

## The Ten Commandments of Doing Business in China

By: **Lawrence A. Freeman**, Chairman, CEO, Global Business Consultants, Inc., and  
**Anita Y. Tang**, Managing Director, Royal Roots Global Inc.

*There is an old saying “When in Rome, do as the Romans do.”  
The same applies to China – “When in China, do as the Chinese do.”*

- (1) **Determine if China is the right market for you. Don't go just because others are there or going there**
  - A. Define what you want to do: manufacture, buy production, sales, trading, distribution, wholesale, etc. Conduct and prepare a feasibility study of exactly what you want to do.
    1. Location – geographically area, compare specific costs, labor availability, near by customers, or supply chain, logistics, specific site, costs, tax incentives, FTZ considerations.
    2. Market research – most people do not fully investigate the actual market situation, do not perform the necessary risk assessment, and fail to get qualified counsel.
    3. Required information, identify and target top customers, do a personal profile of customers, current suppliers, channels, pricing, decision drivers (quality, delivery price, etc.) projected buying, how to compete, key influences, ideas, strategy – differentiation of pricing, “packaging.”

- B. Hire someone who is qualified in your industry, who reads, writes and speaks fluent Mandarin and English, and who is also a team player. These people should have business and functional expertise as well as a good understanding of the cross-border business and functional issues that must be addressed. Do not make the mistake that an ethnic Chinese, who was not raised in Mainland China, will understand or be able to understand the PRC way of thinking, pressures and system. It is unreasonable to expect them to do so, because their backgrounds may have varied from those of the Mainland Chinese.
- C. Understand that the Ministry of Commerce (MOCOM) is responsible for the formation of policies and regulations in attracting foreign investment. The “Catalogue of Foreign Investment Incentives” is essential reading. Is your intended project classified as “permitted,” “encouraged,” “restricted,” or a “prohibited” industry? Thoroughly understand the specific industrial policies set by the supervisory authorities of the relevant industry.
- D. Understand how local authorities interpret and implement these policies, what their attitudes is towards the proposed investment, so that the necessary approvals can be obtained.

**(2) Line up your Chinese professional services – Legal, Accounting and Banking team**

- A. Basic criteria for the team qualified member would be someone who can read, write and speak fluent Mandarin and English.
- B. Include in your team someone, an ethnic Chinese, who has lived and trained both inside and outside of the PRC, so that this person is familiar with more than one system.

**(3) Conduct “Your Due Diligence” as soon as possible and do it thoroughly**

- A. Take nothing on face value.
- B. Test the validity of everything you are told because some things change frequently.
- C. Conduct thorough background checks on the people you are dealing with so you know who they are.
- D. Know the decision structure – make sure the person you are dealing with has the absolute authority to make decisions.

**(4) Establish your China business plan based on the business environment**

- A. Plan your strategy to determine how your China play fits into your overall business strategy.
- B. Take the various levels of governmental planning into consideration –
  - 1. Central government
  - 2. Local governments
- C. Continually update your market intelligence as it constantly changes.
- D. Determine if your project is economically viable.
- E. Search for problems before they materialize.
- F. Do a complete risk analysis of your venture.

**(5) Understand the Chinese Legal System, the Foreign Investment Regulatory Framework, Chinese Tax System, and the Incentives which are offered**

- A. The government departmental regulations –
  - 1. Foreign Investment Enterprise Income Tax Law
  - 2. State tax incentives, Local tax incentives
  - 3. Exchange-control rules
  
- B. The industry regulations –
  - 1. Catalog on guiding foreign investment
  - 2. Administrative measures for foreign investment in the commercial sector
  
- C. The Economic Zone regulations –
  - 1. Administrative measures for free trade zone
  - 2. Administrative measures for export processing zone
  - 3. Administrative measures for State level Economic and Technological Development Area
  - 4. Administrative measures for Hi-Tech Industry Park
  
- D. Learn How to Protect your Intellectual Property Rights –

1. Operations plan vs. legal plan – written plan.
2. Intellectual property registration:
  - a. Trademarks: register with the State Administration of Industry.
  - b. Patents: register with the State Intellectual Property Organization.
  - c. Copyright registration.
  - d. Protect trade secrets, and know-how.
  - e. Personnel policies – non disclosures, non-compete agreements.
  - f. Record registered IP rights with Chinese customs and notify Customs of each infringement case.
3. Continuously monitor the markets on a constant basis to be aware of violations and develop a policy of how to address infringements on a cost effective basis.
4. Beware of IP hijacking: Designs, Patents, Company names. The use of company name is not a trademark infringement under Chinese law. **Domain names.**

## **(6) Determine your Form of Commercial Relationship in China**

- A. Offshore operations –
  1. Purchase and sale

2. Distribution
  3. Distributions/Representation
  4. Miscellaneous design, development, etc.
- B. Onshore operations – only after you have completed your feasibility study.
1. Representative Office – simplest and least expensive way to create a presence, not allowed to do business, no income; however, can be taxed.
  2. Foreign Invested Enterprises (“FIEs”) –
    - a. Wholly foreign-owned enterprise (WFOE) is the most popular option for companies that want to earn income in the PRC, either by manufacturing products for export or by distributing products and services domestically within the PRC.
    - b. Equity joint-venture used to be the most popular way for overseas companies to do business in the PRC. Some economic sectors remain closed to WFOEs, in which case a joint venture may be the only way a foreign company can invest in that sector.
    - c. Cooperative joint-ventures.
    - d. There is no such thing as a shelf company in China.

- e. There are no LLCs, LP's, or non profits, Co. and Ltd. are the type, but they are different forms and rules to be observed.
  - 3. Assembling and processing contracts (APC) – Under this arrangement, the foreign party technically does not own any subsidiary or office in China. The foreign party provides technology, machinery, spare parts and raw materials, while the Chinese party provides manufacturing facilities and services for a subcontracting fee.
  - 4. Bonded Zone Company, there are 15 bonded zones in the costal areas.
- C. Government roles – know the system and ensure you follow the rules.
- 1. Approval –
    - a. Set up process
      - Phase 1 – Application to local foreign investment committee of the project registration of enterprise name, for initial consent by committee.
      - Phase 2 – Official application to MOC in Beijing with feasibility study, Articles of Association,, equipment, material list, Board, etc. and wait for formal approval.
      - Phase 3 – Application for issuance of business license.
      - Phase 4 – Business license organizational code certificate issued.

Phase 5 – Open bank account,

Phase 6 – Miscellaneous local Department registrations  
Foreign Exchange Administration, Statistics, Customs,  
Taxation, Industry & Commerce, Employment, Finance &  
Administration.

- b. Changes
  - c. Close a business
2. Registration, update registration, and de-registration
  3. Report / filing requirements
  4. Inspection and audit
  5. “Partner” with the Chinese government – Central and local governments

## **(7) Determine Your Actual Investment**

- A. Pick the appropriate PRC location based on your feasibility study. China is a large country with 23 provinces, five autonomous regions, four centrally administrative municipalities, and two special administrative regions. Government support, tax incentives, infrastructure, transportation, market size, labor quality and costs as well as the distribution network are all factors to be evaluated in your feasibility study.
- B. Relationship – the right PRC partners can help you in your China business. They have better *guanxi* (relationships or connections) than you

do. Recognize that trust building requires time and effort; do not expect a contract to guarantee trouble-free business.

C. Mind the Store –

1. Set up the right systems and monitoring procedures.
2. Do not expect your China activity to succeed without extra attention by you.

**(8) Know That Knowledge is The Key to Power**

A. Understand there are cultural differences between the mainland Chinese and the non-mainland Chinese as well as yourself. Develop a working understanding of the reality of Chinese culture in order to do business in China.

1. Different perceptions –

<b>China View of Westerners</b>	<b>Westerners' view of Chinese</b>
Direct, assertive, up-front, and can give offense	An indirect approach, distrust apparent openness and wonder what the hidden agenda is
Use colloquial, unfamiliar language	opinions are not expressed strongly
Dominate in meetings which shows that they don't think the Chinese are competent	Don't want to share information; difficult to tell if silence and nodding of heads means a "yes" or "no"
Difficult to tell if they are serious or joking	Don't show physical signs of urgency or excitement
Tend to be culturally arrogant	

2. You must understand the five relationships –
  - a. Ruler – subject
  - b. Parent – child
  - c. Husband – wife
  - d. Elder – younger
  - e. Friend – friend
3. Face is very important; you must understand the concept and the role of face. Face is about one's self respect and prestige and one's standing in the group. It is a public phenomenon and has powerful emotional consequences. The emotions are about dignity and dignity's enemy, shame. Face can be lost by: insulting someone intentionally or unintentionally, cultural insensitivity or pure ignorance, declining an invitation to a social or business function, refusing a request, refusing a present, being too independent, or losing control of yourself by displaying anger, aggression, or grief.
4. Overtures to Business –
  - a. Westerners – tend to see things in black and white.
  - b. Chinese – prefer to talk over a meal on anything else but the business on hand, they go to karaoke, drink, and then shake hands later on the deal.
5. Different concepts of time, seniority, attitudes to age, gender, etc.
6. Learn to read body language emanating from the other side.
7. Learn then difference between “high” context cultures such as China, and “low” context cultures. In high context cultures, communication depends on the non verbal aspect of

communication, i.e. interpreting what is meant rather than what is actually spoken.

- a. What is unsaid, but understood carries more weight than a verbal or written contract.
  - b. Agreements are made on the basis of general trust.
  - c. Negotiations are slow and ritualistic.
  - d. Relationships and goodwill are highly valued.
8. Low context cultures such as the US or the UK, communication depends on what is actually said or written.
- a. Negotiations are expected to be quick and efficient. Don't waste time.
  - b. Relationships are not a priority.
  - c. Legal contracts are necessary and binding.
  - d. Expertise and performance are valued above reputation or connections.
  - e. Interpretation depends on what actually is said.
9. The Chinese notion of space and time are very different Western ones. Chinese perception of time is it has a much slower pace.
10. There are four stages of any negotiation –

- a. Exploration, in China, this is a lengthy process. Here the Chinese determine how much guanxi they have and how they can hope to gain from the interaction.
  - b. Expectation structuring, here the Chinese will heap praise upon you.
  - c. Solution building, here compromise is a natural, healthy outcome.
  - d. Finalizing the agreement, here there is a fundamental difference in perception and attitude. For the Chinese, formalization of a contract does not imply that it is final and fixed. It is a snapshot of a relationship, meaning the parties do really understand each other, and there is now a platform for further trading and mutual exchange of favors.
- B. Put the right talent on the right job – ideally try to use overseas returnees, Mainland Chinese who have lived, studied and worked abroad. These people will serve as a critical link for your business.
- C. Gain respect by showing respect, understand that all Chinese are not the same.
- D. Use English Effectively –
1. As the English language is becoming more widely spoken and it is now considered the business language in China, one has to bear in mind that this does not mean that people in China will speak English at the same level of competency as you do. English is possibly their second or third language. Accents and speech patterns affect clarity, even for native speakers (remember that

your audience may have learned British English, rather than American English. Furthermore, their instructor was most likely not a native American or British speaker).

2. The following are basic tips for more effective communication:
  - a. Speak slowly
  - b. Enunciate and pronounce words clearly
  - c. Use visual aids, if you are making a presentation

### **(9) Set up Your Appropriate Financial Structure**

- A. Determine “registered capital,” “total investment,” etc.
- B. Better to start low and make capital increases as required.
- C. Formulate optimal debt / equity structure.
- D. Avoid side agreements.

### **(10) Determine Your Exit Strategy**

- A. Income Tax Treaties
- B. Holding Companies
  1. Mauritius company with a Category 1 Global Business License
  2. Singapore Investment Holding Company
  3. Hong Kong

4. Belgium
  5. Macao
  6. Barbados
- C. You must have a comprehensive exit strategy and the appropriate clauses written into your investment contracts in order to protect yourself and minimize possible difficulties during the exit process. The problems of an early termination of a venture exceed the application and approval process. If the contract does not spell out the details of a termination clearly, the negotiations will be tough. A failure to pay attention to the details in the set-up stage can cost you “break-up fees” in order to get your partner’s consent to dissolution.

*We promise you:*

*If you do not follow the above Ten Commandments, you will lose your wallet.*

*If you do, you have a chance to be successful.*