Doing Business in China Report

Considerations for Establishing and Doing Business in the Peoples Republic of China

INCLUDING AN EXPORT READY PLANNING GUIDE

HRCOACH research institute

This report is part of a series of specialist reports published by the HR Coach Research Institute, sponsored by HR Coach International. The reports include traditional White Papers taking an in-depth view of an emerging business trend or issue that has implications internationally. The information is designed for the use of businesses, government and special interest groups.

Synopsis

Human resources and business practice constantly evolve to keep pace with emerging issues and trends. At the HR Coach Research Institute, we understand that it is important to identify these changes as they happen, and to identify trends before they take effect in order to best deal with and benefit from them.

Our collaborative approach to research brings together senior executives, advisors, human resource professionals, special interest groups and expert matter specialists to make a difference to our understanding and application of knowledge for organisations now, and in the future.

The Australian business sector has always been a large proponent of export in response to the size of the domestic market. As traditional export markets continue to reel from the lingering affects of the Global Financial Crisis, Australian businesses are increasingly looking to China for opportunity.

In response to this trend the HR Coach Research Institute commissioned a report to explore China as an export market. The report was designed to outline considerations for foreign investors looking at establishing a presence in China.

Over the years we have come to learn that SMEs in Australia are heavily relationship focused. This can sometimes be at the sake of systems and processes. This can place pressure on the business and put both the international and domestic operations at risk.

This report is designed to inform business owners and managers of the major considerations of establishing a presence in China. An Export Ready Planning Guide for key employees has also been included to help in this process.

All the best with your future planning and exporting.

The HR Coach Research Institute

Version: 1.1
Date Release: 1st August 2012
Supervised by: Louise Broekman, Chair HR Coach Research Institute
Author: Udo Doring

Further information: international@hrcoach.com.au

Published by the HR Coach Research Institute, P O Box 2292, Fortitude Valley, Queensland, Australia 4006.

Doing Business in China Report

Considerations for Establishing and Doing Business in the Peoples Republic of China

Contents

Introduction

The rapid rise of China in the past 20 years is well documented. The world's most populous nation has transformed itself from an insular socialist country to one of the most influential economies, responsible for a growing amount of the world's economic activity. Despite this influence it is argued that the domestic market is largely yet to come online in regards to consumption and contribution to the broader international economy. Small and medium enterprise (SMEs) will play an increasingly important role in this development as the Chinese government continues to move away from a state run economy, the economic model of yesteryear. Moreover, foreign businesses that have the advantage of real world, free market experience in their home markets now stand to benefit from this next step of economic evolution. For those organisations China now shapes as a very attractive market yet how do they access its 1.4 billion consumers. This paper will explore the commercial legal framework that governs foreign companies looking to do business in China. It will outline the options available in regards to governance structures, necessary considerations and the process involved in each option. This report will also look to expand on the theoretical understanding by incorporating contemporary experiences of foreign enterprises that have established a business presence in China. It will examine why certain structural decisions are made and the practical limitations of different business structures.

It is important to state at the outset of this paper that it is not intended to be a guide or to constitute legal or commercial advice. It is a document designed to outline the legal framework in place in China at the moment and to suggest considerations that need to be made by investors looking to establish a commercial base in China.

Given the rapid rate of change in China, accurate reference material is challenging to come by. Further to this not all materials such as legislation and regulations are translated into English. It is for these reasons that commercial materials have been sourced for this report. By doing so it has added a practical dimension to this paper, as the parties referenced are actively involved in modern commercial China.

Industry Sectors

In order to consider the advantages and disadvantages of different business structures in China it is important to understand what industry sectors are open to foreign investors. Moreover it is also worth looking at what industries foreign firms have entered. This provides an indication of market acceptance, government approval and opportunity.

Most industries are accessible to foreign investors in china. There are exceptions such as the aviation sector, specifically domestic routes within China. Certain financial and insurance activities as well as utility provision and distribution are not open to foreign investors directly.[1] This is thought to be because they are essential

[1] 'China and the Paradox of Prosperity' (2012) January 28th –February 3rd *The Economist* 9.

to the public interest and therefore must be controlled by the Communist Party. This is often done through state-owned or part state-owned enterprises.[2]

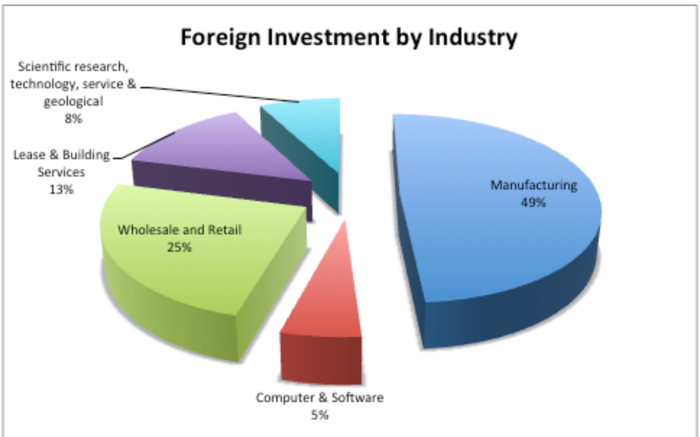
There are a number of industries that appear to be heavily regulated and therefore more challenging to enter for foreign investors. Looking at all foreign enterprises in China by industry sector the following constitute less than 1% of the total:[3]

- Mining - 0.54%
- Construction 0.95%
- Finance 0.17%
- Management of water conservancy, environment and public equipment 0.05%
- Education 0.09
- Healthcare 0.04%
- Culture and public entertainment 0.62% public management and social organisation 0.01%

These industries are either subject to heightened government regulation or are competitive and have not been identified by foreign investors as attractive.

Conversely the industries that have attracted a large portion of foreign investment are:[4]

- Manufacturing 42.01%
- Computer and software 4.67%
- Wholesale and retail 21.26%
- Lease and business services 11.4%
- Scientific research, technology, service and geological prospecting 6.68%



[2] Jordan Brandt, 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286, 297.
[3] 'Sectoral Distribution of FDI in China' (2010) April 22nd *Invest in China: Ministry of Commerce P.R.China* http://wwwfdi.gov.cn/pub/FDI_EN/Statistics/homenews/t2010042
[4] 'Sectoral Distribution of FDI in China' (2010) April 22nd *Invest in China: Ministry of Commerce P.R.China* http://wwwfdi.gov.cn/pub/FDI_EN/Statistics/homenews/t2010042

Manufacturing is by far the most popular industry sector in regards to foreign investment. It is a sector that has taken advantage of low wages, existing infrastructure and an extensive skills bank. There's is, however mounting speculation that this sector will shrink in China in the coming years as wages expectation increases, demand from Europe and the United States dissipates and real-estate prices and rent continue to rise.

Governance Structures

The most recent data of foreign investment structures in China is from 2010 recorded by the Chinese government. The report stipulates that as of April 2010 there were 27537 active projects involving foreign investment registered and operating in China.[5] This number does not include representative offices. Whether the global financial crisis affected this number won't be clear until more recent data is released.

The most prevalent business structure at this time was wholly owned foreign enterprises with over 22000 entities registered in China.[6] Given the autonomy and scope of operation permissible under this structure it comes as little surprise.

The second most subscribed business structure was equity joint ventures listing over 4600.[7] The Chinese government has made no secret that their preference in regards to foreign investment are joint ventures.[8] They allow Chinese organizations to gain exposure to technology and western management techniques. Contractual joint ventures are noticeably less subscribed to as there were only 468 registered.

As the foreign investment partnership enterprise is a relatively new structure the data does not make mention of it. One could assume that given the length of time that this structure has been available to foreign investors, the number of registered partnerships would not be high.

Considerations and Analysis

Given the varied structures available to foreign investors there are a number of considerations that need to be made by those looking to establish a permanent presence in China. Lessons can be learnt from those organisations that have taken the step in the past. As a component of the research for this paper a number of enterprises with operations in China were interviewed. Their honest and open contribution was contingent upon anonymity, as they did not want to compromise their status in China. Furthermore some organisations communicated that the governance structure under which they operate in China is market sensitive information. The overall consensus for those operating in China was that operating

---

[5] 'Statistics of FDI by Form' (2010) April 22nd *Invest in China: Ministry of Commerce P.R.China* http://wwwfdi.gov.cn/pub/FDI_EN/Statistics/homenews/t2010042
[6] ibid
[7] ibid
[8] Jordan Brandt, 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286, 297.

as a foreign business is a constant challenge where conditions and regulations change. There is a lot of grey and very little black and white. For the purposes of analysing what structures best suit particular industries and considerations that need to be made, their commentary and experiences will be drawn upon.

As stated above, the most popular structure for organisations looking to establish a presence in China is a Wholly Owned Foreign Enterprise(WOFE).[9] It is important to note that Wholly Owned Foreign Enterprises do require registered capital to be committed. Registered capital does differ from investors total investment in that is must be registered with the authorities, approved by the relevant authorities and verified within two years of establishing the company.[10] Company law was modified in October 2005 and came into effect in 2006 stating in Article 26 the minimum capital contribution was RMB30,000. This is for a limited liability company with more than one shareholder.[11] For those companies with one shareholder the minimum registered capital contribution is RMB100,000. Anecdotal evidence suggests that these amounts are legally stipulated but are not sufficient to gain approval from authorities. A licensed law firm in China has stated that foreign investors generally need US$140,000 of registered capital to gain approval for operations.[12] Specific legal and financial advice is needed when reviewing registered capital, as it is a major consideration in this process.

The benefits of a Wholly Owned Foreign Enterprise are the flexibility in scope of operations and independence. A WOFE is able to operate in almost any sphere of commerce in China. As long as the relevant authorities approve them they have operational freedom. WOFEs also enjoy the ability to convert RMB profit and into foreign currency, which is not a privilege enjoyed by all foreign investors in China. They have full control over their human resources, including recruitment and the appointment of expatriate staff. WOFEs are not required to apply for import and export licenses for their own products. Furthermore they can be established as a new entity and do not require a head office to have been in operation in a home nation for over 2 years, unlike a Representative Office.

Perhaps most importantly though they have absolute control of their strategy and business activity. This can't be said for joint venture operations. If a foreign investor is confident that a market exists for its products and services in China, operating under the structure of a Wholly Owned Foreign Enterprise gives the ability to make all decisions regarding the business. This is a major drawcard for many foreign investors who want to exert control.

This is also a major consideration for those businesses that rely heavily on intellectual property. If the control and exploitation of intellectual property is essential to the business then this structure offers a relatively protected model under which to operate. This is in contrast to joint venture operations as a Chinese based partner is

---

[9] 'Statistics of FDI by Form' (2010) April 22nd *Invest in China: Ministry of Commerce P.R.China* http://wwwfdi.gov.cn/pub/FDI_EN/Statistics/homenews/t2010042

[10] Lily Han, Kelly Zong and Wei Wei Ye, 'Registered Capital of Foreign Invested Enterprises in China: Not as Scary as it Seems' (2012) *Lehman Lee & Xu* www.lehmanlaw.com

[11] 'Starting a Business in China: Doing Business' (2011) *The World Bank Group* http://doingbusiness.org/data/exploreeconomies/china/starting-a-business-in-china

[12] Lily Han, Kelly Zong and Wei Wei Ye, 'Registered Capital of Foreign Invested Enterprises in China: Not as Scary as it Seems' (2012) *Lehman Lee & Xu* www.lehmanlaw.com

involved in all areas of the local business operation. This is a major consideration for joint ventures in China.

Joint venture operations do offer substantial advantages to foreign investors. The most obvious is local market knowledge. China is not an easy place to do business despite its size and the opportunity its represents. “Guanxi” and relationships matter. Quality and price are not the only element at play in business in China and local market intelligence and relationships are crucial. If a foreign investor is able to leverage the local existing relationships this can expedite matters considerably.

Further to this there is also the advantage of being able to avoid the legwork of registering the business in China. It is estimated that registering a foreign enterprise can take up to three months.[13] Anecdotal evidence suggests that this is an optimistic timeframe and that the reality can be much longer. Under the joint venture regulations, the Chinese partner is responsible for collating and submitting the appropriate documents in China.

It is important to note that there are some industries in China that are protected and are not open to foreign investment. Examples of these are the Telecommunications, Banking, Insurance and Domestic Aviation industries.[14] In some instances access to protected Chinese markets can be gained through joint venture relationships.[15] This is obviously a major advantage to this structure.
The commercial benefit of a successful joint venture can be substantial however the consequences of a fall out are even greater. Business relationships, strategy and intellectual property can all be lost if a joint venture ceases. It is important to consider the relationship ending before it is established so that it is an informed decision.

The same can be said for Foreign Invested Partnerships Enterprises if they involve a Chinese partner. A major benefit of this structure is that it does not require a local partner be involved yet allows for one. This means that if a relationship exists or a suitable partner is found in China they can be added to the structure.

Other advantages are that in this structure, approval from the Ministry of Commerce is not required and registration of this structure sits solely with the SAIC. Seeing as though the structure is so new it is yet to be seen if this is actually the case. Further to this there is no minimum capital requirement. More detailed information is included in subsequent sections of this report.

It is understood that this structure was introduced primarily to give foreign individuals and organisations an effective vehicle to invest in financial businesses in China.

Representative Offices are also exempt from registered capital requirement, which is an obvious advantage for business. This means that the businesses can establish a business in China without having to commit substantial capital. The structure is also arguably one of the easier businesses to register in China, as an agency is required to handle the process with the SAIC on behalf of the foreign investor. An external

---

[13] ‘Starting a Business in China: Doing Business’ (2011) *The World Bank Group* http://doingbusiness.org/data/exploreeconomies/china/starting-a-business-in-china
[14] ‘China and the Paradox of Prosperity’ (2012) January 28th –February 3rd *The Economist* 9.
[15] Ibid

party, a FESCO, must also handle recruitment. Once again, more detailed information is included in subsequent sections of this report.

The major limitation of this structure is that Representative Offices are only permitted to engage in non-profit making activity.[16] These activities include market investigation, display, publicity activities, liaising domestic procurement and domestic investment of foreign companies.[17] Conversely they are not permitted to negotiate or enter into contracts, invoice or issue tax receipts in China.[18]

Representative Offices have also been subject to heightened regulation and inspections in recent years. It has been suggested that because little or no tax applies to this structure, the Chinese authorities view it unfavourably and want to assure that any revenue generating activity is taxed and therefore is conducted within other business structures.

This business structure suits those businesses that require a sourcing function in China or looking at establishing a presence in China and are researching the feasibility of the market.

The Historical Context of Foreign Investment in China

China has long held a particular fascination for foreign traders.[19] Commercial activity between China and the outside world date back millennia. The nature and routes have changed over time from Asian seaborne merchants from the straits of Malacca to the overland caravans of the Silk Road to established foreign trading ports along China's vast coast.

Japanese occupation of a large part of China, World War II and its devastating effects, civil war that ensued and the Communist revolution saw international trade essentially suspended with the outside world.

From 1949 Socialist Maoist reforms were enacted that empowered the Chinese Communist Party to control all facets of society, not least of all the commercial activity and the nation's legal framework. Chairman Mao Zedong issued five basic tenets to govern foreign trade, which consisted of:[20]

- Confiscating the bureaucratic capital of the Guomintang Government
- Abolishing the beneficial treatment extended to the aristocracy in China
- Protecting the industry and commerce of the bourgeoisie
- Establishing a state economy
- Imposing state control over foreign trade

[16] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[17] Zeng Xianwu, 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276
[18] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[19] Tim Jay, 'Riding the Dragon: Law and Legal Opportunities in China' (2009) 15(1) *The National Legal Eagle*, http://epublications.bond.edu.au/nle/vol15/iss1/5
[20] Jordan Brandt, 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286.

Foreign owned import export enterprises deemed essential to the national interest of China were, for a time, permitted but by 1956 all private import export companies had become part of state owned enterprises.[21] It wasn't until 1978 that international trade was reintroduced to China in a meaningful way.

Gaige Kaifang, the reform opening China to the international world, is largely attributed to Deng Xiaoping. Succeeding Mao Zedong, Deng set about introducing a raft of reforms from 1978. Despite economic reforms having been introduced more than a decade earlier the events in Tiananmen Square in 1989 threatened their implementation as conservative factions within the Communist Party in Beijing began to question their feasibility. Deng argued that without economic growth the Communist Party would suffer the same fate as its brethren in the Soviet Union and Eastern Europe.[22] He forged on and in 1992 he set out on the southern tour of the most reform minded provinces of China, an astonishing endorsement of reform. It was a masterstroke and the economy has barely looked back since.[23]

Since then China has transformed itself into a bona fide economic power. It has lifted almost 500 million people out of poverty, the largest such effort in the history of the world.[24] This economic revolution and sustained growth over the past 30 years has become the foundation upon which the present day Communist Party has been able to construct its political legitimacy and relevance. All of this was made possible by the reforms enacted by Deng Xiaoping allowing private enterprise to exist is China and encouraging foreign investment.

Foreign investment has played a significant role in the rise of China. It has been encouraged in a number of ways one of which has been the establishment of foreign enterprises in China. A primary motivation for reforming the commercial legal framework in China to allow foreign direct investment was to absorb advanced technology and western managerial skills.[25]

It is important to note that commercial law, as with most law in China, has evolved at a meteoric rate. This is a consequence of opening reform and having to keep pace with the rapid development of the economy. As a result it continues to change and no doubt will in the future. A historical context is important in understanding where the law is now and its propensity for change.

Business Structures Available to Foreign Investors in China

Broadly speaking there are five legal structures available for foreign organizations seeking to establish a permanent presence in China. Foreign organizations are able to choose the most appropriate entity in accordance to their intended scope of operation. It is important to consider current business operations as well as future goals as changing business structures once established is not an easy or quick process.

---

[21] Jordan Brandt, 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286, 292.
[22] 'China and the Paradox of Prosperity' (2012) January 28th –February 3rd *The Economist* 9.
[23] ibid
[24] Christine Laguard IMF Interview Beijing March 19th 2012 *CCTV News*
[25] Jordan Brandt, 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286, 292.

The options most often used by foreign organizations are:[26]

- Representative Office
- Wholly Foreign Owned Enterprise
- Equity Joint Venture
- Contractual Joint Venture
- Foreign invested Partnership Enterprise

Representative Offices

The Representative Office (RO) is arguably the simplest business structure available to foreign organisations. A Representative Office provides a relatively easy path to a presence in China as a company operating outside of China need only register with the State Administration of Industry and Commerce (SAIC).[27] With the exception of a few heavily regulated industries such as the insurance, financial and legal sectors no further permissions or licenses are required. That being said there are limitations to the scope of operations and resourcing permissible under the current regulation.

Representative Offices are only permitted to engage in non-profit making activity.[28] These activities include market investigation, display, publicity activities, liaising domestic procurement and domestic investment of foreign companies.[29] Conversely they are not permitted to negotiate or enter into contracts invoice or issue tax receipts in China.[30]
Recently the regulations governing Representative Offices were tightened following an announcement from the SAIC. Amongst the newly introduced rules, Representative Offices are now only permitted to employ up to 4 expatriate workers. Licenses to operate as a Representative Office must now be renewed annually as opposed to every three years, the previous term. Finally the SAIC in conjunction with the Ministry of Public Security are permitted to inspect Representative Offices within 3 months of registration. Any transgressions may incur administrative fines.[31]

Registering a Representative Office

As with the general structure of Representative Offices the process of registering one is also the easiest, comparatively speaking. Foreign organizations must appoint a Foreign Enterprise Service Company (FESCO) to submit their registration papers to the provincial Ministry of Commerce. These papers include:[32]

- A letter of authorization signed by the principal of the organization
- Letters of incorporation

---

[26] Zeng Xianwu, 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276
[27] China Market Intelligence, 'China Issues New Rules Governing Representative Offices' (2011) March-April *China Business Review* 39.
[28] 'China Knowledge'(2011) www.chinaknowledge.com/business/CBG
[29] Zeng Xianwu, 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276
[30] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[31] China Market Intelligence, 'China Issues New Rules Governing Representative Offices' (2011) March-April *China Business Review* 39.

[32] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG

- Financial records
- A bank or auditors guarantee attesting to the solvency of the business
- A letter of appointment of the chief representative for China signed by the board of directors, chairman or general manager of the organization
- The resume of the chief representative as well as identification
- Lease agreements for any office facilities required

Other information may be requested by the provincial or local authority. It is also worth noting that in order to establish a Representative Office the organization must have been in continuous operation in their home market for over two years.

Once these documents are submitted the Ministry of Commerce should issue a permit. This permit enables a foreign organisation to register with the SAIC for a business certificate. Once the business certificate is issued the Representative Office is legally registered in China it does however not enjoy the status of a legal person.[33]

In order for a Representative Office to be operational there are further requirements that are necessary for the chief representative to complete. These are:[34]

- Residency application of the chief representative - this is to be submitted to the Public Security Bureau
- Open a the relevant local bank accounts for the operation of the Representative Offices
- Register at the local tax authority
- If the organisation requires any recruitment to be completed in China, a FESCO must be appointed to perform the process

Wholly Owned Foreign Enterprise (WOFE)

The most common business structure available to foreign investors in China is a Wholly Owned Foreign Enterprise (WOFE). This option is traditionally chosen by organizations that have been involved in China for some time and have a relatively solid indication that there is an appropriate market for their goods or services. It is necessary to choose this structure as they contravene the conditions of a Representative Office in that they intend to perform profit making activity and they have determined that a permanent presence in China is a business imperative.

A Wholly Owned Foreign Enterprise is a limited liability company incorporated in china owned by one or more foreign investors.[35] In light of this status there are a number of additional permissions and approvals required to establish a Wholly Owned Foreign Enterprise.

[33] 'Order of the President' (2005) No 42 article 196, *The Company Law of the People's Republic of China*
34 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[35] Zeng Xianwu, 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276

Registering a Wholly Owned Foreign Enterprise

The first step is to prepare a project proposal to be submitted to local authorities. These authorities vary throughout China depending on location. The project proposal will be considered by the local authority and a reply will be issued. This process takes no more than 30 days. If the authorities approve the proposal the foreign organisation is able to register the company name with the SAIC and move forward with the application. To do this the foreign entity is required to have:[36]

- Objectives of the company
- Business scope and scale
- Details of any land and or plant equipment required
- Utilities required for operation
- Details of public facilities required

Once a response is received from the SAIC in regards to the entities name the foreign investor should apply to the Ministry of Commerce for approval. This approval process actually requires two applications. The first application is to receive approval for the project or business. The second is contingent upon approval of the first application. If the foreign enterprise receives the approval for the project they must then apply to the Ministry of Commerce for an official approval certificate.

These applications require the same documentation as the previous exercise with the local authority however may require additional information depending on the amount of investors, the type of business and the location.

Once the final approval is received the foreign investor must register for a business license with the SAIC. This process should take no longer than 10 days if they are satisfied with the documentation of the project.[37]

As with the establishment of all business structures in China the final step in the process is satisfying the administration needs of the business. These include registering for tax and with the local authorities such as the public security bureau, foreign exchange administration and banking and insurance inspection departments, applying for a company seal and enterprise code and opening bank accounts.

Joint Ventures

Contractual Joint ventures and equity joint ventures are a further two options available for foreign investors in terms of establishing a permanent presence in China.

A joint venture broadly speaking is a business arrangement in which the participants create a new business entity or official contractual relationship and share investment and operation expenses, management responsibilities and profit and losses.[38] This

[36] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[37] ibid
[38] 'Joint Venture Registration in China' (2012) February 10th *Path to China* http://wwwpathtochina.com

type of business structure is encouraged by the Chinese government but can often be resisted by foreign investors. Chinese law permits for two such types of business. They are structurally similar and the process of registration is similar however there are differences in their commercial and capital requirements.

Contractual Joint Venture

A contractual joint venture or Sino-foreign joint venture is a contractual partnership between two entities, one Chinese and one foreign. They can be registered as a limited liability company and enjoy the status of legal entity[39]. However they may also remain separate legal entities and bear liabilities separately.[40]

A further feature of this structure is that there is no minimum capital requirement stipulated for the foreign investor to contribute. This means that the foreign party may choose to be a minor shareholder. It is also left to the discretion of the parties to determine what form the investment of each party will take i.e. money, resources, technology. Finally the profit distribution of this business structure is also left to the parties meaning that profit sharing need not align absolutely to the share agreements but the contract. [41]

Equity Joint Venture

Equity joint ventures, however similar in overall structure to contract joint ventures, differ in regards to regulatory conditions. Equity joint ventures are the second most used business structure by foreign investors entering china and the preferred manner for cooperation where the Chinese government and Chinese businesses are concerned.[42]

Firstly there is minimum capital requirement of the foreign investor of at least 25%. This does not apply to the Chinese partner. The profit and liability are divided in accordance with the equity percentages. This means that if the foreign investor holds 50% equity in the company they are entitled to 50% profit and 50% of any loss or liability incurred. Terms for this sort of business structure normally range from 30 to 50 years however in certain situations a perpetual term may be granted.[43]

Equity may not be withdrawn during the term of the agreement and shareholdings are generally not transferable.[44]

[39] Zeng Xianwu, 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276
[40] 'Joint Venture Registration in China' (2012) February 10th *Path to China* http://wwwpathtochina.com
[41] ibid
[42] ibid
[43] ibid
[44] 'Joint Venture Registration in China' (2012) February 10th *Path to China* http://wwwpathtochina.com

Registering a Joint Venture

The process of registering both types of joint ventures in china is similar. As a rule the Chinese entity is responsible for the majority of the administration in the establishment of the partnership.

Upon reaching a mutual agreement, the Chinese partner will be solely responsible for the preparation and submission of the project proposal for preliminary scrutiny.[45] This highlights the importance of a thorough due diligence process before entering into the arrangement.

A letter of intent outlining the nature of the partnership signed by both parties of the joint venture is the first requirement of submitting a project proposal.[46] Once this proposal is submitted to the local authority an approval or rejection letter will be sent to the Chinese party. If the initial project proposal is accepted the name of the new company should be registered with the SAIC.

This process will require the key information about the project that includes:[47]

- Technology involved in the venture
- Utility requirements if substantial
- Capital contribution and financing
- Foreign equipment required for the project
- Environmental feasibility study

Other information may be required depending upon the nature and industry sector of the venture. A number of documents are also required to be submitted in this process. These include:

- Enterprise registration certificates of both parties
- Credit certificates
- Letters of intent from both parties

Once the entity name is registered it is suggested that a feasibility study be prepared in cooperation with both parties to outline operational detail and expectations. This process is recommended yet may be not mandatory.[48]

The joint venture contract and articles of association may be prepared at this stage. The Chinese entity usually takes a leading role in the preparation of this documentation. All of the aforementioned information and documentation will be required for the submission in order to receive approval. The project proposal, letter of intent, entity name certificate feasibility study, any supporting documents from the parties or government bodies, a list of board of directors and registration and personal identification information of key individuals will all be included in the

[45] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG
[46] Jaime Ubilla, 'Establishment of a Joint Venture – China' (2009) *HG .Org Legal Directories* http://www.hg.org/article.asp?id=7496
[47] ibid
[48] ibid

documentation as appendices.[49] Once completed and compiled the Chinese party will submit the document to the Ministry of Commerce for approval.

Once the parties receive approval from the Ministry of Commerce they are required to apply to the SAIC for a business license. The joint venture is officially considered to exist once this license is obtained. As with a WOFE there are administration requirements such as applying for a company seal and code and registering for tax. A major benefit with joint ventures is that the Chinese partner has local market knowledge, contacts and experience that enables them to expedite the process.

Foreign Invested Partnership Enterprises

Foreign invested partnership enterprises (FIPE) are a relatively new structure available to foreign investors. The Administrative Measures on Establishment of Partnership Enterprises by Foreign Enterprises released by the State Council in March 2010 allows for foreign investors to be able to access this structure along with Chinese nationals.[50] The major advantage in this structure is that fact that approval from the Ministry of Commerce is not required and registration of this structure sits solely with the SAIC. Seeing as though the structure is so new it is yet to be seen if this is actually the case.

The structure is a limited partnership and can be between two of more foreign investors and or Chinese partners. Further to this there is no minimum capital requirement.

Registering a Foreign Invested Partnership Enterprises

Foreign investors are able to apply directly with the SAIC for approval and a business license. This process should take no longer than 10 days if they are satisfied with the documentation of the project.[51] This documentation includes:

- Registration application
- Partnership agreement
- Personal identification of key personnel within the entities

Other information may be required at the discretion of the authority.

It is also worth noting that the partners must appoint one person and has authority to represent the new entity in this process. This responsibility may be deferred to a third party but the appointment must be unanimous.[52]

---

[49] 'China Knowledge' (2011) www.chinaknowledge.com/business/CBG

[50] Charles Qin and Elva Yu, 'Foreign Invested Enterprises- New Mode of Foreign Invested Private Equity Fund' (2010) October, *Llinks Asset Management Bulletin* 1, 2.

[51] 'The Significance of the Foreign-Invested Partnership Enterprises for Foreign Investors in China' (2010) February 1st, *Novasage Incorporations* http://www.novasage.com/jnews/cn-20100201-the-significance-of-foreign-invested-partnership-enterprises-for-foreign-investors-in-china

Once approval is given by the SAIC the entity must file a report to the ministry of commerce outlining the information that has been given to the SAIC in the application process.[53] The regulation stipulates that the information need only be filed and no approval is required as stated above.

As with the establishment of all business structures in China the final step in the process is satisfying the administration needs of the business. These include registering for tax and with the local authorities such as the public security bureau, foreign exchange administration and banking and insurance inspection departments, applying for a company seal and enterprise code and opening bank accounts.

Conclusion

The ascendency of China will likely be the most significant economic event of a generation. The accessibility the internet and globalisation has brought to the world now presents a unprecedented opportunity for foreign investors. In recent years this opportunity has coincided with a downturn in much of the developed world. As the domestic market matures foreign investors have the experience, resources and opportunity to establish a presence in China. Despite the opportunity it still remains a daunting option for many businesses.

This paper has explored the commercial legal framework that governs foreign companies looking to do business in China. It has outlined the options available in regards to governance structures, necessary considerations and the process involved in each option. This report has looked to expand on the theoretical understanding by incorporating contemporary experiences of foreign enterprises that have established a business presence in China. It has examined why certain structural decisions are made and the practical limitations of different business structures.

---

[52] 'The Significance of the Foreign-Invested Partnership Enterprises for Foreign Investors in China' (2010) February 1st, *Novasage Incorporations* http://www.novasage.com/jnews/cn-20100201-the-significance-of-foreign-invested-partnership-enterprises-for-foreign-investors-in-china

[53] ibid

Bibliography

Jay, Tim. 'Riding the Dragon: Law and Legal Opportunities in China' (2009) 15(1) *The National Legal Eagle*, http://epublications.bond.edu.au/nle/vol15/iss1/5

Brandt, Jordan. 'Comparing Foreign Investment in China Post-WTO Accession, With the Foreign Investment in the United States, Post-9/11' (2007) 16(2) *Pacific Rim Law and Policy Journal* 286.

'China and the Paradox of Prosperity' (2012) January 28th –February 3rd *The Economist* 9.

Lagaurd, Christine. 'IMF Interview Beijing' March 19th 2012 *CCTV News*

Xianwu, Zeng. 'China; Overview of Doing Business in China' (2011) *Mondaq* http://www.mondaq.com./article.asp?articleid=159276

China Market Intelligence, 'China Issues New Rules Governing Representative Offices' (2011) March-April *China Business Review* 39.

'China Knowledge' (2011) www.chinaknowledge.com/business/CBG

'Order of the President' (2005) No 42 article 196, *The Company Law of the People's Republic of China*

'Joint Venture Registration in China' (2012) February 10th *Path to China* http://wwwpathtochina.com

Ubilla, Jaime 'Establishment of a Joint Venture – China' (2009) *HG .Org Legal Directories* http://www.hg.org/article.asp?id=7496

Qin, Charles and Yu, Elva. 'Foreign Invested Enterprises- New Mode of Foreign Invested Private Equity Fund' (2010) October, *Llinks Asset Management Bulletin* 1, 2.

'The Significance of the Foreign-Invested Partnership Enterprises for Foreign Investors in China' (2010) February 1st, *Novasage Incorporations* http://www.novasage.com/jnews/cn-20100201-the-significance-of-foreign-invested-partnership-enterprises-for-foreign-investors-in-china

'Sectoral Distribution of FDI in China' (2010) April 22nd *Invest in China: Ministry of Commerce P.R.China* http://wwwfdi.gov.cn/pub/FDI_EN/Statistics/homenews/t2010042

Han, Lily, Zong, Kelly and Ye, Wei Wei, 'Registered Capital of Foreign Invested Enterprises in China: Not as Scary as it Seems' (2012) *Lehman Lee & Xu* www.lehmanlaw.com

'Starting a Business in China: Doing Business' (2011) *The World Bank Group* http://doingbusiness.org/data/exploreeconomies/china/starting-a-business-in-china

Parker, Polly, Verreynne, Martie-Louise and Wilson, Marie, 'Employment Systems in Small Firms: A Multi-level Analysis' (2012) *International Small Business Journal*

Harris, Dan, 'Foreign Investment (FDI) in China. The Glass is Half Empty Not Half Full' (2010) *China Law Blog: China Law for Business* http://www.chinalawblog.com/2010/05/foreign_investment_fdi_in_chin_2.html

China's FDI and Non-FDI Economies and the Sustainability of Future High Chinese Growth, (2011) http://www.nber.org/papers/w12249

Zhang, Xueyuan, Krug, Barbara and Reinmoller, Patrick, 'Historical Attitudes and Implications for Path Dependence: FDI Development and Institutional Changes in China' (2004) December, *ERIM Report Series Research in Management*

Yu, Peter, 'Intellectual Property, Foreign Direct Investment and the China Experience' (2007) *Oxford University Press* www.peteryu.com

Fung, K.C, Iizaka, Hitomi and Tong, Sarah 'Foreign Direct Investment in China: Policy, Trends and Impact (2002) June, *China's Economy in the 21st Century*

Riley, Michael, Vance, Ashlee and Schneeweiss, Zoe, 'Its Not Paranoia if They're Stealing Your Secrets: Inside the Chinese Boom in Corporate Espionage' (2012)March 19th -25th, *Bloomberg Businessweek*

Ferguson, Niall, 'Civilization: The Rise and Fall of East and West' (2011) *BBC Documentaries*

Export Ready Planning Guide

Below is a guide to assist businesses who are at the early stages of looking to export. Consider the information in this report and review the resources and in particular the human resources required to enter export markets.

Review your completed results with internal parties and external advisors as part of your problem solving and decision making process.

Consideration	Details	Action
Timing What is the timeframe for export?		
People Who will be responsible for the project (internal resource/new hire /contractor)?		
Industry Sectors What industry sector(s) and core products or services will be exported?		
Regulatory Considerations What sort or licenses, permissions, registrations will be required?		

Advisors Who will be responsible for expert advice (domestic or international resource)?	
Budget What is a realistic budget for this project (time/money/resources)?	
Timeframe What is the timeframe for the project?	
Model Options What are the model options for the business?	
Government Bodies What government bodies will need to consulted and or can help with this project (domestic and international)?	
Other Considerations	

Disclaimers

Notwithstanding anything contained in this document:

HR Coach Research Institute disclaims responsibility (including where HR Coach or any of its employees, agents or contractors has been negligent) for any direct or indirect loss, damage, claim, or liability any person may incur as a result of any:

I. reliance on or compliance with this document
II. inaccuracy or inappropriateness of this document; or
III. inconsistency of this document with any law

IP rights

Information and systems, which are used to compare with this document may require the use of copyright information which is protected in Australia. Questions about the availability of such information, under licence or otherwise, should be directed to the HR Coach Research Institute.

Keeping the Information and Data up to date.

The information is a living process which reflect current market information. To maintain currency, this data analysis will be reviewed periodically and new editions will be published. Editions and amendments may be issued from time to time and it may also be withdrawn. It is important that readers assure themselves they are using a current documentation. Information on this data will be maintained by the HR Coach Research Institute. We welcome suggestions for improvement in this document and encourage users to notify us. Please address your comments to the Secretariat of the HR Coach Research Institute, P O Box 2292, Fortitude Valley, Queensland, Australia 4006.