

DOING BUSINESS WITH  
**CHINA**

A Guide for Canadian Exporters and Investors



# ABOUT THE GUIDE

*Doing Business with China* is intended to help you learn about the Chinese marketplace and how your company can do business there. It concentrates on basic, practical information, but also refers you to dozens of other resources that will help you plan and carry out a Chinese export strategy, starting with your initial readiness assessment and basic market research, and ending with product delivery and payment methods.

A word of caution, however: if your company has never exported before, you probably shouldn't pick China as your first foreign market. Considerable investment in time and money is needed in order to establish the relationships and conduct the due diligence that is essential in determining how your company and its products align with what China and its consumers are seeking. The country is far too complex and there are far too many pitfalls for the inexperienced. But if you already have a solid foundation in exporting and are ready to commit to the China market, a Chinese venture may work out very well for you.

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# CHINA

## A Guide for Canadian Exporters and Investors

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# 1 CHINA'S BUSINESS ENVIRONMENT

The rise of China to its current rank of a global economic powerhouse is not an anomaly but, in fact, a return to the norm. For most of its long history, China had been a cultural and scientific world leader. The new generation of leadership after the death of Mao Zedong began a gradual and methodical re-engineering of China's economy, including the adoption of market-oriented economic policies that emphasized rapid modernization, renewed interest in foreign investment and fostered export-dominated industrialization. The Middle Kingdom was awake.

Today, China is firmly asserting itself as a global engine of growth. Since 1978, the country has experienced a more than tenfold increase in GDP, with annual growth rates averaging approximately 10 per cent since 1993. More recently, China has been able to maintain its growth even through the economic downturn that has affected the West since 2008. In 2009, the country surpassed Germany as the world's largest exporter and by mid-2010, it had surpassed Japan as the second-largest economy in the world.



## 1.1 The economic environment

When China's economic liberalization began in 1978, few could have foreseen the country's eventual transformation into a global economic power. The process has left no sector of the country's economy untouched, creating a vast middle class while fostering a culture of canny and ambitious entrepreneurialism. While much of this growth has been a result of becoming the world's factory, China is now in the midst of a new stage of transformation. It is moving up the value chain in manufacturing, cultivating high-technology industries, creating globally recognizable brands and building an internal consumer market that is reducing its dependence on foreign exports.

### 1.1.1 An accelerating economy

China's economic acceleration has been underway since the early 1990s. A major stimulus to development occurred in 2001, when the country formally joined the World Trade Organization (WTO) and, in consequence, lowered its tariffs and abolished a wide range of trade and market barriers. Since then, not only has the country's internal economic growth been extraordinarily vigorous, but its trade with the rest of the world has also exploded. China now imports vast amounts of machinery, oil, chemicals, fertilizers, agri-food and raw materials to feed its industries, which include:

- › automobile manufacturing and parts;
- › iron, steel and aluminum production;
- › oil and gas production;
- › electrical generation through traditional and alternative sources;
- › cement, chemicals and fertilizers;
- › equipment manufacturing;
- › textiles and apparel;
- › consumer products; and
- › electronics and information technology.

Agriculturally, China is also a giant; it's one of the world's largest producers of rice, corn, wheat, soybeans, vegetables, pork, cotton and oilseeds. On the export side, it sends enormous quantities of machinery, electronics, plastics, textiles and garments to countries all over the globe. Moreover, its expansion has shown no signs of slowing down. The World Bank estimates that China's GDP grew by 9.5 per cent in 2010 and will continue at a strong pace in 2011, with a forecast growth of around 8.5 per cent. Such continuous expansion has enabled China to become the world's largest exporter and its second-largest economy.



### Export Development Canada's direct representation in China

Recognizing the opportunities for Canadian companies to do business in China, Export Development Canada (EDC) has established representatives in Beijing and Shanghai. These representatives work closely with the Canadian Embassy and the Canadian Consulates in China to develop and enhance EDC's relationships with the country and its leading corporations, to gather current market intelligence and to help Canadian companies make sales and invest in the Chinese market. For contact information, please refer to Appendix B.

An additional catalyst for the country's economic growth has been its "Go Global Strategy," also known as "Go Out," which the government began in 2000. The strategy's goal is to turn large Chinese domestic companies into global players, both through investing overseas and through mergers with, and acquisitions of, foreign companies. The intent is to diversify Chinese production, improve the quality and complexity of its exports and develop Chinese brand recognition.

Progress has been rapid. Companies such as Sinopec, State Grid and China National Petroleum Corporation are in the top 10 of global 500 companies. More than a dozen bilateral and regional free trade agreements have been signed or are being negotiated by China and its trading partners. Globally, China has become a force in development aid and is investing heavily in Africa, where it has been building hospitals, schools, roads and power stations. It is becoming Africa's second-largest trading partner, trailing only the United States.

This development of ties and bonds on multiple levels, from international trade to foreign aid, is part of China's strategy to extend its global reach, increase its influence and secure access to trading partners and strategic supplies.

### 1.1.2 Economic prospects

Significant instability and economic turmoil often accompany rapid growth and development, and Chinese authorities have been quite willing to adopt vigorous corrective measures when China's economic stability and expansion are endangered. When the growth rate in the early 2000s increased so much that it threatened to produce an overheated economy and severe inflation, authorities stepped in to take control. They introduced measures to slow investment, raised interest rates and increased bank reserve ratios to ensure banking stability. The measures were successful and China's growth moderated to healthier levels, while the economy continued its steady expansion.

Again in 2007, China's growth was threatened by the Western financial crisis that sapped demand for Chinese products. Chinese authorities responded in 2008 by announcing an enormous stimulus package of US\$586 billion that invested heavily in infrastructure and social welfare. Chinese businesses participated by stepping up their stockpiling of commodities, which not only helped ease the impact of the recession in resource-dependent economies such as Canada, but also demonstrated that China was now an important engine of growth in its own right. By mid-2010, it appeared that these measures had succeeded, since the Chinese economy continued to expand at a rate comparable with its recent performance.

Chinese officials, however, have stated that the country is too reliant on exports for its longer-term growth, and that boosting domestic demand is the key to sustaining future expansion. At the same time, they believe that Chinese companies must expand internationally to lock up access to the essential natural resources that fuels the country's domestic economy and its exports.

This expansionist agenda has been influenced by the recent fiscal crisis in the West, which provides convincing evidence that the developed economies have a finite capacity for absorbing Chinese goods. China's current domestic demand accounts for only a third of China's GDP, far lower than the 70 per cent that is characteristic of the United States and other large developed economies.

Uncontrolled expansion of China's domestic economy might, however, lead to the development of property and stock market bubbles that could threaten growth. Such bubbles occurred around the turn of the millennium but were successfully managed, which suggests that China may be able to realign its economy toward domestic consumption in a way that will allow it to grow both robustly and indefinitely.

### 1.1.3 Demographics

With a population estimated at more than 1.33 billion in 2010, China has more people than any other nation on earth. Ethnic Chinese (Han Chinese) make up nine-tenths of the population, with most inhabiting the coastal regions and the southeast interior. There are more than 50 other ethnic groups as well, most living in the western part of the country. According to the Asia-Pacific Economic Cooperation Forum, China's urban population is expected to grow to 750 million by 2020, exceeding its rural population for the first in its long history.

One result of the country's economic growth has been a steady improvement in living standards, although many tens of millions of people remain below the international poverty line. According to the World Bank, the country's gross national income per capita in 2008 was more than US\$3,590 annually, although this figure is substantially higher in the rich, urbanized regions along the coast and in the southern part of the country.

Such increased wealth is behind one of the major economic forces in China's domestic development: the rise of a new middle class, loosely defined as households with annual incomes of between 25,000 and 100,000 yuan (\$4,000 to \$16,000).<sup>1</sup> While there were only 40 million such households in 2005, it is estimated that there will be 600 million to 700 million Chinese in the middle class by 2020. This staggering increase will impose huge demands on the Chinese state and has the potential to redraw the flow of global trade and economic power.

Currently, the average life expectancy in China is 72 years, and demographics indicate that by 2015, about 200 million Chinese will be 60 or older. Combined with the changes brought about by urbanization, this demographic time bomb imposes a timetable on China's leadership: it must develop the capacity of the state and the economy in ways that can meet its citizens' demands and needs, and thus ensure the country's political and economic stability.

### 1.1.4 The investment climate

China's robust growth, despite the economic downturn in the West, has made it the leading destination for foreign direct investment (FDI). Approximately US\$90 billion in FDI flowed to projects in the country in 2009, and current quarterly figures show that this will be surpassed in 2010.

Until recently, much of this FDI was drawn to China's coastal cities and special economic zones (SEZs) by tax and financial incentives and by the availability of low-wage, skilled labour. As the coastal cities grow and prosper, however, wages and shortages of qualified workers are beginning to exceed the national average. As a result, it has become much more expensive to operate in these regions than in China's western and central provinces. In addition, the Chinese government has implemented changes to China's labour laws and environmental policies so that energy-intensive manufacturing facilities, with their high emissions and relatively cheap labour, are no longer considered to be worth the poor air quality and environmental contamination that they cause.

### 1.1.5 Developments in FDI policy

In April 2010, the Chinese State Council released preliminary guidelines on foreign investment, called "Further Views on the Utilization of Foreign Capital." The guidelines offer a suite of incentives, such as matching funds, technical support and streamlined procedures, for environmentally friendly, labour-intensive industries willing to locate or relocate to China's central and western regions. These areas are comparatively underdeveloped and offer a large pool of inexpensive labour and property.

<sup>1</sup> All currency figures are in Canadian dollars unless otherwise indicated.

Redesigned incentives for the coast and the SEZs encourage high-end manufacturing, information and communications technology (ICT) and green industries. By the end of 2010, imported goods and equipment for R&D centres established by multinational companies will be exempt from tariffs, import taxes and goods and services taxes.

Further changes are expected in the new release of the Ministry of Commerce's [Catalogue for the Guidance of Foreign Investment Industries](#)<sup>2</sup> (referred to here as the "Foreign Investment Catalogue"). This document, which appears periodically, announces substantive revisions in rules, simplified approval procedures and changes in the list of sectors and industries open to foreign investment.

In addition to financial incentives, China is opening its capital markets to foreign companies. Expected changes include the following:

- › In strategic sectors, restrictions on foreign investment in Chinese-listed companies will be lifted.
- › Rules for investment in Chinese securities and in mergers and acquisitions will be standardized.
- › Qualified companies will be permitted to list and issue corporate bonds or medium-term notes.
- › Procedures for settling foreign exchange capital funds will be simplified and deadlines for capital contributions may be extended.

Despite China's economic robustness, however, the country's commercial environment can be risky for foreign investors. Potential difficulties include:

- › a lack of legal protection for investor rights and intellectual property rights;
- › inconsistent application of regulations;
- › bureaucratic interference; and
- › corruption.

The authorities are aware of these difficulties and are attempting to deal with them through legislative and judicial changes such as the property laws promulgated in 2007, new bankruptcy laws and clearer regulations on mergers and acquisitions. Even so, inconsistencies in applying and enforcing these changes continue.

Such problems are aggravated by the way in which regulations and their interpretation can vary arbitrarily from region to region, and from industry to industry. For any given project, for example, various levels of government may be playing the roles of landlord, supplier, customer, or business partner. In one recent change, regulatory responsibility for FDI – in favoured categories where the investment is less than US\$300 million – has been delegated to lower levels of government.

Such inconsistencies mean that foreign investors must be very diligent in finding out exactly who is responsible for approving, licensing and regulating the projects in which they're involved, and what registrations are necessary to document investors' rights. Investors also should be aware that if foreign ownership of a company is 25 per cent or less, the business may be viewed as Chinese-owned with respect to some regulations, including those policies that govern the ability of the company to obtain offshore funding.

Reducing the risks of establishing and maintaining a healthy operation in China requires an important commitment from a Canadian investor at all levels of management. This includes establishing and fostering good relations with government officials, labour representatives, joint venture partners if any, and other potential stakeholders in the region where the investment is located.

<sup>2</sup> The most recent revision to the Catalogue was published in 2007, but the Ministry announced in the fall of 2010 that it would shortly be issuing a new edition.

### 1.1.6 The relationship of politics and business

China has been a socialist, one-party state since 1949. As a result, politics, government and business remain very closely intertwined despite the seismic shift toward private enterprise that has occurred during the past decade. In general, strategic commodities and industries remain state-controlled, while the commercial and private sectors operate in a market-oriented environment.

However, even apparently private companies can have an element of government involvement. Because this can affect how a Chinese business operates, part of your due diligence should be to establish whether your prospective customer or partner is a state enterprise or a private firm – and if the latter, how much government control still exists behind the scenes.

There are three main types of Chinese businesses:

#### **Businesses owned by the state**

These tend to be large, strategically important enterprises, such as communications, transportation, energy, heavy industry and resources. During the past few years, however, segments of these enterprises have been released from tight state control and function as independent firms with autonomous management and full responsibility for their finances. The consequence has been a decline in the number of enterprises that are wholly owned and controlled by the state.

#### **Collectives**

State-owned enterprises are commonly urban-based. Collectives are largely rural and are composed of small business organizations and individuals. Their numbers are declining because of the overall Chinese shift toward private enterprise.

#### **Private businesses**

Most private businesses are small, individually-owned firms operating in the service sector, in light industry and in general commerce. They now make up a large proportion of China's established companies.

## 1.2 The China-Canada trade relationship

Canadian exports to China have increased sharply during the past five years, resulting in China now ranking as Canada's third-largest export destination. We sold about \$11.2 billion worth of goods there in 2009, up 6.6 per cent over the previous year, which makes Canada the only major trading partner to show a year-over-year increase for that period.

Canadian exporters are especially active in ICT, transportation, aerospace and auto parts. We are also showing success, to varying degrees, in areas such as building products and construction materials, environmental equipment and services, agriculture, agri-food, energy, resources, mining and financial services.

In terms of market share, though, we are lagging. The growth rate of our exports to China is less than that of any other major trading nation and, according to recent figures, about 21 countries export more goods and services to China than we do. As of mid-2010, moreover, several countries and regional trade groups either had completed or were negotiating free trade agreements with China. Canada is not currently pursuing such an agreement, but is instead working toward a Foreign Investment Protection Agreement (FIPA) with Beijing.

## 1.3 Researching China

There are many sources of export-related information about China. The following list is far from exhaustive, but it will help you begin your market research.

### 1.3.1 China-specific resources for exporters

- › The federal government's Canadian Trade Commissioner Service has a range of valuable [resources for China](#). One of its most recent and comprehensive publications is *Navigating China: A Guide to Doing Business 2010*. There is also a [list of service providers](#), where you can find purveyors of everything from accommodations to vehicle rentals.
- › The [Canada China Business Council](#) (CCBC) is a private, membership-based association that seeks to facilitate and to promote trade and investment between Canada and China. Its members represent many sectors of the Canadian economy, including financial services, legal services, information and communications technology, education, manufacturing, construction, transportation, mining and energy.
- › [China](#) is China's main government web site and presents the official view of everything from sports to business.
- › The [Hong Kong-Canada Business Association](#) focuses on helping Canadian companies do business between Hong Kong and Canada, and through Hong Kong into China and Southeast Asia.
- › The [Hong Kong Trade Development Council](#) is a good source of information for trade events, market intelligence, sourcing and small business resources.
- › [BizChina](#) is a major source of official information about China's industry, agriculture, finance, trade and economic affairs in general. It is operated by the Ministry of Commerce of the People's Republic of China (MOFCOM).
- › The [Asia-Pacific Foundation](#) maintains a website that includes news and information about China and the rest of the Asia-Pacific region.
- › The [CIA World Factbook](#) has a useful chapter on China.

### 1.3.2 General resources for exporters

- › [Export Development Canada](#) (EDC) is a Crown corporation that provides financial services and global market expertise to Canadian exporters. It's an invaluable resource for companies involved in foreign trade. EDC also offers free 90-day access to [eLearning](#), a variety of online learning courses geared to the needs of small exporters.
- › [Canada Business](#) is one of the first places you should go for general export information. It's a collaborative network of federal (and in some cases provincial) government services that help Canadian entrepreneurs and exporters build their companies.
- › [Canada's International Market Access Priorities](#) describes the federal government's priorities for improving Canadian access to foreign markets. It is updated yearly.
- › The [Department of Foreign Affairs and International Trade](#) (DFAIT) provides information about foreign affairs, foreign policy, travel information, the Canadian economy and international trade.
- › [CanadExport](#) is a free, online magazine published by DFAIT (see above). It provides news about trade opportunities, export programs, trade fairs, business missions and more.
- › For information about goods that require Canadian government export permits before they can be exported to China, refer to DFAIT's [Export and Import Controls](#).
- › [Industry Canada](#) is an excellent source of information, offering market reports as well as the Trade Data Online research tool.
- › The [U.S. Commercial Service](#) has a range of useful research tools, including market reports and commercial guides related to world markets.



**QUICK FACTS**

- Population:** 1.33 billion (July 2010 estimate)
- Official language:** Mandarin with many dialects throughout the country.
- Main imports:** machinery and equipment, oil and mineral fuels, plastics, medical equipment, organic chemicals, iron and steel.
- Canadian exports:** pulp and paper, industrial chemicals, auto parts, electrical machinery, agrifood.
- Largest import partners:** Japan 12.3%, South Korea 9%, Taiwan 6.8%, US 7.7%, Germany 5.5% (2009)
- Climate:** extremely diverse; tropical in south to sub-arctic in north.
- Currency:** Chinese yuan (CNY) note: also referred to as the Renminbi (RMB)
- Time difference:** +13 hours (eastern standard time)/ +12 hours (daylight savings time)
- Business hours:** Monday to Friday, 8:30 a.m. to 5:30 p.m. (with an hour for lunch).
- Government office hours:** Mondays to Fridays: 8:30 a.m. to 5:00 p.m.

## 2 ENTERING CHINA'S MARKETS

For a small or medium-sized company, starting to do business in China can be a substantial undertaking. A successful venture will take time, financial commitment and human resources, and the costs of travel, research and marketing may be high. Nevertheless, many smaller firms have done well in China, and have found that they can sell to Chinese customers just as effectively as large companies.

However, if your business is completely new to exporting, you probably shouldn't pick China for your first foreign venture; the market is far too complex and there are far too many pitfalls for the inexperienced. But if you already have a solid foundation in exporting, a Chinese venture may work out very well for you.



## 2.1 China's many markets

China has more than 50 distinguishable markets, but most of Canada's exporters to the country have concentrated on the geographical regions described in this section.

### 2.1.1 The Beijing-Tianjin corridor

The adjacent cities of Beijing and Tianjin, and the corridor between them, are at the core of economic development in north-central China. Beijing's dense population and vigorous economy made it a centre for China's early industrial growth, with iron, steel, coal, machinery, chemicals, petroleum, textiles and electronics as economic mainstays.

Beijing itself has been undergoing a transformation in recent years as China has matured economically. Financial businesses have supplanted many of the heavy industries that have either been compelled to reduce emissions or have relocated to less developed regions. With more than 30 universities and 40 scientific research institutions, Beijing is also a centre of culture, education, science and technology.

Tianjin, being an export-processing centre for a wide range of products, has become an important part of the region's manufacturing base. Its major industries include automobiles, electronics, petrochemicals, metallurgy, medicine, building materials, plastic products, consumer goods and food. It is also a major transportation hub, lying as it does at the intersection of two main railway lines and possessing a seaport with the biggest container dock in China.

### 2.1.2 Shanghai and the Yangtze River Delta

The Yangtze River Delta, which covers the Shanghai municipality and parts of the provinces of Jiangsu and Zhejiang, is a highly urbanized region with several major cities including Suzhou, Nanjing and Ningbo. It has less than 1 per cent of China's land and 5.8 per cent of its population, but according to official statistics, it accounts for about 20 per cent of the country's GDP, 22 per cent of its tax revenues and 35 per cent of its imports and exports. Because of its huge industrial and manufacturing base, the region's companies need a wide range of natural resources and commodities such as wheat, pulp and paper, sulphur, iron ore, copper, nickel and potash.

The economic giant of the region is the municipality of Shanghai, which is now China's leading financial and commercial centre. The municipality includes the Pudong Special Economic Zone, which in turn contains the Lujiazui Finance and Trade Zone; the latter is intended as China's new financial hub and is already home to the country's biggest stock market.

Suzhou serves as a base for manufacturing for many foreign companies. Nanjing is a hub for the automotive sector as well as the electronics, energy, and iron and steel industries. Ningbo is a growing economic port with transportation links and services for regional centres.

## China and the new exporter

In some cases, China can be a suitable foreign market even for a company with no export experience. This may be the case if the company's product or service is uniquely suited to China, or if the company's management is familiar with the country through family ties or for other reasons. If this applies to your business, you might begin by consulting some guides that will introduce you to the basic mechanisms of exporting. Several useful ones are found at [Canada Business](#), which contains guides to the steps involved in exporting and the basics in doing business in other countries, as well as additional general information. Check their website or call 1-888-576-4444.



### 2.1.3 The Pearl River Delta

The Pearl River Delta consists of the nine prefectures of the province of Guangdong, plus Macau and Hong Kong (treated separately below). The region has extensive mineral resources that include tungsten, tin, molybdenum and copper. It is also one of China's chief industrial areas, producing sugar, garments, leather, paper, stationery, pharmaceuticals, plastics, cement, consumer electronics, electrical machinery and communications equipment. Agri-food output includes meat, jute and tropical crops.

The region is well provided with seaports, airports and railway infrastructure, and is home to the Guangzhou Economic and Technological Development Zone (GETDZ), the Shenzhen SEZ, the Zhuhai SEZ and the Shantou SEZ.

### 2.1.4 Hong Kong

Hong Kong is something of a special case. Before China began to liberalize its trade policies, Hong Kong was the preferred launching pad for Canadian exporters wanting to enter the Chinese market. As liberalization has progressed and China has become more open, however, it has made more sense for many companies to go directly into China. As well, potential Chinese partners and customers sometimes see companies that access China via Hong Kong as lacking serious commitment to doing business in the country; this impression may be incorrect, but it can nevertheless influence how a Canadian exporter's interest in China is perceived.

Because foreign companies have been drawn away from Hong Kong, the authorities there are working hard to bring them back; as a result, the commercial environment has become even friendlier towards foreign businesses. Hong Kong, therefore, may offer significant advantages for small and medium-sized Canadian exporters, including the following:

#### **Foreign investment**

Hong Kong welcomes foreign investment. It's committed to free markets, doesn't restrict inward or outward investment, has no foreign exchange controls and lacks restrictions on corporate or sectoral ownership. While it offers no special incentives to foreign companies, neither does it impose disincentives such as quotas, performance requirements, bonds or deposits.

Hong Kong respects property rights and maintains a strong rule of law, which is applied consistently and without discrimination. Moreover, the law does not distinguish between investments made by foreign-controlled companies and those made by local businesses. Hong Kong is also a member of the World Trade Organization in its own right.

#### **Taxes, finance and infrastructure**

Hong Kong levies almost no duties or tariffs on imports, the tax regime is simple and corporate taxes are low at 16.5 per cent. Hong Kong is an excellent source of financial and management services related to China; its banking facilities are excellent, it's a major source of equity funds for Chinese projects and is a major investor in every province of China. Its infrastructure is world class and it can provide excellent transportation, logistics and other services for Canadian exporters doing business there and on the mainland.

#### **Establishing a local presence**

To set up in Hong Kong, you'll need a local presence such as a branch office, agent or distributor. The business culture in Hong Kong is based on personal relationships, and these will develop only if you have people working on the ground.

It's easier to establish a presence in Hong Kong than in mainland China. You can freely incorporate your business, register branches or set up representative offices, and there are no restrictions on the ownership of such entities. Your company directors don't need to be citizens of Hong Kong or even live there, and reporting requirements are straightforward. There is no distinction in law or practice between investment by foreign-controlled companies and those controlled by local interests.

Using agents and distributors is a good strategy for getting started in Hong Kong, which has a wide range of companies that will be happy to work with Canadian firms. Hong Kong has no special legislation on agents and distributors, so contracts can be structured in any way that's agreeable to both parties.

Franchising has become more common in Hong Kong during the past 10 years because of the region's relaxed legal framework and high per-capita income. There is no specific legislation governing franchised operations, nor are there anti-trust laws or laws that govern foreign equity participation and local equity participation.

Joint ventures or strategic alliances can also be very helpful in entering the market and are particularly important if you intend to compete for a major project.

### **Selling to the government**

When you're looking for opportunities in Hong Kong, don't overlook the possibilities of procurement through the [Government Logistics Department \(GLD\)](#), which is the government's central purchasing and supply organization. The GLD purchases by open tender and evaluates bids according to tender specifications, competitiveness in price, backup services and delivery. The GLD gives no preference to any particular source of supply from any country or organization.

### **Hong Kong as a market**

Hong Kong is a significant market in itself. Among other goods and services, its companies and consumers purchase computer peripherals, plastics and resins, electronic components, drugs and pharmaceuticals, environmental technologies, mass transit equipment, architectural services, automotive parts, safety and security equipment, green building materials, and cosmetics and toiletries.

### **Hong Kong as a base of operations**

Finally, the holding companies of many of mainland China's biggest and most important corporations are in Hong Kong. Establishing relationships with these companies can offer potential channels into the mainland market for Canadian businesses.

## **2.1.5 Southwest China**

This region, comprising the provinces of Sichuan, Yunnan and Guizhou, is another large potential market for Canadian exporters.

- › Sichuan is agriculturally important, being one of China's primary producers of rice, wheat, oilseed crops, meat and fruit. Its major industries produce coal, metals, petroleum, machinery, electric power, chemicals, electronics and textiles. Feeding into these industries are extensive deposits of minerals and natural gas. The capital, Chengdu, is the gateway to the rest of Western China and is becoming a major investment destination for multinationals.
- › Yunnan, like Sichuan, possesses major mineral resources. It's also an important agricultural region, producing rice, tobacco, sugar cane, tea and tropical crops.
- › The area around Guiyang, the provincial capital of Guizhou, is a centre for coal, metallurgy, chemicals, machinery, electrical power, textiles and papermaking. The province also produces rice, corn, tobacco and raw lacquer.

### 2.1.6 Special Economic Zones

China has several Special Economic Zones (SEZs) located in the cities of Shanghai, Shenzhen, Shantou, Zhuhai and Xiamen. The entire province of Hainan is also a SEZ.

Until recently, these SEZs, together with scores of development zones and designated cities, offered incentives to foreign investors that included reduced tax rates, tax holidays, lower tariffs and low land-use fees. However, the changed tax regime resulting from the Enterprise Income Tax Law of 2008, together with policy amendments encouraging the industrialization of central and western China, have substantially reduced the tax and financial incentives offered in these zones. Excepted from this are foreign enterprises that are engaged in high and new technology, provided the intellectual property is held in China.

## 2.2 Preparing your market entry

Several basic strategies will help you prepare for the Chinese market. The following are some of the most important.<sup>1</sup>

### 2.2.1 Understand China's business environment

- › Your credibility with potential customers will depend on your grasp of local market realities, so do everything you can to understand them before you go to China. China is regionally diverse, so it's not enough to know broad generalities about the country; you must be acquainted with the particular region in which you're interested.
- › Be aware of the government's economic and social priorities at the national and regional levels, and of the regulatory environment as it pertains to your sector. Since China's accession to the WTO, government officials have had a lesser role in determining the business scope for foreign companies, but it's still important to develop a good understanding of local and national policy trends.
- › Establish a range of contacts relevant to your market segment. These might include potential customers and suppliers, local government officials, Chinese competitors, western firms, industry experts, industry association officials, regulatory officials and Chinese consultants.
- › Investigate and understand the strategy, strengths and weaknesses of your major Chinese and foreign competitors, and be sure you understand the potential competitive advantage that your product or service may have in China.
- › Be aware that Chinese firms are tightly focused on price and value, and if you show a similar concern with the price-value relationship, they will be more receptive to your approaches.
- › Identify the risks your proposed business will face in China and develop ways to mitigate them. For information about these risks, refer to Section 6.11, "Risk management."
- › Don't overlook the possibilities of entry via Hong Kong. For reasons why this might be your best strategy, refer to Section 2.1.4, "Hong Kong."

<sup>1</sup> The information in this section has been adapted, with permission, from material provided by the China Canada Business Council.

### 2.2.2 Use experienced, high-level negotiators

- › You'll need staff with cross-cultural experience who already know or can quickly learn how Chinese businesspeople negotiate.
- › Negotiations can be lengthy. Potential Chinese buyers or partners much prefer to deal with senior management, so face-to-face senior contact is a necessity. You may lose a great deal of credibility if you negotiate through a lower-level employee who has to refer all decisions to your head office; at worst, the Chinese may decide you're not serious about doing business with them, and will decline further contact.
- › The emphasis on high-level negotiations may mean that your CEO will have to be extensively involved.

### 2.2.3 Ensure adequate financial and human resources

- › Gaining an adequate share of the large and complex Chinese market can require substantial, up-front investment. Be sure before going in that you can raise the capital resources you'll need. For information on financing options, refer to Section 6.3, "Financing your exports."
- › You may have to operate at a loss for two or three years before your Chinese business begins to turn a profit, so your company will need the financial capacity to sustain operations during this period. A recent survey by the Asia Pacific Foundation found that 76% of Canadian affiliates in China were operating profitably.
- › Be sure the relevant people in your firm are prepared to make trips to China as frequently as necessary to provide training, service, marketing and sales support. Be sure you have enough such people.
- › Become very familiar with Chinese labour laws and be sure to consult a law firm familiar with China's labour codes. The degree to which the labour force plays a role in your Chinese operation's decision making can significantly affect the growth and direction of its activities.

### 2.2.4 Establish a solid customer service infrastructure

- › Make sure you have the people and the communications capacity to service your Chinese market. Also, don't become overly dependent on a single employee in either China or Canada; be sure you have properly trained backup who can communicate effectively with your customers.
- › Some communications needs can't be adequately met with email or on paper – only talking will do. Consequently, you'll need Chinese-speaking staff who can work with your Chinese customers, partners and suppliers.
- › Potential Chinese customers will usually be concerned about doing business with a supplier on the other side of the world. Be sure you have credible answers for these concerns, and that your people know how to communicate them.
- › Providing solid after-sales service and continuously building your business relationships are critical to winning contracts and sustaining success in China, so be sure to plan and budget for both.

### 3 ESTABLISHING YOUR PRESENCE IN CHINA

Following China's ascension to the WTO, more and more sectors of the country's economy were opened up to foreign investment. However, there are still substantial restrictions placed on foreign ownership, so you should consult the Foreign Investment Catalogue as well as the list of prohibited, restricted and encouraged sectors to find out if your company falls within any of the restricted categories. You should also consult a local law firm to confirm that the area that you are seeking to invest in is open to foreign ownership.

There are several ways to set up a business presence in China, but no matter which approach you choose, you'll need legal assistance to carry it out. For general information about the legalities of operating in China, you can refer to the [Due Diligence for Exporters](#) report published by the Trade Commissioner Service. The report has several useful links, among them a list of [law firms](#) operating in the country.



## 3.1 Canadian direct investment in China

For Canadian companies, the most common forms of direct investment in China are wholly foreign-owned enterprises (WFOEs) and joint ventures (JVs). Using either means, you can set up a business presence in China that will allow you to sell into the domestic Chinese market, to export goods from China to other countries, or both.

### 3.1.1 Wholly foreign-owned enterprises

Wholly foreign-owned enterprises have become the preferred way for companies to set up a permanent presence in China. A WFOE (at times also referred to as a WOFE) is not considered to be a branch or subsidiary of the foreign company that established it, but rather a Chinese limited-liability company that is wholly owned by a foreign investor. There is an upper limit of 50 investors when establishing a WFOE, and each holds a portion of the registered capital; there are no shares.

The major advantage of a WFOE is that you have complete control over the company, its strategies and its profits, and no Chinese partner is involved. The drawback is that you *don't* have a Chinese partner to furnish the local knowledge that can contribute to your venture's success.

The procedure for getting your WFOE approved and set up can vary across China, so be aware that the following is a considerably simplified overview of how it works.

#### Preparing to apply

1. Be sure you can comply with the minimum registered capital requirements for setting up your WFOE. The revised Company Law that came into effect in 2006 sets the minimum registered capital requirements for a limited liability company to RMB30,000 (\$4,512), and for a company limited by shares to RMB500,000 (\$75,227). At least 30 per cent of a company's registered capital must be in the form of cash and in-kind contributions. You can pay these in instalments, provided the first instalment is at least 15 per cent of the registered capital and provided you contribute the balance within two years after incorporation.

Note that it is extremely important to plan and consult with legal and tax professionals when you are setting up the capitalization structure of your company. This is an area where many first-time investors make mistakes that greatly affect their success in China. For more information, refer to Section 3.3, "Capitalization and Debt Structure."

2. Next, reserve your new WFOE's name through the local Administrative Bureau for Industry and Commerce (SAIC). You'll have to propose both a preferred name and two alternatives.

#### Project approval

1. Prepare a project proposal and all necessary supporting documents, such as feasibility studies and articles of association. The proposal must be a thorough description of your intentions for your WFOE, including the scope of its business, its intended products or services, its financing, its personnel, the equipment and technology it will use, and its requirements for land and public utilities.

Be sure that your proposal completely defines what your WFOE is going to do in China, not only at start-up but also in the longer term. You'll encounter problems later on if you define your business scope too narrowly and you later want to change it, for example by moving into a related business, selling to other companies or exporting your goods out of China. These new operations may be prohibited by SAIC if they're not included in the original project proposal, and you'll likely have to set up a whole new WFOE if you want to implement them.

2. You must obtain project approval from the [National Development and Reform Commission](#) (NDRC) and complete an environmental impact assessment examination conducted by the relevant environmental authority. If you intend to do business in the more heavily regulated sectors, an initial approval from the relevant regulating agencies must also be obtained at this point.
3. When you've completed the proposal, submit it to the approval authority in the region where you intend to operate.
4. When the authorities have approved the project – they're required to issue a decision within 90 days – you can proceed to the next stage, the registration for the business license.

#### **Business license registration**

1. Within 30 days of receiving approval for your project, you have to apply for a business license from the local SAIC office. You'll have to submit documentation to SAIC that is similar to the paperwork you provided in the project approval phase.
2. SAIC will issue your license in 30 days or less. Make sure the licence accurately reflects the scope of your project proposal and that it will allow you to operate as planned in both the short and long terms.
3. Once you have the license, your WFOE is deemed to exist under Chinese law and can operate in China within the scope of your license.

#### **Registration with foreign exchange control and other authorities**

1. If you haven't already done so, you must apply for foreign exchange registration with the State Administration of Foreign Exchange (SAFE) within 30 days of receiving your license.
2. Assuming you meet all financing requirements, you'll be issued a Foreign Exchange Registration Certificate, which allows you to open bank accounts with banks that are allowed to deal in foreign exchange. You'll need accounts denominated in both RMB and foreign currency.
3. Finally, register as required with other government authorities such as the tax bureau, labour bureau, statistics bureau and China Customs.

### **3.1.2 Joint ventures**

In a joint venture (JV), you and a Chinese partner carry out manufacturing and sales operations together. There are two main types of JV: Equity Joint Ventures (EJVs) and Cooperative Joint Ventures (CJVs). Under Chinese law, joint ventures are the only allowed foreign investment vehicle in certain sectors. You will need to consult a lawyer and China's Foreign Investment Catalogue before proceeding.

Note that the registration and approval procedures for both of these joint venture entities are very similar to those for WFOEs, as described in the previous section. However, since you are dealing with a Chinese partner, the negotiations involved in establishing your presence will take longer than those for a WFOE.

A joint venture has the advantage of providing you with the local market knowledge and connections of your Chinese partner. That said, you will need to ensure that you and your Chinese partner share the same goals and strategic direction for the venture. Note also that joint ventures present a higher risk of infringement of your intellectual property rights.

### Equity Joint Ventures

An equity joint venture (EJV) is a limited-liability firm set up by your company and a Chinese company. It is legally separate from both your firm and your partner's. You and your partner share the EJV's profits and losses according to your respective contributions to the EJV's registered capital.

The usual minimum required participation from you as the foreign partner will be 25 per cent of the total registered capital, but there is no upper limit on your participation. In some special instances, approval may be obtained for foreign participation of less than 25 percent. Capital contributions may be made in one lump sum or in instalments, and can be in the form of cash or, in some cases, as tangible or intangible assets such as equipment or intellectual property. Note that you have to pay your contribution according to a timetable set out in the contract; if you don't, your business license may be revoked.

### Cooperative Joint Ventures

Not all that common, a cooperative joint venture (CJV) is an arrangement wherein you and a Chinese partner agree to carry out a project with a specific objective and a limited timeframe, such as building an office complex. If desired, you and your partner can operate as separate legal entities and bear any liabilities independently. CJVs can be preferable to EJVs because they provide greater flexibility in capital contributions, profit sharing and investment strategies.

You must contribute capital to the venture in a ratio agreed on by you and your partner, although there is no minimum contribution required. It may be in cash or in the form of tangible or intangible assets, similar to the practice with EJVs. Profits in a CJV are divided according to the terms of the contract rather than by investment share, allowing for more flexible scheduling of returns on investment. However if you leave the CJV earlier than expected, you may have to leave all fixed assets with your Chinese partner.

**NOTE:** Be aware that joint venture companies with a foreign ownership not exceeding 25 per cent will likely have to follow China's foreign debt regulations as applied to Chinese domestic companies. This may significantly impede the joint venture's ability to borrow funds from outside China.

#### 3.1.3 Foreign-invested partnerships

As of March 2010, foreign investors are allowed to establish "partnership enterprises" in China. Foreign investment through such a partnership does not require MOFCOM approval, but NDRC approval and any approvals related to specific industries are still necessary. The investment is also subject to the limitations set out under the Foreign Investment Catalogue, so the partnership can only operate in business sectors that have no foreign shareholding restrictions.

## 3.2 Chinese holding companies

A WFOE or an EJV can be a vehicle for establishing a Chinese holding company (CHC). As of the MOFCOM rule amendments of 2006, the total assets of the foreign investor must be at least US\$400 million, and the minimum registered capital of the CHC must be at least US\$30 million. The US\$30 million must be forthcoming within two years of incorporation.

You can make your capital contributions in convertible foreign currencies or in RMB. The RMB contribution should derive from your Chinese operation's profits, or from proceeds obtained through activities such as share transfer or liquidation. The RMB contribution must be verified by SAFE and must have proof of tax clearance.

The foreign debt of foreign-invested holding companies is limited by the following:

- ▶ If the company's registered capital is less than US\$30 million, the total amount of foreign debt (the sum of short-term foreign debt plus cumulative mid- and long-term foreign debt) cannot be greater than four times the company's registered capital.
- ▶ If the company's registered capital is greater than US\$100 million, the total amount of foreign debt (the sum of short-term foreign debt plus cumulative mid- and long-term foreign debt) cannot be greater than six times the company's registered capital.

### 3.3 Capitalization and debt structure

When setting up a new investment in China, inexperienced investors often fail to develop the optimum plan for the capital structure of their new company. As noted above, all companies in China must have a minimum amount of registered capital, as dictated by Chinese authorities. However, this minimum isn't necessarily (and in fact rarely is) the best option for many new companies that expect to grow. Instead, you need to calculate the amount of money required to sustain the company's operational cash flow until the business becomes self-sustaining.

If you don't pay close attention to this calculation of your break-even point, you will create substantial barriers to the growth of your Chinese business. Consequently, you should project at least five years into the future when planning. In addition, the calculations of projected expenses and capital requirements will be part of the business plan you must file with the Chinese authorities.

#### 3.3.1 Total investment and registered capital

All WFOEs or JVs must have an approved amount of "total investment," which is a Chinese legal concept that greatly affects a company's ability to fund itself and grow. A company is also required to have a certain level of registered capital, which refers to the total amount of capital to be contributed by a company's investors and registered with the relevant government authorities. These contributions must be completed within a certain timeframe, as set out in the articles of association and by Chinese law.

Note that total investment and registered capital are not the same. Total investment refers to the total amount of funding (including registered capital and all loans) that will be required to establish the company and allow it to reach its intended level of production both when it is established and in the future. This intended level of production is defined in the company's articles of association when it is created. Total investment is not subject to a contribution time limit or regulatory inspection.

Chinese regulations stipulate the minimum ratio of registered capital to total investment for new companies (see Table 1). Most important, this ratio determines the maximum debt-to-equity ratio of a company in China. Registered capital must be contributed as at least 30 per cent cash, but the rest can be provided as "in kind" investment, including fixed and movable assets, technology and intellectual property, provided they can be appraised and verified by a qualified Chinese appraiser.

Intellectual property and technology, as defined by Chinese regulations, cannot be more than 20 per cent of the total registered capital of the company. It is possible for different areas and zones within China to have different levels of required registered capital, so you should check with a good Chinese law firm before finalizing your company's funding structure.

**TABLE 1. RATIO OF REGISTERED CAPITAL TO TOTAL INVESTMENT**

TOTAL INVESTMENT	REGISTERED CAPITAL AS PERCENTAGE OF TOTAL INVESTMENT
› Up to US\$3 million	› At least 70%
› Greater than US\$3 million to US\$10 million	› At least 50% and a minimum of US\$2.1 million
› Greater than US\$10 million and up to US\$30 million	› At least 40% and a minimum of US\$5 million
› Greater than US\$30 million and up to US\$100 million	› At least 33% and a minimum of US\$12 million

### 3.3.2 Foreign debt and borrowing

The State Administration of Foreign Exchange (SAFE) requires that the cumulative amount of foreign debt under term loans (meaning loans with a term of more than one year) shall not exceed the difference between its total investment and its registered capital. This difference is referred to as the “borrowing gap.”

If you set up a company in China without sufficient consideration of its future needs, and miscalculate your borrowing gap, you could find your access to funding severely restricted when your company needs to grow. Because of the gap, your firm would be restricted from borrowing from banks outside China, from its parent or from an overseas affiliate.

WFOEs and JVs that have sufficient room in their borrowing gap are allowed to obtain offshore loans and provide security in favour of a foreign party. However, these obligations will be treated as foreign debt by China and will be subject to SAFE regulations. WFOEs are allowed to incur foreign debt without obtaining prior approval from SAFE, but the obligations must still be registered with SAFE. Any borrowing from offshore, regardless of currency, will reduce the available borrowing gap.

### 3.3.3 Moving funds out of China

Foreign investors often find it challenging to move funds out of China for use elsewhere. This can be the result of several factors:

- › Registered capital requirements are not met or were badly planned from the outset.
- › Reserve fund requirements are not met. Companies are required to put money into a reserve fund designated by law for certain purposes. Payments to the reserve fund must reach 50 per cent of your company’s registered capital before you can stop such payments and move funds out of the company.
- › Capital reductions can only occur in certain approved circumstances.
- › SAFE approval is needed for capital-account RMB conversions.

If drawing profits and dividends will be a near-term priority for your Chinese business, you should consult with a qualified tax accountant and lawyer before you establish it. Shareholder loans may be one option to explore.

### 3.4 Representative offices

If you only need a minimal Chinese presence – for example, you merely need liaison between your new Chinese operation and your head office in Canada – you could set up a representative office (RO). An RO gets you into China without much investment; on the other hand, the RO can't engage in any business operations except client relations and market research.

In 2010, China made significant changes to the taxation and incorporation regulations affecting representative offices, including those in Hong Kong, Taiwan and Macao. You should check with both tax and legal professionals to determine if a RO is still an appropriate structure to consider.

The main changes to the regulations are as follows:

- › RO's are subject to a 25 per cent business tax, as well as a VAT of 15 per cent, on their income.
- › Foreign parent companies must have been established for two years before applying to establish an RO. Notarized evidence of incorporation and the financial health of the parent is also required. In some cases, an existing company that has been established in certain locations such as Hong Kong, but is idle, may be used to avoid the two-year waiting period.
- › Verification of all RO application information is conducted within three months after the RO obtains its registration certificate.
- › ROs must have no more than four foreign employees, including the chief representative.
- › All ROs must renew their licenses annually.

### 3.5 Limited trading/distribution companies

In response to the new restrictions imposed on representative offices, some investors are looking at other ways to establish a presence in China. For some, a limited trading/distribution company could be an option, depending on the scope of business to be conducted. Such a company cannot function as a manufacturing firm, but it does offer a few advantages over an RO. It can:

- › engage in activities that are more operational than representational;
- › increase the number of employees beyond four;
- › engage in import and export activities and invoice in local currency;
- › warehouse its inventory for just-in-time deliveries; and
- › limit the risk of tax implications and blacklisting that would apply to an RO, if the RO were found to be engaging in activities forbidden to it.

### 3.6 Subcontracting

You can subcontract to a Chinese manufacturer to produce your products in China, thus making it unnecessary to set up a plant there yourself. Note that the subcontractor must be licensed to export the product; if this isn't the case, you'll need the services of a Chinese export-import company as well.

Alternatively, you can engage an intermediary company that will find a subcontractor for you, help you negotiate the contract, ensure quality control and arrange payments. But no matter which alternative you select, be sure to carry out your due diligence. Engaging an intermediary who turns out to have a bad human-rights record, for example, or uses substandard or fraudulent manufacturing inputs, can do your company considerable damage.

### 3.7 Outsourcing

Outsourcing from China can be a very useful strategy for a Canadian company. By obtaining raw materials, components, subsystems or other goods or services from Chinese suppliers, and using these to manufacture your finished product in Canada, you can strengthen your competitiveness both at home and abroad.

When choosing suppliers, due diligence is again the watchword. Look for Chinese companies that not only offer advantageous terms and pricing, but also have a solid financial history, adequate production capacity, experience with Canadian buyers and a good reputation for customer and after-market service. You'll also need to visit your outsourcer from time to time to monitor product quality and to continue building the business relationship.

### 3.8 Agents and distributors

The Chinese market is so complex that you will almost certainly need the help of a domestic agent. Your best option may be a Chinese trading company, which will have the local knowledge and contacts to promote your products and services, and can help you deal with institutional, language and cultural barriers. The larger firms are authorized by MOFCOM to deal in a wide variety of goods, but China's size means that no single trading company will have the capacity to represent you throughout the country. If you're starting out in a single regional market, of course, this won't present any immediate problems.

Unfortunately, there is no registry in English of MOFCOM-authorized distributors and agents, but Canada-China and Canada-Hong Kong business councils and associations may be able to help you find suitable candidates. You can also contact the Canadian consulate in the region where you'll be doing business, and ask the trade commissioner team for information about reputable firms.

### 3.9 Special Economic Zones

When you're deciding where in China to establish your business presence, be sure to consider the potential of the country's various types of economic zones. These include the Special Economic Zones (SEZ's) of Shenzhen, Shantou, Zhuhai, Xiamen and Hainan; 14 coastal cities; various free ports; hundreds of development zones; bonded zones; national science parks; and many designated inland cities. China is also promoting economic development outside its wealthy coastal areas by encouraging foreign investors to establish operations in Central, Western and Northeast China, which have shared less in the country's increasing wealth.

The benefits promoted by these zones are less than they were a few years ago, but there is still a range of incentives that vary from industry to industry and place to place. Investors should check with the central government authorities as to the legitimacy of any zone they may be considering, since closures of unapproved zones are common. At present, approved zones give preference to government-designated sectors including transportation, communications, energy, metallurgy, construction materials, machinery, chemicals, pharmaceuticals, medical equipment, environmental protection, energy conservation and electronics. These incentives are numerous and may include:

- › reduced import/export duties;
- › reduced land-use fees;
- › priority for obtaining infrastructure services;
- › streamlined government approvals;
- › funding support for start-ups; and
- › limited tax concessions.

## 4 GOING TO CHINA

If you're going to export to China, you'll definitely be spending time there. If you are not ready to make the commitment to travel to China to foster relationships and understand the market, then perhaps China is not for you. For those companies willing and able to make such a commitment, the following sections examine the essentials of travelling to the country and making the most of your visit.

For up-to-date information about travel to China, including health and security issues, you can refer to Foreign Affairs Canada's Consular Affairs web site at [Travel Reports and Warnings](#).



## 4.1 Entering the country

To enter China, you'll need a Canadian passport that will be valid for at least six months. You must also obtain a Chinese business visa, called an "F" visa. These come in three types: single entry, double entry and multiple entry (valid for 24 months). Visas to China are normally issued for a single entry into the country. It is very difficult to obtain multiple- or double-entry visas unless you have a strong business case to back up your request and have obtained similar visas in the past. Until recently, you had to provide an invitation letter from an authorized Chinese entity as part of your visa application, but this letter is no longer required.

Canadians travelling to Hong Kong directly from Canada do not need a visa if staying there for less than three months. However, please note that if you expect to travel to Hong Kong after you have entered China, and then return to the mainland, be sure to obtain a double-entry visa or reconsider the sequence of your trip, since your single entry visa is just that – permission to enter China once.

You can obtain visa applications from the following Chinese embassy and consular offices:

### Embassy of the People's Republic of China

515 St. Patrick Street  
Ottawa ON  
K1N 5H3  
Tel.: 613-789-3434  
Fax: 613-789-1911

### **Consulate-General of the People's Republic of China in Toronto**

240 St. George Street  
Toronto ON  
M5R 2P4  
Tel.: 416-964-7260  
Fax: 416-324-9010  
Consular Service District: Ontario and Manitoba

### **Consulate-General of the People's Republic of China in Vancouver**

3380 Granville Street  
Vancouver BC  
V6H 3K3  
Tel.: 604-736-5188  
Fax: 604-737-0154  
Consular Service District: British Columbia and the Yukon

### **Consulate-General of the People's Republic of China in Calgary**

Suite 100, 1011-6th Ave. S. W.  
Calgary AB  
T2P 0W1  
Tel.: 403-264-3322  
Fax: 403-264-6656  
Consular Service District: Alberta, Saskatchewan,  
Northwest Territories and Nunavut

## 4.2 China: The basics

No amount of reading or research can adequately prepare a visitor for the experience of China, but some of the basic information is simple enough. Here are a few things you'll need to know.

### 4.2.1 Climate

China's climate is extremely diverse. Beijing, in the northerly part of the country, has the four seasons familiar to Canadians; winter temperatures drop to about  $-4.6^{\circ}\text{C}$ , while summer temperatures reach an average high of about  $26^{\circ}\text{C}$ . In Harbin, farther north than Beijing, winter lows are around  $25^{\circ}\text{C}$  and summer highs are in the region of  $28^{\circ}\text{C}$ .

Hong Kong, by contrast, is subtropical, with February lows down to  $10^{\circ}\text{C}$  and August highs of  $31^{\circ}\text{C}$ , accompanied by high humidity. Temperatures in Chongqing, one of the major inland cities of southwest China, range from about  $6^{\circ}\text{C}$  in January to  $34^{\circ}\text{C}$  in August. In Shanghai, January lows are around freezing, while August brings high humidity and temperatures of up to  $33^{\circ}\text{C}$ .

### 4.2.2 Languages

Chinese has seven major language groups, and every region has its own dialects and variants. Mandarin (Standard Chinese) is the national language. In Hong Kong, Cantonese is more prevalent but many people also speak English.

### 4.2.3 Time zones

China's great size means that it extends across several international time zones. Internally, though, it uses only one time zone, so that 9 a.m. on the east coast is also 9 a.m. on the western edge of the country. The time for this internal zone is set at Greenwich Mean Time plus eight hours (GMT+8). China does not use Daylight Saving Time.

### 4.2.4 Business hours

- › Chinese business and government offices are open Monday through Friday from 8 a.m. to 5 p.m., with a one-hour lunch break at noon.
- › Banks in major cities are open seven days a week from 8:00 a.m. to 5:00 p.m. (some close between 12 p.m. and 2 p.m., though).
- › Retail establishments are open every day.

### 4.2.5 Public holidays

Late January and early February are the time of the spring festival. The pace of business slows considerably, and many Chinese take several days off work. The other public holidays are:

- › New Year's Day (January 1)
- › International Labour Day (May 1–7)
- › International Women's Working Day: this is observed by women only, on March 8.

- › Autumn Lunar Festival: this varies by year, but over the next four years the festival will fall on the dates listed below. You should expect business closures a few days before and after the festival date.
  - › 2011: September 12
  - › 2012: September 30
  - › 2013: September 19
  - › 2014: September 8
- › National Day (October 1–3)
- › The Chinese New Year: this is based on the lunar calendar and changes from year to year. Festivities can last for 15 days.

#### 4.2.6 Money

China's official currency is the renminbi (RMB). The RMB is denominated in units of fen, jiao and yuan (¥). Ten fens equal 1 jiao, and 10 jiaos equal 1 yuan. The terms yuan and renminbi are often used interchangeably. In late 2010, the exchange rate was about 6.3 yuan per Canadian dollar.

You're not allowed to use foreign currency in China, so you'll have to exchange Canadian money for yuan (RMB). Traveller's cheques or cash can be exchanged at most banks, and hotels always have an exchange counter. Be prepared to show your passport when changing money, and change only what you'll need, since converting yuan back to Canadian dollars can be difficult. Finally, exchange any remaining yuan for Canadian or U.S. dollars before leaving China, since you will not be able to convert the funds when you arrive back home.

As for credit cards, American Express, MasterCard and Visa are widely accepted in major cities, but you probably won't be able to use them in rural areas or smaller cities and towns. ATMs are rare outside airports, major cities, large tourist hotels and major shopping centres.

#### 4.2.7 Local travel

Don't plan to drive in China. Your Canadian or international driver's license isn't valid there, and to obtain a Chinese driver's license, you have to have a foreigner's residence permit and meet local regulations. Even if you could legally drive in China, it would be dangerous to do so because of low driving standards and the poor roads in some regions.

To travel within cities, taxis are the best option. However, drivers don't usually speak English; to make sure you get to your destination, have a Chinese-speaking person write out the address in Chinese and show it to the taxi driver. Tipping is not expected but it is appreciated, even if it is just for a few extra yuan. In some of the largest cities, you can rent a car with a driver. Tipping in this instance is common.

China's passenger-train system is well developed and quite reliable. Express trains on heavily travelled routes are fast, but on the less-used lines, the trains can be considerably slower. Travel by train will certainly give you a different perspective of life outside the cities and, should you have the time, this can be a worthwhile experience. You can buy tickets at major train stations and hotels.

There's also regular air service to most major Chinese cities. The most convenient way to book a flight is through the travel desk in your hotel.

#### 4.2.8 Telephones

You can make international and domestic phone calls with relative ease, especially from hotels in major cities. If you have a cell phone, though, it won't work in China unless it is of a type that can connect to the 900 MHz and 1800 MHz services that China's cell network uses. BlackBerries do work, however.

You might consider renting a cell phone that will allow you to communicate both within China and internationally; this will also provide you with a local number where your contacts can reach you. Several international companies provide these phones, but you might want to check with your Chinese contacts to find out which one will best meet your needs. Virtual phones that operate over the internet are also a cheap and functional alternative where Internet access is available, such as in hotels.

### 4.3 Dealing with China's business culture

Many Chinese companies have English-speaking staff, but these people may not be the individuals with whom you'll be negotiating. Even if they are, the differences between the two languages can lead to misunderstandings that can greatly hamper the progress of a deal.

As a result, you should expect that most of your business negotiations and formal communications in China (except possibly in Hong Kong) will be done through an interpreter. This is more than just a communications issue; being on good terms with your interpreter, and familiarizing him or her with your business prior to discussions with your Chinese counterpart, can be an invaluable asset in negotiations.

A [list of interpreters](#) and translators is available on the Trade Commissioner Service web site.

#### 4.3.1 General behaviour

If you understand and conform to certain cultural nuances, your Chinese counterparts will appreciate it. Here are some things to be aware of:

- › You should address people as Mr., Mrs., or Miss, plus the family name (surnames usually appears first on the business card), or by their professional titles. Married women retain their maiden names.
- › When meeting people, the first person to greet is the oldest individual or the individual with highest seniority. The Chinese will often nod as an initial greeting but a handshake is prevalent these days as well. Bowing is seldom used except in ceremonies.
- › "Face" is a crucial concept in China. It helps denote one's place and status in society, and the esteem in which one is held by others. Causing a person to "lose face," even accidentally, is a serious breach of courtesy and can permanently damage personal and business relationships. In the wrong circumstances, for example, making a well-meaning, good-natured joke at someone's expense can cause the person to lose face.
- › At the same time, you should also take advantage of opportunities to subtly "give face" by enhancing the prestige of your Chinese counterparts within their own business milieu; one effective tactic is to compliment their work to their colleagues and superiors.
- › Don't talk politics unless you know the person very, very well, and don't criticize the Chinese government.
- › Remember that the Chinese, like people in many other cultures, will try to avoid a direct "no" if they're unwilling to agree to something. Consequently, be alert for prevarications or oblique ways of refusing a request or suggestion. Statements such as "it will be challenging" or "we will have to discuss that further" often mean "no".

The above doesn't cover nearly all the nuances, but numerous web sites provide information on cultural and business behaviour in China and elsewhere. Your best advisor, of course, is likely to be a native Chinese person.

### 4.3.2 Business and negotiation behaviour

The usual Western business practice is to negotiate a transaction and then construct a relationship around it. The Chinese, however, reverse this; they prefer to start out by building a relationship with you. Once that has been successfully established, they will be ready to begin business negotiations.

Keeping this in mind, here are some tips for navigating the Chinese business environment:

- › Business meetings start on time and being late is considered a serious insult. If you are going to be late, be sure to call ahead and let your counterpart know. Traffic often presents a challenge when moving from one meeting to another, so plan accordingly and update your counterpart by phone if you encounter difficulties.
- › Conservative dress for both men and women is the norm for business meetings. Bright colours are considered inappropriate.
- › Bring your own interpreter; don't rely on one provided by the other party.
- › Chinese negotiators think strategically and will take every opportunity to assess your weaknesses and strengths. Be sure you do the same with them.
- › Be patient. Chinese negotiators are prepared to go on negotiating indefinitely, or so it can seem. Sometimes important points will be left unresolved, in the hope of gaining concessions, until you're on the point of returning to Canada. If this happens, you can sometimes turn the tables by unexpectedly extending your stay.
- › Delays by the Chinese side can be intended to wear you down until you're ready to concede more than you should. Expect these delays and ride them out.
- › As mentioned earlier, the Chinese don't like giving or receiving negative replies, so "perhaps" may in fact mean "no." Conversely, if you want to say "no," do so in a politely vague way, by saying "That idea may require more study," or "That would be very difficult."
- › Take notes summarizing important meeting points and get agreement on what both sides have committed to at each meeting.
- › Chinese-speaking people often understand written English better than spoken English, so ensure they know exactly what it is they have agreed to.
- › Double-check translations of any documents and contracts with your own people to make sure they commit you to the same things in both languages.
- › Never assume anything. Verify everything.
- › Be prepared to walk away from the deal if necessary.
- › Never cause anyone to lose face.

All this aside, remember that although the Chinese are skilled businesspeople and expert negotiators, they're also seeking to understand you and your business and to build a long-term relationship with you. The [Canada China Business Council](#) website includes a link to their [Forum magazine](#), which is a further source of information about building business relationships in China.

## 5 OPPORTUNITIES FOR CANADIAN EXPORTERS

In the following sections, we'll examine the Chinese market segments that hold the most promise for Canadian businesses. These segments aren't necessarily the ones from which Canada currently gleans its highest Chinese export revenues, but rather those in which smaller Canadian companies are most likely to find business opportunities.



## 5.1 Agri-food

During the next 10 to 20 years, China is expected to become the world's largest importer of agricultural and food products, and the country's rapidly expanding middle class presents excellent opportunities for Canadian agri-food exporters.

The agricultural sector now contributes about 13 per cent of China's GDP, and growth is trending upward at roughly the same rate as that of the GDP. However, there is only about one hectare of arable land in China per household, much less than in North America. As a result, the top priorities are for technologies that will make the most out of the existing land and the supply of crops, and will help develop new strains of hardy, high-yield wheat, corn, grains and soybeans.

Livestock and animal genomics are also key subsectors. China consumes almost all the pork it can produce domestically, and imports significant amounts from overseas. Canada is an important supplier of pork, but a ban on pork farms using ractopamine means that only suppliers obtaining certification that they are ractopamine-free can export to China. Canadian beef should also see a resurgence of demand in China now that the long-standing ban on Canadian beef – due to “mad cow disease” concerns – has been resolved.

Seafood exports, notably Canadian lobster, sablefish, snow crab, geoduck and scallops, are top Canadian performers. Some of these species require special or chilled storage and transport that increase prices, but Canadian seafood is seen as healthy and, in some cases, as a luxury product that appeals to (and can be afforded by) the growing higher-income classes of China.

According to Agriculture and Agri-Food Canada, food consumption in China is trending toward more organic and health foods, and toward packaged, processed, ready-to-eat and takeaway products. The most promising cities for agri-food exporters are in high-growth regions and include:

- › Qingdao, which has one of the country's biggest ports and thus is very accessible to Canadian agri-food exporters;
- › Dalian, which enjoys both a high per-capita disposable income and a reputation for consumer spending, plus a taste for American food that implies opportunities for Canadian products;
- › Chengdu, which is one of western China's most affluent cities and, because of its location, remains an untapped market with little awareness of non-Chinese foods; and

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- › Shenzhen and Shanghai, whose extremely affluent citizens have developed a liking for foreign foods, which they consider superior to Chinese products in quality, safety and nutrition.

China introduced a new food safety law in 2009 that applies to both domestic and foreign companies. The law seeks to improve the safety of food in China through stricter monitoring and supervision, tougher safety standards, recalls and punishment of offenders. The new laws apply to:

- › the production, trading and safety management of food and food additives;
- › packing materials, transport, equipment used in food production; and
- › food additives and food-related products used by food producers and traders.

For more information about the sector, refer to the various [agri-food reports](#) on the Trade Commissioner Service web site, and to Agriculture and Agri-Food Canada's [Agri-Food Trade Service](#) section on China.

## 5.2 Automotive

In 2009, China became the world's largest automobile market with sales of close to 13.6 million vehicles, exceeding the 10.4 million sold in the United States. Rapidly increasing purchases of passenger vehicles, resulting from the rise of the country's middle class, are a major driver for the market. New car sales and first-time purchases are now higher in second and tertiary level cities than in the major urban centers that were formerly the traditional automobile markets. Increased competition, leading to lower prices for vehicles and vehicle parts, is also spurring growth. At present, there are about 100 vehicles per 1000 people in China's western and central regions, and about 300 per 1000 in the most highly urbanized areas on the east coast. This is far from the 500 per 1000 ratio in advanced western nations, however, and highlights China's automotive growth potential.

There are over 100 vehicle manufacturers and close to 2,000 auto parts makers, located primarily in South, East and Northeast China. The top 10 producers, seven of which are joint ventures, have over 80 per cent of market share, but the market is dominated by three companies: Shanghai Automotive Industry Corporation, First Auto Works and Dong Feng Auto. Sales of Chinese-made parts and components have been growing steadily year-over-year, and foreign-invested businesses and Chinese-foreign joint ventures are also increasing their presence in the market.

The Chinese auto sector is highly competitive, with a well-developed supply network. Imports of cars and trucks will continue their downward trend as foreign OEMs increase production in China and domestic car manufacturers improve their quality. Canadian companies interested in the Chinese auto and truck sector should realize that supplier opportunities are likely to require local manufacturing in order to meet just-in-time delivery and control costs. Clean technology transfer is also encouraged. A joint venture with a Chinese partner may be an imperative, so be sure to check with Chinese regulations regarding how your product is classified.

The industry presents many opportunities for Canadian parts and aftermarket suppliers; among the products needed are gearboxes, vehicle body parts, steering system products, mounted brake linings, automotive electronics and other sophisticated components. Maintenance products are also in demand, such as filters, lubricants, fluids, batteries, and wiper blades. China's recent commitment to reducing air pollutants and greenhouse gases implies a rapidly increasing need for emissions-control systems and parts, as well as equipment for emissions testing.

Major Chinese parts suppliers are Wanxiang Group, Weichai Power, Yuchai Group, Dongfeng Honda Automobile, Norstar Automobile Industrial Holdings and Torch Automotive Group. Notable foreign parts suppliers are Germany's Bosch Group, the United States' Delphi Corporation and Visteon Corporation, Canada's Magna International Inc. and Westcast, and Japan's Denso Corporation.

## 5.3 Construction materials and technology

China is largely self-sufficient in basic construction materials such as cement, but there are large potential markets for advanced Canadian materials that focus on green building technologies. There is also a growing appreciation of the benefits of wood frame housing since the destruction caused by severe earthquakes in China in 2008. Changes to some of the building codes in certain municipalities, like Shanghai, are also opening up opportunities for Canadian wood building product suppliers. While still in its infancy and often misunderstood, wood frame housing and related materials are finding a growing niche with some of China's urban developers.

## 5.4 Environment

China's spectacular growth has come at a steep cost to the environment. Most of the country's rivers are severely polluted, urban air quality can reach levels hazardous to human health and Chinese industry, while improving, is very inefficient in its use of energy. The government, however, has promised to take action on all these fronts, especially in the area of greenhouse gas (GHG) emissions and the reduction of its reliance on fossil fuels for energy. It is anticipated that the market for clean energy technology will grow from approximately RMB1.3 trillion (\$195 billion) in 2010 to RMB4 trillion (\$600 billion) in 2020.

The country's chief needs lie in the following sectors:

- ▶ **Air pollution and GHG control:** Canadian technologies, such as air handling equipment, dust collectors and chemical recovery systems, incinerators and scrubbers, and filtration and emission controls may find that China's industrial regions are a rich market.
- ▶ **Water and wastewater management:** China's capacity for wastewater treatment remains inadequate. There is a demand for technologies and equipment for membrane manufacturing, anaerobic biological reactors, organic wastewater treatment, microfiltration, waterless production, water-treatment agents and water-quality monitoring.
- ▶ **Solid-waste management:** China's huge urban populations require advanced technologies for managing solid wastes, and low-cost resource recovery and waste-handling systems offer good export prospects.
- ▶ **Alternative and renewable energy sources:** China has set a 2020 goal of increasing the percentage of non-fossil fuel sources in its energy generation by 15 per cent. This will be achieved through development of China's biomass, wind and solar energy sectors. The targets for 2020 are 100GW of wind power, 20GW of solar units, and 30GW of biomass energy generation.

## 5.5 Health care

China's population is large but also aging. Demographics, increased personal wealth and public concerns about safety and health, together with a push by the Chinese government to improve social services for all its citizens by 2012, are contributing to the growth of China's health care industry. Opportunities for foreign companies can be found in the sale and production of medical devices, collaboration on pharmaceutical R&D, e-Health systems customized for China's healthcare industry, and leveraging China's own technology incubation centres for research and biotech collaboration. Upgrades to medical equipment in hospitals also present opportunities for companies offering higher-end medical technologies and devices.

Chinese consumers are also becoming more aware of nutraceuticals and are seeking quality-assured products, primarily from imports. Canadian companies able to commit the time and money necessary for navigating China's regulatory requirements could find a welcoming market for their nutraceutical products.

A word of caution is in order, however. The Chinese market for healthcare products is highly competitive, with many local and foreign companies contributing to a fragmented sector. Canadian firms are strongly encouraged to be aware of intellectual property protection issues and labelling requirements, as well as the stringent but frequently changing regulations that can lead to considerable uncertainty in some subsectors of the industry. You should consult with lawyers, sector specialists and the Canadian Trade Commissioner Service before trying to sell any health care product into China.

## 5.6 Large infrastructure projects

Highway, rail, airport and marine port construction continue to lag behind China's development rate, and this lack of infrastructure has created bottlenecks in economic growth. China's highway network is being expanded rapidly, but can't keep pace with the economy's growing needs and remains very underdeveloped. The country's maritime ports likewise need enlargement and upgrading to deal with the ever-growing volume of coastal and deep-sea traffic.

The Chinese government has also made improving the country's rail infrastructure a top priority, and it is estimated that China spent \$100 billion in 2009 on refurbishing and developing the rail network. Similar levels of investment are expected over the next two to three years. Plans are to expand the rail network by some 20,000 km of track to 110,000 km by 2012, and further expansion to 120,000 km is projected by 2020. Electric railways and high-speed rail connecting major urban centres are also priorities. Where the domestic supply of components is limited, or where local technology is lacking, there will be opportunities for Canadian suppliers across the entire urban and extra-urban rail supply chain.

These are undertakings on a vast scale, and there is room for Canadian suppliers in many subsectors, especially security and monitoring systems, signalling and ticketing systems, logistics infrastructure and clean technologies. Many large transnational construction firms also like to hire subcontractors who can provide unique, high-quality services that will ensure their projects' efficient and profitable execution. Some are interested in forming partnerships to carry out specific projects, which gives Canadian businesses another way into the market. Canadian manufacturers can also supply machinery and equipment to these large companies.

## 5.7 Logistics and distribution

Domestic Chinese logistics companies are usually small local firms with a handful of trucks, and Chinese logistics in general are very fragmented and inefficient. Most Chinese manufacturers recognize that better logistics services can help them reduce costs and increase competitiveness. This can create opportunities for Canadian transportation firms that can provide integrated supply-chain management, logistics systems for foreign-operated manufacturing operations, and systems for retail distribution.

## 5.8 Oil, gas and mining

Despite partial privatization of the petroleum industry, the Chinese government retains a majority stake in the sector through the China National Petroleum Corporation (CNPC), the China Petroleum and Chemical Corporation (Sinopec), China Gas Holdings Ltd. (CGH) and the China National Offshore Oil Corporation (CNOOC). Many foreign companies have been contracted to undertake oil exploration and production activities in the country; however, the national oil companies are entitled to take up to a 51 per cent stake in any commercial discovery.

Natural gas has seen its market share as a fuel source increasing rapidly, with consumption expected to triple to 300 billion cubic metres by 2020. The state-owned oil companies mentioned above are the dominant players in this sector, and Xinao Gas, China Gas, Towngas and Beijing Gas are some of the country's major suppliers. The largest gas reserves are in western and north-central China, and several recent discoveries promise to increase production. Companies selling complete distribution systems or fuelling stations, as well as monitoring, maintenance and security systems, may find opportunities in this industry segment.

China's mining industry faces numerous challenges, such as low efficiency, environmental degradation and low competitiveness in world markets. Depletion of known ore reserves is a concern, so acquiring foreign investment for locating and developing new resources is an important priority for the government. There can be considerable risks for foreign investors engaging with the sector, particularly in the areas of safety and of corporate and social responsibility.

The coal sector has some of the severest problems. Coal provides almost 70 per cent of China's primary energy output, and while some coal mines are state-owned, thousands of others are owned and operated at the municipal or even village level. This fragmentation, together with low investment, outdated equipment and safety problems, has led to a government push to consolidate the coal industry.

Canadian oil, gas and mining companies have decades of experience in the areas where China needs the most help. Coupled with our advanced expertise, technologies and equipment, this makes China an attractive opportunity. Companies should be aware, though, that the rules pertaining to the transfer of rights from the exploration stage to the development stage are not at all clear. A Canadian company could conceivably invest a great deal in finding a valuable deposit, but lose the right to develop it in favour of a Chinese firm.

## 5.9 Telecommunications

China is already a major player in the global telecom market and, for next few years, is expected to account for most of the sector's growth in the Asia-Pacific region. It is not only the world leader in exports and imports of ICT products, but is also the world's largest mobile and wireless market, and much of the growth will continue to be in this subsector.

Gaming and application development for wireless communications are also growing segments of this industry. However, Canadian companies looking to the ICT sector in China will have to be ready to face stiff domestic competition, a high level of government regulation, narrow margins and ongoing intellectual property (IP) protection issues. To succeed, you should be prepared for some degree of technology transfer and should have an on-the-ground presence that is working with local partners. China's ICT industry is heavily weighted towards favouring products and services that have been developed in China, for China.

## 5.10 Services

While exporting services to China is complicated by the barriers of language and culture, it nevertheless offers many potentially lucrative markets.

- › **Architectural services:** China's architectural market has some of the strongest potential in the world, and the booming infrastructure and construction sectors provide good opportunities for architecture firms.
- › **Banking and insurance:** China has removed many restrictions on the banking and insurance sectors. Canadian providers of private banking and wealth management services may find good opportunities here.
- › **Engineering and urban planning services:** Project management and other engineering services can be attractive in China because of the surging construction sector.
- › **Environmental services:** China's environmental problems need urgent attention. Canadian environmental services firms should look for opportunities in air pollution and GHG monitoring; water and wastewater management; solid-waste management; and the development of alternative and renewable energy sources.
- › **Language training:** As of 2010, the English-language training market was valued at approximately \$4.3 billion. More than 50,000 English-language schools are already operating, and demand is high for enhanced training in oral English.
- › **Safety and security consulting:** Security consulting is becoming a growth sector as China's safety and security market expands from the financial, insurance, customs, police, airport and IT sectors into the construction, transportation and education fields.
- › **Services related to equipment sales:** In many cases, Canadian companies selling machinery and equipment into China can also obtain the servicing and training contracts for their products.

## 6 FINANCES AND TAXATION

The financial and taxation aspects of doing business in China are quite complex, and the details are well beyond the scope of this guide. The fundamentals are straightforward, though, and this chapter provides some basic information about the country's financial system and its tax regimes and about the types of financial assistance available to Canadian exporters.



## 6.1 China's financial system

China's financial system consists of the following institutions:

- › The People's Bank of China (PBOC) is the central bank and makes decisions about monetary policy. It is relatively independent but must ultimately answer to the State Council, which is responsible for the country's administrative affairs.
- › The China Banking Regulatory Commission regulates banks, both local and foreign. The China Securities Regulatory Commission regulates brokerage and securities firms, while the China Insurance Regulatory Commission regulates insurance companies.
- › The Ministry of Finance, supervised by the State Council, deals with economic strategy, enforces financial policies and manages state revenue and spending.
- › Specialized commercial banks, which include the Industrial and Commercial Bank of China, the Bank of China, the Agricultural Bank of China and the Construction Bank of China, provide a full range of commercial banking services. A number of regional commercial banks have also been established during the past decade.
- › There are three policy banks that handle low-interest, long-term loans made to firms in strategic sectors. These are the China Development Bank, the Import-Export Bank of China, and the Agricultural Development Bank.

### 6.1.1 Foreign-owned banks

Regulations that took effect in 2006 allow foreign-owned banks to acquire legal status as corporate banks in China. Foreign banks must still incorporate locally to gain full access to the retail market, but then have the same status as Chinese corporate banks and can accept deposits from the public; issue short, medium and long-term loans; accept bills; trade in government bonds and other currency portfolios (except stocks); and carry out foreign and domestic settlements.

### 6.1.2 Accounting standards in China

In general, Chinese accounting principles follow the International Financial Reporting Standards (IFRS). China's most recent accounting regulations are the Accounting Standards for Enterprises (ASE), which came into effect at the beginning of 2007. Although China has made substantial progress in aligning its overall system with IFRS, not all companies are required to adopt IFRS rules. The involvement of the Chinese government in companies at the municipal, provincial and state levels blurs the lines related to transparency and the ways in which regulations on accounting standards are adopted across the system. The varying degrees of training and experience in IFRS can influence decisions in accounting practices and reporting, which can lead to errors.

## 6.2 Taxes

This section gives you an overview of the Chinese tax system. Since the country's tax regime tends to be a work in progress, be sure to consult legal and accounting professionals before you make assumptions about how Chinese taxes will affect your export business.

### 6.2.1 China's tax system

China's tax authorities levy a range of direct and indirect taxes at the national, provincial and municipal levels. These include:

- › corporate taxes (these rates are changing; see next section);
- › personal income taxes (progressive, from 5 up to 45 per cent);
- › VAT (17 per cent on most products, with a reduced rate of 13 per cent on certain goods such as foods, utilities and books);
- › business tax (3 to 5 per cent for most services, with entertainment businesses taxed at 20 per cent);
- › withholding taxes (rates vary);
- › consumption taxes affecting production or import of luxury goods (exports are exempt) and;
- › miscellaneous levies such as construction, consumption, land use and urban real estate taxes, and custom duties.

All foreign companies must pay income tax. Resident companies are taxed on their worldwide income, with a credit for foreign tax; non-resident companies are taxed only on their income from Chinese sources.

The tax year is the calendar year, and tax quarters are calendar quarters. Final tax settlements must be made within four months of the end of the year.

### 6.2.2 Changes in corporate taxes

In early 2007, the National People's Congress approved a new corporate income tax law that equalizes corporate tax rates for foreign and domestic companies. Under the previous tax regime, foreign companies could pay as little as 15 per cent in taxes, depending on where in the country they operated. Domestic companies, by contrast, could pay taxes of up to 33 per cent.

The new tax regime, which took effect in 2008, taxes both domestic and foreign firms at a unified rate of 25 per cent. This is comparable to average worldwide corporate income tax rates, and will level the playing field for Chinese and non-Chinese companies. The change in rates is being phased in over five years starting in 2008, with the tax rate for foreign firms rising by 2 per cent each year until it reaches the target of 25 per cent.

That said, some high-technology sectors may find their tax rates lowered to 15 per cent. This incentive is intended to foster certain strategic sectors identified by the Chinese government.



## How export financing works

If you've never used export financing, you might want to consult EDC's online [EXPORT Finance Guide](#) for an introduction to the subject.

## 6.3 Financing your exports

As any small- or medium-sized exporter knows, it can be hard to finance a foreign initiative solely from company resources. But if you're intending to do business in China, you can tap into a substantial range of financial assistance.

### 6.3.1 Types of financial assistance

From time to time, you may need one or more of these three types of financial help:

- › **Pre-shipment export financing:** This provides you with the means to provide the goods or services your customer wants. You'll need to show the lender that you have a firm export sale and a contract that is acceptable in terms of repayment risk, payment terms, production timeframes and recourse conditions.
- › **Post-shipment export financing:** This covers your financial needs from the time you ship the goods until you're paid.
- › **Medium-term export financing:** This is often used with capital goods exports and can be obtained for terms of 180 days to two years, sometimes more.
- › **Foreign investment support:** Canadian companies interested making a new investment in a foreign country can take advantage of EDC's [Canadian Direct Investment Abroad](#) (CDIA) financing solutions.

### 6.3.2 Sources of financial assistance

Financial institutions and government institutions such as export credit agencies are the most common sources of export financing.

- › **Export Development Canada:** Export Development Canada (EDC) is the export credit agency of the Government of Canada. EDC provides a wide range of financial tools for Canadian exporters and investors, particularly small- and medium-size companies. These include:
  - › *Export Guarantee Program:* Through this program, EDC encourages Canadian financial institutions to advance pre-shipment loans to Canadian companies exporting goods or services. This can give your company the financial strength to close and fulfill a Chinese deal. This product can also be used to support Canadian Direct Investment Abroad (CDIA).
  - › *EXPORTEpressCredit:* EDC and Mercantile Finance Services Ltd. are collaborating to create an unsecured small-business loan program of up to \$50,000 to help small businesses with annual sales of less than \$5 million that are trying to expand their export business but have limited access to cash.

## EDC and China

EDC has been active in China since 1979, making it one of the first export credit agencies to establish business ties with that country.

China is one of the key countries in EDC's strategic business development plans. During the last five years, EDC has supported more than \$11 billion worth of exports to Chinese buyers in several key sectors. These include advanced technology, base and semi-manufactured goods, forestry, mining, infrastructure development and services. In 2010 alone, EDC facilitated more than \$2 billion in export and investment transactions in mainland China on behalf of more than 270 Canadian companies.



- › *Foreign Buyer Financing*: EDC offers a range of financing solutions for foreign buyers of Canadian capital goods and services. This can allow you to win more business by offering your Chinese customers flexible options for financing and payment.
- › *Master Accounts Receivable Guarantee (MARG)*: MARG lets you use your foreign receivables to increase your operating line of credit up to a maximum of \$500,000. EDC provides a guarantee to your financial institution that insures you against a loss should you fail to repay your operating line.
- › *Canadian Direct Investment Abroad (CDIA)*: If you want to expand your facilities in China or make a new investment there, you may be able to take advantage of EDC's CDIA financing instruments. These can include direct financing to your company to support your foreign investment, project financing to a foreign affiliate or subsidiary, or working capital financing to a foreign affiliate or subsidiary.

Refer to [EDC Financing](#) for more information.

- › [Business Development Bank of Canada \(BDC\)](#): BDC provides flexible financing for the development of international markets, R&D, product modifications and new production equipment or technology.
- › [Canadian Commercial Corporation \(CCC\)](#): The CCC acts as prime contractor in export sales by Canadian suppliers to foreign governments, international agencies and other overseas buyers. It can help your company close a deal by guaranteeing your contract performance, and can help you prepare and transmit bids, assess risks, and negotiate, execute and manage contracts.
- › **Canadian banks in China**: All major Canadian commercial banks are active in China, particularly in the area of trade finance. They accept and confirm Chinese bank letters of credit, and can provide operating loans and term loans for appropriate projects. EDC is often involved in these transactions.
- › **Chinese banks**: Many Chinese banks have correspondent banking arrangements with Canadian banks, and issue letters of credit for confirmation by Canadian banks. For Canadian exporters, the four main Chinese banks are the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China and the Bank of Communications. In addition to these, there are many smaller, regional Chinese banks that provide trade finance services.

### 6.3.3 Foreign buyer financing

SAFE places strict controls on the borrowing abilities of China-based companies. If the company that the exporter is selling to is fully Chinese-owned (for example, a domestic Chinese entity), then that Chinese company must obtain permission from SAFE in order to borrow foreign exchange. In practice, such permission is nearly impossible to obtain, so most Chinese-owned companies are restricted to dealing solely with domestic banks when it comes to receiving loans.

Joint ventures and wholly foreign-owned enterprises (WFOEs) do not have to seek authority to borrow foreign exchange from overseas sources, but when the loan is made they must still register the debt with SAFE. The amount of the loan must also be within the borrowing ceiling imposed on the borrower by SAFE, that is, within the company's borrowing gap.

If you're faced with a request for buyer financing, first determine the ownership of the buyer. If the business is fully Chinese-owned, be sure to request evidence that it has SAFE authority to borrow. Most Chinese-owned companies are fully aware that they can't arrange a loan, so such a request for financing can actually be a veiled request for better payment terms, such as a letter of credit on longer terms or payment on open account.

If the buyer is a WFOE or JV, EDC will consider the buyer for potential financing. However, since China's domestic banking system is flush with foreign currency, most China-based companies have ready access to funding from banks at home. EDC would nevertheless be happy to explore financing solutions separately or in partnership with a company's China-based bank. However, inability to borrow from the local banks (domestic or foreign) may indicate a credit risk or be a sign that the company has already reached its borrowing limit and is trying to circumvent Chinese regulations.



## EDC and Sinosure

Sinosure, China's export credit and insurance agency, offers a range of insurance and guarantee services to promote exports from China. In 2005, EDC and Sinosure developed a joint Risk Sharing Agreement that may offer EDC clients access to Accounts Receivable Insurance for their affiliate export sales business in China, as well as potentially better access to working capital from China-based banks.

## 6.4 Payment

The Chinese Government, through SAFE, regulates all international payments. Before foreign funds can be transferred overseas, Chinese importers must present their banks with all required documentation, such as shipping documents and customs declarations, as required by SAFE. As part of your due diligence, always verify that your prospective Chinese customer has the required licences, and that the necessary documentation can be obtained. You will probably need professional legal assistance to carry out this verification.

### 6.4.1 Changes in currency regulations

As of August 2010, Chinese authorities expanded a pilot scheme that allowed for commercial contracts and their payment terms to be negotiated and conducted in RMB. This is an important development, since it now means that you can accept payment for goods exported from Canada in RMB. It also allows you to accumulate RMB offshore, in designated bank accounts, that you can use to pay for goods you import from China as part of your supply chain. Be sure to discuss the option of accepting payment and transfer of funds in RMB with your bank. Some banks may not deal in RMB despite these changes or may have limitations on how much business they can conduct each year in RMB.

While the ability to negotiate commercial contracts and make payments in RMB has expanded with these changes, you should still conduct the same due diligence on your Chinese counterparts as you normally would. Moreover, if you accumulate RMB in offshore accounts, and then move those funds into China as a loan to a Chinese company or affiliate, the usual SAFE regulations on foreign loans apply and the loan will affect the recipient company's borrowing gap.

SAFE determines whether a debt is classified as short-term trade credit or medium/long-term foreign borrowing. If a deferred payment term is longer than 180 days and/or greater than US\$200,000 then SAFE usually considers that obligation to be medium/long-term in nature, and subject to the same regulations as a foreign loan requiring SAFE approval. There can be some variation in this, however, depending in part on the ownership of the buyer located in China.

As a result, short-term trade credits in China most often have tenors less than 180 days, with the majority offering 30–90 day terms. When negotiating payment terms with Chinese buyers, you need to be aware of this SAFE threshold to avoid contravening China's foreign borrowing regulations.

### 6.4.2 Letters of credit

If you export to the U.S., you may be accustomed to being paid by the open account method. Many of your financial transactions with your Chinese buyers, however, will be done through letters of credit (LCs). LCs are the most prevalent form of payment in China and offer the best protection for exporters because they designate banks to receive and check shipping documents, and to guarantee payment. Consequently, they should be the first form of payment you seek when entering into a business relationship with a new buyer in China.

There are two major types of LC: confirmed LCs and unconfirmed LCs. A confirmed LC has been issued on behalf of the customer by the customer's bank, and its validity has been confirmed by a domestic Canadian bank. If you have a confirmed LC, you are reasonably assured of receiving payment from the Canadian bank even if the foreign customer or the foreign bank defaults.

An unconfirmed LC is less secure, since it has been guaranteed only by the bank that issued it, not by a receiving bank in Canada. The issuing bank merely informs you that the LC has been opened, and tells you what the credit terms and conditions are.

LCs can also be irrevocable. This means they can't be cancelled or amended without your approval. The most secure form of payment is an LC that's both confirmed and irrevocable.

Unconfirmed LCs are the usual payment instrument for Chinese companies. Despite this, you should do your best to get a confirmed, irrevocable LC from your customer. If you can't, try to ensure that the LC is issued by a Chinese bank that has a good track record and is acceptable to your Canadian bank. Still you should expect that many Canadian banks may demand that you obtain EDC accounts receivable insurance, or seek such insurance themselves, to mitigate the perceived risk.

### 6.4.3 Tips for using letters of credit

Keep the following in mind when using letters of credit:

- If your Chinese customer intends to pay you via an LC issued by a Chinese bank, check with your Canadian bank to ensure that it accepts LCs from the Chinese bank.
- Ensure that the LC allows partial shipments and transshipment.
- Make sure you can prove that you shipped the goods by the date specified in the LC.
- Always check shipping conditions with your freight forwarder to make sure that nothing will cause a delay in delivery.
- Present all documents by the dates specified.

Note that most letters of credit are subject to the Uniform Customs and Practice for Documentary Credits (UCP), which is the universally recognised set of rules governing the use of documentary credits in international trade.

### 6.4.4 Payment on open account

In some sectors, larger and well-established Chinese buyers may press for payment on open-account terms – that is, the buyer orders the goods, you ship them, and the buyer pays you at a pre-determined time after receiving the shipment. This obviously offers you very little security and very little recourse if the buyer fails to pay. You should avoid agreeing to open-account terms unless the buyer has established a history with you of reliable payment via LCs. Even then, do credit checks and exercise due diligence. You would also be very wise to purchase Accounts Receivable Insurance from EDC; this will protect you if the buyer fails to pay.

#### 6.4.5 Holdback of payment

Your Chinese customer may request a holdback of 5 to 10 per cent of the total payment, to be paid to you upon final acceptance of the goods or service. This exposes you to the risk of delayed payment of the holdback, and there have been many cases where the holdback was never paid at all.


If you can't avoid a holdback, protect yourself by insisting on a separate LC for the amount. This LC should have a specific date for final approval of the goods or services, at which time the holdback must be paid out. Also include "deemed acceptance" clauses in your commercial contract, based on contract milestones, in order to limit the amount of time that your holdback will be outstanding. In other words, don't permit an open-ended timeframe for disbursing the holdback.

If you can't get an LC for the holdback, and the buyer fails to pay it after a reasonable time, you may have to take further action. Refer to Section 7.5, "Litigation and arbitration," for more information.

#### 6.4.6 Cash deals

In some cases, your Chinese customer may be unwilling to pay via LC because the funds specified by the LC will be temporarily frozen by the customer's bank, and this will affect the customer's cash flow. Instead, the customer may suggest working on the basis of a cash advance or cash on delivery. You're more likely to encounter this if you're in a sector characterized by strong cash flows.

### Fraud alert



Several exporters have recently reported unsolicited approaches from prospective Chinese buyers that turned out to be bogus. Many of these approaches were made through email and the Internet. While not all unsolicited interest is fraudulent, you should always be on the alert for scams. Some warning signs are: a request for a small order, which quickly escalates into a large order that is tied to you providing samples or prototypes; a request for cash for a banquet that is far in excess of the typical cost when negotiating a contract; or cash for travel expenses for an implied, essential meeting. The Canadian Trade Commissioner Service can help you with suspected fraudulent approaches such as these.

## 7 THE FINE PRINT

The Chinese legal system is considerably different from ours, so Canadian exporters to China will need local legal counsel if they want to avoid difficulties. Some of the general issues you might have to deal with include the following:

- › China's courts and officials have a good deal of leeway in how they apply laws and regulations. Laws and regulations in China are much less specific than they are in Canada, which means that they can be interpreted in different, and possibly inconsistent, ways.
- › In some cases, it may be difficult to determine whether you are in fact complying with a particular regulation, especially if it has been inconsistently interpreted by different regulators.
- › Multiple levels of government have the authority to establish regulations. Sometimes the regulations issued at one level may contradict those issued at another.
- › If you want to appeal an official ruling or the official interpretation of a regulation, it may be difficult to do so because there are no clear appeal procedures.
- › Be aware that even though a law or regulation may exist, it isn't necessarily enforced in a consistent way (or sometimes at all).



## 7.1 Obtaining legal services in China

China regulates foreign law firms rather strictly when they operate in China, and they can practice only on a limited basis. To quote from DFAIT's [Navigating China: A Guide to Doing Business 2010](#):

*When doing business in China, it is essential to have reliable legal counsel. Foreign and international law firms are allowed to open representative offices, but are not officially allowed to practice law in China. This means that international firms are not allowed to represent clients before a Chinese court, give legal opinions on Chinese law or employ certified Chinese lawyers.*

*Pursuing legal action through the People's Court can be a very lengthy and expensive endeavour with some cases taking years to litigate. Increasingly, firms are turning to alternate dispute resolution methods. Arbitration has become a popular option especially among the construction, shipping, insurance and securities industries.*

The Trade Commissioner Service has a list of [legal service firms](#) you might find useful. Note the disclaimer, however.

## 7.2 Due diligence

As a company that's already exporting, you'll be acutely aware of the need for due diligence when dealing with foreign customers. This is especially true when you're exporting to China, which can be a hazardous market for the unprepared or unwary. While most Chinese firms are reputable, a handful are not; moreover, the differences between our cultures and business attitudes can sometimes lead to misunderstandings that can sabotage a promising business deal, or make an existing one go badly wrong. Such misunderstandings can be aggravated by the lack of transparency and consistency in the Chinese regulatory and legal systems.

The most crucial part of due diligence is checking out your customer; for more information about how to do this with Chinese businesses, refer to Section 7.6.1, "Customer risk." Other areas requiring due diligence include (at the minimum):

- › making sure you have a sound understanding of the Chinese market in which you're working;
- › verifying that your buyers have the required licenses and that you understand Chinese foreign-exchange regulations (if you don't make sure of this, you may not get paid);
- › verifying that distributors or agents (as distinct from end-use customers) are reputable and that they can actually provide the services you need; and
- › ensuring that you know what customs documents are required for the import of your product into China, and about any regulations that may affect your products.

Finally, be sure to visit your market regularly. Agents are no substitute for your personal presence, and your visits will demonstrate your interest and involvement in your Chinese operations.

## 7.3 Coping with contracts

The first rule is to have a written contract. Don't rely on other instruments such as purchase orders; they are legally worthless. The second rule is that you should never sign any contract until it has been carefully reviewed by competent legal counsel; this is especially important when doing business in China, partly because Chinese and Canadian attitudes to commercial law are quite different, and partly because of the divergence between our legal systems. If you do sign without legal advice, you risk disputes and possibly litigation related to payment, breaches of contract or guarantees, unclear ownership of intellectual property, violation of creditors' rights and other difficulties too numerous to mention.

Here are several things to keep in mind when dealing with contracts in China. Note, however, that these pointers are in no way a substitute for competent legal advice.

- › Does the contract establish clearly what is expected of everyone? This is a very important point, because a major intention of any Chinese contract is to avoid misunderstanding among the contracting parties. Chinese courts can deem a contract unenforceable if one party did not clearly understand its terms. The language used should therefore be clear and straightforward, as this reduces the risk of misunderstanding and mistranslation.
- › Is the contract detailed enough? Covering all the details is crucial, even if this results in a very long contract. Short contracts may be short because they've left things out, and what's been omitted may later cause you great difficulties.
- › Does the contract clearly identify the contracting parties, and have the right people signed it? A contract is unenforceable in China if it's signed by the wrong people. Note that an agent for a Chinese buyer may not be a valid signatory.
- › Does the contract require any government approvals or import/export licences? If so, who is responsible for obtaining them?
- › What are the terms for payment (time, place, currency), inspection and delivery of goods?
- › What is the contract completion date?
- › What warranty and/or maintenance terms and conditions apply?
- › Are there contract performance security requirements, such as bank letters of guarantee or surety bonds, and what are they?
- › What remedies are available if the customer defaults or cancels?
- › Does the contract establish clearly which country's law will govern the terms of the contract and any disputes that might arise from it? This is called, in legal jargon, "the proper law" of the contract. Chinese jurisdiction is becoming increasingly accepted but that doesn't mean it's your only option. Choosing a jurisdiction other than the province where your Chinese business is located, however, may increase the costs of legal counsel and enforcement of your contract, so check with your lawyer first.
- › What provisions exist for independent mediation or arbitration to resolve disputes, and in which jurisdiction would this take place? If the contract doesn't specify this, a Chinese court will decide any disputes. You should stipulate that any mediation or arbitration must take place outside China, but arbitration in Beijing is more and more acceptable these days. A Chinese court is likely needed to enforce any arbitration award in any case.

- › Does the contract specify the currency of payment, and is this the correct currency given the nature of your business presence in China?
- › Chinese businesspeople much prefer standard-form Chinese contracts over foreign contracts and will usually avoid the latter. However, adding special clauses to a Chinese contract is not usually a problem. Be sure, though, that these are clearly understood by everyone involved.

## 7.4 Performance guarantees and bonding

Your Chinese customer may require some kind of contract performance security to ensure that that you'll fulfill your end of the bargain. These securities are usually referred to as "bonds" and include standby irrevocable letters of credit, letters of guarantee and contract surety bonds.

A bond is a financial guarantee to your customer that your company will abide by the terms of the contract. Before issuing a bond, the bank will require you to provide security by freezing cash in your account. This protects the bank if the company fails to perform and if the customer calls the bond – that is, if the customer demands that the value of the bond be paid out.

This, of course, means that the frozen funds are inaccessible to you. EDC can help you by guaranteeing to the bank that it will be reimbursed if your customer demands that the bond be paid. This means that the bank won't freeze your funds, which frees up your company's cash flow.

EDC provides a range of bonding instruments, including:

### **Performance Security Guarantees**

Performance Security Guarantees cover 100 per cent of losses incurred by your bank when a foreign customer makes a call on a bonding instrument, such as an irrevocable letter of credit or a letter of guarantee.

### **Surety Bond (re)Insurance**

Surety Bond (re)Insurance gives surety companies a reinsurance capacity of 100 per cent, enabling them to provide your company with the bonding support you need to conduct business overseas.

### **Financial Security Guarantees**

A Financial Security Guarantee replaces the collateral that you usually must provide to secure operating lines of credit with foreign banks, or letters of guarantee for suppliers. It provides a 100 per cent, irrevocable and unconditional guarantee to your bank, and is equivalent to the amount of the letter of guarantee for a period of one year.

### **Foreign Exchange Facility Guarantees**

A Foreign Exchange Facility Guarantee allows your company to free up working capital when you purchase forward contracts from your financial institution, thus enabling you to lock in the exchange rate as protection against foreign currency fluctuations.

For more information, refer to EDC's [Bonding](#).

If you do arrange one of these bonding instruments, make sure that your contract clearly stipulates your performance obligations, as well as the conditions under which your customer can make a valid call for non-performance and thus have the security paid out. The chief risk associated with a bond is that of a "wrongful call;" for more information on this, refer to Section 7.6.3, "Wrongful calls."

## 7.5 Litigation and arbitration

The most common disputes between Canadian and Chinese businesses include:

- › breach of contractual payment obligations;
- › irregularities in accounting practices;
- › financial mismanagement;
- › undisclosed debt; and
- › conflicts over the control of joint ventures.

If you have these or other legal problems with a Chinese customer or partner, don't be in a hurry to begin litigation. No matter how justified your position, litigating in a Chinese court will be time-consuming and expensive, and may not be in your best interest. Your opponent, moreover, is very unlikely to allow the case to be decided in a non-Chinese court.

A better choice might be arbitration. Also called alternative dispute resolution, arbitration uses a tribunal to consider the questions over which the parties are in conflict and to decide how to resolve them. China is a signatory to the New York Convention on the Recognition and Enforcement of Arbitral Awards, which means that arbitration awards can be enforced within the country.

## 7.6 Risk management

Doing business abroad is inherently more risky than operating in Canada. But you can minimize and manage these risks, provided you know what they are, and if you understand the level of threat they represent. The major dangers in China include:

- › customer risk (for example, bad credit or insolvency);
- › failure of the customer to pay;
- › wrongful calls of bonds;
- › theft of intellectual property;
- › Internet fraud;
- › corruption; and
- › other risks.

### 7.6.1 Customer risk

The more you know about your potential Chinese customer or partner, the better. You should be aware of the company's creditworthiness, its financial record, the quality of its management, its business history and its reputation in the Chinese and international marketplace. You must also be sure that you know who controls the company, and who has the authority to undertake binding legal agreements and who does not.

All Chinese companies and foreign companies operating in China have to register with the local State Administration of Industry and Commerce (SAIC) office to obtain a business licence. These licences can be examined by the public and will tell you the identity of the company's legal representative, the amount of its registered capital and the scope of its business.

Many apparently private Chinese companies are still linked to the state, although this may not be immediately obvious; many used to be state-run businesses that are now under private management. Some are in fact subsidiaries of government ministries. If you're dealing with one of these, check with its parent ministry to verify the validity of its business license.

However, the business license won't necessarily tell you who really owns the company – hiding assets and using proxies for the legal owner is common in China. Finding out who the real owner is may not be easy, but you have to do it, since this knowledge may be crucial to receiving payment.

The question of credit checks can also be difficult. China doesn't have a centralized source of credit information, so carrying out a thorough check can be a challenge. At the very least, you should obtain banking references for the customer's company and as much of its relevant banking history as possible. You may be able to get references from other companies that have done business with the customer, although concerns about breaching confidentiality may be a barrier here.

The Trade Commissioner Service lists several types of resources you can use in your due diligence, including [legal services](#), [credit check services](#) and [investigative services](#). Note the disclaimers.

### 7.6.2 Failure to pay

A customer's failure to pay can jeopardize the very survival of your business. Even if you know a company well and it has always paid you promptly, it still could collapse without warning and leave you unable to meet your bills. EDC has a range of products to protect you against this and other unfortunate events, such as customer insolvency, cancellation of import or export permits, cancellation of contracts, refusal to accept goods, and war, revolution and insurrection. These products include:

#### **Accounts Receivable Insurance**

EDC's Accounts Receivable Insurance (ARI) will cover up to 90 per cent of your losses if your Chinese customer doesn't pay because of bankruptcy, or refuses to pay for no good reason. It also covers you if the customer refuses to accept the shipment or if your import permits are cancelled. And while neither revolution or war is likely in China, ARI will cover you for these, too. You can visit [Insurance](#) to apply online or request a free quote, or you can call 1-866-283-2957 to learn more.

#### **Single Buyer Insurance**

On contracts worth up to US\$250,000, EDC's Single Buyer Insurance can be used to cover an unlimited number of sales to the same customer for six months. The policy insures up to 90 per cent of your losses against non-payment after your customer has accepted the goods. Refer to [Single Buyer Insurance](#).

#### **Contract Frustration Insurance**

EDC's Contract Frustration Insurance (CFI) will cover up to 90 per cent of your losses in relation to a specific export contract for services, capital goods or projects. Refer to [Contract Frustration Insurance](#).

### 7.6.3 Wrongful calls

Suppose you've worked with a bank to post a contract performance bond in the form of a standby irrevocable letter of credit, or a letter of guarantee. Your Chinese customer was satisfied by this assurance, and you've fulfilled the contract in all respects. (For information on bonds and what they do, refer to Section 7.4, "Performance guarantees and bonding.")

But instead of paying you, the customer “calls the bond” – that is, alleges that you haven’t met the contract conditions, and demands that your bank pay them the value of the bond. The bank complies, and then comes back to you to recover its loss. The customer’s action in this case is known as a “wrongful call” and can cause no end of financial problems.

However, you’ll be protected in this situation if you have EDC’s Performance Security Insurance (PSI), which will cover up to 95 per cent of your loss when a customer issues a wrongful call and there proves to be no legitimate reason for doing so. For more information, refer to [Performance Security Insurance](#).

#### 7.6.4 Theft of intellectual property (IP)

Many businesses own proprietary technology such as industrial processes, patented machine designs and other types of intellectual property such as computer software code. These IP assets may comprise most of a company’s value, and losing control of them can have severe repercussions.

China’s record for IP protection has improved during the past few years. The country signed the WTO Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) in 2001, and now has laws aligned with international standards that protect virtually all forms of IP including patents, trademarks, business secrets and copyrights. Enforcement of these laws is not all it might be, however; in consequence, you need to protect your IP rights very carefully when doing business in China.

The essentials for protecting your IP include the following:

- › Consult a law firm familiar with Chinese IP law to identify the intellectual property that your company needs to protect. Then take measures appropriate to the type of IP, such as registering a patent.
- › If you are licensing IP to a Chinese company, make sure your contract is very precise about the licensee’s rights and where these rights are valid. Vagueness about these rights can create serious problems; for example, if the licensee uses your technology to create other technologies, this can severely undermine the value of your original technology.
- › Ensure that all employees, partners and distributors sign enforceable non-disclosure and confidentiality agreements as to the ownership and use of your IP.
- › File all IP registrations yourself. Don’t rely on a JV partner or agent to do so, since you may inadvertently give them rights to your IP.
- › Make sure your patents and trademarks are registered in China under Chinese law. You must do this even if you have registered them in Canada, because a Canadian patent or trademark has no legal standing in China.
- › *Patent and design registration:* Like Canada, China is signatory to the Patent Cooperation Treaty. Therefore, when you apply for a patent in Canada, you may also submit an application for a Chinese patent. You can do this either within Canada, via the Canadian Patent Office under the Patent Cooperation Treaty (PCT), or directly to the patent office in China.

If you file your patent outside China before filing in China, you may still need to apply to China’s patent office for examination and approval in order to protect your rights in China. Failure to obtain prior approval from the State Council Patent Administration Department will frustrate the filing of the same patent in China at a later date.

Registration in China is recognized on a “first to file” basis. You must also utilize your patent rights in China within three years of filing or risk the revocation of those rights. For more information, refer to the [Canadian Intellectual Property Office](#), [World Intellectual Property Office](#) or [China State Intellectual Property Office](#).

- › *Trademark registration:* As with patents, trademarks are protected on a “first to file” basis, with the exception of trademarks that can be proven as being already well known (“well known” has usually been difficult to substantiate in Chinese courts). To register trademarks in China, you go through the Trademark Office of the State Administration for Industry and Commerce (SAIC). You should contact the Trade Section of the Canadian Embassy in China for a trademark agency approved by the State Intellectual Property Office.
- › *Copyright registration:* Copyrights are protected in China under international copyright law once they are registered in Canada, so you don’t have to register a Chinese copyright. You can, however, register voluntarily through the Chinese-only web site of the [National Copyright Administration](#).
- › *Software Protection:* Software can be registered with the National Copyright Administration, but this requires release of your source code. Not surprisingly, many companies forego registering software in China for this reason.

It should be clear from the above that if you do need to take legal action on IP infringement in China, registering your IP there is a prerequisite – failure to register negates your right to legal recourse. The catch is that to register your IP in the first place, you’ll usually have to provide the Chinese with detailed information about the very IP you are trying to protect.

#### 7.6.5 Corruption

The Chinese government is aware of the problems presented by corruption and has introduced sanctions to curb it, including anti-money-laundering legislation and the dismissal and prosecution of corrupt officials.

Corruption in China is mostly related to local officials who demand bribes in exchange for favourable business decisions. Most Canadian companies will never encounter this, but there are always exceptions. Your best protection is to carry out careful due diligence before you engage in any business with a Chinese firm.

Although it hardly needs to be said, you should walk away from any sale that suggests even a hint of impropriety. No exporter should ever do business with a Chinese company that makes such overtures, and pursuing the relationship can lead to long-term, expensive and damaging repercussions.



### Guarding against corruption

Canada has laws against corruption, including laws against the corruption of foreign officials. This legislation is set out in the *Corruption of Foreign Public Officials Act*, which provides for the prosecution of Canadians in Canadian courts if they break the anti-corruption laws or counsel other people to break them. For a plain-language guide to this legislation, download EDC’s pamphlet, [Keeping Corruption Out](#).

### 7.6.6 Other risks

Risks related to corporate and social responsibility can be high with certain Chinese companies and sometimes even with foreign companies operating in China. Canadian companies should exercise due diligence in checking the corporate social responsibility (CSR) records of your suppliers, distributors and other business counterparties in your supply chain. Failing to do so could ultimately cause considerable harm to the Canadian firm; there have been recent examples of multinationals failing to enforce quality and safety assurance checks along their manufacturing supply chains, so that lead and other toxic substances became incorporated into their products and reached consumers. These companies have been subjected to extremely severe reputation and litigation risks as a result.

Other kinds of risk include foreign exchange risk, which you have to factor into your plans and pricing to allow for fluctuations in the value of the Canadian dollar. A financial professional can advise you on various methods for handling these risks, such as forward contracts and exposure netting.

Another obvious risk is the loss or damage of goods in transit. Shipping insurance is covered in Section 8.9, “Insurance.”

## 8 DELIVERING TO CHINA

China's import regulations are complex and are evolving quickly. The following overview will give you a broad outline of what's involved in getting your goods into China, but you'll need professional advice and assistance to smooth the way when you're actually making your deliveries. As an exporter, you're likely already aware that customs brokers and freight forwarders specialize in this sort of help, which is outlined in Section 8.10, "Customs brokers and freight forwarders."

For detailed information about import rules, regulations, licensing, tariffs and other import-related matters, you should contact one of the [Chinese offices](#) of the Trade Commissioner Service.



## 8.1 Import regulations

Because of China's commitment to trade liberalization, there are no restrictions on the import of most products. However, some commodities are subject to tariff rate quotas, and a few products require a special import permit issued by MOFCOM.

Don't make assumptions, though. Always verify the relevant import requirements with your Chinese buyer, and cross-check these requirements with MOFCOM.

The Chinese authorities divide imports into three categories:

- › contraband goods that are prohibited from import and include such items as weapons, poisons, and toxins;
  - › restricted goods that need an import licence or are subject to a quota; and
  - › permitted goods (most products now fall into this category).
- › MOFCOM publishes notifications of policy changes that have or are about to occur, and that will affect the categorization of imported goods. While many of these notices are only available in Chinese, they can be accessed from the [MOFCOM web site](#).

## 8.2 Standards and certification

There are three main government bodies for establishing and overseeing Chinese product standards, and for verifying that both domestic and imported goods conform to these standards. These are:

- › The umbrella organization that oversees a wide range of functions in this area is the [General Administration of Quality Supervision, Inspection and Quarantine](#) of the People's Republic of China (AQSIQ).
- › The [Standardization Administration](#) of the People's Republic of China (SAC) is under AQSIQ and is responsible for standardization of goods.
- › The [Certification and Accreditation Administration](#) of the People's Republic of China (CNCA), also under AQSIQ, deals with the certification of goods.

### 8.2.1 Certification and the CCC mark

A China Compulsory Certificate (CCC), which verifies a product's quality and safety, is compulsory in China for about 159 kinds of goods. This includes most electrical devices and motors, audio and video equipment, medical equipment, agricultural and motor vehicles, and household goods. In 2009, China added 13 types of ICT products, mostly dealing with data security, network firewalls and encryption technologies, to the categories of goods that must obtain CCC certification.

All these products must have a CCC quality and safety mark before they can be imported into the country. If they don't have one, they will be refused entry at Chinese Customs.

### 8.2.2 Obtaining the CCC mark

The CCC mark is administered by the CNCA, which has designated the [China Quality Certification Center \(CQC\)](#) to process CCC mark applications.

Information about the CCC mark is also available at the [CCC Certification Online Service Center](#). The Trade Commissioner Service also provides extensive information about the CCC mark and how to obtain it in the document [Certification Regulations for Canadian Exporters](#).

If you need a CCC mark, you'll have to submit a product sample with extensive technical documentation to an accredited Chinese laboratory, which will carry out the required tests. Your factory must also be inspected (at your expense) by Chinese officials who will determine whether the goods being produced match the samples you provided. Be prepared to wait at least 60 to 90 days for your certification, and possibly several months. The total cost of certification can be upward of \$5,000.

## 8.3 Tariffs and duties

China Customs collects the tariffs on imports. Tariffs vary depending on the category of the goods. Duties to be paid are assessed mainly on an ad valorem basis or as a percentage of the cost, insurance and freight (CIF) value of the goods.

Import tariff rates are divided into six categories: general rates, most-favoured-nation (MFN) rates, agreement rates, preferential rates, tariff-rate quota rates and provisional rates. Because Canada is a member of the WTO, our exports to China are assessed at the MFN rate. The five Special Economic Zones offer a range of duty reductions or exemptions.

As a general principle, ask your Chinese importer to disclose all customs and tariff requirements for your goods and then verify these requirements independently with [China Customs](#).

## 8.4 Temporary entry of goods

If you need to bring products to Chinese trade shows and exhibitions, you can do so without paying duty, provided you comply with some fairly complicated Customs rules. A much simpler alternative is to use an ATA Carnet.

An ATA Carnet is an international customs document recognized by most of the world's nations, including China. You present it when you enter the country with equipment or merchandise that you'll be re-exporting within 12 months, and the Carnet exempts the equipment or merchandise from duties or taxes. For information about acquiring an ATA Carnet, refer to [ATA Carnet](#).

## 8.5 Non-tariff barriers to trade

Non-tariff barriers are government measures or policies, other than tariffs, that restrict or distort international trade. In China, these may include the barriers outlined below; before you close a sale, be sure to find out whether any of them may affect your exports.

- › Standards, testing, labelling and certification requirements exist to make sure that imported goods meet a country's health, safety and quality standards. China, like most countries, requires conformity assessment licenses, quality and safety licenses, sanitary and phytosanitary testing, and labelling verification for imported goods. However, these standards are sometimes applied to imports more rigorously than they are to domestic products. This obviously gives the domestic producers an advantage over Canadian companies.

- › China is prone to using anti-dumping measures to protect its domestic industry from foreign products. Among the products it has targeted in this way are chemicals, paper products, agricultural products and pharmaceutical products.
- › China applies tariff-rate quotas (TRQs) to imports of wheat, barley, corn, rice, wool, cotton, sugar and fertilizer. Under this system, China restricts the amount of these commodities that can enter at a low tariff rate. Imports above that quota are charged at much higher rate.
- › Liberalization has expanded the opportunities for non-Chinese companies in China's service sector, including financial, insurance, telecommunications, distribution and professional services. At the same time, some of the new regulatory structures that have accompanied these developments can obstruct foreign access by requiring high capital commitments and limiting expansion.

## 8.6 Labelling and marking

As noted in the “Standards and certification” section above, products requiring the CCC mark must have this mark physically applied before they can enter China. Be sure you comply with any applicable CCC requirement and any other labelling and marking specifications for your product, since an error can stop your shipment on the dock and leave it in a customs limbo.

Labelling regulations and requirements vary according to the goods being imported. Prepared foods, for example, must be labelled in Chinese and must include trademark, food name, list of ingredients, net content, name and address of manufacturer and distributor, production and expiry dates and country of origin. In general, consult with sector experts and the [Trade Commissioner Service](#) as to the labelling requirements for your product, and also ask your Chinese customer to specify exactly what should be on the labels. Try to have a sample label approved as part of your contract.

## 8.7 Documentation

The usual documentation procedure is for the Chinese importer to collect the required paperwork and submit it to Chinese Customs. Depending on the product, documentation can include:

- › bill of lading
- › invoice
- › shipping list
- › customs declaration
- › insurance policy
- › purchase and sale contract
- › import quota certificate as applicable
- › import license as applicable
- › inspection certificates as applicable

For information on Canadian export regulations and documentation, you can refer to the Canadian Border Services Agency guide, [Exporting Goods from Canada](#).

## 8.8 Canadian export controls

Some Canadian goods and technologies can't be exported to certain countries unless you have an export permit to do so. Examples are military equipment and technology, nuclear equipment and technology, munitions, firearms, sensors and lasers. Also be aware of what are considered “dual use” technologies as these may also require export permits.

Export of these goods and technologies is overseen by the [Export and Import Controls Bureau](#) (EICB), which is responsible for issuing the necessary export permits. For detailed information, download the EICB's [A Guide to Export Controls](#).

## 8.9 Insurance

A shipper assumes only limited liability for goods in transit, so you'll be primarily responsible for your shipment until it arrives at the Chinese port of entry. You can usually obtain insurance through a freight forwarder (see the next section), which is often preferable to doing it yourself.

## 8.10 Customs brokers and freight forwarders

For most Canadian exporters, shipping goods to China and dealing with Chinese Customs is a process better handled by customs brokers and freight forwarders. Some customs brokerage firms are also freight forwarders, and can provide you with convenient one-stop shopping.

Canadian companies exporting to China usually engage a licensed customs broker based in Canada, who then works with a broker based in China. The latter handles the documentation and logistics required to clear goods through Chinese customs. The Canadian Society of Customs Brokers ([CSCB](#)) offers a [list of questions](#) you should ask when choosing a customs broker.

Freight forwarders are primarily responsible for moving goods, although many offer customs brokerage services as well. You can select from among a forwarder's various services or have the company manage the whole process, starting at your loading dock and ending on your customer's doorstep.

Choosing a freight forwarder requires its own brand of due diligence. The most important thing to find out is whether the forwarder is experienced in clearing goods into China. Even if it passes this test, you should also:

- › ask the forwarder for a list of customers and ask those customers about the forwarder's quality of service;
- › check the forwarder's credit references;
- › find out if the forwarder is experienced in handling your type of product; and
- › make sure the forwarder can handle the volume of shipping you expect.

You can obtain more information about freight forwarders from the Canadian International Freight Forwarders Association ([CIFFA](#)). There is also a range of useful tools and information on shipping goods across borders on CIFFA's [Transportation Information Tools](#) page.

## 9 APPENDICES

### A. Key Canadian contacts in China

#### Canadian Embassy, Beijing

19 Dongzhimenwai Street  
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Tel.: 86-10-6532-3536  
Fax: 86-10-6532-4311

#### Canadian Consulate General, Shanghai

Shanghai Centre, Tower 4, Suite 604  
1376 Nanjing Xi Lu  
Shanghai 200040, PRC  
Tel.: 86-21-6279-8400  
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#### Canadian Consulate General, Guangzhou

Room 801, China Hotel Office Tower, Liu Hua Road  
Guangzhou 510015, PRC  
Tel.: 86-20-8666-0569  
Fax: 86-20-8667-2401

#### Canadian Consulate, Chongqing

Suite 1705, Metropolitan Tower,  
68 Zou Rong Lu, Yu Zhong District  
Chongqing 400010, PRC  
Tel.: 86-23-6373-8007  
Fax: 86-23-6373-8026

#### Canadian Consulate General, Hong Kong

13th Floor, Tower 1, Exchange Square  
Central, Hong Kong  
Tel.: 852-2847-7414  
Fax: 852-2847-7441

## B. EDC contacts in China and Canada

### China

#### EDC Shanghai Representation

Tel.: 86-21-3279-2832

Fax: 86-21-3279-2837

#### EDC Beijing Representation

Tel.: 86-10-5139-4126

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Tel.: 709-772-8808

Fax: 709-772-8693

## C. Major Chinese Ministries

- › [Ministry of Commerce](#)
- › [Ministry of Foreign Affairs](#)
- › [State Administration for Industry and Commerce](#)
- › [State Administration of Taxation](#)
- › [General Administration of Customs](#)

## D. Key China-related business organizations

- › [Asia Pacific Foundation of Canada](#)
- › [Canada China Business Council](#)
- › [China Council for the Promotion of International Trade: China Chamber of International Commerce](#)
- › [Hong Kong-Canada Business Association](#)
- › [Hong Kong Trade Development Council](#)

## WANT TO KNOW MORE?

If you would like more information, please contact us at

**1-800-368-6664**

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