EU SME Centre:
Exporting Goods, Services and Technology to the Chinese Market

Contents

All exchange rates in this report are calculated on the basis of: EUR 1 = CNY 7.80 = USD 1.11

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1. Exporting goods, services and technology to the China market

Exporting goods, services and technology to the China market

- Exporting refers to the shipment of **goods, provision of services**, or **transfer of technology** across national borders.

- Particularly **detailed planning is required by EU SMEs** exporting to a country such as China in order to create the greatest chance of successfully establishing stable and long-term export agreements and relationships.

- The exporting of goods to China always involves engagement of a company that has the right to carry out the import/export activities stated in its **business licence**. Such companies have to be registered in China, and this means that the term “importer” in Chinese trade terminology usually refers to the China-registered company possessing an import/export licence.

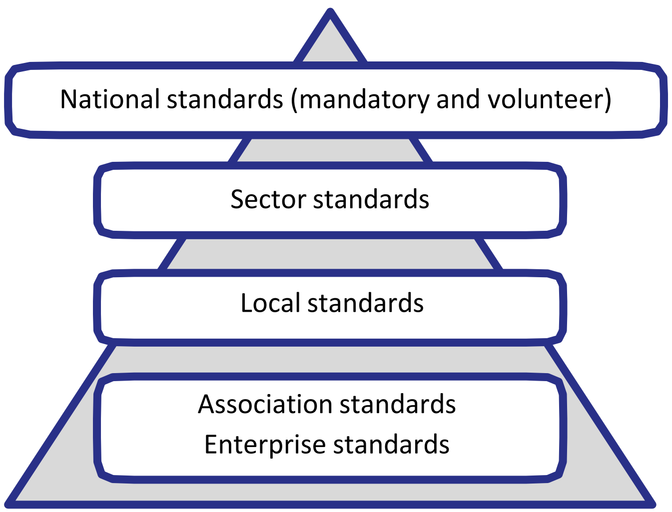
2. Goods

Goods

- Exporting goods to China involves a number of processes, the first of which is **to determine which of the following categories the goods for export fall into**:
  - **Free imports**: In most cases these goods can be imported into China without any restrictions, but selected items require an automatic import licence.
  - **Restricted imports**: Goods are considered restricted if they are subject to quantity-based restrictions (through the use of quotas) or require specific licences.
  - **Prohibited imports**: Some goods are prohibited from being imported into China for national security or health and environmental reasons.

- A number of **different standards** exist in China, and once an organisation has confirmed the import category of its goods and familiarised itself with the necessary paperwork, it must ensure that the appropriate Chinese standards are met.

The levels of standards in China



Goods

- The **complete list of processes** is:
  - Determine which **category** the product falls into;
  - Apply for any required **import licences or quotas** with the Chinese Ministry of Commerce;
  - Ensure that the product meets the **relevant Chinese standards**;
  - Apply for a **China Compulsory Certification (“CCC”)** mark (if required);
  - Ensure that the product meets all **labelling and packaging requirements** (if applicable);
  - Affix **relevant labels** to products before arrival in Chinese port (if required);
  - Have all required **paperwork** ready (such as licences, quota licences, and contracts) to present to customs for inspection at the Chinese port;
  - Be ready for **Chinese customs to take a sample of the product for inspection** and to hold the products until all inspections are completed (if applicable);
  - Pay relevant **customs taxes and fees**;
  - Products are **released by customs** and **successfully imported** into China.

Goods

- The **China Compulsory Certification ("CCC") system** is designed to protect the safety of consumers, plants and animals, the environment, and national security. The CCC mark must be obtained before certain products can be imported and sold in China.

The CCC mark

- Numerous Chinese government agencies also issue **industry-specific standards or testing requirements**.

- All products imported into China require some form of **labelling**, usually in Chinese. Labelling requirements vary by industry – for example, food, beverages, and cosmetic products require Chinese labels, and some electronic products must bear an energy efficiency label which indicates the information in the product specification.

- Goods imported into China are subject to various **packaging requirements** that vary depending on the product and packaging material in question.

- The Catalogue of Import-Export Commodities Subject to Compulsory Inspection and Quarantine lists the types of commodities which are required to be subject to entry-exit inspection and quarantine, and is updated on a regular basis. The documentation required for customs inspection varies between products, and must be provided by the Chinese importer to the Chinese customs agent.

Goods

- Customs duties applied to imported goods and import link taxes levied by customs authorities are collectively referred to as **import duties**. Import duties are collected by customs authorities at the point of entry into China.

- **Common taxes** include:
  - Customs duty
  - Value-added taxes ("VAT")
  - Consumption tax

3. Services

Services

- The **processes** involved in exporting services to China can be summarised as follows:

Determine which category the services fall into

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Decide whether to use direct or indirect entry

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Meet relevant guidelines

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Pay relevant taxes and fees

- **Direct market entry** requires more resources but provides full market access.

- **Indirect market entry** requires fewer resources but provides only limited market access.

- Foreign investment in China is governed by the **Foreign Investment Industrial Guidance Catalogue**, which classifies industry sectors as one of the following:
  - Encouraged
  - Permitted
  - Restricted
  - Prohibited

Services

- Service industries into which foreign investment is permitted are governed by a **negative list system**: in **2018**, in order to further liberalise its investment environment China fell into step with **international common practice** on market access by adopting its negative list management system. China has two negative lists, and the number of prohibited or restricted items on both lists has **fallen considerably** during the past decade. They are There are the [Special Administrative Measures for the Access of Foreign Investment [Negative List]] and the [Negative List for the Pilot Free Trade Zones].

- All services not listed as prohibited on a negative list can be considered services into which foreign investment is **permitted**, and government approval for services not on a negative list is usually granted **automatically**.

- The service industries into which investment is encouraged are governed by the [Catalogue of Services Encouraged to Import]. Encouraged industries are generally those that can introduce **new or advanced technology** into China, increase product quality and efficiency, or conserve resources and protect the environment.

- Investment into some industries in China may be **restricted for a variety of reasons**, including situations in which China does not stand to gain new technology, if the industry may have an adverse effect on the environment, or if the industry is highly regulated by the State Council. In order to export services in restricted industries, foreign companies may be required to establish a joint venture with a Chinese partner and/or limit their shareholding ratio. The transportation, finance, and education industries are among those into which some service activities are restricted.

Services

- Services in **prohibited industries** are completely off limits to foreign investors, and such industries are prohibited because the government has deemed that imports might harm national security, the public, public health, or the environment, or lead to a loss of Chinese intellectual property.

- All service companies that have obtained income in China or have consumers located in China are subject to **Chinese taxes**, unless expressly exempted by Chinese regulations. Taxes vary depending on a company's industry, income, place of service, and business model.

VAT rates payable by both direct and indirect market entrants

Taxable item	VAT rate
Small-scale SME taxpayer	3-5%
Modern services (such as R&D and technical services, information technology services, cultural and creative services, logistics support services, and consulting services), financial services, value-added telecommunications services, insurance services	6%
Transportation services, postal services, basic telecommunications services, books, newspapers, magazines, audio and video products, electronic publications	9%
Tangible movable property rental services	13%

4. Technology

Technology

- A company whose business is based on **intellectual property** may wish to consider exporting technology to China. One way to get a foothold in China is to license or transfer ownership of key technology and designs to Chinese subsidiaries of European firms, joint venture partners, or Chinese manufacturing and service companies.

- The **processes involved in transferring technology** to China can be summarised as follows:

Understand the project (including technology ownership, core advantages, IP status, and project maturity)

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Evaluate the competitiveness of your technology in order to develop an IP strategy appropriate for the China market (including any advantages, IP position in target market, market potential, risks, value, equity, and structure/ownership structure

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Conduct market research and partner identification in China

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Conduct a feasibility study

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Carry out due diligence for the partner

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Decide to carry out licensing and ownership transfer

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Negotiate a technology transfer contract

Technology

- Technology can be transferred through either **licensing** or **ownership transfer**.

- Licensing is based on the **rights** conferred by a patent and permission granted by the patent owner to another party to use the patented invention based on agreed terms and conditions (including, for example, the payment of royalties), while the patent owner continues to retain ownership of the patent. Licensing not only creates an income source for the patent owner, but also establishes a sound legal framework for the transfer of technology.

- Where licensing is used to **export technology**, the following channels are available:
  - Licensing the technology to an unrelated Chinese company
  - Setting up a joint venture ("JV")
  - Setting up a Wholly Foreign-Owned Enterprise ("WFOE")

5. Import contracts

Import contracts

- A **sales and purchase contract** is the most basic form of import contract, and the most common. If a company is looking to export its products to a Chinese importer, the two sides will need to negotiate and agree upon a sales and purchase contract. A foreign company that suitably negotiates a sales and purchase contract, along with fair and favourable dispute resolution mechanisms, will greatly reduce the risks of exporting to China.

- The important **components of a sales and purchase contract** are:
  - Selection of legal jurisdiction
  - Clear definition of buyer and seller
  - Contract product
  - Quantity
  - Quality enforcement. Quality maintenance systems can include the following:
    - A sample of the product to be inspected with the contract;
    - Pre-shipment of the product for inspection;
    - Inspection at the port by the Chinese importer;
    - Inspection at the final destination by the Chinese importer;
    - In case of dispute, both parties should first try to solve it through mediation;
  - Price and payment method
  - Confidentiality
  - Delivery
  - Time of effectiveness
  - Insurance
  - Liability for breach of contract
  - Dispute settlement – litigation or arbitration.

Import contracts

- A **letter of credit** is a promise to pay that is issued from the Chinese buyer's bank to the European exporter.

- The letter of credit **guarantees** that as long as the European exporter provides its goods to the Chinese buyer as agreed upon, it will be paid. Even if the Chinese buyer ultimately fails to pay the European exporter, its **Chinese bank** will still pay the full amount.

- Letters of credit are commonly used in **large international transactions** to lower the risk for the seller. Letters of credit are often used by European businesses exporting to China.

- Only letters of credit from well-established Chinese banks should be accepted. With letters of credit, it is possible to receive advance payments for sales and purchase contracts even before the product is delivered.

- The usual amount of an advance payment is **10-20%** of the total value of the contract.

Import contracts

- **Litigation** is typically lengthy and expensive in Chinese contracts. A lawsuit involving an international sales and purchase contract can take more than a year to resolve. Furthermore:
  - Trade secrets and IP may be leaked due to the public nature of some lawsuits.
  - According to Chinese law, litigation brought against a Chinese legal entity usually has to be resolved where the defendant is registered.

- When using **arbitration**, contract parties are free to choose the arbitration institution. In China, it can be said about arbitration that:
  - It is possible to select an international arbitral body to ensure neutrality.
  - Arbitration is the predominant dispute resolution mechanism for sales and purchase contracts in China and can take place in a third country that is neither China nor the foreign enterprise's home country.
  - The decision to enter into arbitration is binding and legally enforceable in China, even if it is made outside the country, as long as the place where arbitration takes place is a member country of the Convention on the Recognition and Enforcement of Foreign Arbitration Awards.

6. Foreign exchange controls and limitations

Foreign exchange controls and limitations

- **Foreign exchange** involves the **buying and selling of currencies** and is a key part of international transactions. Within an import contract with a Chinese partner, companies must specify in which currency they would like to receive payment. Typically, European companies prefer to receive payment for products and services in **EUR**, whilst Chinese importers prefer to pay in CNY. Foreign exchange risk enters the equation at the point at which one currency is converted into another. The risks associated with foreign exchange can be controlled by:
  - Requesting that all transactions be made in euros or the currency of the company's home country;
  - Developing a strategy to manage foreign exchange risk.

- Sometimes Chinese partners are reluctant to pay for transactions in a currency other than **CNY** because the process of foreign exchange in China is typically cumbersome and highly restrictive. As regulated by the **State Administration of Foreign Exchange**, foreign exchange can only be purchased from certain banks in specified amounts. There are also multiple regulations relating to the usage and holding of foreign currency. Regulations relating to foreign exchange are available on SAFE's website at: http://www.safe.gov.cn/safe/hwmywhgl/index.html

- Examples of these regulations include:
  - The Regulations on Foreign Exchange Control of Trade in Goods
  - The Regulations on Foreign Exchange Control for Trade in Services

7. Distribution channels

Distribution channels

- There are several **distribution channels** in China available to foreign exporters. Each channel varies in complexity, risk, and suitability for the distribution of different types and volumes of products. Specific product, sector, and industry regulations and distribution goals should be considered when selecting a distribution channel for China.
  - **Cross-border E-commerce**: The cross-border E-commerce sector has grown rapidly in recent years. Spurred on by the advent of E-commerce platforms like Tmall Global and JD Worldwide, Chinese consumers have become more at ease with purchasing international products online. E-commerce is a readily available distribution channel that provides access to the China market, and distribution through online platforms allows for the promotion of goods to a vast market spread across a large geographic area at a relatively low cost.
  - **Local distributors and partners**: A popular way to sell products in China is through a local partner, such as a distributor or an agent. An agent is a company's direct representative on the ground, and is paid a commission. A distributor buys an organisation's products and sells them on to customers through a third party. Their income is derived from the difference between the buying and selling price. Criteria indicative of a good agent or distributor include:
    - Knowledge of your product/service and its market;
    - Good references and previous experience;
    - Language skills;
    - Access to a strong network, geographical coverage, a support team, staff, and sub-agents;
    - Soft skills and sales experience;
    - The ability to work with incentives.

Distribution channels

- **Franchising**: At least two levels of personnel are involved in a franchise system: the franchisor, who lends their trademark or trade name and a business system; and the franchisee, who pays a royalty and often an initial fee for the right to do business under the franchisor's name and system. The following points regarding franchising are also important to know:
  - When considering franchising in China, organisations should be aware of China's legal framework for commercial franchises.
  - In February 2007, China's State Council published the revised Regulations on Administration of Commercial Franchises. These regulations apply to both domestic and foreign franchisors engaged in commercial franchising in China.
  - Only enterprises may engage in franchising as franchisors;
  - A franchisor must own a developed business that can provide long-term commitment, technological support, business training, and other services;
  - A franchisor must have prior experience of ownership and operation of at least two outlets for at least one year before they can establish their own franchise in China;
  - In order to act as franchisee, a foreign company must first establish a foreign-invested enterprise in China.

Distribution channels

- **Foreign-invested enterprises**: The establishment of a foreign-invested enterprise gives foreign companies more control over the distribution of their product and the management of their brand. It is the case of foreign-invested enterprises in China that:
  - Depending on the product and industry, the process of setting up a foreign-invested enterprise can be relatively simple or more complicated and time-consuming.
  - It is important that enterprises first research Chinese regulations in their industry in order to familiarise themselves with the laws and regulations that govern foreign-invested enterprises.
  - The types of foreign-invested enterprise in China are:
    - Wholly foreign-owned enterprise (“WFOE”, although also sometimes known as “WOFE”);
    - Equity joint venture (“EJV”);
    - Cooperative joint venture (“CJV”);
    - Foreign-invested partnership (“FIP”);
    - Representative office (“RO”).

8. Recommendations on how to enter the China market

Recommendations on how to enter the China market

- Before entering the China market, it is recommended that businesses develop a comprehensive strategy that addresses:
  - What stands to be gained by entering the China market;
  - What China stands to gain through this entry into the market;
  - What risks are likely to be faced;
  - How potential risks can be managed.
- Below are several questions, arranged in the form of a SWOT analysis, intended to help companies determine the strengths, weaknesses, opportunities, and threats they may encounter.
  - **Strengths and weaknesses**
    - What is your current level of brand recognition a) in your home market, and b) in China?
    - How capable is your company of adapting its structure and/or current practices to fit the Chinese business environment?
    - Is your current staff capable of managing a transition into China (in view of factors such as workload capacity and cultural and language challenges)?
    - What are your current competitive advantages (such as costs, quality, market permeation, and customer service) and are these transferrable to China?
    - Does your current customer base have a presence in China, and if so, can these relationships be leveraged in order to aid in gaining traction?
    - What other strengths and weaknesses that exist within your organisation will need to be addressed while developing a China-specific entry strategy?

Recommendations on how to enter the China market

- **Opportunities**
  - What level of demand for your product currently exists in China?
  - Does your market offering coincide with current political agendas in a) your home market, or b) in China?
  - Is there potential for technological advances to strengthen your organisation's position?
  - What does your current target consumer group look like? In what ways is it likely to change?
  - What is your prime motivation for entering the China market?

- **Threats**
  - How will fluctuations in the local and global economy affect your market position in China?
  - Do you have a strategy to protect your IP (namely patents, trademarks, copyrights, and trade secrets)?
  - Do your products face restrictions on market access?
  - What challenges have your competitors faced, and how have they managed them?
  - Do you have a strategy to manage foreign exchange risk?
  - What assumptions are you making regarding your motivations for entering China, and how can you confirm/disprove them?