

# Ways to enter the Chinese market

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## **Table of Contents**

1. Preliminary remarks .....	1
1.1 Compliance.....	1
1.2 Protection of your intellectual property rights.....	1
1.2.1 Introduction to IP.....	2
1.2.2 Registering IP in China.....	2
1.2.3 Trademark registration .....	2
1.2.4 Patent registration .....	2
1.2.6 IP enforcement channels in China.....	3
1.2.7 Online IP enforcement in China .....	4
1.3 Foreign exchange control .....	5
1.4 China, Hong Kong, and Pilot Free Trade Zones .....	5
2. Broad methods of market entry .....	7
3. Exporting .....	10
3.1 Indirect exporting (using an intermediary).....	10
3.2 Direct exporting.....	11
4. Licensing and franchising.....	13
4.1 Licensing .....	13
4.1.1 Technology transfer.....	13
4.1.2 Transferring technology to China.....	13
4.1.3 Steps for transferring technology to China.....	14
4.1.4 Documentation generally required for recording a patent licensing contract.....	14
4.1.5 General provisions for copyright licensing.....	15
4.1.6 General provisions for trademark licensing.....	15
4.2 Franchising .....	16
4.2.1 Franchise requirements in China .....	16
4.2.2 Franchise agreement .....	17

4.2.3 Recording the franchise agreement with MOFCOM.....	17
4.2.4 How to Record a franchise agreement with MOFCOM .....	18
4.2.5 Advantages and disadvantages of franchising.....	18
4.2.6 Suggestions for new-to-China franchisors.....	19
5. Selling online.....	20
5.1 Standalone websites.....	20
5.2 E-commerce platforms .....	20
5.2.1 C2C (consumer-to-consumer) platforms .....	20
5.2.2 B2C (business-to-consumer) platforms .....	20
5.2.3 Online-to-offline service platforms .....	21
5.2.4 Selecting an E-Commerce platform either within or outside of China.....	21
6. Directly investing - Wholly foreign-owned enterprises and joint ventures.....	23
6.1 Wholly foreign-owned enterprises ( “WFOEs” ).....	23
6.2 Joint ventures ( “JVs” ) .....	24
6.3 Activities.....	25
6.4 Capital structure.....	26
6.4.1 Total investment amount .....	26
6.4.2 Registered capital .....	26
6.5 Foreign exchange control on current and capital accounts.....	26
6.6 Approval process .....	27
6.6.1 General procedure for setting up a foreign invested enterprise .....	28
7. Direct investment – partnerships .....	29
7.1 Authorised activities .....	29
7.2 Capital.....	29
7.3 Approval process .....	29
8. Branches .....	31
8.1 Approval process .....	31
9. Representative offices ( “ROs” ).....	32

9.1 Approval process .....	32
10. Pilot Free Trade Zones ( “PFTZs” ).....	33
10.1 Locations and features of each PFTZ.....	33
10.2 The features and benefits of PFTZs.....	35
10.3 Recommendations .....	36
11. Using Hong Kong as an entry point to mainland China.....	37
11.1 Supervision from mainland China.....	37
11.2 Two special areas and one agreement for Hong Kong as a channel to mainland China .....	37
11.2.1 Qianhai and Hong Kong .....	37
11.2.2 The Greater Bay Area.....	37
11.3 China and Hong Kong’ s Closer Economic Partnership Arrangement ( “CEPA” ).....	38
11.4 Setting up in Hong Kong .....	38
12. Recommendations regarding the best way to enter the Chinese market .....	41

### **Exchange rates**

All exchange rates in this report are calculated on the basis of: EUR 1 = CNY 7.80 = USD 1.11

## 1. Preliminary remarks

As befits such a large and complex economy, there are numerous ways to enter the China market. It is important for EU SMEs to consider what they are hoping to achieve in China, as it is through knowing this that they will be able to enter the market in a way that allows them to establish suitable relationships with Chinese partners, protect their investments and intellectual property, and minimise risk.

### 1.1 Compliance

China has issued and amended a range of laws and regulations to attract foreign investment in recent years. It is therefore important to understand the latest polices before entering into the market or trading with businesses in China. This will avoid risky behaviour such as non-standard business practices which could negatively influence business and future prospects.

The primary laws to focus on are:

- The [Foreign Investment Law of the People's Republic of China](#) (中华人民共和国外商投资法) and its implementation regulations: These took effect in January 2020;<sup>1</sup>
- The [Regulations of the People's Republic of China on the Administration of Import and Export of Technologies](#) (中华人民共和国技术进出口管理条例, “TIER”): These were revised in 2019, with the elimination of forced technology transfer being a key feature;
- The [Special Administrative Measures for the Access of Foreign Investment \[Negative List\]](#) (外商投资准入特别管理措施【负面清单】), a separate [Negative List for the Pilot Free Trade Zone](#) (自由贸易试验区外商投资准入特别管理措施【负面清单】, “FTZ Negative List”), and the [Catalogue of Industries for Encouraging Foreign Investment](#) (鼓励外商投资产业目录): These were updated in 2019 with listings of the encouraged, restricted, and prohibited industries that foreign businesses can get involved in.

These laws and regulations provide guidelines for foreign businesses regarding market access and business operations in China. It is, however, always recommended that an enterprise seek legal advice before entering the China market and pay attention to the considerations below, so as to be in compliance with relevant laws and polices:

- Protection of personal privacy and data, and cybersecurity compliance;
- Anti-commercial bribery, anti-unfair competition, and anti-monopoly policy compliance;
- Environmental and health and safety compliance;
- Tax compliance;
- Employment compliance;
- Intellectual property (“IP”) protection;
- Due diligence towards Chinese partners or suppliers.

Seeking detailed advice from reputable law firms or accounting firms to ensure that practices are in compliance with local polices is recommended.

### 1.2 Protection of your intellectual property rights

A prerequisite before entering the market in China is obtaining proper IP rights protection for products in China. Without patent, trademark, or copyright registration and protection in China, it is not possible to file

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<sup>1</sup> <http://en.pkulaw.cn/display.aspx?cgid=bb7e08ee6f9a35f4bdfb&lib=law>

complaints with the relevant authorities, and such complaints can help investigators find the person(s) liable for encroaching on an enterprise's rights. Registration of IP rights in other jurisdictions does not necessarily enable the extension of these IP rights to China, unless it is admitted through the international protocols and treaties that China has ratified, such as the Patent Cooperation Treaty ( "PCT" ), the Madrid Protocol, the Paris Convention, and TRIPS.

### **1.2.1 Introduction to IP**

IP refers to creations of the mind, such as inventions, literary and artistic works, and designs, as well as symbols, names, and images used in commerce.

IP is protected in law by concepts including patents, copyright, and trademarks, which allows the relevant owners to be recognised for and/or financially benefit from what they have invented or created. By striking the right balance between the interests of innovators and the wider public interest, the IP system aims to foster an environment in which creativity and innovation can flourish.<sup>2</sup>

### **1.2.2 Registering IP in China**

IP rights are a common concern for companies doing business in China. If a company is doing business in China or plans to do so, it is important to know how to use, register, and enforce the IP rights that are relevant to the business activities carried out or to be carried out. It is also important to appreciate that registered IP rights are territorial. Thus, for example, a patent or trademark granted in an EU country has no effect in China.<sup>3</sup>

### **1.2.3 Trademark registration**

China is a "first-to-file" country, which means that the person who registers a trademark for a product will also have all exclusive rights to distribute and sell the product. Applying for a trademark is therefore a crucial step for foreign enterprises doing business in China. There are two ways for foreign applicants to apply for a trademark:

- National registration: A foreign individual or a foreign company can authorise a local trademark agency to apply to the [Trademark Office of China at the National Intellectual Property Administration](#) (国家知识产权局商标局中国商标网, "CNIPA Trademark Office" or "TMO");
- International registration: A foreign applicant can file an international application via the World Intellectual Property Organization ( "WIPO" ) under the Madrid Protocol, which enables the owners of trademark applications and registrations to extend their rights to many other members, including China.

The process for trademark registration in China usually takes 12-14 months, based on Chinese trademark law (nine months for trademark examination and three months for the trademark gazette process). The registered trademark is valid for 10 years and can be renewed for another 10 years before expiration.

### **1.2.4 Patent registration**

In China, there are three types of patent: invention patents, utility models, and design patents.

China, like most other countries, has a "first-to-file" system for inventions, designs, and utility models. This means that it is usually necessary for an enterprise to consider its filing strategy for China at an early stage in

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<sup>2</sup> <https://www.wipo.int/about-ip/en/>

<sup>3</sup> [http://handbook.cbbc.org/handbook#chinabusinesshandbook/4\\_4\\_registering\\_trade\\_marks\\_ip\\_protection](http://handbook.cbbc.org/handbook#chinabusinesshandbook/4_4_registering_trade_marks_ip_protection), the article was contributed by Potter Clarkson LLP

the development of a product, perhaps many years before the product is taken to China (whether it is to be manufactured or marketed there).

Invention patents provide protection for a product or process that has a practical application. Chinese invention patents provide protection for a maximum period of 20 years from the date on which the patent application was filed. Utility model protection is available for products that have a practical application, but not for processes, chemicals, or biotechnology. Design patents protect the visual appearance of a product, such as the shape, pattern, or colour of a product or any combination of these. Utility models and design patents both provide protection for a maximum of 10 years, and it is also the case that renewal is not allowed for registered patents but innovation based no registered patents can be registered as new patents.

### **1.2.5 Copyright registration**

According to the Berne Convention, copyright protection is obtained automatically without the need for registration or other formalities.<sup>4</sup> However, China provides voluntary registration systems which can help solve disputes over ownership or creation, as well as facilitate financial transactions, sales, and the assignment and/or transfer of rights.<sup>5</sup>

Although copyright registration is voluntary in China, it is recommended that rights owners register their copyright in China, as a copyright certificate could be helpful when enforcing rights in China. Foreign rights owners usually authorise local law firms to record copyright at the [Copyright Protection Center of China](#) (中国版权保护中心, “CPCC” ).

The types of works that can be recorded in China are:

- Written works;
- Musical works;
- Cinematographic works;
- Dramatic works;
- Traditional forms of Chinese performing arts (e.g., acrobatics, traditional opera);
- Fine art;
- Architectural works;
- Photographic works;
- Graphic works;
- Computer software.<sup>6</sup>

If an application is carried out smoothly it will take two to three months for the rights owner to obtain the copyright certificate.

### **1.2.6 IP enforcement channels in China**

There are three main formal routes for IP enforcement in China:

- Administrative enforcement (including customs authorities)

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<sup>4</sup> <https://www.wipo.int/copyright/en/index.html>

<sup>5</sup> <https://www.wipo.int/copyright/en/index.html>

<sup>6</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/821339/Copyright\\_Recodal\\_in\\_China\\_-\\_June\\_2017.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821339/Copyright_Recodal_in_China_-_June_2017.pdf)



Administrative enforcement is one of the most common routes for IP enforcement in China, as it can often provide a quick, low-cost remedy when compared with litigation, and it does not necessarily require a representative from a law firm to file the complaints (although this is recommended if the enterprise is not familiar with the administrative procedures and documents required in China). China's IP laws empower various government agencies to enforce the law to counter IP infringements. For example, in cases of trademark infringements and false advertising, the [State Administration for Market Regulation](#) (国家市场监督管理总局, "SAMR") and its local branches are the relevant authorities to enforce the law. The Chinese customs authorities are another source of administrative enforcement, albeit with a special jurisdiction over goods crossing borders to enter or leave China. To enforce IP rights through this body, the rights owner must record its IP rights with the [IP Rights Database](#) (知识产权海关保护备案子系统) of the [General Administration of Customs](#) (中华人民共和国海关总署, "GACC"), which requires a contact person in China, namely an agent or the IP rights owner's own local representative.

- Civil litigation

Civil litigation against IP infringement through China's courts is becoming increasingly common since the Chinese judicial system can be characterised as procedurally simple and fast, without evidence discovery procedures and juries. Due to the efficiency and low cost of civil litigation for straightforward cases, many IP rights owners see civil litigation as an add-on solution to an administrative action where the facts of infringement have been established and the only remaining issue pertains to the amount of compensation to be paid. Such cases may be concluded within four to six months, or more quickly if the parties are able to settle.

- Criminal enforcement

Criminal enforcement focuses on crimes related to severe IP infringement, including infringement of trademark rights such as selling counterfeits, passing off others' trademarks as one's own, copyright piracy, and illegal disclosure or acquisition of trade secrets. China's Public Security Bureau (派出所, "PSB") has the jurisdiction to investigate suspected IP infringements that reach the criminal threshold. Following the investigation, if the case is successfully filed with the PSB it will then be brought to the public prosecutor, who will review the case, issue arrest warrants, and indict the suspects for trial. The IP rights owner will be required to provide a statement verifying that the suspect goods are counterfeits.<sup>7</sup>

### **1.2.7 Online IP enforcement in China**

The internet is a popular channel for those selling counterfeit and pirated products in China. It is possible to protect IP online in China using various platforms' own interfaces, including:

- Alibaba: The Alibaba Group is one of the world's leading E-commerce platforms, with its offerings including Taobao, Tmall, Alibaba.com, AliExpress.com, 1688.com, and Lazada. Alibaba has a sophisticated IP protection platform, which accepts notifications related to IP protection for all its platforms. The English version for registering an IP complaint is available at <https://ipp.alibabagroup.com/index.htm?>
- JD.com: JD.com is one of the top two E-commerce platforms in China. It has a sophisticated system for receiving notifications related to IP protection, which is available in Chinese at <https://ipr.jd.com/edition> or in English after an account has been register at <http://enipr.jd.com/>.
- Weixin ("WeChat"): Weixin, which is known as WeChat in English, is an app owned by one of China's largest data companies: Tencent. Weixin offers an interface to file complaints about personal accounts within the app, which then get sent to brand owners registered with Tencent for verification. It also has a

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<sup>7</sup>[http://handbook.cbbc.org/handbook#chinabusinesshandbook/4\\_5\\_1\\_ip\\_enforcement\\_channels](http://handbook.cbbc.org/handbook#chinabusinesshandbook/4_5_1_ip_enforcement_channels), the article was contributed by Rouse & Co. International LLP

platform which is able to accept notifications for official accounts related to IP protection, which is available at [https://weixin110.qq.com/security/readtemplate?t=security\\_center\\_website/report](https://weixin110.qq.com/security/readtemplate?t=security_center_website/report).

### 1.3 Foreign exchange control

The circulation of foreign currency is strictly controlled both across China's borders and within its territory. Rules related to foreign exchange control can significantly influence the financing of businesses from abroad (impacting factors such as time considerations and sources of funding) and can also complicate cross-border payments for goods, services, and other cash transactions. It is therefore necessary for new market entrants to prepare medium- and long-term financial and business plans, as well as allocate more time for payment settlements.

The movement of foreign exchange into and out of China is regulated using a “managed float” system, managed by the [People's Bank of China](#) (中国人民银行, “PBOC”) and the [State Administration of Foreign Exchange](#) (国家外汇管理局, “SAFE”). Under current rules, all overseas payments made by companies with a payment term of more than 90 days (calculated with reference to the date on the import declaration form) must be reported to SAFE, irrespective of the amount this payment is worth. Exchange rates are also set using the “managed float” system.<sup>8</sup>

On 23<sup>rd</sup> October 2019, SAFE announced a number of new measures as part of continued efforts to reform China's business environment. The 12 measures, all of which are now in effect, are intended to benefit both foreign investors and domestic enterprises, and also relax the rules on cross-border trade and investment. While some apply only to the pilot areas of Shanghai, Zhejiang, and the Greater Bay Area, others have taken effect across China.<sup>9</sup>

### 1.4 China, Hong Kong, and Pilot Free Trade Zones

As well as the responsibilities that lie with its central government, the administration of China is carried out at provincial, municipal, county, district, and township levels.

Hong Kong, which returned to China in 1997, is not part of this structure. Instead, it is a special administrative region (“SAR”) governed under the principle of “One Country, Two Systems”. This means that Hong Kong enjoys a high degree of autonomy, along with executive, legislative, and independent judicial powers, whilst at the same time being subject to the decisions of the central government, such as through the [Basic Law of Hong Kong](#) (中华人民共和国香港特别行政区基本法), which was enacted by the [National People's Congress of the People's Republic of China](#) (中国人大网), and serves as the constitutional law of Hong Kong.

Hong Kong's economy went into recession in the third quarter of 2019 for the first time in a decade. Although the core causes for this recession will require time to resolve, Hong Kong will remain a key platform for doing business with China in the long run, and will continue to be a key part of China's Great Bay Area initiative.

Since the establishment of the first Pilot Free Trade Zone (“PFTZ”) in Shanghai in 2013, China has expanded this initiative to 18 PFTZ, covering all coastal and some inland provinces. These zones have made administrative reforms in the areas of investment, finance, foreign trade, and filing supervision, so as to create

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<sup>8</sup> <https://www.export.gov/article?id=China-Foreign-Exchange-Controls>

<sup>9</sup> <http://www.safe.gov.cn/en/>

a more business-friendly environment. Free trade zones are considered pilot projects and should be viewed as indicators of potential future policies that may be implemented across China, rather than exceptions that operate indefinitely.

The six newest PFTZs in the provinces of Guangxi, Hebei, Heilongjiang, Jiangsu, Shandong, and Yunnan, have each been tasked with testing different reforms, under plans issued by the CCP Central Committee (中央委员会) and [State Council](#) (国务院) in August 2019. This represents the continued efforts by the Chinese government to integrate international practices seen within foreign trade and investment into the Chinese economy. According to the State Council, this decision is “a strategic move to advance reform and opening up in the new era” .<sup>10</sup>

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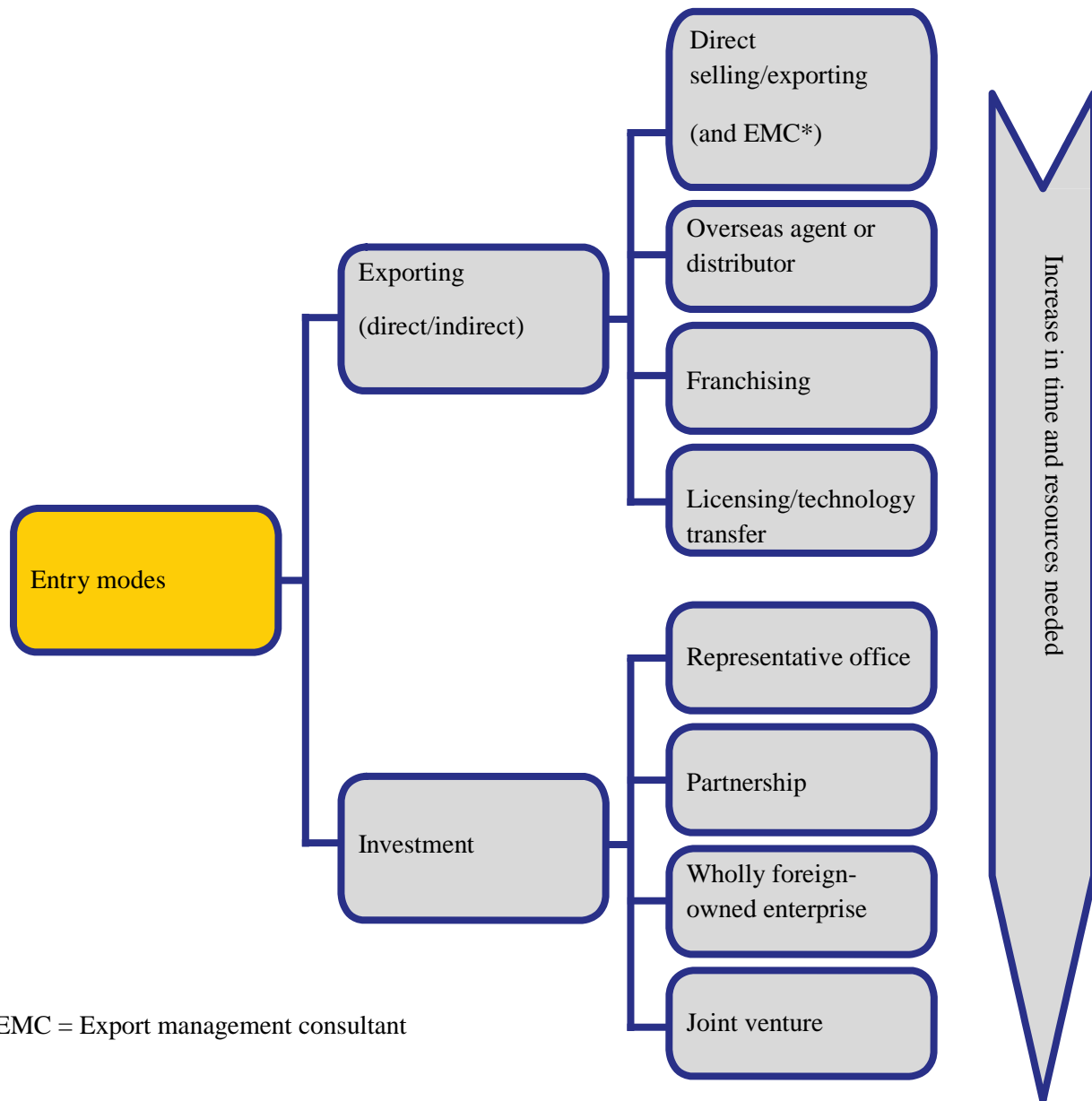
<sup>10</sup> [http://www.xinhuanet.com/english/2019-08/26/c\\_138339873.htm](http://www.xinhuanet.com/english/2019-08/26/c_138339873.htm)

## 2. Broad methods of market entry

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

- **Direct exporting:** Direct exporting refers to the exporting of goods or services from one country to another, and sending them directly to the final customer.
- **Indirect exporting (using an intermediary):** Indirect exporting is the selling of goods to an intermediary that focuses on the enterprise's target market by selling the products to customers. Intermediaries include agents, distributors, and franchisees.
- **Investing directly:** Investing directly involves the 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 ( "WFOEs" ), joint ventures ( "JVs" ), and partnerships.
- **Cross-border E-commerce (using a direct shipping model):** The cross-border E-commerce direct shipping model is used for orders that are arranged and shipped by international retailers and/or brands directly via their commercial websites. These goods are then transported to consumers after receiving customs clearance. This model also requires that these goods feature on the [Positive List of Cross-border E-commerce Retail Imported Commodities](#) (跨境电子商务零售进口商品清单), and is also suitable for companies that initially wish to test their products' suitability for the China market on a trial basis. Commodities shipped to China through this model are also subject to the Cross-Border E-Commerce Comprehensive tax rate. Three purchase records – the order, shipment, and payment information - are required to pass the customs process in China and the maximum order value for each order is CNY 5,000 (EUR 641).
- **Cross-border E-commerce (using a bonded warehouse model):** The cross-border E-commerce bonded warehouse model is used for orders that are shipped from bonded warehouses directly to consumers after customs clearance. This model is suited to products which appear in the Positive List of Cross-border E-commerce Retail Imported Commodities and tends to reduce delivery times, to the benefit of the online shopping experience. This model also allows products to be sold in bulk.

Figure 1: Methods of market entry



While each model of market entry has strengths and weaknesses, most companies develop a gradual approach based on the time and resources available to them and the market responses they receive along the way.

Considerations regarding the model of entry most suitable for an individual company's business plan include:

- The size of the enterprise;
- The nature of its products;
- Previous export experience and expertise;
- Business conditions and regulations in China (both exporting and investment requirements);
- The need for on-the-ground representation (such as marketing and after-sales services);
- The need for control of the product and IP rights protection;
- The time and resources available to the company.

## *Ways to Enter the Chinese Market*

The following sections provide a brief description of various models of market entry, along with a discussion of their advantages and disadvantages.

Please note: Before exporting their goods, services, or technology to China, EU SMEs should ensure that all IP rights are properly registered in China.

### 3. Exporting

#### 3.1 Indirect exporting (using an intermediary)

Another method of entering the China market is through an intermediary (i.e. an agent or distributor) based in China. An agent acts as a company's direct representative and is usually paid a specified management fee and/or a commission to represent and sell a product in China. An agent works more closely with the company, whereas a distributor works more closely with the company's customers.

For small and medium-sized companies, an easier way 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 those created by language and cultural differences.

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 an organisation's eyes and ears on the ground.

However, finding a dedicated, reliable, professional, and credit-worthy agent or distributor requires effort. Embassies and national chambers of commerce are often aware of agents who offer such services, hence organisations are advised to check whether the commercial department of their embassy or chamber of commerce 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, an agent cannot be hired as an employee, but the agent can enter into a service contract if they have their own company.

EU SMEs can benefit from the following advantages of using an agent:

- Greater control over the terms of sale;
- Greater control over marketing methods;
- The freedom to choose customers with whom to deal;
- The agent can give reports about the company's competition;
- The agent can focus on the company's best-selling products with the highest margin;
- The agent can advise the company on new products to launch;
- The manufacturer retains control over the storage of its goods (in contrast to the use of a distributor);
- An agent's commission is typically lower than the margin of profit earned by a distributor.

EU SMEs can be affected from the following disadvantages of using an agent:

- If the agent's work is not reviewed on a regular basis, sales may not increase;
- Supervising the agent's work requires frequent communication;
- If the company decides to end its cooperation with an agent, the agent may go on to work with the company's competitors;
- Sometimes a principal will be treated as trading in a territory if they have an agent there, which could have tax implications. Consideration should be given to local laws and double taxation;
- Maintaining stock inventory can be costly;
- The agent and the EU SME may sell similar products.

Criteria to be used by EU SMEs in order to find a suitable agent include:

- Knowledge of the product/service and its market;

- Good references and previous experience (check these to ensure quality);
- Language skills, including at least English and standard Mandarin, with Cantonese and local dialects an added advantage;
- Access to strong networks and geographical coverage;
- Access to a support team, staff, and sub-agents;
- Soft skills and sales experience;
- Ability to work with incentives (i.e. commission-based and subject to customer's prior payment);
- A strong work ethic, such as the ability to prepare and submit reports and marketing plans, conduct training, work within limited marketing budgets, translate closely-related marketing materials, and travel, as well as being respectful of the professional image of the company, and being transparent about potential conflicts of interest;
- Companies should be wary of agents who proactively approach them to be their representative. In some cases, these are scams. Companies should also be told whether an agent represents any other companies, and should consider initially assigning smaller tasks in order to assess how the agent performs.

A distributor buys a company's products and then sells them to customers either directly or through a third party. Their profit is derived from 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, however, recommended that a company have only one distributor for all of China. Not only would this be highly difficult to execute – in fact, there are only a handful of companies that can claim they have a distribution network covering all of China – but would also leave the organisation completely in the hands of one exclusive partner.

EU SMEs can benefit from the following advantages of using distributors:

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

EU SMEs can be affected by the following 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;
- 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 mainland China. EU companies should ensure that distributors are not implicated in any illegal trading activities. To minimise this risk, due diligence should be performed.

### **3.2 Direct exporting**

Direct exporting refers either to the shipment of goods or provision of services across borders or to the 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 the engagement of a company with a licence for importing/exporting according to Chinese law. Such companies are required to be registered in China, and



therefore the term “importer” in Chinese trade terminology usually refers to the registered company in China that possesses 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 or intermediary assisting with imports (specifically, bringing goods across the border and facilitating international payment).

Practically speaking, direct export is best suited for products of a smaller quantity that do not require a developed distribution network, or for the export of services or technology. EU SMEs can export through cross-border E-commerce channels to China, which enables them to sell directly to Chinese consumers without going through distributors as they would with the general trade model. Cross-border E-commerce provide two routes to EU SMEs: direct shipping from overseas to Chinese consumers ( “B2C” ) and bonded importation ( “B2B2C” ). The former model requires relatively low up-front investment in bulk shipping and inventory stocking while the latter model requires that inventory should be shipped and stocked in warehouses within free trade zones in China. Both routes require that the imported commodities should be on the [Positive List of Cross-border E-commerce Retail Imported Commodities](#) (跨境电子商务零售进口商品清单).

Higher gains come from cutting out any middlemen (such as intermediaries and agents) and avoiding the costs of setting up in China. However, such companies also have 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 and banks, as well as manage customs procedures (if not handled by the Chinese import/export company). The result of this is that companies develop a deeper understanding of their customers, the processes, and the market itself.

EU SMEs can benefit from the following advantages of direct exporting:

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

EU SMEs can be affected by the following disadvantages of direct exporting:

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

## 4. Licensing and franchising

### 4.1 Licensing

Licensing is permission granted by an exclusive owner of IP rights, such as technology or patents, trademarked content, and copyrighted content, to another party to use this IP on the basis of agreed-upon terms and conditions, such as payment of royalties, while the IP owner retains ownership of the IP.

There are three types of licensing: an exclusive licence, a sole licence, and a non-exclusive licence. An exclusive licence is only granted to a single licensee, and excludes the holder from using the IP and from granting licences to any other person. A sole licence is only granted to one licensee and excludes the holder from granting licences to any other person, but does not exclude the holder from using the IP. A non-exclusive licence does not exclude the holder from using the IP nor from granting licences to any other person.<sup>11</sup>

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

Licensing IP 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.

#### 4.1.1 Technology transfer

According to Article 2 of the [Regulations of the People's Republic of China on the Administration of Import and Export of Technologies](#) (中华人民共和国技术进出口管理条例, “TIER”), technology transfer includes the assignment of patent rights or rights to apply for patents, the licensing of rights to implement patents, the assignment of technical know-how, and technical service.<sup>12</sup>

It is important to bear in mind that the transfer of technology could be severely hindered if organisations do not patent their inventions; indeed, without IP (patent) rights, the transfer of technology is difficult. The transfer of technology assumes that one or more parties have legal ownership of a technology and this can only be effectively obtained through appropriate IP protection. Without IP protection for the technology in question, all sides tend to be suspicious of disclosing their inventions during technology transfer talks, fearing that the other side may “run away with the invention”.<sup>13</sup>

#### 4.1.2 Transferring technology to China

Before licensing their technology to China, organisations should consult the [Catalogue of Technologies Prohibited or Restricted by China from Import](#) (中国禁止进口限制进口技术目录), revised in 2007, published by the [Ministry of Commerce of the People's Republic of China](#) (中华人民共和国商务部, “MOFCOM”). This catalogue lists restricted and prohibited imports, while all other imports not mentioned on the list are, in principle, permitted.

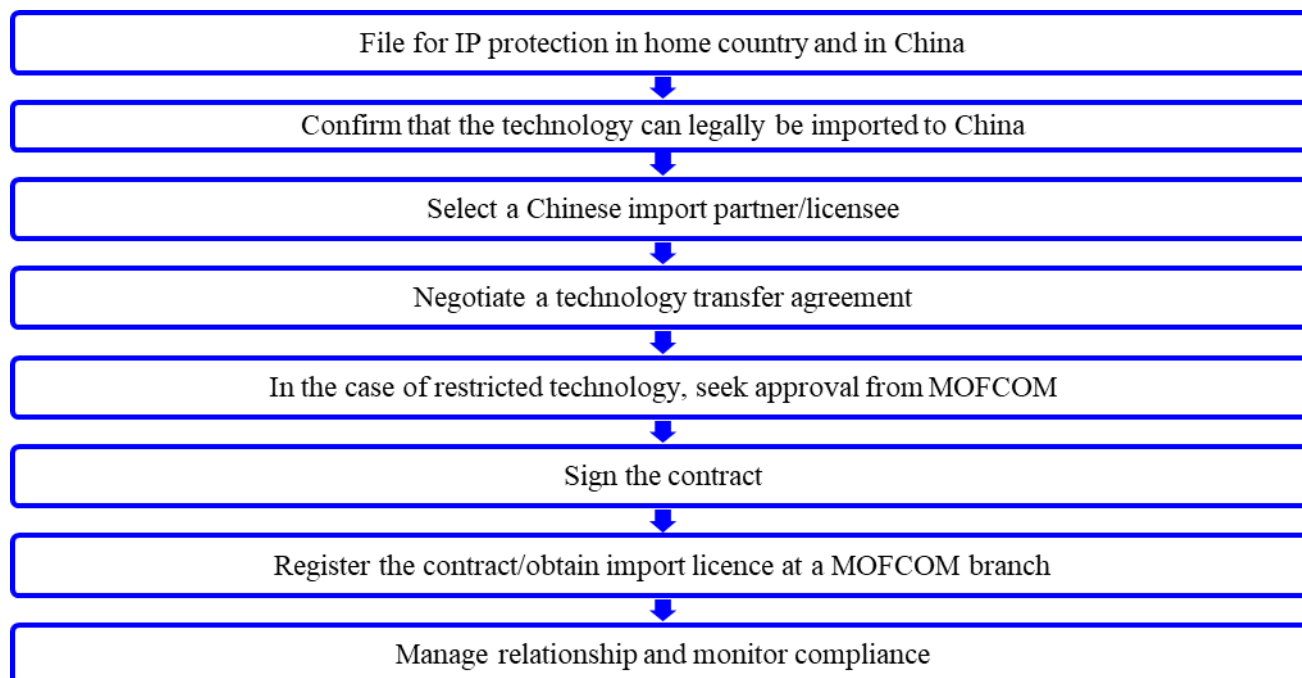
<sup>11</sup> <https://www.wipo.int/edocs/pubdocs/en/marks/835/pub835.pdf>

<sup>12</sup> <http://en.pkulaw.cn/display.aspx?id=fa9e39957fe937c6bdfb&lib=law&SearchKeyword=&SearchCKeyword=%d6%d0%bb%aa%c8%cb%c3%f1%b9%b2%ba%cd%b9%fa%bc%bc%ca%f5%bd%f8%b3%f6%bf%da%b9%dc%c0%ed%cc%f5%c0%fd>

<sup>13</sup> [https://www.wipo.int/patents/en/faq\\_patents.html#accordion\\_collapse\\_01](https://www.wipo.int/patents/en/faq_patents.html#accordion_collapse_01)

According to TIER, contracts for technology imports and exports must be either filed for the record (in the case of permitted technologies) or reviewed for approval (in the case of restricted technologies). Contracts are recorded on MOFCOM's website: <https://ecompany.mofcom.gov.cn/loginCorp.html>.<sup>14</sup>

#### 4.1.3 Steps for transferring technology to China



#### 4.1.4 Documentation generally required for recording a patent licensing contract

According to the [Regulations of Recording Patent Licensing Contracts of the People's Republic of China](#) (专利实施许可合同备案办法), relevant parties should record their contract with the [National Intellectual Property Administration](#) (国家知识产权局商标局, "CNIPA") within three months of a contract taking effect (for more guidance, please refer to CNIPA's [website](#)). When recording a contract, companies must provide CNIPA with the following documentation:

- Patent licensing contract application form;
- Patent licensing contract;<sup>15</sup>
- Patent certificate;
- Identification documents of the licensor;
- Identification documents of the licensee;
- Power of attorney details.

Furthermore, the patent licensing contract itself must include the following information:

- A clear description of the patent, such as the name, number, application date, and authorisation date;
- Name and address of the licensor and licensee;
- Territorial scope of use;
- Licensing period;
- Type of licensing applicable, from the following:

<sup>14</sup> <http://fms.mofcom.gov.cn/article/a/ae/200403/20040300198767.shtml>;  
<http://fms.mofcom.gov.cn/article/a/ae/200403/20040300198772.shtml>

<sup>15</sup> <http://www.sipo.gov.cn/bgxz/zlssxkhtbg/>

- Exclusive licensing;
- Sole licensing;
- Non-exclusive licensing;
- Royalties to be paid and terms of payment;
- A non-disclosure agreement;
- Remedies for breaches of contract and claims for damages;
- Provisions regulating enforcement against patent infringement;
- Provisions stipulating resolution mechanisms if the licensing patent is invalidated.

#### **4.1.5 General provisions for copyright licensing**

A copyright licensing contract signed between the licensor and licensee must include the following information:

- A clear description of the copyrighted works;
- Categories for licensed rights, based on the following types:
  - The right of reproduction;
  - The right of distribution;
  - The right of rental;
  - The right of exhibition;
  - The right of performance;
  - The right of projection;
  - The right of broadcasting;
  - The right of communication through information networks;
  - The right of production;
  - The right of adaptation;
  - The right of translation;
  - The right of compilation;
  - Other rights which shall be enjoyed by the copyright owners;<sup>16</sup>
- Types of licensing applicable, based on the following types:
  - Exclusive licensing;
  - Sole licensing;
  - Non-exclusive licensing;
- Territorial scope of use;
- Licensing period;
- A non-disclosure agreement;
- Remedies for breaches of contract;
- Provisions specifying the applicable laws and dispute resolution mechanisms.

According to the [Regulations for the Implementation of the Copyright Law of the People's Republic of China](#) (中华人民共和国著作权法实施条例), revised in 2013, the licensing contract can be recorded at the [Copyright Protection Center of China](#) (中国版权保护中心, “CPCC”).

#### **4.1.6 General provisions for trademark licensing**

A trademark licensing contract must include the following information:

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<sup>16</sup><http://en.pkulaw.cn/display.aspx?id=031d1a891d84891fbdfb&lib=law&SearchKeyword=&SearchCKeyword=%d6%f8%d7%f7%c8%a8>

- Clear description of the mark;
- Purpose(s) of the licence (i.e. for merchandising);
- Territory and/or distribution channels to which the licence applies;
- Types of licensing applicable, based on the following types:
  - Exclusive licensing;
  - Sole licensing;
  - Non-exclusive licensing;
- Statement(s) 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;
- Royalties to be paid and terms of payment;
- Audit rights;
- Provisions specifying what constitutes proper use of the mark and the licensor's rights of prior approval;
- A non-assignment clause;
- A 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.

According to the [Trademark Law of the People's Republic of China](#) (中华人民共和国商标法), revised in 2019, a licensor must record the licensing contract with the [Trademark Office of China at the National Intellectual Property Administration](#) (国家知识产权局商标局中国商标网, “CNIPA Trademark Office” or “TMO”), after which the TMO will publicise the contract on its official website. A trademark licensing contract which has not been recorded with TMO cannot be enforced against any third parties in good faith.<sup>17</sup>

## 4.2 Franchising

Franchising describes the process through which an entity (franchisor) that has developed a particular way of doing business expands the business by giving other existing or would-be entrepreneurs (franchisees) the right to use the franchisor's proven business model in another location for a defined period of time in exchange for payment of initial and ongoing fees.

Along with the right to use the business model, the franchisor permits the franchisee to use the franchisor's IP and know-how, and provides both initial and ongoing training and support. In essence, a successful business is replicated and run by the franchisee under the supervision and control, and with the assistance, of the franchisor.<sup>18</sup>

### 4.2.1 Franchise requirements in China

The [State Council](#) (国务院) has published the [Regulations on Administration of Commercial Franchises](#) (商业特许经营管理条例), revised in 2007, which includes rules applying to both domestic and foreign franchisors that engage in commercial franchising in China.

The regulations stipulate that only enterprises (that is, not individuals or other entities) may act as franchisors. A franchisor must own a developed business that can provide a long-term commitment, technological support, business training, and other services. The regulations also require that a franchisor has former experience in

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[http://www.pkulaw.cn/fulltext\\_form.aspx?Db=chl&Gid=937235cafaf2a66fbdfb&keyword=%e5%95%86%e6%a0%87%e6%b3%95&EncodingName=&Search\\_Mode=accurate&Search\\_IsTitle=0](http://www.pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=937235cafaf2a66fbdfb&keyword=%e5%95%86%e6%a0%87%e6%b3%95&EncodingName=&Search_Mode=accurate&Search_IsTitle=0)

terms of ownership and operation of at least two outlets for at least one year before it can establish a franchise in China.

According to the [Administrative Measures for Commercial Franchise Information Disclosure](#) (商业特许经营信息披露管理办法), revised in 2012, issued by the [Ministry of Commerce of the People's Republic of China](#) (中华人民共和国商务部, “MOFCOM”), the franchisor shall disclose information on the following topics to the franchisee at least 30 days before signing a franchise agreement:

- Basic details about the franchisor and its business, such as registered capital, business scope, and number of outlets;
- Franchisor's registered trademarks, patents, or know-how;
- Payment of royalties;
- Conditions of the products or services that the franchisor provides to the franchisee, such as whether or not the franchisee is only allowed to purchase products from specific suppliers;
- Technical training and support provided by the franchisor;
- Guiding the operation of the franchisee and the relevant responsibilities when dealing with customer complaints;
- Budgets for operating a franchise, such as royalties, training fees, and decoration costs;
- Introducing franchisees in China;
- The franchisor's accounting reports issued by an accounting firm within the past two years;
- If applicable, the status of the franchisor's lawsuits or arbitrations within the past five years;
- If applicable, a record of any illegal operation by the franchisor or its legal representative;
- The format of the franchise agreement.

#### **4.2.2 Franchise agreement**

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

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

#### **4.2.3 Recording the franchise agreement with MOFCOM**

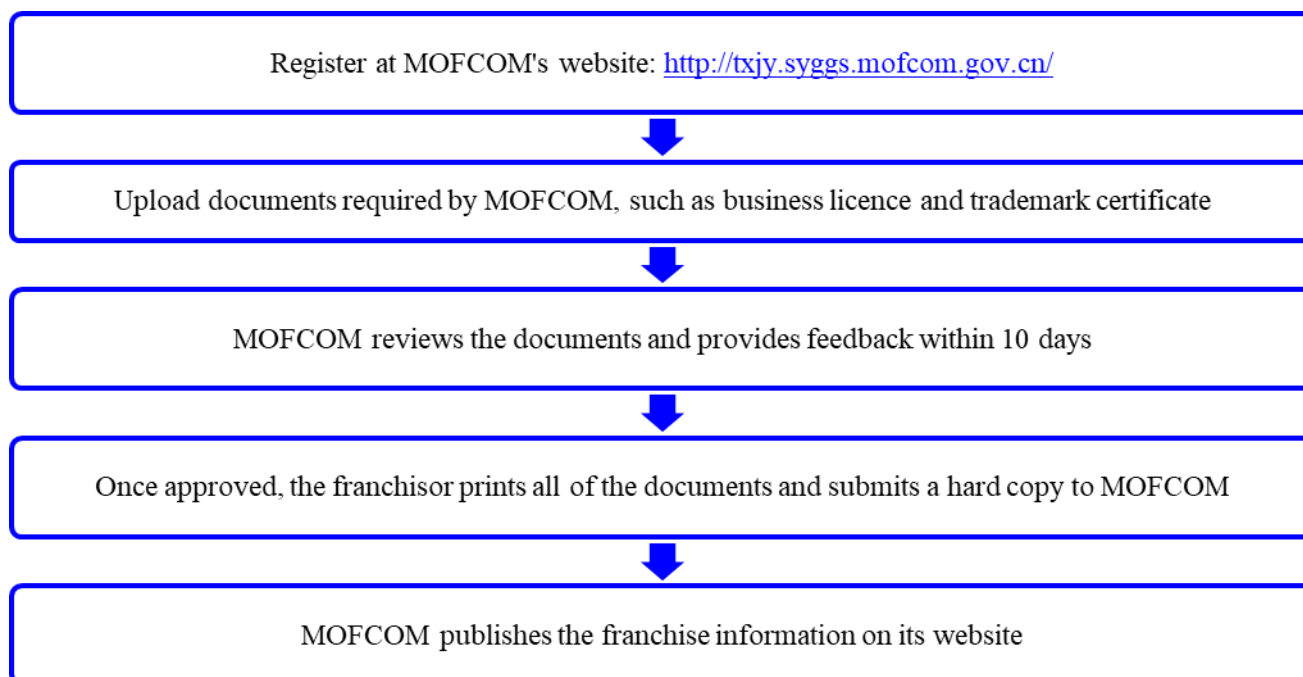
According to the [Administrative Measures for Archival Filing of Commercial Franchises](#) (商业特许经营备案管理办法), revised in 2011, issued by the Ministry of Commerce of the People's Republic of China

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<sup>18</sup> <https://tind.wipo.int/record/28658?ln=en>

(“MOFCOM”), the franchisor must record the franchise agreement with MOFCOM within 15 days of the agreement being signed. Failure to do so results in the imposition of penalties.<sup>19</sup>

#### 4.2.4 How to Record a franchise agreement with MOFCOM



#### 4.2.5 Advantages and disadvantages of franchising

The advantages of franchising can be summarised as follows:<sup>20</sup>

- Business expansion through franchisee's investment
- Infusion of new capital through franchise fees
- Additional and increasing revenue streams through royalties
- Uniformity of procedures in franchises
- Lower costs of market entry and reduced operation costs
- Spreading of risks by multiplying the number of locations
- Smaller central organisation, hence less risk of management fraud
- Potential buyback of successful franchises

The disadvantages of franchising can be summarised as follows:<sup>21</sup>

- Risks and costs associated with seeking out and training a new franchise operation
- A bad choice of franchisee could have a negative effect for the entire franchise network
- Cost of maintaining the franchise network
- Confidential business information is shared, and thus becomes more vulnerable
- Pressure from franchisees to introduce change
- Franchisor must have a reliable business model and one year's worth of experience operating at least two outlets in order to open a franchise in China

<sup>19</sup> [http://www.gov.cn/flfg/2011-12/21/content\\_2025612.htm](http://www.gov.cn/flfg/2011-12/21/content_2025612.htm)

<sup>20</sup> <https://tind.wipo.int/record/28658?ln=en>

<sup>21</sup> <https://tind.wipo.int/record/28658?ln=en>

#### **4.2.6 Suggestions for new-to-China franchisors**

- Register company name and trademark when first entering China. An official registration in China is needed to avoid situations in which competitors try to register a foreign company's 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 and that has access to channels of distribution, industrial connections, and good relationships with government organisations;
- Adjust market access strategy to account for cultural differences. A foreign franchiser should fine-tune its products to accommodate different consumer habits. For example, McDonald's, KFC, and Starbucks have all developed products attuned to the unique tastes of their Chinese customers.



## 5. Selling online

### 5.1 Standalone websites

An existing standalone website outside China may be the easiest method of selling online, but it is not likely to be the most effective.

Standalone websites use the direct mailing model to carry out cross-border E-commerce business. Orders are arranged by international retailers and/or brands directly, and then shipped and cleared by the customs authorities. This model is for products that are on the [Positive List of Cross-border E-commerce Retail Imported Commodities](#) (跨境电子商务零售进口商品清单) and which the producer would like to first test in the China market, and requires relatively low upfront investments for bulk shipping and inventory warehousing. Commodities shipped to China through this route are also subject to cross-border E-commerce comprehensive tax rate. Three purchase records – the order, shipment, and payment information - are required to pass the customs process in China and the maximum order value for each order is CNY 5,000 (EUR 641).

At a minimum, a company wishing to use this approach should develop a Chinese language version of its website, offer content translated into Chinese or use translation plug-ins that provide such a service, and arrange to accept Chinese credit card payments (using Chinese third-party payment platforms such as Alipay or WeChat Pay). In addition to these challenges, another disadvantage to using a standalone website is that consumers will have to endure longer shipping times.

### 5.2 E-commerce platforms

E-commerce platforms can be divided into three categories, according to the services they provide:

#### 5.2.1 C2C (consumer-to-consumer) platforms

This category brings together platforms with the sole responsibility of driving the potential buyer directly to the vendor, such as Taobao and eBay (which withdrew from the China market several years ago). A number of online shopping agents operating on Taobao have formed a so-called “grey market” made up of “Daigou traders” ; this refers to the distribution by freelance exporters of various products, including cosmetics, food and drink products, and luxury products, to consumers in China. These online shopping agents charge a fee for providing the Daigou service but their imports do not pass through the customs authorities, hence this cost is lower than it would be if import tax were to be levied. However, the implementation of the [E-Commerce Law](#) (电商法) has resulted in stricter supervision and additional restrictions being placed on Daigou trade.

#### 5.2.2 B2C (business-to-consumer) platforms

There are various vertical E-commerce platforms in China which compete fiercely while targeting different consumer groups (differentiated by purchasing power, purchasing habits, and the tier of city that they live in). The majority of these platforms have international versions as well.

Under special customs clearance regulations, international retailers and brands can work with B2C cross-border E-commerce platforms in order to reach Chinese consumers through bonded warehouses within free trade zones.

Tmall Global, JD Worldwide, and RED are three of the most representative cross-border E-commerce platforms in China, although many others exist, such as VIP International. Three of these platforms are profiled below:

- **Tmall Global:**

Tmall Global was founded in 2014 and is a large division within the Alibaba Group, China's largest retail conglomerate. It differentiates itself from other E-commerce platforms such as Taobao (a leading C2C platform based in Hangzhou, also part of Alibaba Group) by allowing international brands to offer products directly to consumers in China. As a result, it mainly offers imported products via cross-border E-commerce. Currently, Tmall Global works with more than 22,000 international brands – more than 80% of which are not otherwise operating in China – from 78 countries and regions, and the platform has reported record growth and sales revenues on each “Double 11” shopping holiday (which takes place annually on 11<sup>th</sup> November and is also known as “Singles Day”). Following Alibaba Group's acquisition of Kaola in September 2019, it now possesses an aggregate market share of over 50%, placing the group in a dominant position within China's cross-border E-commerce sector.
- **JD.com:**

JD.com is a leading B2C platform. It is China's largest online retailer and the world's third-largest internet company by revenue. JD Worldwide is JD.com's cross-border E-commerce platform, based in Hong Kong. JD Worldwide's market share was ranked third (after Tmall and Kaola) within China's cross-border E-commerce sector in 2018.
- **RED:**

RED (also known as “Little Red Book”) is a leading content-driven and community-based E-commerce platform that was founded in 2013. The content on the platform is sourced from multiple creators; some is created by RED itself, while some is created by featured brands, key opinion leaders (“KOLs”), and individual users. It has a predominantly female audience and relatively young user base, and specialises in fashion, beauty, and other lifestyle products.

### **5.2.3 Online-to-offline service platforms**

There are a number of additional platforms (such as Dianping) that focus on providing online-to-offline services without offering any escrow payment services. Instead they offer local information, detailed merchant profiles, consumer services, and ratings systems.

### **5.2.4 Selecting an E-Commerce platform either within or outside of China**

In China, selling through a third-party platform based outside of China's borders (such as eBay or Amazon) is unlikely to be very successful. Chinese consumers prefer to purchase goods on domestic E-commerce platforms which do not present a language barrier, and where they are sure that their credit cards and other online payment methods, such as WeChat pay and Alipay, will be accepted.

Domestic E-commerce platforms (such as Tmall Global, JD Worldwide, and RED) use the bonded warehouse model to perform cross-border business. This model allows commodities to be stored temporarily in a bonded warehouse. After consumers place their orders on E-commerce platforms, the products are transported from the bonded warehouse directly to the consumers (subject to customs clearance). The advantages of this model include shorter delivery times and better after-sales services.

While Chinese law does not restrict foreign companies' access to selling online in China via E-commerce platforms, each platform has its own restrictions. An analysis of the general terms and conditions of individual platforms, therefore, will best inform these companies of whether a specific platform is suited to their business needs.

**Figure 2: The advantages of E-commerce platforms**

	Outside China	Inside China
For Chinese consumers	<ul style="list-style-type: none"> <li>• Sometimes provide access to goods not available in China</li> </ul>	<ul style="list-style-type: none"> <li>• More likely to be trusted</li> <li>• Easier online payments</li> <li>• Faster delivery</li> <li>• Better after-sales service</li> </ul>
For EU sellers	<ul style="list-style-type: none"> <li>• Familiarity of platforms and their services</li> </ul>	<ul style="list-style-type: none"> <li>• Sellers benefit from platforms' existing traffic</li> </ul>

**Figure 3: The disadvantages of E-commerce platforms**

	Outside China	Inside China
For Chinese consumers	<ul style="list-style-type: none"> <li>• Language barrier</li> <li>• Use of Chinese credit cards problematic</li> <li>• Long delivery times</li> <li>• High shipping costs and risk of damage</li> <li>• No after-sales service</li> </ul>	N/A
For EU sellers	<ul style="list-style-type: none"> <li>• No target market access</li> </ul>	<ul style="list-style-type: none"> <li>• Involves marketing on an unknown platform in a foreign language</li> <li>• Certification requirements</li> </ul>

## 6. Directly investing - Wholly foreign-owned enterprises and joint ventures

Wholly foreign-owned enterprises ( “WFOEs” ) and joint ventures ( “JVs” ) are the most commonly used mechanisms when foreign investors want to invest in China.<sup>22</sup>

**Figure 4: Investment in WFOEs and equity JVs in China by year, 2013-2019**

	2013	2014	2015	2016	2017	2018	Jan-Nov 2019
<b>Total FDI (EUR billion)</b>	100.65	107.71	113.76	113.51	118.05	121.59	112.07
<b>WFOEs</b>	77.59	85.35	85.85	77.59	82.29	80.54	76.85
<b>Equity JVs</b>	19.56	18.92	23.32	27.21	26.79	31.08	24.23

Foreign investors generally prefer WFOEs to JVs. This is due to higher confidence in their ability to establish and run China operations on their own. More specifically, success with JVs is often difficult to achieve because of issues relating to control, objectives, management approaches, culture, and language. WFOEs, on the other hand, leave foreign investors in complete control, providing better protection of proprietary technology and other IP, as well as retaining control over human resources.<sup>23</sup>

Moreover, the conditions for approving WFOEs have been relaxed over time. For example, the requirement that at least 50% of a WFOE’ s production be exported has been lifted in recent years, and a minimum registered capital is no longer required.<sup>24</sup>

However, JVs present the advantage of gaining access to an already-developed network of distributors, assisting with the strategic need for a local partner or simply the desire to share operational costs.

The new [Foreign Investment Law](#) (中华人民共和国外商投资法), which came into effect on 1<sup>st</sup> January 2020, aims to improve China’ s business environment and IP protection mechanisms. The impact of the Foreign Investment Law on the governance structures of WFOEs will be limited because they have been governed by the Company Law (公司法) since 2006; however, JVs will be required to make a number of structural changes relating to a wide range of matters, including voting rules, dividend distribution, and share transfer mechanisms. The law stipulates a five-year transition period within which such changes must be made – this began on 1<sup>st</sup> January 2020.<sup>25</sup>

### 6.1 Wholly foreign-owned enterprises ( “WFOEs” )

The wholly foreign-owned enterprise ( “WFOE” , although sometimes referred to as “WFOE” ) was originally introduced as a means of encouraging specific types of manufacturing within China, such as

<sup>22</sup> <http://www.mofcom.gov.cn/>

<sup>23</sup> <https://www.chinalawinsight.com/2019/06/articles/foreign-investment/china-foreign-investment-law-how-will-it-impact-the-existing-fies/>

<sup>24</sup> <https://www.chinalawinsight.com/2019/06/articles/foreign-investment/china-foreign-investment-law-how-will-it-impact-the-existing-fies/>

<sup>25</sup> <https://www.chinalawinsight.com/2019/06/articles/foreign-investment/china-foreign-investment-law-how-will-it-impact-the-existing-fies/>

manufacturing which would introduce new advanced technology into the country. WFOEs are limited liability companies that are owned by foreign nationals and solely financed by foreign investors.<sup>26</sup>

Since the lifting of various institutional controls and China's accession to the World Trade Organization ( "WTO" ) in 2001, WFOEs have become increasingly popular and have come to be used by traders, service providers, and software developers. They have also increasingly been used by service providers rather than just manufacturers, a change which the regulations governing them has accommodated over the years.<sup>27</sup> There are limitations on the types of activities that a representative office ( "RO" ) can carry out in China, particularly revenue- and profit-generating activities. Such limitations are not found with WFOEs, meaning they, alongside JVs (when a local partner is involved), are more suited for foreign investors looking to establish a long-term presence in China that will make revenue and profit. WFOEs are able to directly employ staff, issue CNY-based invoices, and directly sign contracts with third parties, thus simplifying the process and widening the possibilities of having a local presence.<sup>28</sup>

The set up process of a WFOE has been significantly simplified following the Foreign Investment Law coming into effect in January 2020. Foreign investors cannot invest in industries on the [Special Administrative Measures for the Access of Foreign Investment \[Negative List\]](#) (外商投资准入特别管理措施【负面清单】) and now have to obtain permission for industries limiting foreign investment. Investing in industries outside this list enjoys the same treatment as local companies enjoy.

As long as a WFOE is not operating in a regulated industry (such as banking, insurance, or securities), there are no minimum registered capital indications for setting up a WFOE, although it is generally the case that a trading company will use a minimum of CNY 300,000-500,000 (EUR 38,500-65,100), a consultancy a minimum of CNY 100,000-200,000 (EUR 12,800-25,600), and manufacturer a minimum of CNY 600,000 (EUR 76,900).<sup>29</sup>

## 6.2 Joint ventures ( "JVs" )

Joint ventures ( "JVs" ) are legal entities made up of a partnership between a Chinese company and a foreign individual. Their liability is limited to the assets that shareholders bring to the venture, and as such does not extend to the parent company. They are mainly set up in the following situations: A JV is a limited liability company structure formed by a foreign investor, which could be a foreign individual or enterprise, and a Chinese company. Once formed, the JV becomes a new legal entity in which the liability of the shareholders is limited to the assets they brought to the business. This liability is then restricted to the JV and does not extend to the parent company.<sup>30</sup>

The advantages that can be gained from finding a local partner result in the use of JVs in two main situations: firstly, when a local partner is required in order to enter into a certain industry, as stated in the [Special Administrative Measures for the Access of Foreign Investment \[Negative List\]](#) (外商投资准入特别管理措施【负面清单】); and secondly, when a local partner can offer tangible benefits such as established relationships with government and local market connections.<sup>31</sup>

<sup>26</sup> <https://www.wfoe.org/>

<sup>27</sup> <https://www.wfoe.org/>

<sup>28</sup> <https://www.dezshira.com/library/qa/setting-up-wfoe-china.html>

<sup>29</sup> <https://www.dezshira.com/library/qa/setting-up-wfoe-china.html>

<sup>30</sup> <https://www.china-briefing.com/news/setting-up-joint-venture-china/>

<sup>31</sup> <https://www.tradecommissioner.gc.ca/china-chine/market-facts-faits-sur-le-marche/132234.aspx?lang=eng>

A local partner is able to offer specific benefits, including:<sup>32</sup>

- Established distribution channels;
- Established government relationships;
- Knowledge of the relevant market.

Under the new Foreign Investment Law, JVs will need to adopt three-tier governance structures in accordance with the Company Law, which requires the establishment of a board of shareholders, a board of directors, and a manager during the five-year transition period.

### 6.3 Activities

The [Special Administrative Measures for the Access of Foreign Investment \[Negative List\]](#) (外商投资准入特别管理措施【负面清单】) came into effect on 30<sup>th</sup> July 2019 and was published by the [Ministry of Commerce](#) (中华人民共和国商务部, “MOFCOM”) and the [National Development and Reform Commission](#) (国家发展改革委员会, “NDRC”). The general trend is towards liberalising foreign investment in China and therefore attracting more foreign investment. In particular, restrictions have now been removed in the following sectors:<sup>33</sup>

- Oil and gas exploration: foreign investors no longer require a Chinese JV partner;
- Financial services (securities, life insurance, futures, and fund management): all limits on foreign investment are to be removed in 2020;
- Cinemas: there are no longer restrictions on foreign ownership;
- Large-scale gas and heat network infrastructure: Chinese majority control is now no longer needed;
- International freight forwarding: Chinese majority control is now no longer needed.

There are, however, still foreign ownership restrictions within a range of other sectors, including:

- Telecommunications;
- E-commerce;
- Education;
- Hospitals;
- Aviation;
- Rare earth materials.

Restrictions in the sectors listed above are timetabled to finish in 2022.<sup>34</sup>

There is also a [Catalogue of Industries for Encouraging Foreign Investment](#) (鼓励外商投资产业目录), which is made up of two parts and came into effect on 30<sup>th</sup> July 2019. It aims to support the Special Administrative Measures for the Access of Foreign Investment with a focus on high-end manufacturing, advanced services, and labour-intensive industries – especially the latter in central and western China – with incentives for foreign investors that invest away from China’s eastern coast, where a large proportion of investment into China goes. This catalogue is split into two parts:

- Sub-Catalogue of Industries Encouraged for Foreign Investment Nationwide;
- Sub-Catalogue of Priority Industries for Foreign Investment in Central and Western China.

<sup>32</sup> <https://www.tradecommissioner.gc.ca/china-chine/market-facts-faits-sur-le-marche/132234.aspx?lang=eng>

<sup>33</sup> <https://www.lexology.com/library/detail.aspx?g=9d84f78f-97fb-4394-b39b-1dddc7a6aae>

<sup>34</sup> <https://www.lexology.com/library/detail.aspx?g=9d84f78f-97fb-4394-b39b-1dddc7a6aae>

## 6.4 Capital structure

The capital structure of a foreign invested enterprise is divided into 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 as a loan. This is an important factor in determining which level of governmental authority must approve the project.<sup>35</sup>

### 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 that debt is included within the former but not the latter. Registered capital has the features listed below:<sup>36</sup>

- It is subscribed capital, as opposed to paid-in capital;
- Although registered capital is not generally a necessity, not paying it can limit the ability to access foreign exchange loans, while there are limits on registered capital for certain activities;
- A company’ s articles of association should specify that registered capital will be paid before the end of the company’ s term, and in certain circumstances a fixed contribution deadline may be required in the articles of association;
- There are no minimum ratios of cash to other forms of registered capital, as long as the other forms are of a permissible type;
- Registered capital can be given in either a foreign currency or CNY.

## 6.5 Foreign exchange control on current and capital accounts

CNY is not yet a freely convertible currency, although China is moving in that direction. The two types of account in the investment field are detailed below:<sup>37</sup>

- Current trade accounts are for transaction items, including payments and receipts relating to goods trading, service provision, and other standard business fund transfers;
- Registered capital accounts are for items that increase or decrease the debt or equity due to capital outflows or inflows such as direct investment, all types of loan, and securities investment.

All inward or outward foreign currency transactions must be declared to the relevant bank in a timely fashion. It is also important to convert foreign currency to CNY in order to pay certain local expenses, such as salaries, and maintain records to demonstrate that these conversions are for business purposes so that documentation to prove the validity of these transactions can be produced. Conversely, a similar process of verification may be required when converting CNY to foreign currency in order to pay foreign entities.

The State Administration of Foreign Exchange issued its [Circular on Further Promoting Cross-border Trade and Investment Facilitation](#) (国家外汇管理局关于进一步促进跨境贸易投资便利化的通知) in October 2019. It covers the following:<sup>38</sup>

<sup>35</sup> <https://www.pinsentmasons.com/out-law/guides/doing-business-in-china-part-2---establishing-a-business-in-china>

<sup>36</sup> <https://www.pinsentmasons.com/out-law/guides/doing-business-in-china-part-2---establishing-a-business-in-china>

<sup>37</sup> <https://www.tradecommissioner.gc.ca/china-chine/market-facts-faits-sur-le-marche/50775.aspx?lang=eng>

<sup>38</sup> <https://www.safe.gov.cn/>

- “I. Expanding piloting for the facilitation of foreign exchange receipts and payments under trade
- II. Removing restrictions on domestic equity investments by non-investment-oriented foreign investors with their capital
- III. Expanding piloting for the facilitation of foreign exchange receipts and payments under the capital account
- IV. Easing the restrictions on foreign exchange settlement and use under the capital account
- V. Simplifying receipts and payments procedures under trade in goods for micro and small cross-border ecommerce players
- VI. Reforming the external debt registration management
- VII. Removing restrictions on the number of foreign exchange accounts opened under the capital account
- VIII. Optimizing reporting of foreign exchange under trade in goods
- XI. Allowing discretion to open accounts pending verification for export revenues
- X. Facilitating the directory registration of branches and sub-branches
- XI. Expanding piloting for the transfer of domestic credit assets
- XII. Allowing centralized management of their offshore funds by engineering contractors.”

## **6.6 Approval process**

According to the new Foreign Investment Law, the previous approval and filing system has been replaced by a system of pre-established national standards and a negative list. However, foreign investment will be subject to information reporting requirements.

The foreign investment information reporting system is a new management system under the framework prescribed by the new Foreign Investment Law. Information reporting is not a precondition for setting up a foreign invested enterprise.

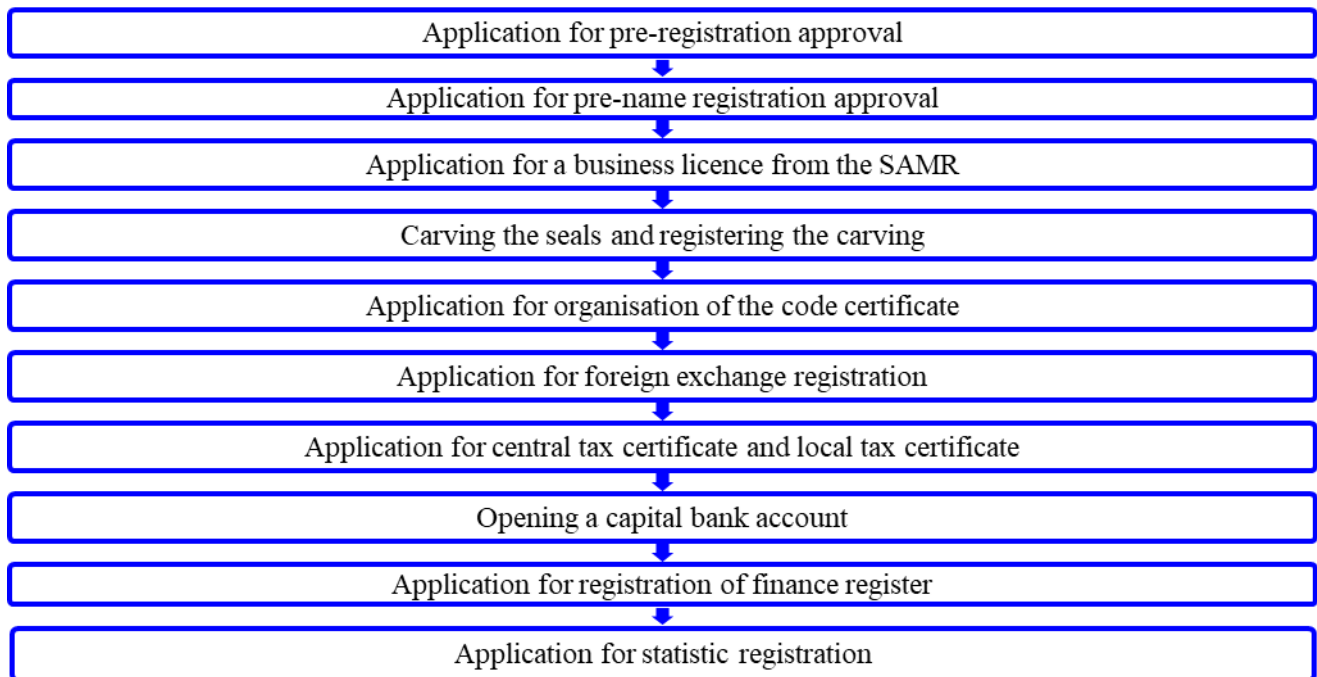
In the past, both the NDRC and MOFCOM acted as approval authorities. Under the new Foreign Investment Law, MOFCOM will no longer approve new or changed foreign investments. The authorities that now regulate the establishment of foreign-invested enterprises are:

- The NDRC: for project management through the approval and filing of projects;
- Industry regulators: for industry entry through the issuing of an industry licence;
- The [State Administration for Market Regulation](#) (国家市场监督管理总局, “SAMR”): For company registration through managing the establishment, changes, and dissolution of foreign-invested enterprises.

Any foreign investment that may impact national security remains subject to a national security review. Foreign investment related to the concentration of undertakings must also undergo a review process.



**6.6.1 General procedure for setting up a foreign invested enterprise**



## 7. Direct investment – partnerships

A foreign-invested partnership enterprise (i.e. a partnership) has been available in China since 2010. The main difference between a joint venture ( “JV” ) and a partnership is that at least one of the partners will assume unlimited liability. Secondly, the process for setting up a partnership is less complicated than the equivalent process for JVs.

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

Partnerships may be set up by:

- Two or more foreign enterprises or individuals;
- Foreign enterprises or individuals acting jointly with domestic individuals, legal persons, and/or other organisations.

Foreign invested partnership enterprises must abide by the Partnership Enterprise Law.

### 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. The industries not falling within the above categories are therefore open to foreign investment partnerships.

State-owned enterprises, listed companies, and social welfare organisations are prohibited from being general partners.

### 7.2 Capital

There is no requirement for the minimum registered capital. However, parties should 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 a convertible or the 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 services in accordance with relevant regulations. A foreign general partner making contributions through labour investment should submit employment licences for all foreign employees to the relevant branch of the [State Administration for Market Regulation](#) (国家市场监督管理总局, “SAMR” ).

### 7.3 Approval process

A foreign-funded partnership should register with the local branch of the SAMR, where it should 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 place of business;
- 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;

*Ways to Enter the Chinese Market*

- 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

The concept of a branch is not clearly defined in China, although they can generally be split into foreign company branches and domestic company branches. Neither type of branch is a legal person, and they cannot exceed the business scope of the company itself. Branches can issue invoices and sign commercial contracts and are also able to keep separate accounts from a head office in China.

Foreign company branches can carry out direct business activities, although they are only permitted in certain sectors. Domestic company branches are for companies that are already established in China and can be set up in a different location from the registered address engaging in the same industries, thus allowing for expansion into new locations without setting up a wholly foreign-owned enterprise ( “WFOE” ).

### 8.1 Approval process

Before registration in China, it is important to comply with the pre-registration requirements:<sup>39</sup>

- Appoint a legal representative: A representative, who can be Chinese or foreign and is legally able to reside and work in China, should be appointed by the branch office to manage the day-to-day operations of the branch;
- Define the business scope: A branch office should conduct activities that fit within the business scope of its head office;
- Confirm the location of the registered office: The leasing of office space is to be carried out before registration of the branch office.

The two stages to registration in China for enterprises are:

#### 1. Online pre-filing

China ’ s Integrated Registration Service system began in 2018 to facilitate business registration nationwide. Once an account has been created, the head office ’ s business licence number has been input, and a name for the branch office has been chosen (and approved), the documents listed below should be uploaded by the applicant:

- Relevant head office ’ s business licence;
- ID/Passport of the branch office ’ s representative;
- ID of the agent in charge of the application;
- Office lease agreement.

#### 2. Business licence application

The relevant authorities review the applicant ’ s documents and provide a decision within one working day. If the application proceeds smoothly, the original paper copies of the documents provided during the application process will be required by the relevant municipal government office for on-site verification.

To register a branch in China, a foreign enterprise should submit the following documents to the SAMR:

- Application form for branch registration, signed by the legal representative of the company;
- The articles of association of the company;
- Proof of use of business premises;
- Any other documentation required by the SAMR.

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<sup>39</sup> <https://www.sjgrand.cn/how-to-open-branch-office-china/>

## **9. Representative offices ( “ROs” )**

A representative office ( “RO” ) allows entry into the China market in a more limited way in terms of business activities allowed. As an RO is an extension of a foreign enterprise, it is not able to generate profit or directly employ Chinese staff; the benefit of an RO, however, is that it is relatively easy to set up. Instead of generating profit or directly employing Chinese staff, an RO concentrates on market research, promotional activities, liaisons for developing retail connections, procurement, and investment. It is managed by a chief representative who can also represent the foreign enterprise during the application process for registration, and who can be supported by up to three representatives.

### **9.1 Approval process**

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

- RO application form;
- Letter of appointment for the chief representative of the RO, alongside his/her identity documents and CV;
- Rental contract for the office space to be used (limited to commercial buildings and valid for at least one year);
- The foreign address and evidence of at least two years business operations of the foreign enterprise, to show that it is genuine;
- Certificate of creditworthiness of funds from a financial institution that has business dealings with the company applying for the RO;
- Articles/memorandum of association;
- Power of attorney documentation demonstrating the appointment of the chief representative and any other representatives by the foreign enterprise.

If the process is carried out smoothly, an RO registration certificate will be subsequently issued after approximately 15 working days.

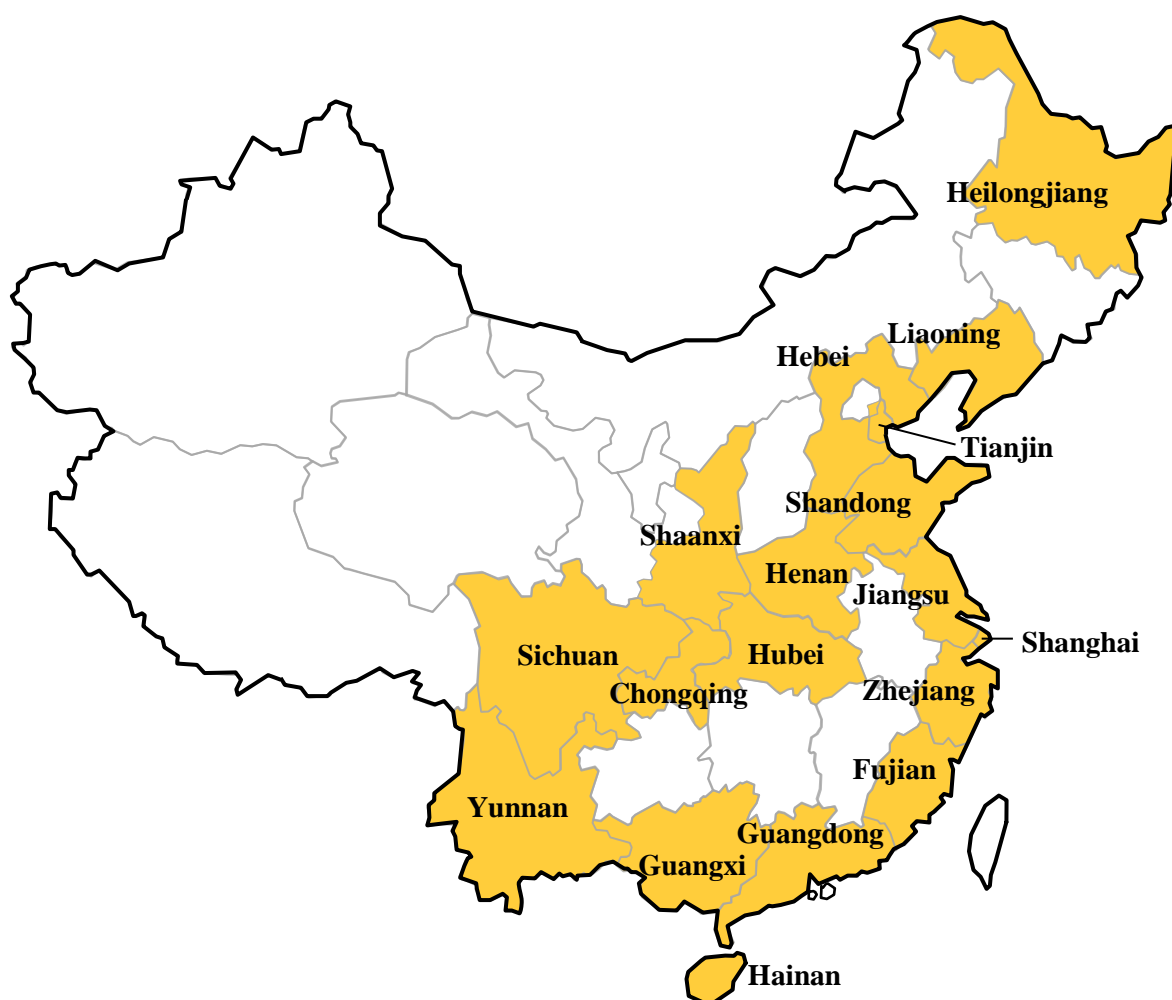
## 10. Pilot Free Trade Zones ( “PFTZs” )

Defined areas with differing customs regulations, restrictions on foreign investment, and administrative procedures from the rest of China, Pilot Free Trade Zones ( “PFTZs” ) exist to encourage regional growth and promote international trade and investment. This means that their customs regulations are relatively open, foreign investment is easier in them than elsewhere in China, and administrative procedures tend to be more streamlined, hence they offer policies that can be particularly attractive to EU SMEs looking to set up or expand in China. In particular, imports into PFTZs are not subject to Chinese customs duties unless they are re-exported from a PFTZ into mainland China, hence PFTZs attract a large number of foreign companies looking to sell their goods wholesale elsewhere in China. It is usually the case that PFTZs are made up of other types of existing economic zone, such as High-tech Parks or Bonded Zones. PFTZs zones do not offer bonded services themselves though.

### 10.1 Locations and features of each PFTZ

The first PFTZ in China was created in Shanghai in 2013, and there are now 18 PFTZs in China. Although they are named after provinces and provincial-level cities, with one exception PFTZs do not cover the whole province or city; instead, they are located in one or multiple areas across the province or city. Their locations and features are detailed in **Figures 5 and 6**:

**Figure 5: The locations of China’ s PFTZs**



**Figure 6: The features of China’ s PFTZs<sup>40</sup>**

PFTZ	Year of establishment	Features
Shanghai PFTZ	2013	As the first PFTZ, it acts as a demonstration for an open economy and for future PFTZs.
Fujian PFTZ	2015	Focuses on the maritime connections being built up as part of the Belt and Road Initiative, which is one of China’ s signature strategies and involves the development of infrastructure and investment in a range of countries stretching across Asia, as well as into Africa and Europe.
Guangdong PFTZ	2015	Part of the Greater Bay Area, which combines the nine cities in Guangdong Province that sit within the Pearl River Delta alongside Hong Kong Special Administrative Region ( “SAR” ) and Macau SAR. The Greater Bay Area promotes integration between mainland China and China’ s two SARs through the use of policy harmonisation that facilitates trade and tourism, supports scientific and technological innovation, strengthens the Belt and Road Initiative, and improves financial services.
Tianjin PFTZ	2015	Supports the co-ordinated and integrated development of the Jing-Jin-Ji region, which encompasses the provincial-level cities of Beijing and Tianjin with the surrounding Hebei Province. This region contributes 10% of China’ s GDP and has 8% of the country’ s population.
Chongqing PFTZ	2017	Focuses on the construction of an inland logistics area that can support the Belt and Road Initiative and the Yangtze River Economic Belt. The Yangtze River Economic Belt is formed of the 11 provinces and provincial-level cities along the Yangtze River, and was created to promote further economic cooperation between these areas, and therefore develop inland China’ s market potential.
Henan PFTZ	2017	Makes use of its location in Central China to help Henan Province become a logistics hub for the country.
Hubei PFTZ	2017	Focuses on the further development of the Yangtze River Economic Belt.
Liaoning PFTZ	2017	Encourages development in North-eastern China, which was traditionally an industrial heartland but has faced challenges since many Chinese companies began to move up the value chain at the expense of heavy industry.

<sup>40</sup> <https://news.cgtn.com/news/2019-08-26/China-announces-a-master-plan-for-six-new-pilot-free-trade-zones-JthIPT32bm/index.html>; <http://china-trade-research.hktdc.com/business-news/article/Facts-and-Figures/China-Pilot-Free-Trade-Zones/ff/en/1/1X000000/1X0A2V2D.htm>

Shaanxi PFTZ	2017	Focuses on developing and deepening economic and cultural ties with countries that take part in the Belt and Road Initiative.
Sichuan PFTZ	2017	Created to coordinate development between China's coastal areas, which are generally more international and prosperous, and China's inland areas, which are encouraged to work with their coastal counterparts.
Zhejiang PFTZ	2017	Developed to support the E-Commerce, in which China is a global leader.
Hainan Pilot Free Trade Port	2018	Due to its status as an island province, Hainan Pilot Free Trade Port is the only province-wide PFTZ in China. It focuses on environmental protection programmes, international commerce, international tourism, and the medical industry.
Hebei PFTZ	2019	Focuses on international logistics due to its location near the large cities of Beijing and Tianjin, as well as establishing a stronger industrial base.
Shandong PFTZ	2019	Takes advantage of its coastal location to support provincial-level economic cooperation with Japan and South Korea, particularly in maritime industries.
Yunnan PFTZ	2019	Yunnan Province borders South East Asia and also part of the Yangtze River Economic Belt, hence this PFTZ aims to develop closer ties between the Belt and Road Initiative and the Yangtze River Economic Belt.
Guangxi PFTZ	2019	Acts as the gateway to South-western China, and therefore as a link between the more prosperous coastal regions and the inland regions that have significant potential for growth and development.
Heilongjiang PFTZ	2019	Focuses on further restructuring and upgrading of the region, as China's traditionally heavy industry-led north-eastern regions aim to diversify. It also develops provincial-level cooperation with Russia and other countries in North East Asia.
Jiangsu PFTZ	2019	Supports international investment cooperation through strengthening the financial sector and linking it more closely to the real economy. It also focuses on pursuing innovation within manufacturing.

## 10.2 The features and benefits of PFTZs

While each PFTZ is different, common features found within and common benefits offered by many PFTZs include a combination of the following:

- Industrial clusters within FTZs, so as to reduce transport and communications inefficiencies, further supported by suitable connections between the areas of the PFTZ and nearby transportation hubs such as ports, railway stations, airports, and motorways;
- Customs-free trade until a product is re-exported outside of the zone, at which point either the Chinese customs authority will levy customs duties (if the product is re-exported into mainland China), or a third party will levy customs duties (if the product is re-exported to another part of the world);
- The ability for foreigners to open WeChat business accounts, so as they can target Chinese employers and customers;
- More liberal policies for accessing foreign websites than can sometimes be found elsewhere in China, so as to support smooth international communications and exchanges;
- A simplified registration process for foreign exchanges;



- The free transfer of funds between free trade accounts ( “FTAs”), and non-resident accounts based both onshore and offshore;
- The ability to loan CNY from offshore funds;
- A policy of supporting interest rates that are more liberal than those found elsewhere in the country.

### **10.3 Recommendations**

The following are a series of recommendations for EU SMEs to bear in mind when setting up in a PFTZ:

- Pay attention to employment regulations for foreigners, as they can change and are not necessarily the same across the country. Some cities and provinces will offer more favourable policies that make it easier to resettle foreign talent, while others will make it more difficult.
- Speak to local officials during the negotiation process, as it is often the case that a PFTZ negotiates with partners on a case-by-case basis, therefore may be able to offer incentives beyond those set down in the standard offer. Negotiating with multiple PFTZs at the same time and making each aware that it is in competition with others can also be useful for obtaining the best deal available.
- Do not attempt to manage a site remotely from the EU, as this often causes inefficiencies in terms of knowledge of on-the-ground operations and the propagating of ideas. Instead, either spend a significant amount of time in China each year or empower local staff, such as Chinese staff, to make relevant decisions.
- Ensure that there are sufficient supplies of labour and utilities for any site chosen. PFTZs may vary in terms of how much support they offer in getting connected to local water, electricity, gas, and internet services, and some parts of China contain large numbers of workers from elsewhere in the country who may be highly mobile and therefore be an unstable long-term work force.
- If offered land in place of rented factory facilities, consider this offer, as the land may prove to be valuable if developed correctly, despite the lack of flexibility that comes with not having quick access to already-developed factory facilities.

## 11. Using Hong Kong as an entry point to mainland China

### 11.1 Supervision from mainland China

Hong Kong has been, and in many ways remains, the traditional gateway to doing business in China. Since returning to China in 1997, Hong Kong 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 an 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 headquarters, most EU SMEs bypass Hong Kong and enter China directly, particularly if they are exporting. However, there are a variety of specific reasons why some EU SMEs may consider establishing a legal entity in Hong Kong, a decision which depends on the sector, the size of the company, and the nature of the business.

The benefits of the One Country, Two Systems policy are:

- No foreign ownership restrictions;
- English and Chinese as official languages, with English being the preferred language for business and contracts;
- Free movement of capital, talent, goods, and information;
- Independent participation in international forums.

Hong Kong is the key investment route for mainland China’ s outward foreign direct investment ( “FDI” ). According to the [Ministry of Commerce](#) (中华人民共和国商务部, “MOFCOM” ), in 2017 Hong Kong channelled 57.6% of the mainland’ s FDI outflows, amounting to USD 91.2 billion (EUR 82.2 billion). By the end of 2017 it accounted for 54.2% of mainland China’ s outward FDI stock, the cumulative value of which stood at USD 981.3 billion (EUR 884.1 billion). Hong Kong’ s statistics show that as of 1<sup>st</sup> June 2018, 1,591 Chinese mainland companies had a presence in Hong Kong, including 197 regional headquarters.<sup>41</sup>

### 11.2 Two special areas and one agreement for Hong Kong as a channel to mainland China

#### 11.2.1 Qianhai and Hong Kong

The Shenzhen-Hong Kong Modern Service Industry Cooperation Zone in Qianhai was approved by the State Council on 26<sup>th</sup> August 2010, with the aim of developing Qianhai into a demonstration area for Guangdong-Hong Kong innovation and cooperation in modern industry.<sup>42</sup>

Innovative policies have been established for Qianhai. Besides tax deductions for both corporations and individuals, an entirely new legal system is to be put in place, which will include judges and lawyers from Hong Kong working within this area.

#### 11.2.2 The Greater Bay Area

The Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Greater Bay Area in Hong Kong was signed on 1<sup>st</sup> July 2017.<sup>43</sup> It aims to set up innovative and ground-breaking policies designed to enhance cooperation among the two SARs of Hong Kong and Macao and the

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<sup>41</sup> [www.hktdc.com](http://www.hktdc.com)

<sup>42</sup> <http://www.szqh.com.cn/>

<sup>43</sup> <https://www.bayarea.gov.hk/en/>

nine municipalities of Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen, and Zhaoqing in Guangdong Province. This initiative is intended to further the joint development of the Greater Bay Area.

Under this framework, both physical and policy-level connectivity within the area is set to be substantially enhanced. For example, the recently completed Hong Kong-Zhuhai-Macao Bridge provides Hong Kong with the benefit of better connection to key cities in the Pearl River Delta.

### **11.3 China and Hong Kong's Closer Economic Partnership Arrangement ( "CEPA" )**

CEPA is a bilateral free trade agreement between mainland China and Hong Kong that came into effect in January 2004. Under the agreement, China has agreed to eliminate tariffs for all products of Hong Kong origin and allow preferential treatment to Hong Kong service suppliers in certain service sectors. Foreign companies registered in Hong Kong are also eligible to benefit from CEPA rules. Forty service sectors have been listed under CEPA since 1<sup>st</sup> January 2009, but preferential treatment requires fulfilment of some initial requirements; for example, a company must have been established for at least three years before it is recognised as being Hong Kong-based.

### **11.4 Setting up in Hong Kong**

These are several reasons to set 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 taxation/financial systems, including easier profit repatriation and lower corporate tax;
- Use of a Hong Kong shell company to set up a Representative Office ( "RO" ) in China (which requires an office outside of China). This is necessary for European entrepreneurs in China without an office in Europe;
- A legal entity in Hong Kong can be established quickly (in two weeks, as opposed to requiring at least three months in China).

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 obtaining further legal advice if in doubt about the optimal approach in view of their own situation.

For more information on the advantages of Hong Kong or for specific enquiries, please contact:

- The Hong Kong Trade Development Council (香港贸易发展局, "HKTDC" )  
[www.hktdc.com](http://www.hktdc.com)
- The HKTDC also operates an SME centre that provides specific information and services for SMEs  
[www.hktdc.com/mis/smecentre/en/HKTDC-SME-Centre.html](http://www.hktdc.com/mis/smecentre/en/HKTDC-SME-Centre.html)
- InvestHK (香港特别行政区政府投资推广署)  
[www.investhk.gov.hk](http://www.investhk.gov.hk)

The advantages of Hong Kong for doing business in China are:

- Supportive government:
  - Government as a facilitator and promoter;
  - An ideal location in Asia;

- The ability to reach all of the GBA;
- An open business environment: an international business city which also enjoys the benefits of unrivalled access to opportunities in mainland China.
- Tax and financial infrastructure:
  - A low, simple, and competitive tax system:
    - Lower corporate profit tax up to 16.5%;
    - Income tax with a standard rate of 15%;
    - Property tax of 15%;
    - No capital gains tax;
    - Inbound or outbound dividend not taxed;
    - No VAT or sales tax;
    - No estate duty;
    - Ability to use transfer pricing techniques;
    - Generous allowances and deductions with a taxable amount;
  - Well-regulated;
  - No foreign exchange controls;
  - Easier profit repatriation.
- A legal system with long and continuous traditions:
  - An independent judiciary;
  - Numerous international law firms;
  - A level playing field;
  - More predictable regulatory framework with less frequent changes in regulations;
  - Strong intellectual property ( “ IP ” ) rights: better protection of IP rights if some component or assembly takes place in HK; regional hub for licensing;
- A multicultural talent pool:
  - Visa-free entry for most countries;
  - No language barriers;
  - International education available;
  - International cuisine readily available;
- The opportunity to use holding companies and still set up legal entities in China (such as WFOEs and JVs):
  - Approximately EUR 2,500 required to incorporate, plus EUR 1,000 to renew annually;
  - Consequent reduction of liability risks to the parent company;
  - Makes registering in China somewhat easier as mainland Chinese officials recognise many documents from Hong Kong more readily than those from other countries;
- Ownership transfer can take place without government approval in most cases;
- A world class infrastructure:
  - Convenient public transport;
  - Complete internet coverage;
  - International access.

The disadvantages of Hong Kong for doing business in China are:

- Tax implications (a company that is registered in Hong Kong but not mainland China, and then conducts business in mainland China is in non-compliance with mainland Chinese tax regulations, therefore it should register as an entity/representative office or a WFOE in mainland China, so as to conform to local tax regulations);
- Products that do not originate from Hong Kong cannot benefit from CEPA;
- Higher costs in Hong Kong may not justify the lower tax rates and other benefits;

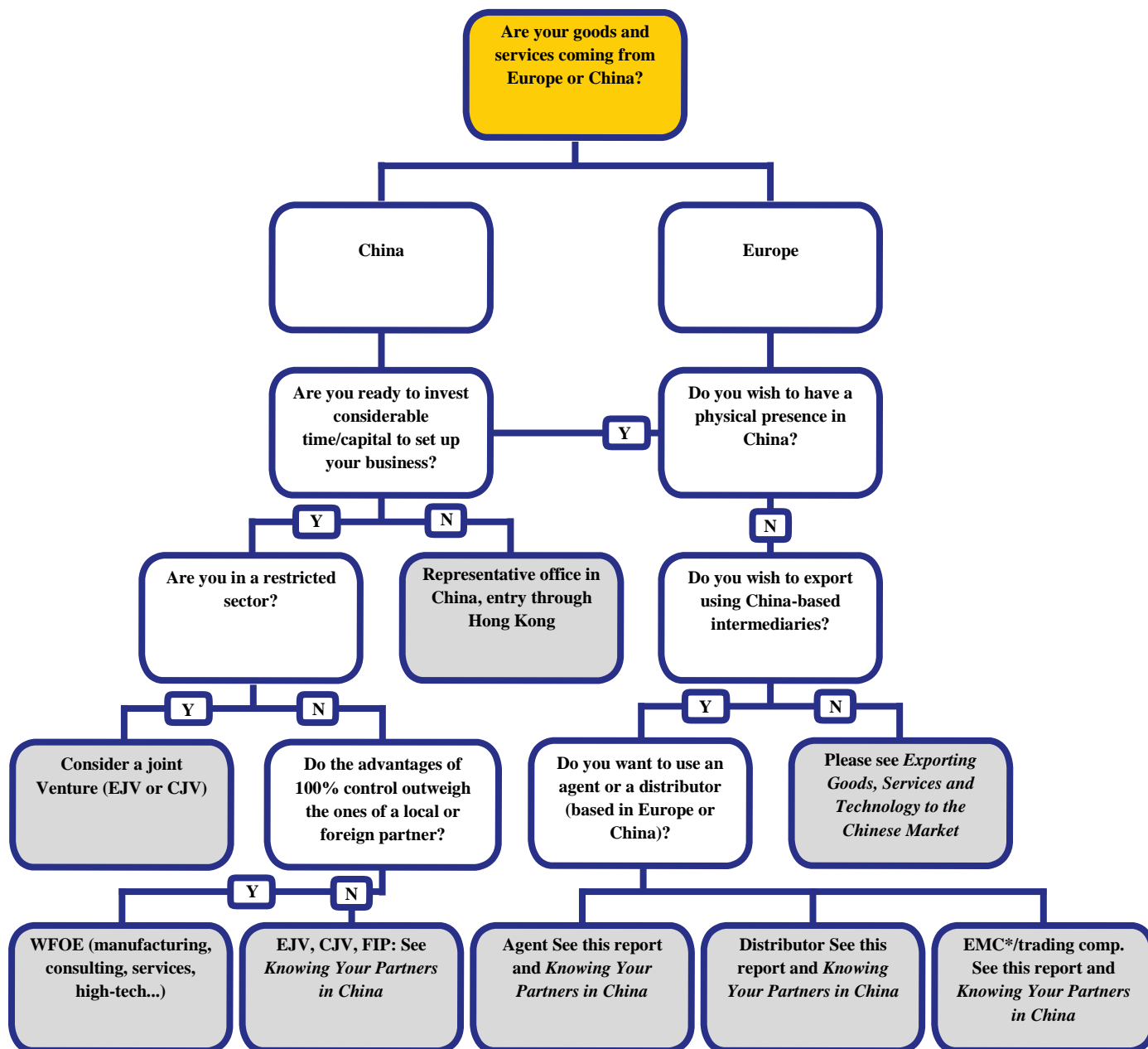
### *Ways to Enter the Chinese Market*

- Hong Kong retains a different culture from mainland China, both in business and in everyday life. To explore the mainland China market, a representative in this market would be an advantage, in addition to a presence in Hong Kong.

The advantages of doing business in mainland China are:

- Closer than Hong Kong to your market, including consumers, competitors, partners, mainland Chinese authorities, supply chains, and industry clusters;
- Local tax benefits (normally 15-24%) and incentives for over 200 special economic zones and some encouraged sectors;
- Easier relationship building, business development, and networking;
- Lower labour and other costs.

12. Recommendations regarding the best way to enter the Chinese market



EMC = Export management consultant

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.

## About the Centre

The EU SME Centre helps EU SMEs prepare to do business in China, by providing them with a range of information, advice, training and support services. Established in October 2010 and funded by the European Union, the Centre has entered its second phase which will run until April 2020.

The Centre is implemented by a consortium of six partners – the China-Britain Business Council, the Benelux Chamber of Commerce, the China-Italy Chamber of Commerce, the French Chamber of Commerce in China, the Eurochambres, and the European Union Chamber of Commerce in China. All services are available on the Centre’s website after registration, please visit: [www.eusmecentre.org.cn](http://www.eusmecentre.org.cn).

## About CBBC

This report is compiled in partnership with the China-Britain Business Council ( “CBBC” ) and is an introduction to Chinese economics. It aims to help EU SMEs gain an understanding of the different BRI programmes and how EU SMEs can take advantage of these programmes in a cost-efficient way.

CBBC is the leading organisation helping UK companies grow and develop their business in China. CBBC delivers a range of practical services, including: advice and consultancy, market research, event management, an overseas market introduction service, trade missions and exhibitions, and setting up rep offices. For more information about what CBBC can do to help your business develop in China, please visit: [www.cbbs.org](http://www.cbbs.org).

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