

# Strategies and Paths of China Entry

## For Small to Medium Companies Entering China Market

### Market Entry Alternatives for this Industry

It is of high importance to Western companies taking a serious look at the China market to understand what the investment alternatives are, and in particular whether to set up local production or to sell to this market through importing products. Several options are available, and which to select depends greatly upon the size, strategic objectives, end-users, and product/service of the company.

### The Rationale and Options for Direct Investment

In general, the decision to invest in manufacturing is closely related to the type of product involved and the technological sophistication of such products. If a company's products utilize more common technologies, or if they have viable domestic competitors, then local manufacturing becomes a must in many cases. There are two primary considerations here:

- Technology Transfer. Whether technology can be transferred to this market, either officially or unofficially, in the right way. If a company thinks that its design (through reverse engineering) or manufacturing process technology can easily be copied, this can be a prime incentive not to localize production.
- Pricing/Market Analysis. Whether the company's products can be sold in this market without being produced locally. Or, whether key components can be manufactured or sourced in China to lower costs significantly. A market-demand price-threshold analysis is very useful in determining this.

The following table lists possible China market vehicles in general (may not apply to each industry) and summarizes many of their advantages and disadvantages. It is important to note that not all of these options are mutually exclusive. For example, many companies in China choose to have a WOFE *and* sell through distributors. On the other hand, it is possible to sell through distributors and not actually have legal representation in China.

**Figure 1: Advantages and Disadvantages of Various Market Vehicles**

Vehicle	Advantages	Disadvantages
<b>Local Production Options</b>		
<b>Local Production</b>	<ul style="list-style-type: none"> <li>▪ Can Accept payment in RMB</li> <li>▪ Can (maybe) compete better on cost</li> <li>▪ Closer to end-user; faster delivery time, other such benefits</li> <li>▪ Many options for manufacturing</li> </ul>	<ul style="list-style-type: none"> <li>▪ Requires investment</li> <li>▪ Could require higher operating costs</li> <li>▪ Potential dangers in Tech. Transfer</li> </ul>
<b>Direct Imports</b>	<ul style="list-style-type: none"> <li>▪ Easier to Protect Technology</li> <li>▪ Lower costs all around</li> <li>▪ Less risk, exit strategy easier</li> </ul>	<ul style="list-style-type: none"> <li>▪ Cannot accept payment in RMB</li> <li>▪ May face import restrictions</li> <li>▪ Products will likely cost more</li> </ul>
<b>Legal Options</b>		
<b>Rep Office</b>	<ul style="list-style-type: none"> <li>▪ Cost-effective way to enter market</li> <li>▪ Can understand market better before setting up production</li> </ul>	<i>(relative to other direct import options)</i> <ul style="list-style-type: none"> <li>▪ Operating costs for China presence</li> </ul>
<b>JV</b>	<ul style="list-style-type: none"> <li>▪ Partner may provide some benefits</li> <li>▪ May be easier to get investment approval (depends on industry)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Technology could be at risk</li> <li>▪ Must run business with partner</li> <li>▪ More difficult exit strategy</li> </ul>
<b>WFOE*</b>	<ul style="list-style-type: none"> <li>▪ No partner- a free hand in the market</li> </ul>	<ul style="list-style-type: none"> <li>▪ No assistance from partner</li> </ul>
<b>Sales Options</b>		
<b>Agents/Dist</b>	<ul style="list-style-type: none"> <li>▪ Very useful for broad footprint of end-users</li> <li>▪ Can provide service</li> </ul>	<ul style="list-style-type: none"> <li>▪ Dangers in losing control of marketing</li> <li>▪ Not applicable for all products</li> </ul>
<b>Franchise</b>	<ul style="list-style-type: none"> <li>▪ No need to be in China</li> </ul>	<ul style="list-style-type: none"> <li>▪ Technology risked, very difficult to monitor/control, little recourse in disputes</li> </ul>
<b>Direct Sales (no dist, rep.)</b>	<ul style="list-style-type: none"> <li>▪ No need to be in China</li> </ul>	<ul style="list-style-type: none"> <li>▪ Operationally difficult, applicable to products with small end-user footprint</li> </ul>

\*Not presently an option many service companies and manufacturers of those industries that have particular protection.

The two greatest advantages of direct investment in China are:

- 1) Companies can accept payment in RMB. That is, companies can be paid in China. This is important in that some domestic companies and government organizations often have great difficulty paying in USD.
- 2) Products manufactured in China are taxed much less than their imported counterparts, and there are shipping costs on top of this. Local manufacturing and local sourcing for select components will render the final price even less expensive. Depending upon the product or service, this can often mean the difference between 10 percent of potential end-users being able to afford one's product, compared to more than 50% in some cases.

Even with WTO, in which tariffs will be lowered for many products and companies that manufacture locally will largely lose their tax advantages, local product will still (in most cases) mean significantly lower prices.

As most markets in China are very competitive, starting small and smart, then growing as able is a strategy not to be discounted. Some Western companies, after having established a presence in China through a representative office, may decide that this is enough, or may decide to go ahead with direct investment.

Local production means having a manufacturing facility in China, and this can only come through a JV or WOFE, each of which is discussed in greater detail below. There are several operational (as opposed to legal) options for manufacturing:

- Making one or more products or components through a mechanical manufacturing process.
- Importing key components, sourcing the rest locally, and assembling these.
- A combination of these.

The point to emphasize here is that there is considerable flexibility in what qualifies as local production. Many Western companies that “manufacture” in China are essentially assembling components, packaging, or something short of what is often considered “real manufacturing.” This varies greatly by product. It may be possible to source 90 percent of components and materials locally and import or manufacture one or more key components.

While there are local sourcing requirements for various industries, most companies that produce in China source for economic reasons, and exceed these requirements. Western companies are often not aware of the variety of components, quality ones at that, that can be sourced in China, either off-the-shelf or by custom order- and at reasonable costs. Furthermore, components can be first imported and then sourced locally once the company has found reliable suppliers. This can take time, and is very difficult to do from abroad, so companies may wish to plan for a phased-in approach to sourcing and/or begin to investigate procurement well before local production commences. For example, General Motors imported plate steel products for the first phase of its production before beginning to purchase from local suppliers.

⇒ **The most important thing for Western companies considering direct investment in China for sales is that there be a market for their goods.**

This means that there is a large enough group of potential end-users willing to purchase one’s product at an acceptable price. Thus the principal acid test for investment is market-based, rather than of legal considerations. If not enough customers will purchase one’s products in China, the legal structure of market entry has only nominal significance. This sounds very basic, but the fact is that many companies have made significant commitments in China without real markets for their products. There are also opportunities to manufacture in China for export to other countries, and

financial incentives to do so, though most foreign companies of any industry prefer to manufacture in China if there are opportunities in the domestic market.

### Options and Rationale for Direct Imports

If a company's product occupies a critical niche and is not manufactured in China, then it is usually advisable to develop the market on the basis of import sales. At such a time as domestic competitors are able to compete more effectively, or a strong foreign competitor begins domestic production, then the investment/production decision can be re-evaluated. It is a common misperception of companies that they cannot enter this market incrementally, or that they have to start big in order to show their “commitment” to this market. With a few exceptions these perceptions are erroneous. (This is in general, and not applicable to all industries- one cannot, for example, incrementally set up a semi-conductor fabrication facility).

Selling to China through direct imports can take several legal and operational forms:

1. A representative office only (sales carried out through this)
2. A network of distributors managed by a representative office
3. Use of distributors or agents without a rep. office
4. Licensing agreements
5. Direct sales to China without agents, licensees, or distributors

Of these, the most common and most effective in general are the first three, two of which require a legal presence in China.

**Licensing agreements** Licensing agreements, while technically possible, are in all likelihood not a smart option for Western companies in this market. This amounts, in essence, to a technology transfer agreement, on a compensation-per-unit basis. There is normally no effective way for the company to verify sales, and very limited effective recourse if a dispute arises. The only real recourse is the Chinese legal system. As many Western companies tend to be of small to medium size, with no leverage in this market, this is probably not the best path to take.

**Direct Sales without agents, distributors, licensees** This option does not have the pitfalls of licensing, but operationally it can be quite difficult. This could include Internet sales, though this is still under-developed and payment issues could be a problem. It is also possible to sell products/services to Western-based OEMs, though in this case the marketing focus is not on China.

It is likewise possible to come to China on occasion to market, preferably from another Asian office. This is more feasible, and some companies do this, but this also has some distinct disadvantages:

- If the end-users (or decision-makers) for products are numerous, such as for common components/products, this approach will not work.

- In marketing for large projects, this approach is feasible but the company will need to come to China on a very regular basis to make and maintain relationships and properly incentivize these. This could make costs even greater than it would to have a permanent presence in China.

### **Use of Distributors/Agents, with or without a legal presence**

Whether to use distributors, in what way and to what extent really hinges upon the end-user base for one's products in China. If there is a large footprint of end-users, it is best to use a wider range of distributors. These can be segmented regionally or by product type, or even by industry/end-user. If there are just a few end-users in China likely to purchase this product, a single distributor or agent is probably best.

Subject to serious market-potential analysis, in general, a larger distributor network should be managed directly from a representative office, WOFE or JV in China proper. Successful remote management and communications of a substantial distributor network in China is difficult, and instances of success are rare.

Another advantage of managing such a network "in country" is that it allows for the network to be grown in a rational and controlled fashion. Foreign companies have frequently run into channel management problems by trying to establish their distributors too quickly. The problems in establishing a distributors network typically encompass the following:

- Insufficient knowledge of the distributor.
- Insufficient knowledge of the Chinese market.
- Insufficient knowledge of Chinese business practices.
- Insufficient knowledge of government regulations and authorities.
- The need for market education.
- The need for distributors to have sufficient technical and product knowledge.
- Immature or not sufficiently localized financial and contractual procedures and arrangements.
- Communications between distributors and channel management personnel.

### **Establishing a Representative Office**

Establishing a representative office in China before investing could be advisable for several reasons:

- This will allow companies to become more familiar with the market, and get a better picture of what the market for their products and services are, and what the customer wants.

- This will also allow for a company to both promulgate their brand and start to make key relationships, both of which are very important and in China can take longer than in western countries.
- This will allow for a company to get a much better idea of the operations side of the business in China: costs, procurement, laws and regulations, and perhaps most importantly, market practices.

A representative office, while it cannot accept payment in RMB, and cannot manufacture, is a convenient vehicle for sales of imported products, which are paid for through standard import procedures (eg, letters of credit). Representative offices can market products or coordinate distributors to do so, bringing management and coordination that cannot be done effectively from overseas. Provided that the products can be imported legally and in a cost effective manner, and that there is a market for these, all the important aspects of a company's operations (marketing, channel management, payment pathways, legal standing) can be carried out effectively and with cost efficiency through this vehicle.

Specific investment rules and guidelines vary by industry, and can be procured from a variety of sources. For American companies, for example, the Department of Commerce is a very useful source of such information. There are correspondent organizations in other countries as well. Or, it can be procured directly from the Chinese government, though without the useful insights that an organization such as the US DoC can bring.

However, we would emphasize again that market-based issues here must be considered before legal ones.

## Establishing a JV in China

### *Options*

Establishing a joint venture is often the cheaper of the direct investment alternatives. Basically there are two types of Joint Venture in China: the Equity Joint Venture and the Cooperative Joint Venture. The primary difference between these two is that the Cooperative Joint Venture is a contractual arrangement that may, or may not, be a legal entity as well depending upon the nature of the contractual arrangements and the intent of the partners. Cooperative JVs are more common for project-based cooperation and for trial "engagements" prior to the marriage that an equity Joint Venture represents. Cooperative Joint Ventures are also more common for smaller companies.

Chinese law stipulates that foreign contributions must be no less than 25% of contributed investments. Some sectors receive further restrictions, while others are treated more liberally. It is imperative for each case to be researched completely and treated in its specific circumstances. In practice there is a great deal of variation in the application of such contributions, and in the approval

of various ventures. Regional policies, domestic partners, specific industries and various loopholes all commonly impact the organization and approval of joint ventures.

Most foreign companies selling products (rather than services) that want to be in China can take either a majority or minority stake in a JV, or even go 50-50. This applies to most kind of products where there is a market for foreign products, but may not apply to lower technology products (such as steel products) where the domestic industry receives greater protection, and there are few opportunities for technology transfer. With the exception of a few industries and areas, it is almost always advisable to be the majority partner in the JV, as it is the majority partner that controls the management and finances, and thus the company. The main advantages of opting for a JV are:

- It is often (though not always) cheaper than a WOFE
- The foreign company can take advantage, in some cases, of existing manufacturing facilities, sourcing of parts, government relationships and coverage, sales channels and the like.
- It will allow, in many cases, some level of quick access to existing sales channels, relationships and knowledge.

When considering a JV, the Western company should consider what they really want to get from a partner. Many Western or foreign companies that invest directly in China to sell products choose to partner with a domestic company in a joint venture not to save investment costs, but to take advantage of the partner's sales channels and relationships. This is particularly the case in business-to-business markets, because, in contrast to consumer markets, the personal relationships needed to sell these products takes more time and effort to develop. Also, for both equipment and engineering companies, domestic companies (particularly well-connected ones) can be very helpful in dealing with government relationships and bureaucracy.

Naturally, the main disadvantage of a JV- even if the Western company has a majority stake- is that the company has to operate in China while married to a domestic company. This is not an inherent disadvantage, but many of the following things can and do happen:

- Cultural and business differences are hard to bridge, and hinder operations.
- Products and technology may be copied
- The domestic partner does not carry out its responsibilities
- Exit strategies and getting cash out can be more difficult

The most common JV problem is one of cooperative intent. This can be traced to two main root causes.

**One** It is often the case that either the foreign partner, the Chinese partner, or both, comes to the Joint Venture with short-term income objectives and is not really oriented toward the medium and longer-term development of the project. This inevitably leads to JV failure when placed against the

normal operational and managerial difficulties of operating in China while bridging a wide range of operational and communications issues.

**Two** The second is one of control. It is frequently the case that the Chinese partner will exercise effective control over the JV, regardless of equity participation. Typically this is because the JV staff will be brought over from the Chinese side. These people tend to retain their parent company world views, objectives and relationships, creating effective, even if not official, Chinese control of the JV. Successful JVs have dealt with this problem in several ways, the most typical being patience and continual, in-depth participation, interface and communications. A less typical, but more immediately effective method is to organize a clean slate wherein JV managers are responsible for hiring all JV personnel. In this case a deliberate attempt is usually made to restrain Chinese partner personnel from dominating key positions within the JV.

In contrast to 5-10 years ago, in most cases it is not obligatory any more to form a JV in order to invest in China. While there are many examples of successful JV's in China, there are likewise a large number of "problem" JVs. Based on our experience here, GCiS suggests the following guideline:

⇒ *If* one is going to invest in China, **only** form a JV if there is a compelling reason to do so. Otherwise, form a wholly owned company (WOFE).

Compelling reasons could include access to markets (in an industry or market which or more closed, for example), legal restrictions, strong market channels, etc. Normally, the reasons are **not compelling**, and a WOFE is the better option.

### **Procedures**

**The procedures for establishing a JV are clearly defined. After the Western (foreign) company has reached agreement with the domestic company, the proposed joint venture must be agreed upon and approved by various government ministries.**

**First, agreement is needed from the following ministries:**

- 1. Local MoFTEC (*Wai Jing Wei*)**
- 2. Local State Administration of Industry and Commerce (*Gong Shang Ju*)**
- 3. Other local ministries, depending upon the industry**

**Then the JV must be approved by the following national ministries in Beijing:**

- 1. MoFTEC (*Wai Jing Wei*)**
- 2. State Administration of Industry and Commerce (*Gong Shang Ju*)**
- 3. Other national ministries, corresponding to the local ones.**

**The domestic partner in many cases is very helpful in getting the local ministries to sign off, and while procedures may take time, Chinese officials rarely turn away investment.**

**The requirements can vary by location and industry. Not all Chinese partners are capable of shepherding this process effectively through to approval. Western partners are highly advised to retain professional assistance in this regard as there are a number of areas where homework and verification performed in advance will save considerable time and expense. The retention of professional assistance may also lead to an early exposure of unqualified or disingenuous prospective Chinese partners.**

Documents Needed for Application Joint ventures and Cooperative Enterprises (the original is needed unless otherwise specified) (as of late 2000)

1. Application report of the Chinese project unit
2. Contract and constitution of the joint venture or cooperative enterprise
3. Duplicate of Chinese business license of the Chinese side (with the seal of the Administration for Industry and Commerce)
4. Legal business certificate from foreign country
5. Credentials of the legal representatives of each party
6. Credit certification of each party
7. Appointment letter of directors and recommendation of general manager and vice general manager.
8. List of directors
9. Resume and identification card of Chinese directors
10. Checklist of imported materials
11. Approval of related managerial department should be attached to the state-controlled projects
12. If the import and export license is involved, the permit and quota instructions issued by the Ministry of Foreign Trade and Economic Cooperation shall be supplied
13. Advice letter of the name registration and approval of joint ventures and cooperative enterprises
14. Application form for registration of foreign-invested enterprises
15. Registration form of legal representative of foreign-invested enterprises
16. Other necessary documents

### **Common Hybrid Investment Forms**

Under China's evolving regulatory environment there have developed a number of investment formats that take the appearance of the Joint Venture, but operationally work as a WOFE. These are typically legal, but care must be used as with some formats as they are clearly illegal under current Chinese law. Some foreign investors have made the calculated bet that a marginally legal structure will eventually be opened and/or legally recognized. There are many instances of this. In

telecommunications, foreign companies that partnered with China Unicom in operating ventures clearly did so illegally, and have been called on it - with resulting significant losses. On the other hand, retailing ventures of many companies, likewise clearly in conflict with existing Chinese law, have been allowed to continue and are being legalized.

The most important of these alternative structures is the structuring of a large majority holding (cooperative or equity) in the range of 95% to 98%. This basically amounts to the Chinese side "renting" itself (its name and legal status) out for an annual fee. This is common in industries where joint ventures are allowed, but WOFE's are not.

There are a variety of such strategies now active in China. Extreme caution must be used when entering into such a structure. Again, the specifics of the case must be researched and the assistance of a professional third party who is experienced is highly recommended.

### **Establishing a Wholly Owned Foreign Enterprise (WOFE) in China**

#### *Options*

The WOFE is currently the most popular structure for foreign investment in China. This is due to both the increased legal acceptance and support for the format from the Chinese government as well as the less-than-desirable success rate for joint ventures in general. While WOFE's are still not allowed in some sectors, this will change with WTO (over a specified timetable), and in some localities obtaining a WOFE is easier than others. For example, many service companies can get WOFEs in Pudong, Shanghai, but not in the Puxi section.

The main advantage of establishing a WOFE is that the foreign company can operate freely without having to cooperate with a domestic partner, and all the disadvantages that this can entail. At the same time, the foreign company forgoes advantages such as access to existing sales channels, local knowledge in sourcing, and help in government relationships. For most companies that will manufacture, the investment requirements (registered capital, etc.) are normally lower than the necessary operational investment, so this should not be a major hurdle. It is really a decision of whether the foreign company wants a domestic partner.

⇒ While "going at it alone in China" can be an intimidating proposal, if done smartly it is not as difficult as it used to be. If done the right way, the main challenges will be those of business development, rather than bureaucratic entanglements and other "China" issues.

As mentioned above, this is a large reason why it can pay to start small, become familiar with the market and operating environment, and then take greater risks.

### ***Procedures***

Like the Joint Venture, the procedures for establishing a WOFE are now well established. The approving authorities are the same, and many of the document submissions are the same. It is important to remember that the Chinese authorities typically scrutinize WOFE investments more closely than JVs with the objective of ensuring that it fully complies with relevant policies (both published and unpublished). In general, with the Chinese authorities' emphasis on capital investment and technology transfer, there is a preference for foreign companies to enter into joint venture agreements. The realities of declining foreign direct investment, regional competition, and the general dissatisfaction with the overall success rate of joint ventures has forced a gradual, and continuing, loosening of WOFE investment regulation application. It is thus very important to investigate the issues of WOFE investment on a case specific basis with the assistance of professional, local (PRC) expertise.

#### Wholly Owned Foreign Enterprises

*(the original is needed unless otherwise is specified- as of late 2000.)*

1. Application form for registration
2. Constitution of foreign-invested enterprise
3. Feasibility study report
4. Registration certificate and legal representative certificate (recent certificate issued by the registration institution), if it is invested in one's own name, house property certificate and domicile certificate shall be offered.
5. Notarized trust deed that the legal representative gives to the trustee
6. Credit certification issued by the savings bank of the company
7. Balance sheet of the company for the last three years
8. Plan for the balance of income and expenditure
9. Checklist of imported materials
10. Approval of related managerial departments shall be attached to the state-controlled projects
11. If the import and export license is involved, the permit and quota instructions issued by the Ministry of Foreign Trade and Economic Cooperation shall be supplied.
12. List of the directors (with the signature of the legal representative of the foreign company and the official seal)
13. Letter of appointment of general manager and vice general manager (with the subscription of the legal representative of the foreign investment company)
14. Application form for registration of foreign-invested company
15. Registration form of the legal representative of foreign-invested company
16. Other necessary documents

### Strategies for Channel Management

#### *Effective use of Agents and Distributors*

Using agents or distributors is an option to companies with an official China presence or those without. This is really most applicable to sales of products, or equipment. Foreign service companies may have partners or affiliates in different parts of China, but these are not classified as agents or distributors. For a Western company whose products have only limited application in China, or that wants to get into this market incrementally, this is a strong option.

#### *Options for Western Companies*

When considering the use of agents or distributors for the China market, Western companies should consider the following issues:

#### **Choosing a Distributor or Agent**

Companies can either choose a general agent (sometimes called first level agent) or a series of independent companies. There are companies in China that specialize in selling specific kinds of products, though many of these will carry products from competing companies, if not competing products. According to many of these companies, as long as they do not sell the same basic models of different companies, there is no conflict- though Western companies may not see it this way. If a Western company chooses to have a network of independent distributors in China, and have no presence in this country itself (such as through a rep. office), they should really consider how these distributors will be managed.

If a company aims to sell lots of smaller units, then a larger network is often better. If the aim is to sell large units or packages of equipment, then a single distributor or agent may that has access to the right relationships and information sources may be best.

#### **Segmentation and Control**

This can be either through geography (region) or by product type, industry, or other. There must be some means to segment or divide responsibilities, or else poaching can become a real problem. Also, while some distributors/agents operate nationwide, many are regional, and their sales scope should be limited to the region in which they are strongest. Normally regional segmentation is the cleanest and best way to set up and manage a network, and if there is only one product then this is a given.

**Credit** Whether to give credit to distributors or end-users is a key consideration. One Western company says that its distribution network has been a success precisely because it does **not** give credit of any sort. In some cases, distributors will offer credit themselves, while the foreign company bears no responsibility to do this. They are usually in a better position to do so, as they know the end-users better, and often know who will honor the arrangements. It should be kept in mind that legal debt collection remedies in China are only marginally effective, time and resource intensive and the process is often stacked in favor of the local enterprise. Thus credit, if important and

necessary, should be offered by the distributor. If trusted and capable distributors have been established, then policies and financial arrangements between the manufacturer and the distributor can be organized so as to facilitate wider credit availability.

**Service** Companies with no presence in China need a way for their products to be serviced. This can include installation, training, along with after-sales service. A domestic company will frequently balk at purchasing a product, with reason, if there is no dedicated service provider. If a company wants to set up sales offices throughout China, or make an arrangement with a company that already has these, this is one way to solve the problem. Otherwise, they may have to rely upon the distributor to do so. In this case, it is of particular importance that the company pick distributors that can do the service well. Otherwise, it will reflect negatively upon the foreign company's brand in China.

In some cases, foreign companies have developed separate service networks on a contractual basis. There are currently several major state run companies that specialize in this business. Such a company might be an option for a foreign company that needs nationwide coverage. Alternatively, such a network can be established and coordinated through a general agent, a representative office or more substantial investment structure.

**Other considerations** These include length of contract (normally one year), sales incentives, means of penalizing distributors, inventory and spare parts, assistance in importation of products, and others.

### ***Recommendations for Using Distributors***

The basics of finding and using distributors in China are the same as in the United States. The following characteristics are desirable:

- Familiarity with industry, product and application,
- Familiarity with customers,
- Sufficient business experience and scale,
- Sufficient technical capabilities,
- Ability to communicate effectively,
- Good credit and reputation,
- Others.

In addition, it is often critical in China for the agent/distributor to have good relationships within the government or other end user group. In China such relationships are called Guanxi. Guanxi is often talked about in conjunction with doing business in China. It is extremely important, especially in project-based work. Guanxi does not *usually* (but sometimes can and does) replace price and quality, but it always makes the difference in highly competitive situations. It is also critical in discovering business opportunities in the first place.

### Recommendations on Direct Investment

If a company thinks that they can make it here, over the long term, then setting up the investment is just a matter of procedure. Investments, if done according to law, are almost always approved, though some take longer than others.

#### The Decision to Invest

It should be re-emphasized that the most important decision is whether or not to set up local production, and in what capacity. Direct investment does not need mean millions or tens or millions of dollars invested, nor very high operating costs. Unless one is a completely dominant, large player, such as a Volkswagen (\$1.5 billion invested), it is often best to start small and grow as the company's sales grow, and as a company gains a better understanding of the market. It is likewise possible to invest incrementally. This is also important because in China a business and a brand can take longer to develop.

#### Small Investment, small costs

Some foreign companies, when they come to China to scout investment, are somehow lead to believe that they need to come in with a bang, and that the market will receive them with open arms. Companies that set up manufacturing facilities have tended in the past to have excessive operating costs, which often means too many expatriates. Large Western companies such as General Electric are the leaders among foreign companies operating in China in localizing management, and Western companies with an eye on this market should take note. There is no better facilitation for the Chinese market than to have good local staff.

Yet, localization can be carried to an extreme. There is fierce competition for qualified senior level management, technical and sales staff in China. There have been many instances of local staff, being far removed from direct supervision, not having long experience or deep roots in the company, getting into various forms of trouble. These have ranged from management methods and decisions, to business practices to outright fraud or other kick-back related activities.

### Last Words

A few last words on the subject, and to re-cap:

- ⇒ Entering the China market is much easier than making money in this market.
- ⇒ A decision to enter this market should be based on market considerations, rather than legal ones.
- ⇒ (Again) If there is not a market for your product, and this will not be an export base, there is no point in entering this market.

- ⇒ Unless there is a compelling reason to enter a JV, it is best to do a WOFE.
- ⇒ For a small to medium size company, it is often best to start small, both in terms of operations and legal structure, and then work up, as one progresses in the market.
- ⇒ Only sign up distributors or agents that can be effectively managed and controlled.
- ⇒ Expect to take some time in developing the market, and in building a brand and presence in this market.
- ⇒ However, if done smartly, success is achievable, if a company has a good understanding of its markets in China and pursues them the right way.

### About Orbiso

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