

Doing Business in China: A Practical Approach



MA Exports by Country - 2009

Rank	Country	Value	%Δ 2008-2009
	Total Massachusetts Exports	\$23.57 Billion	-16.90%
1	United Kingdom	\$4.05 Billion	+15.56%
2	Canada	\$3.10 Billion	-21.74%
3	Japan	\$1.70 Billion	-29.39%
4	Netherlands	\$1.99 Billion	-25.88%
5	China	\$1.37 Billion	-12.23%
6	Germany	\$1.75 Billion	-29.77%
7	Mexico	\$.90 Billion	-22.50%
8	Korea	\$0.63 Billion	-6.06%
9	Taiwan	\$0.62 Billion	-12.69%
10	Hong Kong	\$0.53 Billion	-11.09%

MA Exports to China by Product – 2009

Rank	Product	Value	%Δ 2008-2009
	Total Exports to China	\$1.37 Billion	-12.23%
1	Electronic Integrated Circuits & Microassemblies	\$415 Million	+30.48%
2	Machinery for Manufacturing of Semiconductor Boules	\$74 Million	-34.71%
3	Medical, Surgical, Dental & Veterinary Instruments	\$66 Million	+27.90%
4	Analytical Instrumentation	\$54 Million	-41.61%
5	Scrap & Waste Paper & Paperboard	\$45 Million	+37.63%
6	Raw Hides of Bovine & Equine Animals	\$41 Million	-30.40%
7	Semiconductor Devices	\$28 Million	+27.92%
8	Automatic Data Processing Machines	\$26 Million	-0.78%
9	X-Ray Machines & Parts	\$23 Million	-20.37%
10	Plastics Plates, Sheets & Film	\$23 Million	-11.40%

Overview

- Setting up operations in China
- Working with China Customs
- Export controls on product and technology transfers
- Getting paid by China customers
- Standards and other regulatory issues
- Options for sourcing products from China
- Resources for doing business in China



Setting up Operations in China

- Distribution System
- Manufacturing Facilities
- Service and Engineering / R&D Centers
- Operating in Trade Zones
- Importing into China and Exporting from China
- Participating in Government Procurement



Setting Up Operations in China

- Every company is issued a business license by the Ministry of Commerce
- Business scope is specifically defined in the business license – e.g., a company may be only allowed to manufacture, and/or sell and/or service its products
- Trading is defined as buying and selling. Until recently, Wholly Foreign Owned Enterprises (WFOEs) were not allowed to trade. WFOEs are now being granted trading licenses, but... manufacturing companies are not permitted to reclaim VAT on trading and vice versa
- Selling spare parts may be considered trading. Bonded trading company experienced in post-sales service parts, obtaining duty reductions/exemptions and VAT recovery can be used for that function



Distribution System

- Setting up a distribution system in China tends to be a complex process and usually involves several parties
 - Domestic distributors may not be able to import products or spare parts; or to export
 - Manufacturers may not be able to import raw materials or to export products
 - China legal entity needs to be an exporter of record
 - Sourcing agent may not be able to export
 - VAT/duty refunds may only be obtained by certain entities



Distribution System

- Due to the complexity and frequent changes in regulations, SMEs often open dedicated sales and service offices and use direct sales force in China (this is more common than in many other emerging markets)
 - Sales force may be managed locally or from the home base
 - US visa issue for China reps make it difficult to bring them over to the US for training



Operating in Trade Zones

- Several types of trade zones:
 - Export Processing Zones vs. Free Trade Zones
 - Rules vary by region and type of zone – some promote domestic sales, others promote exports
 - Operations in trade zones routinely audited by China Customs
 - Most products “imported” into zones must be exported. For China sales, exports to Hong Kong for re-import to China (via “virtual Hong Kong” Bonded Logistics Parks in selected areas)



Special Economic Zones

Zone Type	Business Function	VAT Refund Policy	Administration
Free Trade Zones (FTZs)	<ul style="list-style-type: none"> • Manufacturing and processing • Warehousing and logistics • Exhibitions 	VAT refunds for domestically purchased goods (when exported from China)	<ul style="list-style-type: none"> • Total enclosure • Usually in operation 8 hours/day
Export Processing Zones (EPZs)	<ul style="list-style-type: none"> • Only for export processing • Warehousing and logistics 	VAT refunds for domestically purchased goods available upon delivery of goods	<ul style="list-style-type: none"> • Total enclosure • Usually in operation 24 hours/day
Bonded Logistics Parks (BLPs)	<ul style="list-style-type: none"> • Warehousing and logistics • Only simple processing allowed 	VAT refunds for domestically purchased goods available upon entry into BLP	<ul style="list-style-type: none"> • Total enclosure • Usually in operation 8 hours/day



Working with China Customs

- Importers are assigned a Customs rating:
 - Start with “B”
 - If good history, can apply for “A” rating
 - Problems will lower rating to “C”
 - “D” category – for really bad behavior!
 - If successful audits and clean record, can apply for “AA”
 - If “AA” and electronically filing with Customs, can apply for “AAA”
- Importers with high ratings receive fewer audits



Other Importing Challenges

- China maintains a list of prohibited and controlled commodities that often changes:
 - Dangerous drugs, psychotropic substances, controlled chemicals, antibiotics, arms, ammunition, strategic commodities, rough diamonds, textiles, animals, plants, endangered species, telecommunications equipment, game, meat and poultry
- Stringent labeling requirements for food products, cosmetics and pharmaceuticals
- Wood packing materials
 - All wood packing materials imported into China must undergo treatment and be stamped



Other Importing Challenges

- Import licensing system applicable to some AV laser discs and electronics products, chemicals that are used for military weapons, toxicants or drugs, as well as ozone depleting materials
- Restrictions on importing plastic and metal waste
- Importing “used” equipment requires a permit from CCIQ (China Customs Inspection and Quarantine)
 - Otherwise imported goods must be new
 - Used goods imported as new can be seized and destroyed



Exporting from China

- China legal entity must be exporter of record:
 - Must file with SAFE (State Administration of FX)
 - Reconcile log books and match imports with exports if claiming VAT rebates and/or duty exemptions
- Some exports prohibited or require a license:
 - Raw materials (e.g., certain kinds of wood, silica sand); all agricultural products
 - Products that are considered scarce
- Export taxes on some products:
 - E.g., steel products, pig iron



Getting Paid by China Customers

- China customers must receive permission from SAFE (State Administration of Foreign Exchange) to transfer funds out of China
 - Commercial Invoice must match PO and Accounts Payable invoice
 - Locally delivered services must be invoiced separately, unless they are included in the selling price (e.g., warranty, installation)
- Methods of payment
 - Cash in advance may be problematic for China customers
 - LCs are expensive and cannot be confirmed when issued by Chinese banks – bank reputation is paramount
 - Cash on delivery is becoming more common and increasingly expected by Chinese buyers – receivables insurance is an option



US Export Controls

- US export controls cover military and dual-use items:
 - Embargo on military sales to China (Department of State - ITAR), including technology transfer (“deemed exports”)
 - Controls of many dual-use items (Department of Commerce – EAR), including technology transfer (“deemed exports”)
 - Certain dual-use items are controlled for “military end-use” and require export licenses
 - “End-use” statements should be a standard practice when selling to China
 - Certain parties are prohibited from receiving US goods and technology or can only receive them when an export license is issued
 - www.bis.doc.gov/complianceandenforcement/liststocheck.htm
 - Validated End-User Program is limited
 - www.bis.doc.gov/validated_enduser.pdf
 - Significant penalties for violations!



US Export Controls

- Have implications for operations both inside and outside China
 - Foreign nationals working with controlled or prohibited technology and products
 - US technology as basis for development of technology/products inside China
 - Shipment to non-China customers supporting China military
 - Transshipments of prohibited or controlled items and technology



Government Procurement

- China plans on spending RMB 992.7 billion on infrastructure projects in 2010
- GPL –Government Procurement Law
 - Preference for domestic supply
 - Rules of origin not spelled out in the law (substantial transformation, ad valorem, tariff shift?)
 - Do items manufactured in China by foreign owned subsidiaries qualify?
- Law applies to government and quasi government organizations
- SOEs (State Owned Enterprises) are not covered by the GPL but they may apply the law in practice



Government Procurement

- In January 2010 Government published Draft Implementation Regulations for the GPL
 - Clarified that GPL applies to tangible and intangible goods
 - Goods manufactured in China by WFOEs with certain level of domestic production value qualify
- National Indigenous Innovation Policy (NIIP)
 - In November 2009 Ministry of Science and Technology, National Development & Reform Commission and Ministry of Finance published NIIP Accreditation Program
 - Establishes preferential program for government procurement that leverages Chinese IP
 - Sets up accreditation requirements for products to be included in approved government procurement catalog



Other Issues to Consider When Doing Business in China

- Tax Implications – 17% VAT Impact
- China Compulsory Certification (CCC)
- Other Pending Regulations (RoHS)
- Change in Sourcing Trends
- Foreign Corrupt Practices Act (FCPA)



China Compulsory Certification (CCC)

- Safety certification system in China applicable to 132 product categories
 - IT, medical devices, electronics, appliances, etc.
- Number of products keeps expanding (recent addition of IT security products)
- Effective August 1, 2003
- Products require CCC mark before they can be exported or sold in China
- Non-conforming items will be held by Chinese customs and may be subject to fines



China Compulsory Certification (CCC)

➤ Exemptions may apply

- Not all products require CCC, based on HTS (Harmonized Tariff Schedule) Number
- An exemption may be granted for service parts imported to service exempt product
- Exemption may be granted if a product is imported for manufacturing and then re-exported as part of finished goods

➤ For further information:

- www.cnca.gov.cn
- www.mac.doc.gov/china/docs/businessguides/cccguid.html



Application Process for CCC Mark

- Can take 60-90 days or longer
- Requires testing by accredited labs in China
- Generally does not permit self-certification or third-party testing
- Requires submission of technical documents
- Requires submission of a product sample to a Chinese testing laboratory
- Requires factory inspection by Chinese officials at the applicant's expense
- Requires follow-up inspections every 12 to 18 months
- May cost several thousand dollars, time, IP



China Sourcing Trends

- Low to High Value
 - Labor-intensive goods shifting to inland China, Thailand and Vietnam
 - Manufacturing higher-tech products
 - Technology development and co-development
- Increasing Costs
 - Transportation and labor costs increasing
 - Gradual reduction of favorable VAT rebates
- Increasing Quality
 - Suppliers beginning to implement control mechanisms
 - Increase in talent pool



Many Sourcing Options

- B2B websites such as Alibaba and TradeKey, HKTDC directory
 - Independently contact manufacturers and suppliers directly
 - Pro: Lowest cost
 - Con: No guarantee on quality of product and timeliness of delivery
- Hire sourcing agent or source from Hong Kong
 - Outsource service: sourcing, inspection, factory audits, etc.
 - Pro: Easy
 - Con: Higher cost
- Set up legal entity (Joint Venture, WFOE)
 - Direct involvement in the manufacturing process
 - Pro: Greatest degree of control
 - Con: Higher investment and setup



Resources for Doing Business in China on the Web

Massachusetts Export Center

www.mass.gov/export

China Business Information Center
US Department of Commerce

www.export.gov/china

U.S. Small Business Administration –
Office of International Trade

www.sba.gov/oit

MA Office of International Trade &
Investment

www.mass.gov/moiti

U.S. Department of Commerce
Bureau of Industry & Security

www.bis.doc.gov

U.S. Census Bureau – Foreign Trade
Division

www.census.gov/foreign-trade/www

U.S. Customs & Border Protection

www.customs.gov

Export-Import Bank of the United
States

www.exim.gov



Resources for Doing Business in China on the Web

Hong Kong Trade Development
Council
www.hktdc.com/

China Ministry of Commerce
<http://english.mofcom.gov.cn/>

American Chamber of Commerce in China
www.amchamchina.org

China Inspection and Quarantine Service
<http://en.ciqcid.com/about/about.shtml>

China Customs
<http://english.customs.gov.cn/Default.aspx>

China Country Commercial Guide
www.buyusainfo.net/docs/x_1853262.pdf



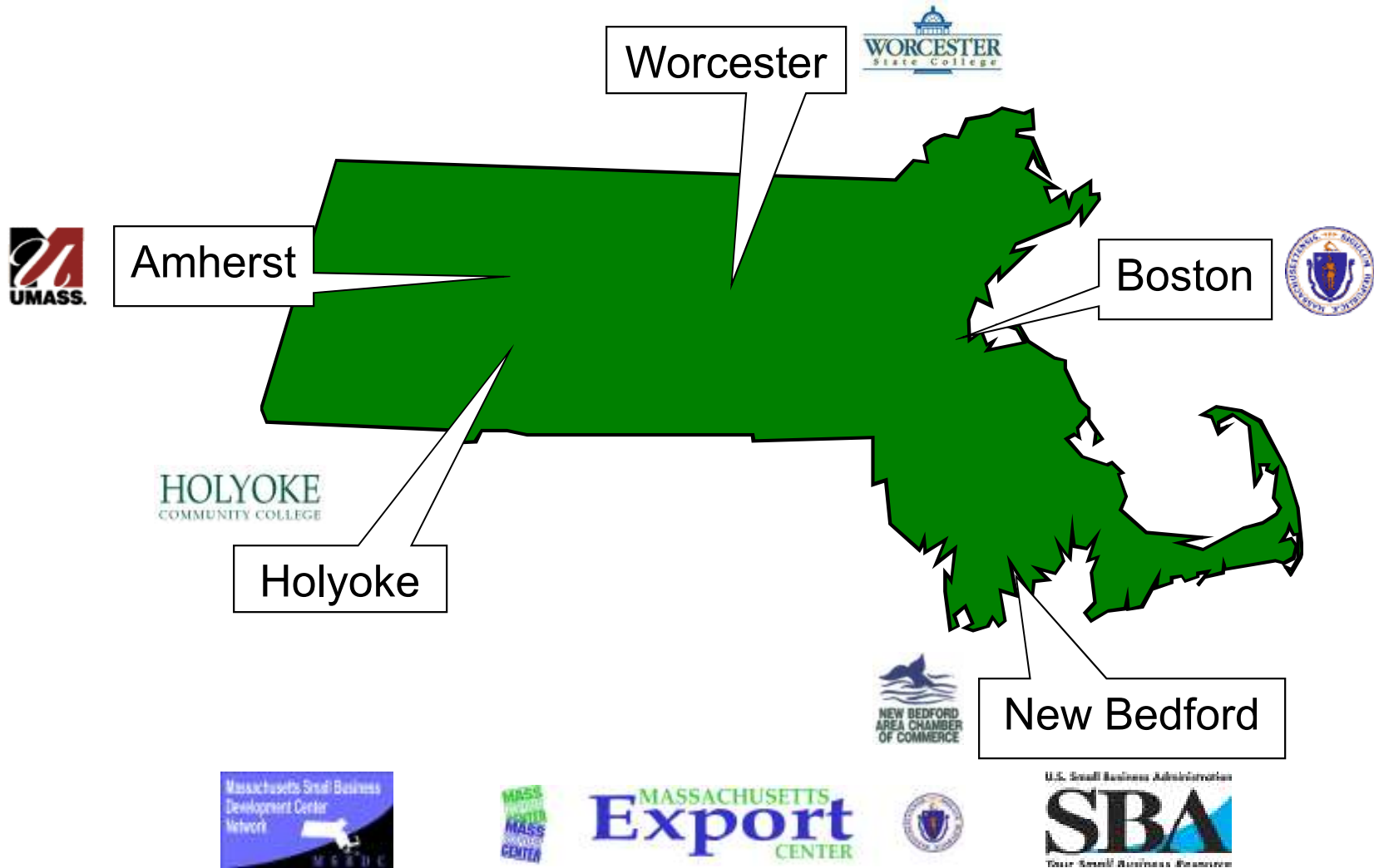
Our Mission

The Massachusetts Export Center is part of the Massachusetts Small Business Development Center Network.

Our mission is to help companies throughout the Commonwealth achieve success in global markets, thereby contributing to economic growth in the state. Our goal is to meet the complex needs of exporters by developing and providing targeted, high-impact services delivered through a state-wide network of international trade professionals.



Office Locations



Providing Assistance Through the Entire Export Process

Counseling · Technical Assistance · Market Research & Promotion · Training



Export Counseling & Technical Assistance

- Assessment of export readiness & export planning
- Export strategy and international business plan development
- Export market assessment & selection
- International sales, marketing & distribution channel development/management
- Overseas trade show identification and facilitation
- Mechanics of exporting (classification, payment, financing, documentation, shipping & logistics)
- Export Regulatory Compliance



2008 Economic Impact

- Clients reported nearly \$190 Million in export sales as a direct result of the assistance provided by the Mass Export Center in 2008
- Overall, companies assisted by the Export Center generated well over \$1.5 Billion in export sales in 2008.
- Between 2007 and 2008, Export Center clients increased their export sales by 39% – more than triple the growth rate of 11% for Massachusetts' export performance during the same time period.
- 98% of clients found the services of the Massachusetts Export Center to be beneficial and 68% indicated that the Export Center's services exceeded their expectations
- The Export Center's impact translates to over 3,000 new/retained jobs in Massachusetts (based on the Commerce Department's exports-to-jobs formula).



Mass Export Center Wins 2 National Awards in 2008



- **U.S. Small Business Administration's Small Business Development Center (SBDC) Service Center Excellence and Innovation Award**
 - Honors SBDCs for their innovation and excellence in assisting small businesses -- there are over 1,000 SBDCs in the U.S., and the Massachusetts Export Center was the nation-wide winner of this award
- **Presidential 'E' Award for Export Achievement**
 - The highest honor the federal government can give to American people, firms or organizations that have made significant contributions to the increase of American exports – presented by President George W. Bush and U.S. Secretary of Commerce Carlos Gutierrez



Massachusetts Small Business Development Center Network
Massachusetts Export Center

www.mass.gov/export



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