Atradius
Managing risk, enabling trade

Trade successfully with China

Ten important principles

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In every crisis, there is opportunity.

Chinese proverb

China is indeed experiencing something of an economic crisis at present, although it's the kind of crisis that many nations would welcome. Its economy reportedly grew by 'just' 6.7% in the first quarter of 2016 - its slowest quarterly growth in seven years – and Atradius' latest China Country Report (January 2016) refers to expectations of 6.6% GDP growth for 2016.

However, compare this with projections for the US and leading Western European economies, where expectations for GDP growth are reaching no more than 2.8% at most - and in many instances much less.

If China has a problem, it's that of being the victim of its own past success as the 'factory of the world'. Now the Chinese government is seeking to rebalance its economy away from investment-led growth and towards consumption. With preparation such as that highlighted in this report, that can spell good news for foreign companies hoping to make their mark in this huge export market.

China is by no means the easiest country with which to do business: the latest World Bank 'Ease of doing business' index places China 84th of the 181 countries assessed. However, China has made great strides towards opening itself to international trade since it joined the World Trade Organisation in 2001 - relaxing tariffs, quotas and other trade barriers. And its currency, the Remnimbi, continues its move towards full internationalisation.

Nevertheless, foreign suppliers do need to understand the peculiarities of Chinese law – and the practicalities of selling to customers in China – when planning their export strategy. We hope that the ten principles we outline here will help with this endeavour.

01

Keep up-to-date with China's import regulations

As in many countries, the rules governing imports to China are complex - and often change.

China classifies goods into three categories: prohibited, restricted and permitted. Some goods, such as waste and toxic material, cannot be imported in the public interest or for environmental protection, and some are heavily restricted: requiring quotas or licenses. For instance, in 2015 it slashed the quota for foreign cotton to boost demand for its domestic product. The Ministry of Commerce (MOFCOM), the government department in charge of foreign trade in China, periodically publishes and revises the lists of restricted or banned goods.

In practice, it is primarily the second category - restricted goods - that may be of relevance to foreign suppliers. Most goods do fall into the permitted category, and foreign suppliers and their Chinese customers can at their discretion decide how much and when to supply and buy these goods. For some permitted goods – including those as diverse as cattle and certain electrical products, MOFCOM oversees a licensing system to monitor imports into China. And, although all companies have the right to import most products, a limited number of goods such as crude oil and fertilizer can be imported only through state-owned enterprises or other enterprises that are approved by MOFCOM.

A detailed list of goods categories can be obtained from MOFCOM itself or through your own country's trade missions to China.

Tariffs apply to most goods imported into China, based on their value inclusive of packaging, freight, insurance and any other charges incurred before the goods are delivered. But, as an indication of China's gradual acceptance of international trade, the average tariff fell from over 15% in 2000 to 9.8% in 2015. A tariff schedule, updated annually, can be obtained from China Customs Press, Jia 1, East Fourth Ring South, Chaoyong District, Beijing 100023; telephone: 86 10 6519 5616.

02

Make the most of China’s Free Trade Zones

In 2013 the Chinese Government, in recognition of changes to global trading patterns, set up the first Free Trade Zone (FTZ) in mainland China, in Shanghai.

In today’s global market, components from one country are often assembled in another and then sold in a third. As global trade expands, so FTZs hold many advantages. Here, foreign goods and components can be landed, assembled or used in the production process and re-exported without the usual intervention of the customs authorities.

The Shanghai FTZ focuses mainly on financial services, trade, shipping and logistics and, in 2015, three more FTZs were established in China:

- Tianjin: focused mainly on maritime and air logistics; financial services; high end manufacturing; shipping services; ship registration; maritime law.
- Fujian: focused mainly on manufacturing and service trade; shipping and machinery maintenance; shipping services.
- Guangdong: focused mainly on manufacturing; leasing; commercial and financial services; pharmaceutical and chemical products research and development.

Foreign companies may find that their products and services can be exported to these FTZs with lower or no duty payable.

Seven new Free Trade Zones have been approved in 2016 opening up trade even more.

03
Think Chinese

Whether you're selling in your own country or abroad, potential customers generally feel more comfortable and confident about entering into a sales contract with you if you appear to understand - and even behave like - them. So it's a wise move to take time to learn about the way that your prospective Chinese customer operates and, importantly, to appreciate Chinese business culture too.

In Chinese business, formality and respect for hierarchy are essential. A key element of Chinese culture is the concept of 'face': a combination of actions and perceptions that can either help or hinder business relationships. For instance, foreign businesses can gain 'face' if their Chief Executive attends meetings and demonstrates a knowledge of and sensitivity to Chinese culture, while 'face' can be lost if foreign business representatives behave inappropriately, in Chinese terms, at the meeting.

Appointments for business meetings are essential – perhaps as early as one or two months in advance. Often it's advisable to make your introduction through an intermediary and bring an interpreter to the meeting. Beforehand always provide a written introduction to your company and what you hope to achieve (written in simplified Chinese) and ensure you arrive at the meeting on time. Attendees will be escorted to their seats in descending order of rank: with senior counterparts facing each other.

The presentation of business cards is an important formality at the start of a business meeting. Your cards should be printed on both sides: one side in your own language and one in Chinese. Offer the card with both hands, Chinese side uppermost.

Make sure that any written material that you bring to a business meeting, again in simplified Chinese as well as English or your own language, is accurate and cannot be misinterpreted. If you intend to use visual aids keep them simple – black words on a white background – as colours have special meanings in China and could be considered offensive.

Above all, be patient. Chinese negotiations take time and your Chinese counterpart may use phrases like 'we will think about it' rather than a straight 'yes' or 'no'. Decisions can take a long time as your prospective customer will want to be sure that a business relationship has the potential to develop profitably.

There is much to learn about Chinese business culture, but it will be well worth the effort.

04

Comply with Chinese competition law

No matter what country's law is chosen to cover the sales contract, any agreement to sell goods or services to China is subject to China's competition laws: mainly covering anti-monopoly, anti-unfair competition, anti-dumping and countervailing (anti-subsidy) regulations.

As in most countries, competitors are barred from entering into agreements to fix prices, restrict production and sales volumes, divide markets, restrict the purchase or development of new technology, or boycott suppliers.

In vertical relationships between suppliers and buyers, the parties are prohibited from agreeing on fixed re-sale or minimum re-sale prices. In foreign trade activities, companies must not engage in unfair competition practices, such as misleading advertising, acting in collusion when bidding, practicing commercial bribery or predatory pricing. Moreover, the authorities may – and do - take anti-dumping or countervailing measures to protect domestic industries.

Since the beginning of 2015 alone, the Ministry of Commerce (MOFCOM) ruled on what it perceives to be the dumping of various materials from overseas, including unbleached sack paper, methyl methacrylate (a compound used in the manufacture of resins and plastics) and flat-rolled electrical steel, as a result of which additional duties have been levied against their import as a countermeasure.

For more information (in English) on MOFCOM's policies and decisions visit http://english.mofcom.gov.cn

Main import sources

(2015, % of total)

10.4%	8.8%	8.5%	8.5%	5.2%
South Korea	USA	Japan	Taiwan	Germany

Main export markets

(2015, % of total)

18.0%	14.5%	6.0%	4.5%	3.0%
USA	Hong Kong	Japan	South Korea	Germany

Industry performance forecast

Agriculture	Automotive/ Transport	Chemicals/ Pharmaceuticals	Construction	Construction Materials
Excellent	Fair	Fair	Poor	Poor

05

Protect your intellectual property (IP)

Historically, China has an unfortunate reputation as a country where the production of pirated and fake goods is widespread. However, it has taken major steps in recent years to change that perception and indeed, as a member of the World Trade Organisation and signatory to the Paris Convention, Berne Convention, Madrid Protocol and Patent Cooperation Treaty, it has put in place laws to protect IP.

IP relates to copyrights, patents, designs and trademarks.

- Copyright IP relates to written or published works including books, songs, films, websites and artwork. While you aren't obliged to register copyright in China, it is advisable in case you need to prove ownership. Copyright extends to 50 years from the author's death.
- Patent IP concerns commercial inventions such as a new industrial product or process. Design IP protects assets such as computer models or architectural drawings. Invention patents give up to 20 years protection, and utility models 10 years protection, subject to an annual fee. Chinese patent law works on a 'first to file' basis: i.e. if two people apply for a patent on identical inventions, the first to file the application will receive the patent.
- Trademark IP relates to logos, symbols, words – even sounds – that distinguish a product or service from those of competitors. As with patents, trademarks are protected on a 'first-to-file' basis.

As well as registering patent, design or trademark rights, the rights holder can apply for filing its recordal, a request for protection, with the Chinese Customs who can then intercept infringing goods – whether they are being imported or exported. The right holders can help by sharing with Customs their knowledge of the infringers and their routes to market.

Registering your rights is the first stage. Enforcement, if required, is the next. As in other business matters, the Chinese preference is for mediation rather than confrontation. In the first instance, before calling on the authorities, a rights holder may choose simply to send a lawyer's letter demanding that the infringer desists and threatening further action otherwise.

Even once the authorities become involved, many IP disputes are resolved before court action is initiated. If that fails then administrative action may be necessary. Law suits for trademark and counterfeiting are usually straightforward but it is always helpful if tangible evidence can be collected to support the case.

Apart from recording your registered IP rights, there are several ways that you can protect your IP. Regular risk assessment checks, advice from local agents or others already trading in China and IP-related clauses in your employment contracts can all help.

A landmark case involving IP infringement in China illustrates how far China has come in its IP protection. In January 2016 the French company Moncler was awarded the maximum damages allowed under China's new trademark law (RMB 3 million: around EUR 408 thousand) for an infringement of its trademark by Beijing-based Nuoyakate. The court's discretionary award shows that China is now prepared to take a much tougher line than in the past, even when the infringer is a Chinese company.

06

Choose the right payment method

There is an oft-quoted saying, especially in credit circles: ‘A sale is a gift until it’s been paid for’. That’s true wherever a sale is made but there is no reason to expect a higher risk simply because your goods or services are supplied to a customer in China.

Even so, in its Market Monitor publication of April 2016, reporting on the consumer durables and retail sector in China, Atradius pointed to the possibility of an increase in payment delays as the economy slows, with smaller businesses particularly relying on unofficial lending channels such as ‘shadow banking’. E-commerce too (a topic that we’ll come to later in this report) may put pressure on funding – and even precipitate a rise in insolvencies – for those companies investing heavily in their online presence.

With that in mind, it’s worth considering the forms of payment – with varying levels of security - that an overseas supplier may wish to consider: not all of which, it should be said, will be appropriate in every circumstance.

Cash in Advance: this is a form of security under which the Chinese customer must have a degree of trust that the foreign supplier will fulfil its obligations under the contract. For goods with a lengthy production period, a schedule of advance progress payments may be suitable.

Letter of Credit: while an LC – especially a Confirmed Irrevocable LC – may provide a level of security, it still has its drawbacks. The main one is that it shifts liability for payment from the customer to the customer’s bank. The bank will have no interest in the quality assurance of the products or services provided but will expect every detail on the LC to correspond precisely to those on the contractual and delivery documents. Any deviation from those details will invalidate the LC and release the bank from its obligation to pay. Moreover, LCs can be expensive to set up, for buyer and seller alike, and may therefore be unsuitable for lower value contracts.

Documentary Collections: under these terms the seller would expect the buyer to pay when the documents confirming shipment have been received. The title documents (such as the bill of lading) will not be released to the buyer until they either pay (cash against documents) or agree to pay (documents against acceptance). This form of security may be suitable in some cases – for instance if the goods are critical to the Chinese customer’s operation – but could pose a risk to the overseas seller, for instance if the goods are perishable, as the buyer may use that fact to renegotiate the price.

If you’re confident that your customer will pay, or indeed if the degree of competition in the market demands it, then open account terms offer the least security and will be the most attractive to your customer.

As with any contract, in the end it comes down to a matter of trust and choosing a payment method that both parties can agree on. But, as will be explained later in this report, a greater degree of security can be added even on open account terms.

07

A local presence can increase your sales

Having a physical presence in China itself can be of real benefit to foreign suppliers: helping them to fully understand the market and giving more opportunity for face-to-face contact with current and prospective customers.

However, the first questions that a foreign company should ask itself are 'What kind of businesses is China looking for?' and 'Where should we locate?'

The answer to the first question may be found in the Chinese Government's five-year plan, which describes the kind of businesses it wants to encourage.

And the answer to the second question will depend on the nature of your business. For instance, if yours is a hi-tech company, Beijing may be the most appropriate location. Depending on the type of business you have, proximity to a port may be important, or conversely your business may be better suited to an inland location.

A simple way of helping with these questions is to seek the advice of a Chamber of Commerce, Trade Association or other businesses that have already 'set up shop' in China.

There are various options for the kind of business structure that would suit you:

- a wholly foreign-owned enterprise (WFOE): a limited liability company with 100% foreign ownership;
- an equity joint venture (EJV): a limited liability company that is established by both the foreign and Chinese parties;
- a cooperative joint venture (CJV): a joint venture with both foreign and Chinese investors; or simply
- a representative office or local representation by a third party

And each has its benefits and drawbacks. For instance, while a representative office is a simple option, it limits the scope of what you are permitted to do in China: effectively it's just a vehicle to build brand awareness.

While it is the most complicated form of business to set up, a WFOE gives a foreign company complete control over the operation: technology, know-how and, importantly, commercial confidentiality.

Between these two extremes are the joint ventures, which can be beneficial to foreign suppliers with limited knowledge of the Chinese market and business culture, as their local partner will have better access to local customers and can help expand sales within China.

A foreign supplier's shareholding in an EJV must generally be at least 25%. Profits are distributed pro-rata to each party's contribution to the registered capital. A CJV offers more flexibility as the parties can agree to profit sharing that is not based on the pro-rata principle. This may be important for a business that would have better market access if controlled by the Chinese partner, while the goods and services are provided mainly by the foreign supplier.

The CJV does not need to be incorporated as an independent legal entity and can therefore enjoy a very flexible management regime. However, PRC authorities have now become unwilling to approve the establishment of CJV due to the "flexibility" of such structure. Particularly, there has been no report of approval of non-incorporated CJV in recent years, due to the tax/accounting and operational challenges associated with this structure.

Other issues to consider are the scope of the local business and the complexity of local labour, tax and administrative requirements. However, despite the additional administrative burden, an increasing number of foreign suppliers are finding that a presence in China strengthens their brand value by giving them more direct access to local customers, better control over distribution channels and more opportunity to provide maintenance and after-sales service locally instead of having to handle these tasks from abroad or through local agents.

Key figures

GDP (billion)	€7065.85 (billion, real 2010 euro)
GDP growth rate (2016 est.)	6.6%

Industries

Since opening up to foreign trade and investment in 1979, China has become one of the world's fastest-growing economies, emerging as a major economic and trading power. It is the world leader in agricultural and industrial output. Manufacturing is the largest sector and spans iron, steel, clothing, chemicals, electronics, telecommunications, shipbuilding, and many other products. The agricultural industry specialises in rice, tobacco, fish and livestock among others.

Export annual growth rate (2016 est.)	7.5%
Imports annual growth rate	6.1%

Industry performance forecast

Consumer Durables	Electronics/ICT	Financial Services	Food	Machines/ Engineering
Fair	Fair	Excellent	Fair	Fair

08
Consider selling online

China has the biggest e-commerce market in the world, with B2C online sales growing by 25% annually. There is even a dedicated annual online shopping day – 'Singles Day' – which in 2015 alone accounted for the equivalent of EUR 12 billion in sales. That creates a tempting opportunity for foreign companies to break into the Chinese market.

But be warned. Even if you already have experience selling online in your own country and the western market, you'll find China's digital marketplace a different matter altogether. Where you may be familiar with social media sites such as Facebook and Twitter, Chinese consumers use Renren, Sina Weibo, Tencent, Tudou and Youku. While Paypal may be the most used secure payment vehicle in the west, in China it's Alipay. And, while western consumers often buy directly from a retailer's website, in China the preference is for extensive e-marketplaces like Tmall.

Provided that foreign companies are prepared to invest time and money in understanding the market the rewards can be high. While Chinese 'surfers' will certainly look for savings online, especially when it comes to items like home electronics, for foreign products that have a certain cachet - such as genuine design clothes - Chinese buyers are prepared to pay high prices online.

In April 2016, the Chinese government introduced new tax rules applying to cross-border e-commerce, to regulate the sector and improve consumer safety. You can find a useful summary of the changes by KPMG at http://www.kpmg.com/CN/en

A large part of a foreign seller's investment will go towards ensuring fulfilment, including logistics and warehousing, and technical support. That will mean having some kind of presence 'on the ground'. And of course your online presence will have to appeal to the Chinese psyche, so it won't just be a case of translating your current website.

09

Choose the best course to resolve disputes

With very few exceptions, the parties to a cross-border supply agreement can choose Chinese or any other country's law to govern their relationships. However, it's worth noting that the mandatory provisions of Chinese law, such as the tax, currency regulation and competition regimes, will apply irrespective of the parties' choice of any foreign governing law.

Before entering into a contract to supply goods and services to a customer in China, a foreign supplier should seek legal advice with a view to including a dispute resolution clause in the contract. There are restrictions in Chinese law about how and where commercial disputes can be resolved, so care needs to be taken in drafting the contract.

For many foreign companies that find themselves in a dispute situation with their Chinese customer, the first choice is for arbitration rather than litigation. This is much easier if an arbitration clause has already been included in the contract. Incidentally, joint ventures operating within China (see point 7 above) are treated as Chinese entities and therefore disputes involving joint ventures will usually be considered to be domestic Chinese disputes for the purpose of arbitration.

Four types of forums are generally available for cross-border supply agreements: Chinese state courts; Chinese arbitration institutions (most notably, the China International Economic and Trade Arbitration Commission - CIETAC); foreign courts; and foreign arbitral tribunals.

The choice of the most appropriate forum for resolving a dispute depends on the circumstances of each case, taking the following into account:

- Foreign litigation and arbitration are available only for agreements with foreign elements and so, as mentioned above, this may be affected if the foreign supplier has entered into a joint venture in China.
- Foreign arbitral awards can be – and frequently are - enforced in China under the New York Convention, while foreign court judgments are usually unenforceable in China.
- Local litigation and arbitration may be desirable when interim relief (such as an injunction) in China is the parties' major concern. Asset and evidence preservation orders are available in support of People's Republic of China (PLC) litigation and arbitration and interim injunction can be obtained only in support of PRC litigation involving copyright, trademark patent infringements or breach of trade secrets.

In any event, careful drafting of the supply agreement will be required where the parties opt to use a foreign law combined with litigation before the Chinese state courts. Most local courts are inexperienced in applying foreign laws and, if a court finds that the governing foreign law cannot be properly verified, it is entitled to apply Chinese law despite the parties' contractual choice.

10

Make sure you have a safety net to protect your credit sales

At point 6 we focused on payment methods and observed that, whenever a sale involves parting with goods before payment is made, there is an element of risk that payment won't be received. That may be because the customer can't or won't pay, or there may be some reason - outside the customer's control - such as a change in the foreign trade policy of the customer's country that blocks payment.

As a sensible precaution the supplier should seek protection in the form of credit insurance to mitigate those potential risks that due diligence alone can't avoid.

There are other benefits too, as credit insurance provides not only protection, but also reassurance about the identity and creditworthiness of your potential customers. That's important: in a country as vast as China it's easy to confuse two similarly sounding company names.

With that combination of protection, reassurance and market intelligence, those foreign companies seeking to establish a market for their goods and services in China can afford to offer competitive payment terms.

In conclusion: the opportunities are there, but don't assume that the business techniques that you use in your home market will work in China.

Our introduction mentioned that the Chinese government is taking measures to rebalance the economy. Atradius' China Country Report (January 2016) throws further light on those measures and their potential for success:

'To a certain degree, private consumption growth has started to balance decreasing investment. Since summer 2015 the government has increased fiscal spending to support the economy. At the same time the central bank, the People's Bank of China (PBOC), has repeatedly loosened its benchmark lending rate since November 2014, to 4.35%. Given the modest inflation outlook below 2.0% the PBOC still has room for further monetary policy easing if necessary.'

While that is a welcome sign for those foreign businesses seeking new sales opportunities in China, they shouldn't assume that the business techniques that have proved successful in their home market will work in China too.

The Chinese have a word – 'Guanxi' – that describes the personal connection, respect and trust that must be created before a business relationship can go further. The existence – or lack – of Guanxi will influence the ease with which a deal can be struck.

Industry performance forecast

Metals	Paper	Services	Steel	Textiles
Bleak	Poor	Good	Bleak	Poor

This overview is intended to provide general guidance on the legal framework applicable to supply relationships with Chinese customers. It is not intended to provide legal advice and cannot replace a thorough analysis of a respective supply arrangement.

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