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“Doing Business in China”

Financing
Compliance and Operations
Procurement in China
Selling in China

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Foreign SMEs in China face different challenges on their day to day operations. These challenges cover human resources issues, marketing, how to get loans and how to choose the right suppliers. Here are some suggestions to help SMEs to avoid or solve their problems in these fields.

Financing

➤ Chinese banks

Today Chinese banks are among the largest and the most profitable banks in the world. Chinese banks still need reforms on their organizational structure and their risk management capabilities. Chinese banks mostly depend on risk management products, especially on bank loans.

The advantages of Chinese banks are they have a large network in China and a wide range of products. While their disadvantage is that they are often less experienced than foreign banks.

➤ Foreign banks

Foreign incorporated banks in China want to achieve an overall market position in all product categories. They are targeting both specialized products and retail market. Foreign incorporated banks build an extensive branch network and have a long history in China.

Foreign banks' branches specialize in certain product categories or client groups.

They don't only focus on Chinese market but also in their own countries. They try to learn the market, get information, explore market opportunities and introduce their application into market. The range of their products depends on their license which is limited, but they can easily obtain financing because their head office or parent company is already well known.

The advantages of foreign incorporated banks are their network is in the most important locations in China. They have a wide range of products and experienced in more sophisticated products. However, the disadvantage of foreign incorporated bank is that they are very profit minded. Foreign bank's branches have fewer networks in China, they are either located in Shanghai or Beijing where is closer to their customers. The disadvantage of foreign bank's branches is their limited product range. Unlike Chinese banks, foreign banks have



no language barrier and foreign people can speak their own language or English.

It is important for foreign SMEs in China to have a better understanding of advantages and disadvantages of different kinds of banks whether they are Chinese banks or foreign banks.

➤ **Loans**

Foreign invested companies used to circumvent FX Debt Gap (Foreign Exchange Debt Gap) by building up foreign account receivables. They can receive materials and products from their parent company and pay them later. According to the new regulation since October 2008, foreign account payables over 90 days need to be registered with State Administration of Foreign Exchange (SAFE). The maximum quota is 25 % of the foreign exchange turnover of the previous year.

Companies can also get financing abroad, they can get loans from international banks and shareholders. The loans should be registered and need a loan contract. Companies should calculate the interest rate, tax payments and prepare the relevant document when they repay the loans. Loan decisions are mostly based on collaterals but the company's state or condition is the most important. Banks in China have quotas for their international refinancing and they

need to pay the withholding tax for international refinancing and business tax for domestic refinancing. Loan proceeds can only be used in foreign exchange. If companies get a loan in China, the interest rates of bank loans are based on PBOC (The People's Bank of China) reference rate. According to the regulation, the trust loans that Chinese organizations and companies are allowed to lend money to another company. Trust loans must be handled through a bank and need a loan contract. The trust loan's interest rates are based on PBOC reference rate.

➤ **Collaterals**

Land use rights can be used to secure loans and buildings can only be included after completion and registration. About 60%-70% of the actual value loans can be secured with a foreign guarantee and usually only bank guarantees are accepted. Guarantee will be included into the FX Debt Gap. Depending on the currency, the guarantee of the loan amount can be up to 90% of the guarantee value. Maturity of the guarantee is at least 1 month after the loan maturity.

One of the challenges for foreign SMEs is obtaining financing. Chinese Banks are less interested in smaller loan amounts and are less willing to accept Standby letter of



Credits (L/C's) from foreign banks. Banks try to diversify their income base, therefore they will ask for additional business generating fee before granting a loan.

Foreign SMEs should prepare for the long period of loan negotiations and they might need to talk to several banks and look for other financing alternatives.

➤ **Foreign exchange**

Foreign exchange in China is limited and inflexible due to China's banking regulations. SMEs can do their foreign exchange outside China, such as Hong Kong or Singapore which is more flexible on foreign exchange regulations. SMEs can also do their foreign exchange by their parent company outside China in order to cover the risk.

Compliance and Operations

According to the Survey of American Chamber in China in 2006 on why SMEs enter Chinese market, 80% of foreign companies enter the sales and products services locally in order to take advantage of the growing market and customers. 44% of foreign companies agreed to become suppliers and servicers. 30% of foreign companies open sourcing offices for overseas markets. And less than 24% of the companies utilize the local cost production base in China for competitiveness at home.

Compliance and operations issues arise from several angles: suppliers, clients, partners, internally and regulatory.

➤ **Review or put in place**

Wages, contractual obligation: companies should make sure that their labour contract complies with the law, and calculate the wages, overtime pay, holiday, minimum wages and companies' social security payment correctly.

Toxic materials: companies should be aware of the risk if they don't check their suppliers; the material may contain toxic component.

Certifications: companies should check their partners' certifications whether they are complete and legal.

License disclosures: companies should check their partners' certificates, business licenses and other licenses. Make sure whether they can conduct business with you as they claimed that they are able to.

Credit check and background check: it is not very expensive and not complicated to conduct credit check and background check on companies. Companies can pay \$2000 to get credit history. People or companies can use this to make sure that what you are dealing with on the new supplier or even employee, especially in sensitive positions,



such as financial management and sourcing department.

Continuity check: Some retailers' only sale commodities in specific seasons or festivals. Their business licenses and operation continuities are only valid in each season. Therefore continuity check is very important for the company.

Pre-audit assessment can be done before you contact the company. Their information can be obtained from the market and review whether they have commercial or financial problems. Technical audit should follow then and engineer can be sent to check whether they are able to do as they are required. Then set up the production process and financing control.

Procurement in China

Today an increasing number of international SMEs have decided to enter the Chinese market by local manufacturing. Many of these companies handle the sourcing process applying the same rules used in their home country. Sourcing from big or internationally experienced Chinese suppliers is usually no problem but sourcing from Chinese SMEs is not easy.

➤ Market entries

Basically there are three major market entries, purchasing via a trader, purchasing

via a consultant and company's own purchasing. The main characteristics of the market channels are quality, safety and transparency.

➤ Cost structure

There are three main areas of cost structure; material cost, labour cost and fixed cost. Raw materials' price is based on global pricing, so there is no difference between China and overseas prices. But companies can expect the huge difference on the labour cost. Chinese labour cost in average is almost only 10%-15% of European standard for labour cost. Fixed cost area is not so advantageous for SMEs, since the fixed cost in China and Singapore is equivalent with Europe. The advantage of fixed cost area is not as big as labour. After the calculation, by taking the material as the same with global cost, the labour as 20% and the fixed cost as 70% of overseas standard. We can conclude that it is still cheaper for the SMEs to be in China.

➤ Supplier evaluations

There are thousands of suppliers in China, companies should think of ways to narrow down their suppliers. Because there is not enough basic information available, the first step to select your final supplier is,



companies should have a supplier pool and product profile, and then select a list of possible suppliers. You can make a basic specification related to what products you are dealing with, and then make a long list probably more than twenty companies. Make a background check and appraisal on each company, and it will lead you to a short list which is more than five companies. In order to make sure whether those companies can meet your requirements, you need to visit those companies. After the visit, you can cut down to two or three companies that can be your regular supplier and do a quality audit. Don not rely on one supplier in China, you should rely on two or three suppliers to ensure your products continuity.

➤ **Market channels**

You can use internet to choose the pool of possible suppliers, Ministry of Commerce of the People's Republic of China (MOFCOM) has a very useful internet page. You can make a product profile which can easily cut down the supplier pool and make a list of supplier you want to deal with.

➤ **Challenges**

You should execute a detailed analysis and check the quality of product, supplier-product-performance, reliability and additional cost of quality. You should have

someone who has experience on Intellectual Property (IP) issues, contract law and liability law in China.

➤ **Technical part of contract**

In China, most of the manufacturers and suppliers usually show beautiful products and nice equipments which they only use as displays and samples to their customers. If you do not mention the exact requirements in the contract, you will not have any chance later to complain or change. Test the equipment, process, control measures and all the possible things that can affect the product or its performance. You can go and visit them not only in their office but also their manufacturing line, in this way you can be sure on how the products are produced and also the quality of the product. You should put all the things including packing, transport, warranty, arbitration, product liability into contract otherwise you will face more problems. To make it easier, use more photos and videos to illustrate what your requirements are because Chinese are very much visual people.

➤ **Licenses & Document managements**

Review all the licenses and documents whether if they are valid and sufficient. Licenses include manufacturing license,



trading license and export license. Documents include drawing management, production and material documents, inspection instruction and translations.

Selling

The company should evaluate where their sales teams are and their places in sales process. They should try to provoke the interest of customers with prospecting message. In old days, companies can rely on their contacts telling them what is happening in the business. But there are many influencing factors in these days. Companies should do more business research from different resources to know what is happening in their clients and prospect organizations. There are many tools in the internet like Google, these tools can help companies to know what is happening on their clients and prospect organizations rather than only rely on their contact. Work with the marketing department to know whether they are aligned with the market reality. Align the market activities

with sales strategy; make the marketing department and sales department together to create the best message. There are two rules of communication, they are customers value what they say and their own conclusions more than what they are told; and customers value what they ask for more than what is freely offered. In this way, if companies have a successful sales talk, they still need to help the client to understand what is their value and what are they looking for from their own minds or by their own words.

There are three sales strategies. Firstly, create the value or demand creation approach. Rethink about what are the skills they should use more to help their clients to understand the demands and what behaviours or techniques they should stop using; secondly, informative prospecting message should be more provoked, persuade and proposal; thirdly, align the marketing message.



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