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## NAVIGATING CHINA

### 6.1 GETTING PAID AND REPATRIATING PROFITS

#### How to get paid and repatriate profits

To get paid by your Chinese customers you'll need to navigate China's banking system, regulations and different attitudes towards business transactions.

Although China's banking system has been largely deregulated there are still some restrictions on the types of accounts different banks can offer, and on what accounts foreign businesses can open.

New Zealand businesses also need to be careful to meet regulatory requirements when setting up in China, otherwise they can run into tax or other compliance issues when they try to repatriate profits.

Equally important is to have a good plan to minimise the risk of a customer defaulting on payment, because forcing payment through China's legal system is likely to be difficult and costly.

Traditional Chinese attitudes towards contracts and contracted prices can be different from Western ones, and New Zealand businesses want to avoid the risk of customers trying to renegotiate prices after goods have been sent.

#### Getting paid

##### Setting up bank accounts

The types of bank accounts you can set up in China will depend

on your on-the-ground presence.

If you don't have an on-the-ground presence (a representative office, wholly foreign owned enterprise (WFOE) or joint venture) you can use your agent, distributor or contract manufacturer and manage this from New Zealand.

Payment must be remitted to your New Zealand bank account by your agent or distributor (or by the customer if you are selling directly to customers in China).

If you have an on-the-ground presence you can set up local currency (RMB) and US\$ bank accounts in China. These can be opened with local Chinese banks or foreign-owned banks that have a licence to operate RMB accounts.

You will need to complete regulatory requirements and show your business licenses to the bank before you can open any accounts.

If you are setting up a WFOE you will need to establish a capital account and remit in the required capital before you can open your \$US and RMB accounts.

The Hong Kong Shanghai Banking Corporation and the ANZ have a good summary of the types of accounts businesses can open in China, along with information on personal and internet banking.

Be aware that the regulations around banking and finance change frequently.

### Choosing a bank

Not all foreign banks operating in China can open capital and RMB accounts. For a list of banks that operate in New Zealand and also offer US dollar, RMB and capital accounts in China, contact New Zealand Trade and Enterprise.

Be prepared for the banking system to be slower and less efficient, says Kiwi education company AIS St Helens. It found that transferring large sums of money could take a week and had to be done in smaller sums. Retail branches are often full, meaning you have to wait for your number to be called before you are served.

### How to invoice

Many Chinese companies prefer to be invoiced in US dollars, particularly if they are already doing business with the USA, although the currency will be determined by the contract.

### Reducing risk of customers defaulting on payment

In China it can be difficult to know who is going to be a good payer and who isn't. New Zealand companies have had widely differing experiences of getting paid. The advice is to go for the most secure form of payment you can get.

When you are dealing with a new customer you should always use Letters of Credit (see below) to secure payment, as well as doing due diligence on the customer and having an enforceable contract.

If you have a long-standing relationship with a customer and want to use an alternative payment method, like Document against Acceptance (see below), take out trade insurance against the risk of default on payment.

Because some contracts are so small, the costs associated with a Letter of Credit don't make this option viable. You need to calculate the financial consequences of your small contract not being honoured.

It can be difficult and costly to use China's legal system to recover payment owed for goods that have already been delivered. Chinese attitudes to legal contracts also differ from those in the West.

Don't agree to releasing documents of title without payment being secured unless you have insurance to cover your counterparty risk, says Jeff McKenzie, former Regional Head Commodity and Trade Finance North Asia with ANZ in China. Even companies that have 10 years trading experience with a Chinese company have been caught out when the counterparty went bankrupt, he says.

### KIWI LESSON – RECOVERING DEBT CAN BE TRICKY

Don Johnson, Marketing Manager for Pan Pac, says all the commercial risks – credit, getting paid, understanding the costs and compliance – are the same in China as in New Zealand. "Where they tend to be a little tricky here [in China] is that the system of recovering debt is a lot more complicated and less robust than in New Zealand, so that makes us a little more wary up front."

### Methods of payment used in China

- **Letters of Credit (or documentary credit, import credit, export credit)**

Letters of Credit guarantee payment and receipt of title from an independent party – the bank.

They are internationally recognised and are the least risky way to secure payment from new customers. Most Chinese commercial banks and foreign banks with licensed Chinese branches can issue a Letter of Credit.

Generally there is no problem with Letters of Credit from Chinese banks being accepted by New Zealand banks, although you should check this with your bank if the transaction involves a Chinese regional bank. Also ensure that all Letters of Credit are received via SWIFT (the Society for the Worldwide Interbank Financial Telecommunication).

It is very important that the documents submitted to banks exactly comply with the strict conditions of the Letter of Credit. It has been estimated that half of Letters of Credit are rejected by banks at first presentation because they do not meet stated conditions. Check the Letter of Credit against the terms of the purchase contract and ask the buyer to make any necessary amendments before you go to the bank. Do not send up documents that contain discrepancies unless these have been pre-approved through the banking system or you risk losing the protection of the letter of credit.

- **Documents against Acceptance, or Documents against Payment**

These are used in ongoing business relationships as they provide some protection and some risk for both parties. They are easier to use and less costly than Letters of Credit.

With Documents against Payment, the documents needed to obtain the goods are only delivered to the importer after they have paid for the goods. With Documents against Acceptance, the documents needed to obtain the goods are delivered to the importer after they have accepted the exporter's bill for payment at a fixed later date.

Documents against Payment are obviously safer than Documents against Acceptance because the buyer only gets the goods after they've paid for them. Trade insurance is often used to cover the risk of default where Documents against Acceptance are used.

The New Zealand Export Credit Office provides credit guarantees for exports to China. However, it only provides longer-term cover (more than a year), so normal trade insurance must come from commercial insurers.

If you can't get trade insurance be cautious about using Documents against Acceptance.



- **Cash in advance**

This payment method is only used when the Chinese buyer has a strong degree of trust in the foreign seller.

- **Open account**

This is when the buyer agrees to pay for the goods within a certain period of shipment, generally 30, 60 or 90 days. It is the least secure form of payment for New Zealand exporters to China and leaves them fully exposed to the buyer getting title to the goods then defaulting on payment. Companies using open account would normally cover their payment risk with trade insurance.

### **Dealing with slow payers**

You can avoid the problem of slow payers by using Letters of Credit or Documents against Payment.

If you sell using less secure payment methods and strike a slow payer, deal with the problem as soon as payment falls overdue. If you have an agent get them to contact the buyer and seek payment immediately. If that doesn't work contact the buyer immediately yourself or ask a 'friend' in China to contact the buyer on your behalf. This 'friend' might be a business associate or other influential person who is willing to work on your behalf.

If all else fails, consider legal action or arbitration which is the most popular way to resolve disputes between Chinese and foreign companies.

For information on arbitration see "Navigating China – Getting Legal Advice".

Note that municipal owned and local government owned facilities can be slow to pay.

### **Financing your China operations**

Representative offices can't borrow money in China, so all working capital will have to be remitted from New Zealand.

WFOEs set up by New Zealanders tend to fund themselves using cash flow from China, or a loan facility from a foreign bank with offices in both New Zealand and China. It is possible to get financing from a Chinese bank, but generally this is only practical for very large businesses.

Overdrafts aren't used in China – the credit account stays in credit and is topped up using a loan account that is drawn down at three, six or nine month intervals.

Foreign banks will also provide home financing in China where they have a link or relationship or they can establish a relationship with the New Zealand parent who can support the WFOE in China.

### **Paying your bills in China**

Most supplies must be paid for in advance or on delivery using cash or credit cards. Chinese companies rarely extend credit until you have a well-established relationship. You may also be asked to pay a deposit for utilities like office telephones.

Representative offices and WFOEs can open US dollar accounts and RMB accounts for paying local expenses. When paying international bills you will need to provide evidence of the bill in order to remit money out of China.

To pay salaries you will need to open a payroll deposit account.

Although use of credit cards is growing extremely fast, only about 100,000 out of several million merchants/retailers accept credit cards. There are only about 10,000 ATMs for cash advances throughout the country, with the main concentration being in major cities.

Be aware that the commission paid to credit card companies by retailers could be added to your bill, for example when paying for travel in China by credit card 2.5 to 4 percent commission is normally added to the cost.

### **Repatriating profits**

You can repatriate up to 90 percent of profits. However, care needs to be taken when you first set up your business because if you do not comply with all the regulations you may not get the approvals needed to send profits out of China. For information on setting up see the "Entering the Market – Typical Models for Setting up in China" section.

Before you can remit profits you must file your fourth quarter tax return with China's State Administration of Taxation (SAT) to confirm the amount of Foreign Enterprise Income Tax payable. You can then finalise your net profit.

Not all profit can be repatriated or reinvested. A portion (at least 10 percent for WFOEs) must be placed in a reserve account. This reserve is capped at 50 percent of the company's registered capital. To distribute the remainder you must get a board resolution authorising distribution and file an application with SAT (in Chinese) that includes an annual audit, tax receipts and other documents.

SAT will then issue a Foreign Enterprise Income Tax Payment Certificate; this certificate enables the bank to convert RMB and then remit funds.

### **Foreign exchange controls**

When a WFOE or joint venture is set up it must register with China's foreign exchange authorities State Administration for Foreign Exchange (SAFE) within 30 days of getting a business license.

It can then buy and sell foreign currency (including exchanging RMB) at authorised banks for current account items, such as importing or exporting goods and services. However, sufficient documentary proof of the transaction's status must be available.

Authorisation is needed from SAFE for capital account transactions – those that increase or decrease a company's capital. These include things like direct investment, new loans and investment in securities.



These foreign exchange controls are likely to continue for the near future, although China has promised to eventually end them. Generally, funds flowing out of China are subject to stricter control compared to funds flowing into China, although China has recently been restricting funds flowing into China in an endeavour to cool growth.

The RMB floats within a band against a basket of currencies from China's major trading partners, so your exposure to foreign exchange rate fluctuations is largely on the New Zealand dollar side.

### Getting help

If you are using consultants to help you with payments and profit repatriation make sure you conduct proper due diligence on them. For information on how to do due diligence see the "Entering the Market – Doing Due Diligence" section

For information/contact details for legal and consulting firms see the "Entering the Market – Using and Managing Consultants" and the "Navigating China – The Legal System" sections.

Some international banks have offices in China and New Zealand, eg. ANZ, HSBC, Westpac.

### KEY LEARNINGS

- There are restrictions on the type of bank accounts you can open.
- Stay up to date – regulations around banking and finance change frequently.
- The banking system can be slower and less efficient than we are used to in New Zealand.
- It's hard to know who is a good payer and who isn't so go for the most secure form of payment you can get.
- Recovering debts is more complicated than in New Zealand

## 6.2 GETTING LEGAL ADVICE AND RESOLVING DISPUTES

### Using lawyers and the legal system

China's legal and regulatory system is fast changing, complex, contradictory, opaque and inconsistently enforced.

It is essential that you get well-informed legal advice before you sign any contracts or legal documents. Good legal advice is indispensable when setting up your legal structure in China to protect intellectual property, to navigate China's regulatory system and to resolve commercial disputes.

### Finding a good lawyer

Your legal advice must come from a lawyer who has excellent language skills and extensive experience working with foreign companies in China. This would almost certainly be a lawyer based in China, which has many good international and local Chinese law firms.

Only lawyers licensed in China can provide legal advice on Chinese law or appear in a Chinese court. International law firms working in China can only advise clients on legal matters related to the country where they are licensed, eg US law firms can advise on US law, and on general international business practices. As a result most international law firms have formal or informal relationships with Chinese firms to deal with clients' affairs.

Although foreign lawyers can't provide legal opinions they can help clients structure transactions and draft contracts.

Chinese law firms tend to cost less than international firms. For example, an international law firm based in Hong Kong can cost US\$800 an hour, while a Chinese law firm based in Beijing might cost US\$280–\$480 an hour.

### Tips on finding a good lawyer

- make a shortlist of firms by using the internet or law journals (which often rank law firms), and check the firms' websites to get a feel for their size and expertise
- make an appointment to talk with the firm (the first consultation is usually free), and question them about issues important to your situation, using the answers to gauge how good they are
- alternatively, seek references from sources like New Zealand Trade and Enterprise or International Chambers of Commerce
- lawyers working in the biggest cities are likely to have more experience dealing with foreign businesses
- consider China-based lawyers or NZ law firms with strong China links. Lawyers working outside the country will find it difficult to keep pace with the rapid development of laws in China
- local Chinese law firms are catching up fast with international practice, making them an increasingly attractive alternative to international law firms.

(Source: Lu Qing, partner at Chinese law firm King & Wood)

### Resolving commercial disputes efficiently

#### Arbitration

Many commercial disputes are dealt with in China through arbitration. Most contracts propose arbitration by the China International Economic and Trade Arbitration Commission (CIETAC). In CIETAC arbitration involving a foreign entity there can be one foreign arbitrator on the arbitration panel.

Provinces and municipalities also have their own arbitration institutions.

For contracts involving a foreign entity, offshore arbitration can be adopted. But offshore arbitration isn't encouraged as it is almost impossible to enforce in China.



## Litigation

In the past foreign firms have experienced inconsistent results using China's courts to settle commercial disputes. None of the courts are independent of the government, which sometimes intervenes in high-profile disputes. Corruption may also influence local court decisions and local officials may flaunt the judgments of domestic courts.

However, the Chinese government is cracking down on corruption, including in the legal system. So while you are still advised to try to settle disputes out of court, litigation remains an option provided you have a good lawyer.

Commercial disputes involving litigation are heard in economic courts within China's Supreme People's Court and at three levels in the provincial court system. Foreign lawyers cannot act as attorneys in Chinese courts but may observe proceedings.

China also has an extensive administrative legal system which adjudicates minor criminal offences. China uses this system extensively to address intellectual property infringements. For more information in intellectual property protection and enforcement, see the "Entering the Market – Protecting IP" section.

China does not enforce any judgments made by foreign courts, so it is a waste of time and money to sue a Chinese entity in New Zealand.

### Tips on avoiding commercial disputes

- Have clear contract terms. Specify terms of payment and performance standards.
- Set time lines. Include specific dispute resolution clauses, including details on the procedure and maintenance of operations during a dispute.
- Pay careful attention to details such as initialling pages of contracts and signing properly.
- Make sure the Chinese version of the contract is consistent with the English version.
- Do not attempt to enter into an agreement without sound legal advice.
- Make certain your project is economically viable on its own terms. Do not rely on promises of subsidies, special considerations, or non-market sources of income to generate a profit.
- Know your partner. Do your due diligence and check the reliability of the information your partner provides from independent sources. Avoid being 'stovepiped' – talking only to those people to whom your partner or buyer directs you.
- Make sure you get paid. Pay careful attention to how you get paid, when you get paid, and in which currency. If you have agreed to be paid in RMB, verify that you can convert profits to US dollars. Use Letters of Credit or other financial instruments to protect yourself.

- Do not enter into prohibited agreements. Companies sometimes enter into agreements with promises from local officials that central government rules will not be enforced in the provinces.
- Problems may arise when these rules are suddenly applied, sometimes retroactively, leaving the company with little recourse.
- Do a thorough risk analysis and limit your exposure. Be realistic about how much risk you are willing to accept. Set milestones for performance and have an escape strategy for each stage of the project, even though you don't plan to use it.
- Mind the store. Projects and sales in China require constant attention. Do not assume they will run themselves.

(US Commercial Service, Department of Commerce. (2003) Dispute Avoidance and Dispute Resolution. Washington D.C.)

### KIWI LESSON – KEEP EVIDENCE FROM DAY ONE

"One of the things that New Zealand companies can do to help themselves around the problems of evidence is to make sure that from the very first day they set foot in China they have a system for collecting and getting in place evidence in a form that is going to be acceptable to the Chinese Courts. It's very difficult to do that two years later," says Kiwi Luke Minford, head of China operations for global IP consultancy Rouse and Co International

"The procedural question almost always decides the case. Have you introduced documentary evidence that actually satisfies the very complex procedural requirements of that Court? That is where having good local advice to help you through those hurdles is very important."

### Get more information

- China's Ministry of Commerce: English language database of China's major laws.
- US-China Business Council: Unofficial translations of China's laws and regulations.

### KEY LEARNINGS

- Don't enter into an agreement without sound legal advice.
- Use China-based lawyers as lawyers in other countries often can't keep up with legal developments in China.
- Be careful with translations of legal documents – what gets lost in the translation from your law firm in China to a New Zealand law firm to the client can sometimes be the difference between doing a deal and not doing a deal, or doing a deal well and not doing a deal well.
- From day one establish a system for collecting and getting in place evidence in a form that is going to be acceptable to the Courts.

## 6.3 TAX AND TAX BREAKS

### Understanding China's taxation system

China's taxation system is more complex than New Zealand's. There are many exemptions available in different sectors and development zones and the central government has sometimes used fiscal policy to address rapid economic development.

Exemptions and concessions can vary greatly depending on where you locate your business, the sector you operate in, and the legal structure you use in China, though location and business structure-related exemptions and reductions have been heavily reduced.

The amount of income tax your employees pay can also vary depending on their terms of employment.

As a result, tax issues may feature strongly in decisions about how you set up and operate in China. But tax should not be the deciding factor as tax laws are constantly changing and many tax breaks and incentives are disappearing.

On January 1, 2008 all preferential tax treatments given to foreign invested enterprises (wholly foreign owned enterprises and joint ventures) over their domestic counterparts were axed, or have started to be phased out. However, they can still get favourable treatment, for example in industries or regions where authorities wish to channel investment.

### Hire local expertise

Because of the complexity and fast changing nature of China's taxation system you need to get expert local advice.

Using the services of a China-based tax consultant will ensure you comply with all the tax laws and that you can take advantage of any exemptions on offer. Many of the major international tax consultancy firms are in China. There are also many reputable Chinese firms.

For a list of tax consultancies in China contact New Zealand Trade and Enterprise.

### The main taxes you need to know about

The information below is high level and for guidance only. You need to contact a tax expert to get advice that fits your own particular circumstance. The main taxes are:

- Corporate Income Tax (or Foreign Enterprise Income Tax) has a top rate of 25 percent (effective year of assessment, 2008) levied on an enterprise's net income after reasonable costs, expenses and losses.

All foreign businesses operating in China are subject to this tax, including companies using agents and distributors and those with representative offices. Preferential rates of 20 percent are available to certain low profit ventures and 15 percent for new or high technological enterprises.

- Business Tax is a turnover tax levied on revenue generated from taxable services, the transfer of ownership of

intangible assets, or the sale of immovable property. It is payable by all enterprises and individuals doing business in China.

Rates vary according to your industry:

- transportation, construction, engineering, post and telecommunications, culture and sports – 3 percent
- services (such as travel agency, warehouse, advertising services, etc), selling immovable properties, and transferring the possession of intangible assets – 5 percent
- finance, banking and insurance – 5 percent
- entertainment – 5 to 20 percent

- Taxes on representative offices – representative offices have to pay tax even though they don't trade or earn income. Any remittances from New Zealand to fund the office are regarded as income. Relevant taxes are:

- Business Tax on the total monthly overheads
- Corporate Income Tax

Note: these percentages are for reference only.

There are four representative office tax payment methods:

1. Pay tax according to actual book keeping, such as law firm and accounting firm.
  2. Cost-plus method, which means the income of the representative office will be calculated according to the expenses spent in current period. Most representative offices use this method.
  3. Actual income method where the representative office declares income to the tax bureau if income is occurred. If no income, declare zero tax to the tax authority.
  4. Non-profit organisation where the representative office declares zero tax.
- Withholding Taxes – foreign enterprises taking profits out of China in the form of dividends are subject to a 10 percent withholding tax. This is levied on overseas companies providing services to China-based business
- Foreign enterprises without establishments in China have to pay withholding tax based on income from:
- dividends
  - royalties generated by providing patent rights, proprietary technology, trademark rights, copyrights and other such rights for use in China
  - interest derived from inside China on deposits, loans, bonds, advance payments made provisionally on another person's behalf or on deferred payments
  - rentals from assets leased to and used by parties in China



- earnings from assignment of assets in China, including buildings, structures and their auxiliary facilities and land use rights
  - any other income derived inside China which may be deemed as taxable by the Ministry of Finance.
- Value Added Tax (VAT) is generally levied at 17 percent on all enterprises and individuals engaged in production, import and export, and commercial business in China. Reduced rates are applied to some activities such as agricultural production and if you are a small business.
  - Consumption Tax is a tax on luxury goods, including alcohol, cosmetics, jewellery, yachts and wooden floor panels. It has to be paid by all enterprises that import, manufacture or process these goods. Rates range from 3 to 40 percent.
  - Individual Income Tax (IIT) – foreign nationals living in China are subject to progressive tax rates from 10 up to 45 percent according to their income. IIT affects foreigners who live in China at least six months a year or who have a management role in a Chinese legal entity. Foreign residents who have spent less than five years in China are taxed on their China sourced income; after five years their global income becomes taxable. You must register with the tax bureau if you intend working in China.

Other taxes include an Urban Real Estate Tax (1.2 percent of original value of the property) levied on all owners of real estate and a Stamp Duty (0.005 to 0.1 percent) on contracts, property leasing, property insurance, certificates and licences and other specified documents.

For information on customs' duties, see the "Selling in China – Getting your goods into China" section.

#### **Enforcement**

Penalties for late payments, non-payment and other contraventions of tax laws can be severe, for example up to five times the amount due plus the original liability. Businesses also face having their licences withdrawn and assets seized in serious cases.

#### **Tax exemptions and reductions**

China offers a variety of tax breaks to attract foreign businesses, though many of these are being phased out.

Breaks include cut-rate duties, national and local income taxes offered in the Special Economic Zones, a small number of coastal cities and in hundreds inland cities with development zones.

There is also special treatment for specific industries favoured by the Chinese government such as electronics, communications, energy, construction materials, machinery, environmental protection and energy conservation.

#### **KIWI LESSON – DEVELOPMENT ZONE INCENTIVES FOR KIWI COMPANY**

Airport baggage handling system maker Glidepath established a Wholly Foreign Owned Enterprise in the Kunshan Economic and Technology Development Zone (KETD) in Jiangsu province, 80 kilometres west of Shanghai.

KETD was set up to encourage IT and the production of computers and electrical components. A number of incentives are offered to qualifying companies including no requirement for an import/export quota or export licence; and an import duty; exemption on raw materials, parts, components, packaging and machines imported for production and infrastructure. The incentives are conditional on half or more of the production being manufactured for export.

#### **KEY LEARNINGS**

- Use local experts.
- Exemptions/concessions can vary depending on where your business is located, the sector you operate in and legal structure you use.
- Penalties for late/non payments can be severe.

## **6.4 MANAGING LOGISTICS**

### **How do I get my products from A to B?**

Getting your products from A to B will cost you more in China than in developed markets.

At their worst, logistical costs and problems can wipe out the advantages of being in China in the first place.

China Federation of Logistics and Purchasing figures suggests that China wastes around one-tenth of its total GDP through logistical inefficiencies caused by fragmentation, complexity, local protectionism, inadequate infrastructure, unfair competition and lack of professional skills.

And though the logistics market has been opened up to competition, there's still a variety of regulatory-driven inefficiencies in the system.

Logistical services are improving with the arrival in China of multi-national logistics companies, but the transport infrastructure they and their Chinese partners and competitors rely on is often stretched to breaking point.

#### **Use local expertise**

The Economist Intelligence Unit says the key to successful distribution in China lies in partnerships with local operators.

#### **Using third party logistics companies (3PL)**

3PL providers are becoming key players in the Chinese logistics industry, though their share of the logistics market is still small.

They provide a full logistics service including customs clearance, warehousing, freight consolidation, inter-modal transportation and distribution. Many also offer 'just-in-time' and 'just-in-sequence' delivery services, inventory services and radio frequency identification tracking.

Basic transportation, warehousing and customs clearance services are the most common ones outsourced to 3PLs.

It's estimated that nine out of 10 multinational companies in China outsource part of their logistics needs to 3PLs. But many are not particularly happy with the level of service they provide.

#### **KIWI SUCCESS – ONE STOP SHOP**

Christchurch-based Commtest Instruments has found that outsourcing to Christchurch 3PL provider SB Global Logistics means lower supply chain costs and removes the headache of working out its own piecemeal solutions. Through its international partners in China SB Global provides a one-stop shop, from collection and packing the product at the factory door in Christchurch to customs clearance and delivery at the other end as well as taking care of commercial invoicing.

#### **Using e-logistics**

China faces a number of challenges when implementing e-commerce, notably economic and educational barriers, lack of ICT infrastructure, high telecommunications costs, lack of payment mechanisms and security and trust concerns.

These issues are compounded in e-logistics by the poor shape of the logistics sector.

#### **Future trends**

- improved service and lower costs with the marriage of multi-national expertise and low local labour costs, plus the effects of deregulation
- further entry by multi-national logistics companies
- consolidation – the logistics industry is undergoing a major overhaul and competition from foreign entrants which will see many smaller inefficient players fall by the wayside
- the transport infrastructure will continue to struggle to cope with economic growth despite investment
- skill shortages as the logistics sector grows.

#### **KIWI LESSON – AT TIMES SLOW**

“At times the logistic services, ie shipping product from point A to point B, is a little longer than what we would expect in most developed countries. However, transport has improved dramatically in recent years. Our major markets are in Shandong province which is approximately 700 kilometres north of Shanghai. The transit time is about two days which in reality isn't too much different than what we would expect in New Zealand.” Keith Stevens, General Manager, Richina Pacific Ltd's Ovine Garment Leather Division

#### **The state of China's transport system**

The Chinese Government is heavily committed to fixing the country's infrastructure and has a massive road, port, rail and airport construction programme underway.

- Road –The Federation of International Trade Associations says China's road network is often badly conceived and of poor quality.

Current government efforts are concentrated on the implementation of the National Trunk Highway System, a system of inter-provincial toll motorways including 12 corridors on 35,000 kilometres. China will have a total of 85,000 expressways by 2020, up from 60,000 in 2008. This network, planned over 30 years, should connect 95 cities, each with more than 500,000 inhabitants.

- Rail – The main form of transportation under the old-style communist model was rail, but it has not adapted to the new-style Chinese economy, says Transport Intelligence. It is primarily geared to moving bulk commodities long distances. China's rail network suffers from a chronic lack of capacity and according to one estimate would need to double capacity just to cope with current demand.

China Logistics 2006 says the Chinese Government's long-term objective is to expand the network to around 100,000 kilometres – three times the current rate of track-laying.

- Ports – China cannot expand port facilities quickly enough to meet rising demand. In 2005 the turnover capacity of coastal ports was officially 2.52 billion tonnes, but 3.38 billion tonnes were actually handled. At that time, seven of the world's top 20 container terminals were in China.

However, the government says its port construction programme should more than match extra demand created by economic growth.

In 2006 alone more than 160 construction projects were launched in China's seaports and the handling capacity of China's ports is scheduled to hit 8 billion tonnes a year by 2010.

River transportation and river ports have also been given priority in infrastructure development to meet China's growing trade.

- Air – China has the second-largest domestic airfreight market in the world after the USA, but the sector is constrained by inadequate infrastructure.

Even so, annual growth of 10 to 15 percent is projected (assuming that road and rail services remain substandard), with much higher growth rates for services catering to high-value products such as electronics and pharmaceuticals.

Airports in the Yangtze River Delta, the Pearl River Delta and Beijing are seeing the most rapid expansion.

#### **Further reading**

- The Federation of International Trade Associations – advice on distribution and transport in China.
- The Logistics Institute – Asia Pacific has China research and reports.
- Logistics Management report on logistics in China.



## KEY LEARNINGS

- The quality of China's logistical and transport systems is patchy.
- The situation in both is improving.
- Look at partnerships with local operators.
- Cool store facilities are lacking, but availability is also improving.

## 6.5 DAY-TO-DAY COMMUNICATIONS

### Getting the communications technology right

Businesses in the leading cities have all the communications services you'd expect at home, but as is often the case, services in the rural and outlying areas are not as well developed. However, mobile communications coverage in many rural places is just as good or even sometimes better than in New Zealand.

Although internet usage as a percentage is still low by Western standards it is growing rapidly – increasing 510 percent in the last seven years to more than 162 million users in 2007.

If you are dealing with major Chinese companies that operate internationally it is likely that your day-to-day communications by phone and email will be with an English-speaking person. Domestic companies, however, are unlikely to have English speaking staff and even if they do you will need to be confident in that person's English. If you are not, arrange to get all important written communications translated from Chinese to English.

### Telephones

The number of landlines in recent years has been falling, from 367.5 million in 2006, to 365.4 million in 2007. If you are calling a company make sure that you have a Chinese speaker on hand unless you are confident you can get through to the person you are calling.

Cold calling is more difficult. Unless you know someone at a company you may find it difficult to connect with the right person.

When contacting a company they will ask up front what business you are involved in and will directly ask what you want with them. Regardless of what you say they are unlikely to continue the conversation, preferring to ask that information about your company be sent to them in writing.

This information is best sent in Chinese and English; although there may be people in these companies who can communicate in English, more often than not the decision makers do not so you would be relying on someone else's translation or interpretation.

### Mobile phones

More than 547 million mobile phones are in use in China (as at Dec 2007), a third more than landlines. They are less expensive to operate than in New Zealand and in some respects more sophisticated as Chinese telecommunications companies have invested heavily in the most modern mobile infrastructure.

The Chinese are also very up to date with their phones, with the quality and technology of the mobile phone being a status symbol.

Chinese business people spend a lot of time on their mobiles, rarely turning them off regardless of the situation. This is not a personal affront or a sign of disrespect.

### Internet

China does have a modern internet system, but the growth rates are such that the service providers and the system are often under pressure. In addition, there are a limited number of qualified technicians.

The internet in China is closely monitored, so if necessary for your business encryption could be considered. It is wise to operate on the assumption that messages, wherever written or sent, could be reviewed by people other than the intended recipient.

### Laptops

The use of laptops is as common in China as it is in New Zealand. Wireless internet is also increasingly common in coffee shops, hotels and in buildings. Security is an issue, so you should take care to protect yourself, but the system is reasonably reliable.

### Email

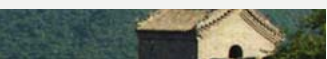
Email is also an increasingly common form of communication, but the set up of company systems is less standard so it's common for companies to use a Yahoo address or other similar service providers.

Be aware that people will change service providers on a regular basis. When they forget a password they will also just start a new address, without access to the previous one. So unless you are frequently in contact by email with an individual or organisation, don't assume that they have received an email communication.

The Chinese law does allow for electronic signatures, but the reality is that the Chinese 'chop' (seal) is what is preferred – a hard copy signed and chopped is what will be most acceptable to most companies.

### Mail

China has a marginally efficient postal system – it will take several days to several weeks for mail from China to reach New Zealand, depending on whether air or surface mail is used. International courier firms such as Federal Express, DHL and UPS are more reliable.



## Fax

Faxes are still a commonly used form of communication, although less in the main centers than in outlying areas. Faxes are often not connected to the phone system independently, so they will need to be switched over manually.

You will need to call first to ensure that the fax is addressed to the correct person, then call back to ensure that it has been received and then call again to ensure that it has been followed up on. Again, there are no guarantees they will receive the fax.

## Face-to-face

Face-to-face meetings are always the most effective means of communication and are critical in establishing a long-term relationship with a company or organisation.

The Chinese much prefer face-to-face meetings, but this doesn't mean that they will always have the desired outcome, nor make the progress expected from the New Zealand end. So it is important to do as much preparation as possible before any meeting, especially one that requires international travel.

For information on etiquette at face-to-face meetings see the "Entering the Market – Chinese Culture and Business" and "Navigating China – Language and Interpreters" sections.

## Handling invitations

When sending out invitations to an event or activity the recommended process is:

1. If you do not have a contact within a company call the company and source someone to send the invitation to. Make sure that you have the contact details of the person who has provided you with this information.
2. Then by email or fax, send information on your company, the event and what you want from the invitee.
3. Once it has been sent, contact them again and confirm that it has arrived and that the appropriate person will receive the information.
4. At a later date you will need to contact them again to confirm or otherwise that the information has been received and acted on.

This is not a guarantee that the information will arrive and will be acted on, but the other option is to have no idea at all. This is a case where persistence will pay off more than assuming that everything will be alright on the day.

## KEY LEARNINGS

- If your size justifies it, have a Chinese speaking person on your staff.
- If you are not confident in the English of a major client who is communicating with you, arrange to get communications translated from Chinese.
- Always have a back up means of communication.

## 6.6 LANGUAGE AND USING INTERPRETERS

### How do I deal with language problems?

Chinese is clearly very different from English and is a hard language to learn for English speaking people.

Kiwis in China (like most Westerners) have mixed feelings about how difficult it makes doing business. Some report they are frustrated at not knowing what's being said at meetings and having to rely on interpreters while others love the challenge.

Ways to overcome language problems include employing Chinese speaking staff and using interpreters. The use of English in business and trade circles is also becoming increasingly common, particularly in the large cities of the south east.

One common piece of advice is to spend more time understanding the Chinese culture than the language. There are many successful Western business people who have been in China for many years who have only a smattering of the language.

### Language

#### What language should I deal in?

English is becoming increasingly common particularly in the large cities of the south east, but unless you have been told otherwise you should assume that the Chinese you are dealing with can't speak English and will generally conduct conversations and negotiations in Chinese. Regional dialects are also common.

The Chinese Government is committed to standardising communication in China around Mandarin – the official spoken language. Most Chinese outside the Beijing region are bilingual and are able to speak Mandarin and their local language or dialect.

Take the time to learn a little Mandarin before you go to China – it will go a long way towards impressing your hosts. You can start with learning greetings and common courtesies such as please and thank you and introducing yourself. Even just learning to pronounce Chinese correctly will be seen as an investment into the relationship.

However, you need to be aware of the huge regional variations in spoken Chinese.

Other common Chinese languages include Wu (spoken in Shanghai), Cantonese (spoken in the south-eastern part of China, especially in the Guangdong province), and Hakka (spoken in the southern provinces, including Guangdong).

### KIWI LESSON – UNDERSTANDING THE CULTURE IS MORE IMPORTANT

"It's not necessary for you to speak fluent Chinese. You have to understand the culture...it's more important for you to understand the people. Why are they thinking like this? Why do they speak like this? Why are they dressing like this?"  
– Mei Wong, Executive Director, Intuto



## Using interpreters

### Tips

- If possible, use a mainland Chinese interpreter.
- If you bring an interpreter with you from another country or region, make sure s/he speaks standard Mandarin.
- If you want to establish a long-term business in China you need to seriously consider having your own interpreter or bilingual staff.
- Fully brief your interpreters before important meetings or negotiations. Where necessary provide them with a list of terminology well in advance of the meeting.

### Using a local interpreter

Although a growing number of younger Chinese managers and government officials speak some English, you will almost always need an interpreter for formal meetings and negotiations in China. The Chinese will usually provide an interpreter for their side.

Using a mainland Chinese interpreter is important. They not only speak standard Chinese but also understand the mainland China environment, mentality and context – which are all very different from other regions such as in Hong Kong, Taiwan or Singapore.

A mainland Chinese interpreter might be more familiar with Chinese culture, business etiquette, practices and *guanxi*, as well as China's social, economic and political environments.

If you decide to bring an interpreter with you from Hong Kong, Singapore or other overseas country, ensure they speak standard Mandarin and have a good appreciation of mainland China's social, economic and political environment.

Interpreting and translating are two different professions with totally different skills. Interpreters are for oral interpreting and translators are for written translation. Though many people have both skills, some of them specialise in one discipline. Decide which one you want.

A good interpreter is either professionally trained or experienced. Just because someone is bilingual doesn't automatically mean they are a good interpreter.

### How do I find an interpreter?

The best way to find the right translator or interpreter is to rely on the recommendation of someone you trust who has used the interpreter before. Remember, just because someone speaks Chinese doesn't mean they will be a good interpreter or translator.

Ways to find translators/interpreters include:

- approach New Zealand Trade and Enterprise in China for advice
- approach the several foreign Chambers of Commerce in China
- China Council for the Promotion of International Trade (CCPIT)
- China-New Zealand business associations at home
- other New Zealand businesses active in China.

It's not advisable to hire an interpreter or translator straight off the web or a trade directory unless they have reputable third party endorsements.

### Interpreter costs

In Beijing or Shanghai a good simultaneous interpreter (one who interprets at the same time as you or your Chinese counterpart speaks) can cost about NZ\$2,000 a day. A consecutive translator (one who interprets after you or your Chinese counterpart has finished speaking) will cost only NZ\$100–\$200 a day. Rates in other cities such as Chengdu will be a lot less.

When calculating the cost of a translator/interpreter, don't forget their incidental costs such as travel and food.

Payment can be either in cash if they are working as individuals or by contract if they are provided by an organisation such as the CCPIT.

### Your own interpreter

To establish a long-term business in China, seriously consider having your own interpreter or bilingual staff. You could either find someone in New Zealand or arrange for an interpreter in China.

You need an interpreter you can trust, someone who will give you confidence in communications and presentations.

If you rely on the interpreter from the other side of the table, you have no control over the conversation. There are also subtle, behind the scenes interactions, which your own interpreters will be able to give you advice on, for example whether the meeting went well, what they really expect, or how to advance the next meeting.

It would be an advantage to find Chinese who have been living in New Zealand to interpret for you, as they are well-placed to understand the practices of both sides.

Most importantly, your own interpreter is likely to work in the best interests of your business.

### Understanding the limitations and strengths of an interpreter

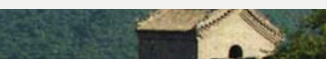
It's important to be aware of an interpreter's limitations.

Interpreting is a tiring profession. One interpreter working for both sides from Chinese to English and vice-versa may get tired and start missing the meaning or detail of what's being said.

Interpreters require background information well in advance to familiarise themselves with the subject matter and terminology. Brief them fully before important meetings or negotiations and where necessary provide them with a list of terminology well in advance of the meeting.

If interpreters haven't been well-briefed they will probably not be able to cope with technical or specialised terminology and may not be able to record or remember everything.

Large numbers are particularly tricky and can be misinterpreted – sometimes leading to a mistake between millions and billions.



For example, ten thousand is one 'wan' therefore 10 million translated into Chinese is "1000 wan (1000 ten thousands)"; 100 million has its own character as 'yi'; and 1000 millions or one billion translates as "10 yi". Understanding Chinese numbers will be beneficial in these situations.

Consecutive interpreting is most commonly used for meetings. This means you speak, pause and then your interpreter interprets. If you are giving a speech or presentation, remember that the need to interpret everything consecutively will approximately double your speaking time.

Some interpreters may be more familiar with British or American English and may have some initial difficulties with the New Zealand accent.

Establishing a good working relationship with interpreters is very important. Interpreters can be the key to successful communication between you and your Chinese business counterparts.

An interpreter can therefore be a very powerful person. For example, you may say something unconsciously that's potentially offensive. An interpreter working in your best interests may put it in a polite way that both sides will be comfortable with. Interpreters can help smooth the way through negotiations.

In some formal conference situations, simultaneous translations are provided. If you want to use simultaneous translations the equipment is very expensive. It requires at least two interpreters (each interpreter interprets for a maximum of 20 minutes alternatively). Use prepared speeches if you can.

#### **How to work with an interpreter at meetings or negotiations**

- When working with an interpreter it helps to speak directly to your counterpart (not the interpreter) and always use the first person. For example: say "thank you" rather than "tell him I thank him".
- Use full sentences. It's easier to interpret and get the correct ideas across.
- Use simple language. This prevents misunderstandings on the interpreter's part and safeguards against misinterpretation to your Chinese counterparts.
- Explain any difficult terms or concepts. An interpreter's job is to take the source language and convert it to the target language – but they usually won't add their own knowledge or understanding to explain something.
- Pause frequently at an even pace. Pause after a thought is complete, or after you have made a major point. Avoid long, complex sentences. If your speech is too long it may make it difficult for the interpreter to remember what you have said.
- Appreciate that interpretations may take much longer than the original speech – especially when interpreting from English into Chinese.

- Speak slowly and clearly, particularly if the interpreter is not used to the New Zealand accent.
- Listen to how your interpreter interprets what you have said. If you have given a lengthy explanation but the interpreter reduces it to a few Chinese words, it may be that s/he has not fully remembered or understood what was said. Check the interpreter has adequately conveyed your point to the Chinese side.
- It's a nice gesture to give your interpreter a gift for his/her services.

#### **Avoid jargon, slang, colloquialisms and jokes**

- Try to avoid leaving sentences unfinished. Your interpreter might find it hard to translate the meaning if you have left a sentence hanging.
- Avoid using jargon or colloquial expressions like "let's get the ball rolling" (which when interpreted may have a different meaning).
- Avoid jokes. Jokes often don't go down well in a different culture or when interpreted.

#### **The importance of your business partner's interpreter**

Your Chinese business partner's interpreter could be arranging your meetings, planning your itinerary, or ordering for your banquet.

More importantly, s/he could be the key contact for your next trip or business opportunity. They could also be the mediator between you and your Chinese business partner or Chinese Government official when things don't go according to plan.

#### **What needs to be translated?**

Though it can be a big commitment, as much material as possible about your company and its management should be translated well ahead of time. This particularly applies to documents relevant to your meetings or negotiations. It is an investment that will pay off.

You must have appropriate translations of:

- business cards
- a well produced one-page company profile including a list of reference projects and clients
- a power point presentation and/or DVD and any handouts
- technical terms and specifications.

When deciding what to translate remember that the person you are dealing with now may speak English but they may not be the person or the only person involved in making the decision. For example in the educational section potential students may speak English, but their parents or grandparents who make the decisions may not.

If you are looking to sell in China, it's essential that your company and product names are properly translated.



A sign that you are serious would be a full Chinese version of your brochure.

#### KEY LEARNINGS

- Learn a little Mandarin such as greetings and common courtesies – it will impress your hosts.
- Pay attention to correct pronunciation.
- Understanding Chinese culture is more important than learning the language.
- Use a mainland Chinese interpreter.
- If you are looking to do long-term business in China, consider having your own interpreter or bilingual staff.
- Interpreting and translating are two different skills.

## 6.7 BUSINESS ETHICS AND CORPORATE RESPONSIBILITY

### How do I deal with corruption?

There's a lot more corruption in China than in New Zealand, however don't think that corruption is generally accepted in China and be aware that the vast majority of people you will deal with in China are not corrupt.

That said, it's always best to be on your guard.

### What types of corruption are common?

Examples of corruption you may come up against include:

- outright requests – usually through agents
- contracts are agreed, then an amount is added that you are expected to pay in cash
- requests for, and giving, expensive gifts
- misuse of funds or inside information
- ignoring labour and environmental rules.

There are also well known problems concerning intellectual property (IP) violations. For more information on how to protect your IP see the "Entering the Market Protecting IP" section.

The frequency and seriousness of corruption varies according to the business sector, region and type of business. In general the situation is improving with the government engaged in a corruption crackdown.

At an operational level you are most likely to run into nepotism or patronage, conflict of interest and excessive exchange of gifts and favours.

Before entering into any contracts or relationships you should also do due diligence. For information on doing due diligence see the "Entering the Market – Doing Due Diligence" section. There is advice on how to avoid scams in the same section.

### Tips for dealing with corruption

- stick to best practice
- if you come into contact with corruption, don't get involved
- understand as much as possible about China
- if you are sub-contracting manufacturing seriously consider including a code of conduct in your agreement
- have an unhitching strategy in case things go wrong.

### Understanding reciprocity

Further complicating Western ethical judgments in China is guanxi – the close personal relations between individuals that often underpin business deals and relationships.

Guanxi creates ethical gray areas for Westerners.

For more information on guanxi see the "Entering the Market – Chinese Culture and Business" section.

To understand gift giving see the "Researching the Market – Business Etiquette" section.

### Implementing a code of ethics

A number of international companies have fallen foul of publicity campaigns highlighting labour or environmental abuses in their factories.

Also be aware of factory managers who are willing to cut corners – sometimes with serious consequences for consumers – to deliver the lowest possible price.

For example, in 2007 an investigation by the General Administration of Quality Supervision, Inspection and Quarantine, found more than 20 percent of Chinese-made toys and baby clothes were below standard, with some actually dangerous.

If you sub-contract manufacturing in China consider a code of conduct for the factory as part of your agreement. If properly implemented this can protect you against serious financial and public relations fall out. Also consider contracting a 3rd party inspection and audit agencies.

You need to be careful how you write and present your code of conduct. Don't take a 'holier than thou' attitude and impose a translated version of your existing code. Work as much as possible with your Chinese managers and partners to write a code that Chinese workers will understand and follow.

### Corporate social responsibility in China

Corporate social responsibility has not made big inroads into the operations of Chinese businesses; they mostly continue to have a narrow focus on profit maximisation with human and environmental considerations coming second.

The Chinese Communist Party is anxious about growing social unrest throughout the country, wanting a redistribution of wealth from the affluent urban areas to the poorer rural regions to restore 'social harmony'.



In an effort to engage business in this objective a Chinese Association for Corporate Social Responsibility (CACSR) was established in August 2006. It has a mandate to encourage businesses to engage in both business-related activities such as 'employee care' and the use of environmentally friendly materials and public activities such as 'contributions to public welfare'. CASR has already been joined by a number of trans-national corporations such as Nokia, IBM CISCO and Chinese companies like Pingan Insurance Company, the TCL Corporation and the China Merchants Bank.

New Zealand businesses looking to set up in China, regardless of size, should at least have some type of corporate social responsibility (CSR) programme on their radar for all the same reasons they would have one back home.

**KIWI SUCCESS – “LEAVE SOME SALT ON THE TABLE”**

“It’s very important when you are doing business in China to ‘leave some salt on the table’. I think that is the Chinese way. We are in their country so getting accustomed to their way of doing things is very important. In my case, I saw a real opportunity in the very early stages of the business that we set up here. I supported three students to go through school and actually paid for their schooling because their families had had some natural disasters. We supported them because they couldn’t afford to go to school. These were very bright students who would have had to drop out, now they’ve gone on to university and I feel great about that.” – Dr Garth Smith, founder Biovittoria

For more information on CSR in China see:

- the US-China Business Council’s best practice on Corporate Social Responsibility
- the Hong Kong Corporate Social Responsibility Charter

**KEY LEARNINGS**

- Corruption is the exception in China.
- Always be on your guard against corruption. Doing due diligence provides good protection.
- Enforcing a ‘China friendly’ code of ethics can protect your business’s reputation.
- ‘Leave some salt on the table’ – look at implementing a CSR programme.

