensing requirements. Companies must also work with freight forwarders, banks and all customs procedures (if not handled by the Chinese import/export company). The result is that companies develop a deeper understanding of their customers, the processes and the market itself.

**Advantages of Direct Exporting**

- Greater potential profit;
- Greater degree of control over all aspects of the transaction;
- Knowing who your customers are;
- Having customers feel secure in doing business directly with you;
- Faster and more direct feedback on your product and its performance in the marketplace;
- Better protection for your trademarks, patents and copyrights;
- Presenting yourself as fully committed and engaged in the export process;
- Development of a better understanding of the marketplace;
- Greater flexibility to improve or redirect your marketing efforts as the business develops in the foreign market.
Disadvantages of Direct Exporting

- You have to handle or be actively involved in all logistics of the transaction: licences, standards, certification, labelling, shipping and customs-related requirements, as described in report 4 of the EU SME Centre Starter Kit regarding exporting goods, services and technology to China;
- Requires more “people power” to cultivate a customer base;
- Demands more responsibility from every level of your organisation;
- You may not have the ability to respond to customer communications as quickly as can a local agent;
- If you have a technological product, you must be prepared to respond to technical questions and provide on-site start-up training.

3.2 Indirect Export

Another method for entering the China market is through an intermediary (i.e. an agent or distributor) in China.

3.2.1 Agents

An agent is your company's direct representative and is usually paid a certain management fee and/or a commission to represent and sell your product in China.

An agent works more closely with you, whereas a distributor works more closely with your customers.

For small and medium-sized companies, one of the easier ways to enter the China market is through a respected agent or distributor. Localised agents possess the knowledge and contacts to promote foreign products and overcome barriers, such as language and culture.

In addition, sales agents and distributors can assist in tracking policy and regulation updates (both locally and nationally), collecting market data and quickly responding to change. Effectively, they are your eyes and ears on the ground.

However, finding a dedicated, reliable, professional and credit-worthy agent/distributor requires effort. Your embassy and chamber of commerce are often aware of agents who offer services. Check whether the commercial department has a relationship with any specialised agents. Likewise, many agents and distributors will advertise their services online and can be met at relevant trade shows.

In China, you cannot hire an agent as an employee but the agent can enter into a service contract if he or she has his or her own company.
Advantages of an Agent

- You have greater control over the terms of sale;
- You have the freedom to choose customers with whom to deal;
- The agent will report on your competition;
- The agent will focus on your best-selling products with the highest margin;
- The agent will advise you on new products to launch;
- You have greater control over marketing methods;
- You (the manufacturer) retain control of the storage of your goods, contrary to using a distributor;
- An agent’s commission is typically lower than the margin of profit earned by a distributor.

Disadvantages of an Agent

- If the agent’s work is not reviewed on a regular basis, your sales may not increase;
- Controlling the agent’s work requires frequent communication;
- If you decide to end your cooperation with an agent, he or she may go to the competition;
- Sometimes a principal will be treated as trading in a territory if he has an agent there, which could have tax implications. Consideration should be given to local laws and double taxation;
- Maintaining stock inventory can be costly;
- An agent may be selling products similar to yours.

Criteria for Finding a Good Agent

- The agent has knowledge of your product/service and its market;
- Good references and previous experience (check to make sure);
- Language skills, including at least English and Mandarin, and preferably Cantonese and local dialects;
- Strong networks 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 closely related marketing materials, the ability to travel, respectful of the professional image of your company and being transparent about potential conflicts of interest.

Companies should guard against agents who proactively approach them to be their representative. In some cases, these can be scams aimed at cheating your company. You should also be told whether an agent represents any other companies. Consider starting with smaller tasks to see how he or she performs.
3.2.2 Distributors

A distributor buys your products and then sells them to customers either directly or through a third party. Their profit is the difference between their buying and selling prices.

Using a distributor can be a cost-effective and relatively easy way to enter the China market. It is not recommended that your company have only one distributor for all of China. Not only would this be highly difficult to execute – in fact, there are only a few companies that can claim they have a distribution network covering all of China – but you would also be completely in the hands of one exclusive partner.

**Advantages of Using Distributors**

- As the supplier, your company can pass on a greater degree of risk to distributors;
- There is monetary incentive for distributors to sell your products/services;
- You avoid the need to have an established place of business in the territory, which reduces your costs;
- You need to monitor only the accounts of several distributors rather than monitoring one account for each customer.

**Disadvantages of Using Distributors**

- Loss of control over the distributor’s activities;
- An exclusive distributor focuses the supplier’s entire credit risk on one entity rather than spreading it over a large number of customers.

**CAUTION:** Some foreign companies will export goods to Hong Kong and sell them knowingly (or unknowingly) to individuals who work on the black market. These individuals then rely on personal connections to smuggle goods into the Mainland. EU companies should ensure that distributors are not implicated in any illegal trading activities. To minimise the risk, due diligence should be performed. Learn more about preliminary due diligence in the fourth report of the EU SME Centre Starter Kit, *Knowing your partners in China*:

Case study: Environnement SA

Environnement SA is a European company and an industry leader in high-precision air quality monitoring. The company began successfully exporting through a Chinese private company distributor but ultimately decided to set up its own company in China.

- Environnement SA's CEO conducted first-hand market research to confirm the demand and potential in the Chinese market;
- Targeting high-end demand, the company does not compete with local vendors who offer cheaper alternatives;
- In 2009, the company decided to establish a WOFE in Beijing but still maintains a good business relationship with its former distributor/partner;
- The general manager of the company’s China office has more than 10 years of China experience;
- The bureaucracy of setting up a WOFE was difficult and took a year;
- Environnement SA now offers a wider range of products in China and is showing strong growth.

For more information, see the full version of this case study on the EU SME Centre website: Environnement SA - Selling Air Quality and Emissions Monitoring Systems in China: www.eusmecentre.org.cn/casestudy/environnement-sa-selling-air-quality-and-emissions-monitoring-systems-china

Note: In the section on indirect exporting, we look at the use of intermediaries in the target country as a way to support companies. However, companies should also consider using domestic (European) intermediaries, such as export trading/management companies in their own country, which leaves all the market research/administrative and logistical burdens (as well as a share of the profits) to intermediaries that specialise in exporting. This is the easiest and least involved way to begin exporting. Find such export trading management companies by searching online, contacting your government’s export promotion office or local chamber of commerce.
4. Licensing and Franchising

Before engaging in any form of licensing or franchising, companies are strongly advised to ensure that their IPR is registered not only in their home country but also in China.

4.1 Licensing

**Licensing** is permission granted by an exclusive owner of intellectual property rights (i.e. technology or patents, trademarks, copyrights etc.) to another party to use with agreed-upon terms and conditions (including, for example, payment of royalties), while the IPR owner continues to retain ownership of the IPR.

As a company grows and develops its reputation for quality products and services, its intellectual property becomes more valuable. Today, licensing and franchising is no longer just for multinationals; smaller or niche-market businesses that have popular products or services can benefit from licensing and franchising agreements, too.

Licensing IPR can cover several areas:

- Technology transfer – including patents (innovation), designs, software, and know-how;
- Copyrights – original works of authorship fixed in any tangible form;
- Trademarks – words, names or symbols identifying goods made or sold that distinguish them from others.

**Technology transfer** is the process of transferring knowledge, technologies and know-how from one institution – owner of the technology – to another, either by selling the technology or by licensing the technology to enlarge the range of users who have access and the ability to use the technology.

4.1.1 Different Ways to Export your Technology to China

1. Licensing the technology to an unrelated Chinese company or selling the technology;
2. Investment plus technology transfer: Some companies wish to combine technology transfer with investment through a joint venture or through a WOFE. In the case of WOFEs, the IPR risk should be managed by reducing or preventing leaks by employees and business partners.
4.1.2 Steps for Licensing Technology

1) File for IPR protection in home country and in China
2) Confirm technology is legally importable in China
3) Select a Chinese import partner/licensee
4) Negotiate a technology transfer agreement
5) In case of restricted technology, seek approval from MOFCOM
6) Sign the contract
7) Register the contract/obtain import licence at MOFCOM branch
8) Manage relationship and monitor compliance

Note: Although most technologies can be imported into China, you need to consult the Catalogue of Technologies Prohibited and Restricted from Import by China (revised in 2007) (Technology Import Catalogue), published by the Ministry of Science and Technology (MOST) (中华人民共和国科学技术部) and the Catalogue for the Guidance of Foreign Investment Industries (Investment Catalogue), jointly published by the Ministry of Commerce (MOFCOM) (中华人民共和国商务部) and the National Development and Reform Commission (NDRC) (中华人民共和国国家发展和改革委员会).

Some licensing contracts must be approved by and registered with the Ministry of Commerce (MOFCOM). The use of confidentiality agreements and non-compete agreements is important.

4.1.3 Documentation Generally Required for Patent Licensing

1. Patent licensing request;
2. Patent licensing agreement;
3. Patent certificate;
4. Identification documents of the licensor;
5. Identification documents of the licensee;
6. Power of attorney;
7. If the agreement is not filed within three months, an additional declaration of the effectiveness of the agreement will have to be produced;
8. If the name(s) used now are not the same as the ones used in the agreement, proof of the official change of name(s) is required.

4.1.4 General Provisions for Trademark Licensing

- Clear description of the mark;
- Purpose or purposes of the licence (i.e. for merchandising);
• Territory and/or distribution channels to which the licence applies;
• Whether the licence is exclusive or non-exclusive;
• Statement or statements that no other right, title or interest in the mark is granted beyond the terms and conditions specifically set forth in the licence;
• Term of the licence;
• Royalty to be paid and terms of payment;
• Audit rights;
• Proper use of the mark and the licensor’s rights of prior approval;
• Non-assignment clause;
• Hold-harmless clause with indemnity/insurance for product liability claims involving the products or services on which the mark is used;
• Conditions under which the licence may be terminated and post-termination rights and duties.

The China licensing market is the world’s fastest growing (16% annually). It is expected to grow even faster in the years to come.

For more on exporting technology to China, please see the third report in the EU SME Centre Starter Kit, *Exporting goods, services and technology to the Chinese market*:


or download the EU SME Centre Guideline on *Technology Transfer Agreements with China*:

www.eusmecentre.org.cn/guideline/technology-transfer-agreements-china

For more on technology transfer, please visit the World Intellectual Property Organisation’s website:

www.wipo.int

For more on IPR protection, please visit the Chine IPR Helpdesk:

www.china-iprhelpdesk.eu

### 4.2 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;
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.

Technically, the contract binding the two parties is the “franchise”, but that term is often used to mean the actual business that the franchisee operates.

#### 4.2.1 Franchise Requirements

In February 2007, China’s State Council (国务院) published the revised *Regulation on Administration of Commercial Franchise*, which includes rules applying to both domestic and foreign franchisors who engage in commercial franchising in China. The regulations provide that only enterprises (that is, not individuals and other entities) may engage as franchisors. A franchisor must own a developed business that can provide a long-term commitment, technology support, business training and other services. The regulations also require that a franchisor have former experience in terms of ownership and operation of at least two outlets for at least one year before he or she can establish a franchise in China. The regulations additionally require foreign companies that intend to engage in commission
trade, wholesale, retail and establish a franchise in China, to do so through a foreign-invested enterprise within China.

### 4.2.2 Franchise Agreement

A franchise agreement is generally valid for no less than three years unless it is otherwise agreed upon by the franchisee. A franchisee may terminate the agreement if the franchisor holds back relevant information from or provides false information to the franchisee.

Main contents that must be included in a franchise agreement include:

- Basic information of franchisor and franchisee;
- Contents and term of the franchise;
- Type, amount and payment method of franchise fees;
- Provisions of operational guidance, technical support and training;
- Quality and standards requirement for product or service and guarantee provisions;
- Promotion and advertising of products or services;
- Protection of consumer interest;
- Amendment, rescission and termination of franchise contract;
- Liability breach of the contract;
- Dispute resolution mechanism;
- Any other matters agreed between the parties.

The regulations require a franchisor to submit the following documents within 15 days after executing its very first franchise contract:

- Business licence or enterprise registration certificate;
- Sample franchise contract;
- Franchise operation manuals;
- Marketing plan;
- Written undertaking and evidence that the franchisor’s qualification requirements have been met;
- Other documents and materials as required by the commerce department under the State Council.

### 4.2.3 Tips for New-to-China Franchisors

- **Register your company name and trademark when entering China at inception.** An official registration IN CHINA is needed to avoid difficult situations where competitors try to register your trademark for themselves;

- **Seek local partners that can navigate the local business environment.** It is very important to choose a franchise partner in the same industry with channels of distribution, industrial connections and good relationships with government organisations. For more information, see the fourth report of the EU SME Centre Starter Kit, *Knowing your partners in China:* [www.eusmecentre.org.cn/report/knowing-your-partners-china](http://www.eusmecentre.org.cn/report/knowing-your-partners-china)

- **Adjust your market access strategy to cultural difference.** A foreign franchiser should fine-tune its products to accommodate different habits. McDonald’s, KFC, and Starbucks have all developed products for the unique tastes of their Chinese customers.
Advantages of Licensing and Franchising

- Lower costs of market entry, e.g. no need to build a distribution network;
- Increased business opportunities. Licensee or franchisee provides local knowledge which might help in reaching new markets and finding new partners. Increased revenues in the form of royalty payments from the company to whom the licence or franchise is granted (licensee/franchisee);
- Branding/reputational impact;
- Wider exposure/advertising for the licensing/franchising company’s brand/technology/work;
- Uniformity of procedures in franchises, resulting in consistency and enhanced productivity levels;
- Franchisee is usually self-motivated since he or she has invested time and money in the business;
- Risks are spread by multiplying the number of locations through other people’s investments;
- A larger, more powerful licensee in a new market can provide instant market access and deter competitors and imitators;
- A licence can be used to supply products locally where there is no opportunity to manufacture in the locality.

Disadvantages of Licensing and Franchising

- Potential IPR infringement risk;
- No contact with end customers;
- Initial investment in terms of training staff, technical assistance;
- Lower control over the business model. It is important to ensure proper control provisions in the licence;
- Risk that a trade name will be spoiled by dubious partners;
- Franchisor must have solid business model and one year of operation for at least two outlets;
- By disclosing your business model, you are risking that franchisees will “amend” the model and establish their own business;
- Over time, royalty payments from a licence may not provide the maximum for a licensor. Thus setting up locally may generate better profits in the long run.
5. Selling Online

China’s current population is 1,354 billion people, and more than 649 million (47.9%) are internet users (http://www.cac.gov.cn). Compare this to Europe, where 65% of individuals use the internet every day or almost every day (http://ec.europa.eu). One can see that China’s e-commerce will keep growing in the next few years.

There are four different methods for a business to sell online and connect directly to consumers in China:

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

5.1 Standalone Website Outside of China

An existing standalone website outside China may be the easiest method of selling online, but it is likely not to be the most effective. At a minimum, companies wanting to use this approach should develop a Chinese language version of the website and arrange for Chinese credit card payments (using Chinese third-party payment platforms such as Alipay or Tenpay). An additional disadvantage is that consumers will have to endure longer shipping times, transportation and import costs if the products are manufactured in Europe.

Finally, in some cases, the Chinese government has blocked online selling websites that do not hold a China ICP licence. By law, a commercial internet content provider (ICP) licence is required to provide commercial internet information services.

There are two types of ICP licences in the context of this article on selling products:

- Commercial internet content provider (includes permit to sell its own products over the websites);
- Value-added internet content provider (can market and sell third-parties products).

5.2 Standalone Website Inside China

Building a standalone website within China solves issues such as overseas delivery fees and import taxes, assuming the company and its goods are in China. However, to build and maintain a website within China, the company must be a legal, registered entity in China to receive the necessary ICP licence (see above). For the foreign-invested telecommunication enterprise which engages in the operation of value-added telecommunication business, the ratio of investment by foreign investors shall not ultimately exceed 50%. However, this cap has recently been withdrawn for enterprises registered in the Shanghai free trade zone, giving foreign internet companies more freedom and the possibility of conquering the Chinese market (see below).

5.3 Third-party Platforms

5.3.1 Categories of Third-party Platforms

Third-party platforms may be divided into three categories, depending on the services they provide. The first category brings together platforms whose sole responsibility is to drive the potential buyer directly to the vendor, such as Taobao and eBay.
In addition to the first category platforms, there are big retailers, such as JingDong, that buy products wholesale and do the retail themselves. These platforms will take care of everything from the moment it buys the goods.

Finally, there are other kinds of platforms that focus on online-to-offline services without offering any kind of escrow payment services. They offer local life information, detailed merchant information, consumer services and rating services (e.g. DianPing).

### 5.3.2 The Choice over the Third-party Platform Outside China and the Ones Inside

In China, selling through a third-party platform based outside China's border (such as eBay or Amazon) is likely to have limited success. Chinese consumers prefer purchasing goods on local Chinese websites (such as Taobao, Tmall, JingDong or WeChat) where they are sure their credit cards are accepted and there is no language barrier.

Assuming the company’s operations are based in China, delivery costs are lower and logistics are easier to follow than when selling from outside the country. Chinese consumers are used to purchasing goods online and will likely continue purchasing through these websites. For instance, Taobao has more than 300 million active users (www.alibabagroup.com), Dianping has 190 million (www.technode.com) and Wechat has 500 million monthly active users (www.techinasia.com).

While the law does not restrict access to foreign companies from selling online in China through a third-party platform, each platform has its own restrictions. For instance, a foreign entity can sell goods on Taobao, but JingDong or DianPing require independent sellers to have a Chinese entity. Therefore, an analysis of the general terms and conditions of a specific platform will tell the investor whether it is suitable for its business.

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<th>Advantages of a Third-party Platform</th>
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<td><strong>Outside China</strong></td>
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<td>For Chinese consumers</td>
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<tr>
<td>- Access to goods not available in China.</td>
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<td>For EU sellers</td>
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<td>- Familiarity of platforms and their services;</td>
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<td>- Low costs.</td>
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<tr>
<td><strong>Inside China</strong></td>
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<td>- More likely to trust;</td>
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<td>- Easier online payments;</td>
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<td>- Faster delivery;</td>
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<td>- After service.</td>
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<td>- Low costs;</td>
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<td>- Benefit from platform’s existing traffic.</td>
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</tbody>
</table>
Disadvantages of a Third Party Platform

<table>
<thead>
<tr>
<th></th>
<th>Outside China</th>
<th>Inside China</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>For Chinese consumers</strong></td>
<td>• Language barrier</td>
<td>/</td>
</tr>
<tr>
<td></td>
<td>• Use of Chinese credit cards problematic;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Long delivery time;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• High shipping costs and risk of damage;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Custom tariffs;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• No after service.</td>
<td></td>
</tr>
<tr>
<td><strong>For EU sellers</strong></td>
<td>• No target market access</td>
<td>• Marketing on an unknown platform in a foreign language;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Company registration in China necessary;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Certification requirements</td>
</tr>
</tbody>
</table>
6. Directly investing - Wholly foreign-owned Enterprises and Joint Ventures

Wholly foreign-owned enterprises (WOFE) and joint ventures (JV) are the most commonly used foreign invested enterprises when foreign investors want to invest in China.

<table>
<thead>
<tr>
<th>Total FDI (Billion USD)</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>WOFE</td>
<td>83</td>
<td>92</td>
<td>90</td>
<td>106</td>
<td>116</td>
<td>112</td>
<td>118</td>
</tr>
<tr>
<td>EJV</td>
<td>20.2%</td>
<td>16.8%</td>
<td>18.3%</td>
<td>18.1%</td>
<td>18.1%</td>
<td>18.4%</td>
<td>18.0%</td>
</tr>
</tbody>
</table>


It appears that foreign investors generally prefer WOFEs to JVs. This is due to their higher confidence in their ability to establish and run China operations on their own.

Since success with joint ventures is often difficult to achieve because of issues relating to control, objectives, management approaches, culture, language and so on, the WOFE is the best alternative. It leaves the entire control to the foreign investor, providing better protection of proprietary technology and other IPRs, as well as control over human resources.

Moreover, the conditions for approving WOFEs have relaxed over time. For example, the requirement that at least 50% of a WOFE’s production be exported was deleted from the laws governing WOFEs a few years ago, and minimum registered capital is no longer required.

Conversely, a joint venture presents advantages in gaining access to an already-developed network of distributors, the need for a strategic local partner or simply the desire to share operational costs.

Case Study: Belgian Tank and Boiler Producer

- A Belgian company designs, manufactures and distributes engineering solutions for hot water generation. The company decided to enter the Chinese market.
- Before entering China, the Belgian company applied to WIPO to register its trademarks and appointed China as a protection country. Therefore, the trademark was protected both in the EU and China.
- The Belgian company established a WOFE in Beijing with an investment of CNY 4 million.
- The WOFE also applied and obtained importation and exportation licences to import the products from its headquarters.
- The WOFE signed distribution and agency agreements with local distributors and agencies to sell products in China. Meanwhile, the WOFE also sells products through its own channels.
- With this business development, the Belgian company increased its investment as capital in the WOFE by CNY 3 million.
6.1 Wholly Foreign-Owned Enterprise (WFOE or WOFE)

A **WOFI** is a limited liability company owned by foreign nationals (companies or individuals) and capitalized solely by one or more foreign investor.

According to WOFI regulations, “foreign investors are permitted to set up a 100% foreign-owned enterprise in industries that are conducive to the development of China’s economic benefits, and not prohibited or restricted by the Chinese government”. A complete list of these categories is found in the *Investment Catalogue*.

6.2 Joint Ventures (JVs)

A **Joint Venture** is a legal entity set up by Chinese and foreign partners holding joint operations and ownership of a limited liability entity, and who have agreed on management and the division of risks. Chinese law contains two types of joint ventures: the general joint venture and the limited joint venture. The **equity joint venture** (EJV) is a legal entity created by Chinese and foreign partners that hold joint operations and ownership of a limited liability corporation. A third type, the **contractual joint venture** (CJV) is a partnership between a Chinese enterprise or organisation and a foreign enterprise, organisation or individual. A contractual joint venture can form a partnership based on an incorporated arrangement with a limited liability company or be based on contractual cooperation agreement.

6.2.1 Differences Between Contractual Joint Venture (CJV) and Equity Joint Venture (EJV)

**Profit Distribution**

The first difference relates to the profit distribution. A CJV permits the parties’ profits to be split disproportionately to their equity percentage. An EJV normally split profits in proportion to the equity investment (registered capital).

**Liability**

The major drawback of the CJV is the unlimited liability of the partners. In an EJV, partners have limited liability and can agree on the management and division of risks.

**Exit**

Finally, it is easier to withdraw investment from a CJV than from an EJV. The foreign party of a CJV is permitted to withdraw its investment amount at will, as long as the fixed assets of the joint venture pass without compensation to the Chinese side at the end of the term. Such a possibility is not offered to the foreign party of an EJV.

6.3 Activities

Activities allowed by foreign investors under Chinese law are listed in the *Investment Catalogue*. This catalogue sets forth three categories of sectors: “encouraged”, “restricted” and “prohibited”. Moreover, businesses not falling under the list are considered permitted.

Those categories reflect the willingness of the Chinese government to encourage or discourage foreign investment in specific sectors.
The catalogue specifies that some sectors are open to WOFEs while others require a Sino-foreign joint venture, and sometimes with the Chinese partners having majority interests (for details, see the Guideline on Foreign Invested Enterprise).

### 6.4 Capital Structure

The capital structure of a foreign invested enterprise is divided in total investment amount and registered capital.

#### 6.4.1 Total Investment Amount

The total investment amount represents the aggregate amount of funds or assets intended to be invested in a foreign invested enterprise (FIE), either as equity or debt (loan). This is an important factor in determining which level of governmental authority must approve the project.

#### 6.4.2 Registered Capital

Registered capital is similar to a shareholder’s equity. The difference between the total investment amount and the registered capital is the inclusion of the debt into the former one. The capital can be denominated either in foreign currency (typically in USD) or in CNY. While the choice of currency denomination does not impact the leverage ratio hereafter, investors should be aware of the special procedure followed in the case of CNY-denominated investment in China using offshore CNY.

Since 2014, the requirement of minimum registered capital and cash contribution has been removed as well as the capital verification. Currently, the foreign investor can contribute either in cash or in kind (tangible or intangible). The deadline for the payment of capital contribution from the foreign investor shall be stipulated in the articles of association (AoA) and in the written application of the establishment of the WOFE. However, the ratio between the registered capital and the total investment remains unchanged. Moreover, for some types of industries (such as banking sector or telecommunication enterprises), there still exist minimum registered capital limits.

Although the threshold of establishing a company in China has lowered, it does not mean that supervision of the companies is no longer that strict. Companies must always maintain compliance with the law.

#### 6.4.3 Leverage Ratio

According to the rules limiting the leverage of an FIE, the investors shall comply with the following proportions:

<table>
<thead>
<tr>
<th>Total Investment Amount (TIA)</th>
<th>Minimum Registered Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>TIA &lt; USD 3 million</td>
<td>70% of the total investment amount</td>
</tr>
<tr>
<td>USD 3 million &lt; TIA &lt; USD 10 million</td>
<td>50% of the TIA but no less than USD 2.1 million</td>
</tr>
<tr>
<td>USD 10 million &lt; TIA &lt; USD 30 million</td>
<td>40% of the total investment amount but no less than USD 5 million</td>
</tr>
<tr>
<td>More than USD 30 million</td>
<td>33% of the total investment amount but no less than USD 12 million</td>
</tr>
</tbody>
</table>
6.5 Foreign Exchange Control on Current Account and on Capital Account

Strict foreign exchange control can complicate the financing and the management of the company's cash flow. Any foreign company based in China and involved in cross-border business must have a current account and a capital account dedicated to cross-border transactions.

Foreign currency from capital account items and funds from conversion of foreign currencies shall be used only for the purposes approved by the relevant authorities and are normally associated with activities resulting from the business scope of the company or its operational needs. The authorities have the right to carry out supervision and inspection of how funds are used.

The current account is dedicated to foreign exchange receipts and payments items based on true and legitimate cross-border transactions. Those transactions are verified by financial institutions that examine the veracity and consistency of the documents. Foreign exchange receipts under current account items may be retained or sold only to financial institutions engaging in conversion and sale of foreign currencies.

Investors shall keep in mind that before making any direct investment in China, they must register with the foreign exchange control authorities. Payment can only be made after approval is obtained.
6.6 Approval Process

6.6.1 General Procedure of Setting up a Foreign Invested Enterprise

1) Application for pre-registration approval

2) Application for pre-name registration approval

3) Application for approval from MOFCOM/Local Commission of Commerce

4) Application for a business licence from the Administration of Industrial and Commerce (国家工商行政管理总局)

5) Carving the seals and registering the carving

6) Application for organization of the code certificate

7) Application for foreign exchange registration

8) Application for central tax certificate and local tax certificate

9) Opening the capital bank account

10) Application for registration of finance register

11) Application for statistic registration

For more details on setting up a foreign invested enterprise, see *Guideline on Establishment of Foreign Invested Enterprise.*
7. Direct Investment - Partnerships

A foreign invested partnership enterprise (partnership) is quite a new member of the family of foreign invested enterprises. The main difference between a JV on one side and partnership on the other side, is that in the partnership, a Chinese individual can be an investor, while in a JV, only a Chinese company can invest. The second difference is that at least one of the partners will assume unlimited liability. Third, setting up the process is less complicated.

A partnership may be formed by general partners bearing unlimited joint and several liabilities for the debts of the partnership (general partnership) or by both general and limited partners, where the latter bear the liabilities for its debts only to the extent of their capital contributions.

Partnership may be set up by:
- Two or more foreign enterprises or individuals; or
- Foreign enterprises or individuals jointly with domestic individuals, legal persons, and other organisations.

7.1 Authorised Activities

A foreign invested partnership (FIP) is neither permitted to invest in prohibited industries nor in industries that are restricted to joint ventures or where a Chinese party must hold a controlling interest. Hence, the industries not falling within the above sentence are open to foreign investment partnerships.

7.2 Capital

There is no requirement for minimum registered capital. However, parties shall submit a confirmation of agreed consideration signed by all parties or an assessment certificate of consideration issued by a statutory agency in China. This measure permits the FIP’s partners to contribute capital in convertible or local currency. Parties to the FIP may also contribute to capital in terms of intellectual property, land use rights and other property rights, including labour investments. However, only the general partner can make capital contributions in labour service and in accordance with relevant regulations. A foreign general partner making contributions by labour investment shall submit employment licences for all foreign employees to the competent branch of the State Administration for Industry and Commerce (SAIC) (国家工商行政管理总局).

7.3 Approval Process

The foreign-funded partnership shall register with the local branch of SAIC, where it shall submit the following documents:

- Establishment registration application signed by all partners;
- Partnership agreement signed by all partners;
- Subject qualification certification of the whole partners or the identification of the natural person;
- Certification of the main business place;
- Proxy of the representative designated or the agent jointly entrusted by all partners;
- Confirmation of the contribution subscribed or actually paid by each and all partners;
- Explanation of compliance with the policy for foreign investment industries signed by all partners;
- Credit certificate issued by financial institutes engaging in business with foreign partners;
- Power of attorney of legal document service signed by foreign partners and the domestic receiver of the legal document service;
- Other related documents, as prescribed in the provisions.
8. Branches

A “branch” of a foreign company refers to a unit incorporated by a company to engage in business activities outside the company address. A branch shall not qualify as an enterprise legal person, and its scope of business operations shall not exceed the one of the company. In addition, one of the major characteristics of a branch is the liability of the parent company for all commitments made by the branch itself. In other words, the branch only consists in a business place located in another country with capital corresponding to its operations. It does not have any independent governance, but the foreign company appoints a representative or an agent to act as the manager of the branch.

In fact, not many foreign companies are eager to open a branch in China because the setup and daily administration is almost equal to that of independent company and a branch shall be also be equipped with “operational capital”.

8.1 Approval Process

To register a branch in China, the foreign company shall submit the following documents to SAIC, the company registration authority, with an application for establishment of a branch:

- Application letter for branch registration signed by the legal representative of the company;
- The articles of association of the company and a photocopy of the enterprise legal person business licence affixed with the company seal;
- Proof of use of business premises;
- Letter of appointment and identity document of the person in charge of the branch;
- Other documents required by SAIC.

The company registration authorities shall issue a business licence to branches that are granted registration.
9. Representative Offices

To conduct business with China, it is not always necessary to set up a company here. Some business models require only a presence in China and, for such purposes, a representative office can work. For example, if an EU SME wishes to find only customers in China, but provide services in Europe, a representative office (RO) can be the right solution.

An RO is not a legal entity but rather a liaison office in China for the company’s headquarters in the home country. It shall not engage in profit-making activities and, under no circumstances, may a representative office do the following in China:

- Directly engage in any business for profit;
- Represent any form other than its headquarters, that is, the foreign enterprise;
- Collect money or issue invoices within China for services or products;
- Buy property or import production equipment.

Consequently, the activities of an RO are limited to market research, exhibition or promotional activities, liaison activities related to sale of products, provision of services, procurements and investments in China of the foreign enterprise. That foreign enterprise shall appoint a chief representative who may, within the scope of the power of attorney executed by the foreign enterprise, represent the foreign enterprise in execution of application documents for registration of the representative office. In addition, the foreign enterprise may, based on business needs, appoint one to three representatives.

9.1 Approval Process

To register and establish an RO, a foreign company must register with SAIC, a process that takes about three months, and shall submit the following documents to the registration authorities:

- Application form for establishment of an RO;
- Proof of address of the foreign enterprise and proof of legitimate business operation for two years or more;
- Articles of association or memorandum of association of the foreign enterprise;
- Power of attorney executed by the foreign enterprise for appointment of a chief representative and the representative(s);
- Identity document and curriculum vitae of the chief representative and the representative(s);
- Certificate of creditworthiness of funds issued by a financial institution that has business dealings with the foreign enterprise;
- Certificate of legitimate use of the premises of the representative office.

### Representative Office

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Disadvantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• ROs are one of the quickest and easiest methods of establishing a presence in China;</td>
<td>• ROs are taxed even though they cannot generate profits;</td>
</tr>
<tr>
<td>• No restrictions on type of business;</td>
<td>• Cannot easily be transformed into a WOFE;</td>
</tr>
<tr>
<td>• No minimum capital requirement.</td>
<td>• Must undergo annual inspection;</td>
</tr>
<tr>
<td></td>
<td>• Limited to four foreign staff members.</td>
</tr>
</tbody>
</table>

10. **Free Trade Zones**

The first pilot program for a special type of free trade zone (FTZ) was launched in Shanghai on September 29th 2013. Established by the State Council under the general Scheme of China, the China (Shanghai) Pilot Free Trade Zone (SFTZ) (中国（上海）自由贸易试验区) aimed to set up a business-friendly environment governed by law, international practices and market, to mainly serve as a testing place for new policies, some of which – when successful and positive for the Chinese economy – will be implemented in the whole of China.

Moreover, opening itself wider to the rest of the world, China decided to launch three new FTZs in Tianjin, Fujian and Guangdong in 2015. The FTZs are intended to boost the economy, develop trade and facilitate investment in those regions.

10.1 **Openness to Investment**

**Registration of Enterprises Establishment**

The Ministry of Industry and Commerce (MOFCOM) set up a mechanism of “application by a single form and acceptance by a single department” for all the administrative issues, including the approval record of foreign-funded projects or the establishment of enterprises.

**Negative List Instead of Pre-approval Process**

Normally, in China, foreign investments are categorized into encouraged, restricted and prohibited investments and are given differentiated treatment accordingly. However, in the FTZ, the government decided to adopt a so-called “negative list”.

The negative list contains special administrative measures considered inconsistent with the principle of national treatment. For instance, foreign investments are:

- Prohibited in the research, breeding and cultivation of rare and unique precious varieties of seeds;
- Restricted (subject to approval) in fishing activities carried out within the waters under the jurisdiction of China.

All investments not falling under the negative list will be granted national treatment. This means that foreign companies will be subject to the same restrictions as local companies in terms of requirements and restrictions on investors’ qualification, shareholding percentage or business scope.

Nevertheless, some actual inequalities still exist. For instance, foreign exchange control, which applies to both local and foreign investors does, in fact, mainly affects foreign investors.

10.2 **Trade Facilitation**

**Entering/exiting the free trade zone**

A classification-based supervision over status of goods was established. It features:

- Electronic network management;
- Paperless clearance;
- Low-risk, high-speed passage.
Goods entering the FTZ from abroad may be declared by presentation of the manifests only. Then, after entry, the enterprise can go through the declaration formalities with entry and exit record lists step-by-step.

For goods transported between the FTZ and areas outside the FTZ but inside China, a supervision system has been adopted. It includes, for instance:

- Entry/exit record lists comparison;
- Enterprising book management;
- Digital information network.

**Inspection and quarantine**

The FTZ uses information technology to set up risk control over entry/exit safety and infectious diseases. Only some listed goods entering the FTZ shall go through entry inspection; the others are exempted from inspection unless they are classified as key or sensitive goods.

**One-stop point**

Finally, a single window for international trade has been established to create a cross-department platform for overall administration serving trade, transport, processing, warehousing and other businesses.

10.3 E-commerce Company

To improve business entry, the Ministry of Industry and Information Technology (MIIT) has lifted the equity ratio in online data processing and transaction processing for businesses (for-profit e-commerce). Currently, the proportion of foreign equity may be up to 100%, meaning that foreign investors may fully enter the Chinese market by themselves.

10.4 Applicable Legislation

- Notice of the State Council on issuing the general plan for China (Fujian) Pilot Free Trade Zone, issued by the State Council on April 8th 2015;
- Notice of the State Council on issuing the general plan for China (Guangdong) Pilot Free Trade Zone, issued by the State Council on April 8th 2015;
- Notice of the State Council on issuing the general plan for China (Shanghai) Pilot Free Trade Zone, issued by the State Council on September 18th 2013;
- Notice of the State Council on issuing the general plan for China (Tianjin) Pilot Free Trade Zone, issued by the State Council on April 8th 2015;
- Regulation for China (Shanghai) Pilot Free Trade Zone, issued by the standing committee of Shanghai Municipality People’s Congress (SMPC) on July 25th 2014.
11. Using Hong Kong as Entry to Mainland China

Supervision from Mainland China

Hong Kong was the traditional gateway to doing business in China and, in many ways, it still is. In 1997, Hong Kong was returned to China. Since then, it has been administered by Mainland China as a special administrative region (SAR) under a “one country, two systems” policy, thereby allowing Hong Kong to continue to maintain its favoured legal and economic structure. English is still the official language, and Hong Kong remains one of the most liberal market-based economies in the world.

While many larger multinationals continue to use Hong Kong as their Asia Pacific (APAC) headquarters, most EU SMEs will bypass Hong Kong and enter China directly, particularly if they are exporting. However, there are a variety of specific reasons that EU SMEs consider having a legal entity in Hong Kong, depending on the sector, size of the company and nature of the business. Below are some examples and a comparison of advantages and disadvantages of this option.

Example reasons for setting up a company in Hong Kong:

- Setting up a holding company protects the parent company from any negative legal issues with its business in Mainland China;
- Benefits from certain tax/financial systems include easier profit repatriation and a lower corporate tax;
- Use of a Hong Kong shell company to set up an RO in China (which requires an office outside of China). This is necessary for European entrepreneurs in China without an office in Europe;
- Getting a quick start: You can establish a legal entity in Hong Kong quickly (two weeks versus at least three months in China).

China and Hong Kong's Closer Economic Partnership Arrangement (CEPA)

The CEPA partnership arrangement is a bilateral free trade agreement between Mainland China and Hong Kong, which went into effect in January 2004. Under the agreement, China has agreed to eliminate tariffs for all products of Hong Kong origin and allows preferential treatment to Hong Kong service suppliers in certain service sectors. Foreign companies registered in Hong Kong are eligible to benefit from CEPA rules. Forty service sectors fall under CEPA as of January 1st 2009, but some requirements have to be fulfilled to enjoy preferential treatment. For example, the company has to be established for at least three years before it is recognised as Hong Kong based.

In short, it is no longer necessary to have a presence or link to Hong Kong to successfully operate in Mainland China. However, companies should consider getting further legal advice if in doubt about the optimal approach regarding their own situation.

For more information on the advantages of Hong Kong or for specific enquiries, contact the Hong Kong Trade Development Council (HKTDC) (香港貿易發展局):

www.hktdc.com

The HKTDC also operates an SME centre that provides specific information and services for SMEs:


For additional information on how to use third jurisdiction when investing in or exporting to Mainland China, please download the relative EU SME Centre Guideline at:

www.eusmecentre.org.cn/guideline/using-third-jurisdictions-when-investing-or-exporting-mainland-china
Advantages of Hong Kong

Legal system with long continuous tradition:
- Independent judiciary;
- Many international law firms;
- Level playing field.

More predictable regulatory framework with less frequent changes in regulations;

Tax and financial infrastructure:
- Well regulated;
- No foreign exchange controls;
- Profit repatriation easier.

Opportunity to use holding companies and still set up legal entity in China (WOFE, JV, etc.):
- Approx. EUR 2,500 necessary to incorporate plus EUR 1,000 to renew annually;
- Helps reduce liability risks to the parent company;
- Makes registering in China somewhat easier as PRC officials recognise many of the documents from Hong Kong more readily.

Simple tax system:
- No capital gains tax;
- Inbound or outbound dividend not taxed;
- No VAT or sales tax;
- No estate duty;
- Lower corporate income tax (17.5% vs. 25% in China - but costs may be higher in HK);
- Ability to use transfer pricing techniques.

Ownership transfer can take place without government approval in most cases;

Visa-free entry for most countries;

Regional headquarters for over 3,000 companies;

Better protection of IPR if some component or assembly takes place in HK; regional hub for licensing.

Disadvantages of Hong Kong When Doing Business in China

- Tax implications (a company registered in Hong Kong but conducting business in China constitutes noncompliance with Chinese tax regulations);
- Products that do not originate in Hong Kong cannot benefit from the Closer Economic Partnership Arrangement (CEPA – see below);
- Higher costs in Hong Kong may not justify the lower tax rates and other benefits.
European IT consultancy and app maker EGGsist has used Hong Kong as a stepping stone:

- Through extensive legal research, the team determined that China was one of the world’s fastest-growing ITC markets and well-suited for market entry;
- Upon multiple visits and legal advice from a Hong Kong law firm, they first set up a company in Hong Kong;
- One of the biggest challenges they faced was human resources – the hiring, development and training of well-qualified engineers and mid-level managers, who usually prefer to work for larger companies;
- By involving employees in the business side of the company and building trust in the leadership they were able to gradually build up a suitable team;
- They eventually narrowed their customer base to foreign companies instead of local Chinese companies or SOEs, which tend to be risk-adverse and reluctant to hire SMEs;
- As the company became more profitable, EGGsist set up a WOFE in Mainland China to handle its management and operations.

For more on this case study, please see the full study, *EGGsist – Succeeding in the IT Consultancy Sector* on the EU SME Centre website. [www.eusmecentre.org.cn/casestudy/eggsist-succeeding-it-consultancy-sector](http://www.eusmecentre.org.cn/casestudy/eggsist-succeeding-it-consultancy-sector)
12. Applicable Legislation

- Law of the People’s Republic of China on Sino-Foreign Equity Joint Ventures, National People’s Congress, Amended on March 15th 2001;
- Law of the People’s Republic of China on Sino-Foreign Contractual Joint Ventures National People’s Congress, Revised on October 31st 2000;
- Company Law of the People’s Republic of China Standing Committee of the National People’s Congress, December 28th 2013;
- Regulations of the People’s Republic of China on Administration of Registration of Companies, State Council, February 19th 2014;
- Administrative Measures on the Establishment of Partnership Enterprises in China by Foreign Enterprises or Individuals, State Council, November 25th 2009;
- Administrative Regulations on Registration of Representative Offices of Foreign Enterprises, State Council, July 18th 2013;
- Administrative Measures on Import Banned and Import Restricted Technology, Ministry of Commerce, March 1st 2009;
- Administrative Regulations on Commercial Franchise Operations, State Council, February 6th 2007;
- Catalogue of Encouraged Industries in Western China, National Development and Reform Commission, August 20th 2014;
- Catalogue of Import–Export Commodities Subject to Compulsory Inspection and Quarantine;
- Catalogue of Industries for Guiding Foreign Investment, State Council, April 10th 2015;
- Catalogue of Priority Industries for Foreign Investment in Central and Western China, National Development and Reform Commission and Ministry of Commerce, June 10th 2013;
- Catalogue of Technologies Prohibited and Restricted from Import by China, Ministry of Commerce, October 23rd 2007;
- Circular of the State Council on the Framework Plan for the China (Shanghai) Pilot Free Trade Zone, State Council, September 29th 2013;
- Framework plans for the Guangdong, Tianjin and Fujian Pilot Free Trade Zone, State Council, April 20th 2015;
- Regulation of the People’s Republic of China on Foreign Exchange Control of the State Council, Revised on August 1st 2008.
13. Recommendations on the Best Way to Enter the Chinese Market

Are You Ready for China?

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**Are your goods and services coming from Europe or China?**

- **Yes**: Europe
- **No**: China

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**China**

- Are you ready to invest considerable time/capital to set up your business?  
  - **Yes**: Representative office in China, entry through Hong Kong
  - **No**: Are you in a restricted sector?
    - **Yes**: Consider a joint Venture (EJV or CJV)
      - **Yes**: WOFE (manufacturing, consulting, services, high-tech...)
      - **No**: EJV, CJV, FIP: See Knowing Your Partners in China
    - **No**: Do the advantages of 100% control outweigh the ones of a local or foreign partner?  
      - **Yes**: EJV, CJV, FIP: See Knowing Your Partners in China
      - **No**: WOFE (manufacturing, consulting, services, high-tech...)

---

**Europe**

- Do you wish to have a physical presence in China?  
  - **Yes**: Do you wish to export using China-based intermediaries?  
    - **Yes**: Please see Exporting Goods, Services and Technology to the Chinese Market
    - **No**: Do you want to use an agent or a distributor (based in Europe or China)?  
      - **Yes**: Agent See this report and Knowing Your Partners in China
      - **No**: Distributor See this report and Knowing Your Partners in China
  - **No**: EJV, CJV, FIP: See Knowing Your Partners in China

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**Note:** In all the cases, creating an entity/holding company in Hong Kong may have some value, and using online platforms as a sales channel may be a viable strategy.
## 14. General Comparison

<table>
<thead>
<tr>
<th>Legal personality</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>No minimum registered capital but leverage ratio</td>
<td>No minimum registered capital but leverage ratio</td>
<td>No minimum registered capital but leverage ratio</td>
<td>No minimum capital requirement</td>
<td>No minimum capital requirement but in proportion to its functions</td>
<td>In proportion to its business scope</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liability of the funders</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited liability</td>
<td>Limited liability</td>
<td>Limited liability</td>
<td>Limited liability</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Authorized activities</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed in the Investment Catalogue</td>
<td>Listed in the Investment Catalogue</td>
<td>Listed in the Investment Catalogue</td>
<td>All activities not prohibited by the Investment Catalogue, restricted to JVs or requiring a Chinese party holding controlling interest</td>
<td>Market researches, promotional activities, liaison with the foreign enterprise</td>
<td>Limited to the foreign company's business activity</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profit distribution</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>To the foreign company</td>
<td>According to the equity investment</td>
<td>According to the JV agreement</td>
<td>According to the partnership agreement</td>
<td>No Profit</td>
<td>Collected by the foreign company</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Governance and human resources</th>
<th>WFOE</th>
<th>EJV</th>
<th>CJV</th>
<th>Partnership</th>
<th>Rep. Office</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board of directors</td>
<td>Board of directors</td>
<td>Joint management committee</td>
<td>Business manager</td>
<td>One chief representative and maximum three other representatives</td>
<td>Representative or agent</td>
<td></td>
</tr>
<tr>
<td>Advantages</td>
<td>WFOE</td>
<td>EJV</td>
<td>CJV</td>
<td>Partnership</td>
<td>Rep. Office</td>
<td>Branch</td>
</tr>
<tr>
<td>------------</td>
<td>------</td>
<td>-----</td>
<td>-----</td>
<td>-------------</td>
<td>-------------</td>
<td>--------</td>
</tr>
<tr>
<td>Efficient in operations, management and future development; easier to terminate than JVs</td>
<td>Foreign partners can gain market knowledge contacts, preferential market treatment and manufacturing capability from their Chinese partner</td>
<td>Depend on terms set in the contract</td>
<td>Easy to establish</td>
<td>Traditionally easy to establish</td>
<td>Full control over the entity doing the same business as the foreign company</td>
<td></td>
</tr>
<tr>
<td>Intellectual property rights</td>
<td>Advised to retain key positions in board of directors and management (risk management, finance, HR) Use of local talent</td>
<td>Based on the contract</td>
<td>Optional</td>
<td>Marketing and R&amp;D activities only; IPR kept by headquarters</td>
<td>IPR kept by headquarters</td>
<td></td>
</tr>
<tr>
<td>Investment risk</td>
<td>More control human resources</td>
<td>High investment risk, no Chinese partner</td>
<td>Risks based on the equity shares of each partner (foreign and Chinese)</td>
<td>Contribution can be made in form of labour or property</td>
<td>Low, however unlimited liability and subject to individual income tax</td>
<td>Low</td>
</tr>
<tr>
<td>Purpose</td>
<td>Manufacturing Services Commerce, retail, distribution</td>
<td>Only option in some sectors according to the Investment Catalogue</td>
<td>Only option in some sectors according to Investment Catalogue</td>
<td>Option for smaller business looking for an easy set-up, willing to have a partner and take on unlimited liability</td>
<td>Liaison with home office</td>
<td>Option for enterprises willing to benefit from the attractiveness of the Chinese labour market</td>
</tr>
</tbody>
</table>
15. Appendices

15.1 Relevant Reading Materials

EU SME Centre Guidelines

China Enterprise Income Tax
- www.eusmecentre.org.cn/guideline/china-enterprise-income-tax

Establishment and operation of a representative office in China

Establishment of a foreign-invested enterprise in China
- www.eusmecentre.org.cn/guideline/establishment-foreign-invested-enterprise-china

Export of goods to China
- www.eusmecentre.org.cn/guideline/export-goods-china

Technology transfer agreements
- www.eusmecentre.org.cn/guideline/technology-transfer-agreements-china

Third Jurisdictions
- www.eusmecentre.org.cn/guideline/using-third-jurisdictions-when-investing-or-exporting-mainland-china

EU SME Centre Reports

Individual income tax in China
- www.eusmecentre.org.cn/guideline/individual-income-tax-china

Selling online in China
- www.eusmecentre.org.cn/report/selling-online-china

Tax liability for non-resident enterprises engaging in service provision
- www.eusmecentre.org.cn/guideline/tax-liability-non-resident-enterprises-engaging-service-provision

EU SME Centre Case Studies

Environnment SA - Selling air quality and emissions monitoring systems in China

Müller Textil - A leader in functional textiles crossing over to China

Stavus Machinery & Electrical Equipment - Exporting machinery to China
- www.eusmecentre.org.cn/casestudy/stavus-machinery-electrical-equipment-exporting-machinery-china

Taste Spain - Setting up shop in the food industry
- www.eusmecentre.org.cn/casestudy/taste-spain-setting-shop-food-industry
15.2 Additional Case Study

Case study: Müller Textil

A German-based manufacturer of high-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 Müller Textil, please visit our website.

Case study: Taste Spain

Taste Spain, a Spanish food vendor, set up two WOFEs to meet growing demand for wine and food products:

- Through market research the company discovered that China’s demand for consumer food and wine products is great but supply is limited, creating vast opportunities for newcomers;
- Taste Spain initially set up a WOFE with the business scope of importing and selling wine;
- It subsequently found that the distribution network was fragmented and time-consuming to navigate;
- It found that warehouses were badly managed, so decided to set up their own storage facilities for greater quality control;
- After increased demand from distribution partners, they decided to set up another WOFE to import and distribute Spanish agricultural goods and food;
- From submitting a sample for inspection to receiving approval from AQSIQ, the entire process for labelling approval took three to four months;
- To protect its IPR, Taste Spain registered its trademark with the China Trademark Office (CTO) in both colour and black-and-white versions. The entire trademark registration process took about 18 months.

To access the full case study on Taste Spain, please visit our website.
www.eusmecentre.org.cn/casestudy/taste-spain-setting-shop-food-industry

Case study: German Biogas

Well-established company in the biogas sector sets up a WOFE in China:

- Biogas technology remains underdeveloped and fragmented in China;
- It took about a year to obtain all the approvals to open the first plant;
- Chinese law required them to partner with a Chinese design company;
- After conducting surveys to assess the market demand for biogas, it established a WOFE in 2009;
- Because of low awareness, there is currently a lack of competitors and market opportunities, but both are expected to increase in the future, especially if the government redirects policy in support of biogas;
- Chinese companies are adept at copying foreign IP, but foreign companies often need their help to expand their business. Since German Biogas was required to find a local partner, the company sought to mitigated its IP risk by partnering with a large Chinese state-owned enterprise (SOE) whose core business is unrelated to biogas;
- Joint ventures can be risky where high-tech IP is involved;
- The long-term strategy is to win market share before opportunities increase and Chinese competitors emerge.

To access the full case study on German Biogas, please visit our website
www.eusmecentre.org.cn/casestudy/german-biogas-design-and-construction-biogas-plants
15.3 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 Starter 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](http://www.eusmecentre.org.cn/quiz)
The EU SME Centre in Beijing provides a comprehensive range of hands-on support services to European small and medium-sized enterprises (SMEs), getting them ready to do business in China.

Our team of experts provides advice and support in four areas – business development, law, standards and conformity and human resources. Collaborating with external experts worldwide, the Centre converts valuable knowledge and experience into practical business tools and services easily accessible online. From first-line advice to in-depth technical solutions, we offer services through:

- **Knowledge Centre** – Containing over 100 comprehensive market reports, guidelines and case studies available to download from our website
- **Advice Centre** – Saving your time, money and providing reassurance that you have the right information to support your business decisions
- **Training Centre** - Offering training programmes both face-to-face and online to plug the knowledge and skills gaps of SMEs entering the China market
- **SME Advocacy Platform** - Providing a coherent, consistent and consolidated voice for European small businesses
- **Hot-Desks & Meeting Rooms** - Ready-to-go workspace available for you in central Beijing

To find out more about our services, visit the EU SME Centre website at [www.eusmecentre.org.cn](http://www.eusmecentre.org.cn)

To download up-to-date and practical market reports, guidelines and case studies, go to [www.eusmecentre.org.cn/knowledge-centre](http://www.eusmecentre.org.cn/knowledge-centre)

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