Australia China Business Council
澳大利亚中国工商业委员会

Alibaba Cloud

CHINESE MARKET SNAPSHOT: ENTRY STRATEGIES

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CHINESE MARKET ENTRY

Foreign businesses entering China must find the right strategy to compete with domestically owned companies.

Key initial considerations for choosing an entry strategy include:

- Size of firm
- Type of products
- Previous export experience
- Business conditions and regulations in China
- On-the-ground support or representation
- Control over product and Intellectual Property Rights protection
- Time and resources available

As with all cross-border commercial activities, there are market barriers and associated risks with entering the China market.

Businesses are advised to obtain professional advice and conduct thorough due diligence.

ENTRY OPTIONS

1. Direct & Indirect Export

Businesses can export products or services directly to consumers in China. Alternatively, they can sell them indirectly through overseas agents or distributors. The benefit of indirect export is that intermediaries can help manage in-country stock distribution and logistics. However, customers are owned by the agents and distributors once the contract is over. Whilst direct and indirect exporting are simple market entry strategies, these models rely on a powerful brand or unique offering to be competitive.

2. Partnering, franchising & licensing

Foreign-invested partnerships (FIPs) are easy and convenient ways to set up business in China. They are an unlimited liability business entity with no minimum requirements on registered capital. However, there are some restrictions to be aware of, including ‘prohibited’ industries stated in the government’s Investment Catalogue which require a Chinese party to hold a controlling interest.

Other options include franchising and licensing. These are business agreements where certain brand aspects are shared in exchange for a fee. Whilst franchising agreements pertain to an entire business’ brand and operations, licensing agreements apply only to Intellectual Property Rights including copyright, technology transfer and trademarks.

3. Opening an operation in mainland China

Businesses may choose to physically set up business locations in target markets. This could initially be a subsidiary or sales office which may lead on to production facilities.

Given the enormous size of the Chinese marketplace, Australian companies should consider breaking down markets into segments. Even niche markets or specific regions can be highly profitable and is a recommended initial approach for smaller companies.

The best locations to begin when seeking new business opportunities include first-tier and second-tier cities. First-tier cities including Beijing, Shanghai and Guangzhou contain the most experienced business people who deal with foreign companies. However, these first-tier cities represent only 9% of the Chinese population despite their economic power.

Meanwhile, second-tier cities have populations of over 3 million people and $2000 GDP per capita. They also have lower costs, fewer foreign competitors and increasingly supportive state and regional governments.

4. Acquisiton or Joint Venture

Another option is to acquire or invest in an existing business operating in China, or set up a new business in partnership with a local business (known as joint ventures). There are two types of joint ventures in China. The more popular option is the equity joint venture (EJV) which allows foreign investors to engage in restricted industries in the country such as healthcare and security. The alternative is the cooperative/contractual joint venture (CJV), which is a partnership between a Chinese and foreign enterprise/organization or individual. However CJVs are rare due to unlimited liability of partners.

FOREIGN INVESTMENT CLIMATE

China maintains government restrictions for certain industries and regulations for foreign direct investment have lagged behind international standards.

However, the policy climate around investment in China is still favourable. The government understands China's growth rate and drive for digitalisation, consumption and more value-add services cannot be achieved without foreign investment. Foreign companies are encouraged to participate in major initiatives and ongoing reforms are leading to improved processes.

For example, the Foreign Investment Law came into effect in 2020 January. With streamlined procedures, it sought to address long-standing demands for foreign investors, including wholly-foreign enterprises and sino-foreign joint ventures, to be treated in a similar manner to domestic counterparts.

While a list of restricted industries remain, they have been shortened year on year. Restrictions on automobile manufacturing, financial and social survey sectors have eased, but there are new restrictions for the news media sector.

1. Geography

Foreign businesses have historically focused on China's east coast and Pearl River Delta region in the south. These are the richest parts of the country and main hubs for manufacturing and services.

However, the distribution of economic activities across the country is expected to change in the future. The central government is eager to diversify China's economy, and regional and provincial governments have a high degree of autonomy in economic planning. Central China which produces mainly agriculture and Western China which is largely reliant on natural resources and commodities but is becoming a new hub for manufacturing and services, both have high quality infrastructure and are well connected to the east coast.

2. Regulatory & Legal Changes

Despite regulations being highlighted as a barrier to market entry, there is a trend towards greater transparency, better communication and a more streamlined regulatory environment in China. There is a shift towards a policy and legal environment that is 'user-focused' as well as increased information disclosure and anticorruption drives across government.

3. A focus on technology

China wants to transition to a high-tech economy by improving the quality and efficiency of its high-end manufacturing and creating a new human capital pipeline. Nevertheless, the government views tech companies as strategically important for their future visions and will continue its vast investment in technological innovation.

CHOOSING A PARTNER

Things to consider when choosing a partner include:

- What the business wants from the partnership (eg. local market knowledge)
- Location - different investment incentives exist across regions
- Due diligence - use sources from press reports, official legal findings to financial reports to identify inconsistencies
- Legal aid as paperwork and regulations may not be transparent
- Leverage as scale of potential partner will have an impact

RISKS TO CONSIDER

1. Language

The average level of written and spoken English across China is generally low. This can make typically straightforward administrative procedures complicated, and it is recommended that businesses find dependable bilingual contacts. Most English speakers are based in major east coast cities such as Beijing and Shanghai.

2. Trade Policy

While China's trade policy has shifted away from protectionism since the beginning of economic reforms, this transformation has not always been steady and varies across sectors. Legislation can change unpredictably at short notice, and understanding the rules and regulations set out by the government can be challenging. Compliance is essential as almost all products that are sold in China are required to go through full clearance at the customs office.

3. Export Control Law

The Export Control Law is China's first comprehensive framework restricting exports of military and dual-use products and technology for national security and public policy purposes. Effective from December 2020, exports on a control list are prohibited or subject to licensing requirements. However businesses should be aware there are also items not covered by published control lists, and authorities have the power to restrict any exports deemed as a threat.

4. Intellectual Property

High-profile incidents of Intellectual Property theft have threatened China's reputation and undermined its relationship with foreign businesses. There has been criticism that market access is being traded for technology transfer, especially when foreign companies entering the Chinese market must partner with local firms.

However the Chinese Government has improved its Intellectual Property laws in recent years, for example introducing legal and regulatory incentives for Chinese companies to file patent applications. They have also worked towards aligning relevant legislations to minimum WTO requirement protocols.

Australian businesses are recommended to have a well-researched and executed strategy to protect their Intellectual Property Rights. They should register as early as possible, use strong contracts and actively enforce against infringers.

5. Regulatory Compliance

Regulation in China can be highly localised, complex and bureaucratic. In recent years they have become increasingly sophisticated and extensive, whilst enforcement agencies have become stronger. Foreign businesses have found it challenging to develop proactive compliance strategies as regulations are constantly changing, vary across industries and inconsistently enforced. As standards are still adapting to suit economic priorities, foreign businesses must engage in contingency planning and prepare to be agile.

6. Labour Costs

China was once the centre of low paid production line jobs but economic development, a shrinking working-age population and the growing value of its currency have pushed wages up. From 2010 to 2020, average wages in China almost tripled. However, with the growing movement towards automation in China, companies can still keep costs down. China's robotic industry is developing rapidly and automation will particularly affect sectors such as automotive manufacturing, electronics and appliances.

7. Skills Gap

Foreign businesses have faced a lack of skilled labour and struggled to stand out in a crowded job market. This has been exacerbated by a growing number of domestic firms looking to attract graduates and skilled workers. While university enrollments are climbing, foreign businesses may find it easier to differentiate from other employers in smaller, lesser known cities.

8. Tech-Specific Issues

It is important for businesses to understand the impacts of China's government controlled internet. Guidelines on cyber governance have been streamlined, and new requirements on data and security have been introduced to improve safety and security for businesses, governments and consumers. For example, companies with sensitive data must store it in China and partner with a Chinese firm.

Alibaba Cloud has been supporting local organisations in Australia such as Chemist Warehouse, Airwallex and The University of Sydney to both expand their business and manage their challenges of operating within the China market. Our data centres have been operational since 2016 and Gartner recently ranked Alibaba Cloud as the 3rd largest public cloud provider in the world in terms of infrastructure market-share.

Since its founding in 2009, Alibaba Cloud has emerged as a global leader in cloud computing and artificial intelligence, providing services to thousands of enterprises, developers, and government organisations in more than 200 countries and regions. Alibaba Cloud has 75 zones strategically located across 24 global regions, providing reliable computing support for billions of customers. Since January 2017, Alibaba Cloud has become the official cloud services partner of the Olympics and also for the Australian Olympic and New Zealand Olympic team members.

If interested in the services of Alibaba Cloud, please contact:

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