

CHINA INVEST.BIZ



The Monthly Magazine on Investment, Tax & Operational Issues
for Foreign Companies Entering & Operating in China

HOW TO EFFECTIVELY ENTER THE CHINA MARKET

Plus:

Interview with Ahmet Uysal, the
President of Power Square Holdings
Limited of Hong Kong

WELCOME TO CHINA INVEST.BIZ MAGAZINE




And welcome to the start of 2011. An exciting year filled with new opportunities and as usual new regulations and updates on behalf of the Chinese government which we aim to provide you in a brief and concise format.

ChinaInvest.biz – a division of Klako Group – has launched since 2010 its first publication in celebration of the group’s 30th anniversary. The magazine is now entering its second year and will be providing monthly insight into investment, tax and operational issues for foreign companies entering and operating in China.

In this issue we aim to provide new investors in China and/or Hong Kong with guidelines on what to consider when entering the China and/or Hong Kong market. Many foreign invested enterprises are unaware of the strategies and risks that could occur when coming to China and hence we have provided a concise format for everyone to understand. It is important that all companies are aware and understand what the policies, regulations and the simple way of doing business in China are.

We hope this can be a guide for everyone.

Your ChinaInvest.biz Team



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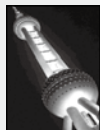


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Klako Group has four strategically positioned offices in Hong Kong, Beijing, Shanghai and Guangdong, with over 100 professionals with comprehensive capabilities and sound local knowledge to help you with your business goals and activities in Hong Kong and throughout China.



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HOW TO EFFECTIVELY ENTER THE CHINA MARKET

Written by

The Foreign Direct Investment Professionals at Klako Group

Foreign companies continue to have mixed experiences in China. Many have been extremely profitable, while others have struggled and failed. To be a success in China, foreign investors must thoroughly investigate the market, take heed of product standards, prequalify potential business partners and draft contracts that assure payment and minimize misunderstandings between the parties. The problems of doing business in China be due to the following:

1. China often lacks predictability in its business environment. A transparent and consistent body of laws and regulations would make the Chinese market more predictable. However China's current legal and regulatory system can be opaque, inconsistent, and often arbitrary. Implementation of the law is inconsistent. Lack of Chinese government protection of intellectual property rights is a particularly damaging issue for many companies, both those that operate in China and those that do not, have had their products stolen by domestic companies.
2. Foreign companies tend to underestimate the challenges of market entry in China. Encouraged by a government eager for foreign capital and technology, and entranced by the prospect of 1.3 billion consumers, thousands of foreign firms have charged into the Chinese market. These companies often do not sufficiently investigate the market situation – common pitfalls involve not carefully reviewing product standards and conformity assessments; not fully understanding legal issues, like protecting intellectual property rights; and not properly vetting local business partners.

It is important to understand that while continued reform is absolutely essential for China to achieve the economic growth it requires and to fully participate in the world trading community, in many areas, the necessary changes have not yet taken place. Companies must deal with the current environment in a realistic manner. Risk must be clearly evaluated. If a company determines that the risk is too great, it should seek other markets.

What should your strategy be?

A company should visit China in order to gain a better perspective and understanding of its potential market and location. Especially given China's rapidly changing market and large area, a visit to China can provide a company great insight into the country, the business climate and its people. Chinese companies respect "face-to-face" meetings, which demonstrate the commitment of the foreign investor to working in China.

Continued long-term relationships are key to finding a good partner in China. To maximize its contacts, companies should aim at forming a network of relationships with people at various levels across a broad range of organizations.

Companies tend to use agents in China to initially create these relationships. Localized agents possess knowledge and contacts to better promote their products and to break down institutional, language and cultural barriers. It is highly recommended for companies to carefully choose their potential business partners and take the time to understand their distributors, customers, suppliers and advisors.

China is a challenging market and requires a strong understanding of a firm's capabilities and in-depth knowledge of the market. Before making a decision to enter the China market, companies should con-

sider their own resources, their past experiences in entering other foreign markets as well as their willingness to commit a significant amount of time to exploring opportunities in China.

Are you ready for the China market?

The below questions can be used as a self-diagnostic tool to open the door to pursue opportunities and evaluate whether your company is prepared to meet the challenges posed by China's system for regulation of international trade.

Self-Assessment Tool

1. Does your company have prior export experience to at least one foreign market?
2. Does your company have a commitment to developing opportunities including top management support, designation of an internal China sales manager, sales and technical staff who are willing to travel to China often, and support staff including an interpreter or translator to facilitate communication with Chinese buyers?
3. Does your company have sufficient financial resources to actively support marketing of products in China including translation of product brochures, participation in trade shows, and organization of customer informational seminars?
4. Does your company have the ability to host visits by potential buyers to conclude sales negotiations, facilitate pre-contractual equipment inspections, and provide installation training?
5. Does your company have the ability to acquire and analyze Chinese market data, identify sources of competition including domestic and foreign firms, and ascertain distribution channels?
6. Does your company have the ability to



acquire familiarity with import and export logistics unique to China including negotiation of letters of credit, freight forwarders, export documentation and export licensing?

7. Does your company have the ability to locate Chinese import regulations, safety certification and labeling requirements and cultural preferences to modify the product and its packaging?
8. Does your company have prepared an international marketing plan with realistic goals, China-specific marketing strategies, progress benchmarks and an exit plan?
9. Does your company have sufficient financial resources to engage the services of local qualified attorneys or consultants to navigate China's system of international trade regulation, develop a sales contract that is enforceable in China, undertake due diligence investigations, and address problems?
10. Does your company have the abil-

ity and financial resources to provide training for a Chinese employee in the HQ and provide continuous guidance for conducting market research and planning sales goals?

11. Does your company have the ability to establish a program for protection of intellectual property including trademark or patent registration, market monitoring, and enforcement strategy?
12. Does your company have the commitment to providing domestic and foreign customers equivalent service quality, which may necessitate frequent travel to China by a technician or establishment of an equipment service and maintenance center with a Chinese partner?

Suggestion: If you have answered NO to any questions from 1-12, your company should consider identifying a management company with China experience to handle these items or approach a different market with fewer technical, logistical,

cultural and business risk hurdles before attempting business in China.

Basic Entry Methods for China

Depending on what your companies objectives are for the China market there are several options available; whether you are planning on **buying from China**, **selling to China** or **providing services** in China.

Buying Structure for Export

We recommend our customers that are sourcing in China and exporting overseas to establish a Hong Kong Company rather than establishing a trading facility in Mainland China due to VAT issues.

By founding a Hong Kong company you will enjoy significant tax and operational benefits. Profits can be structured tax free or at a low rate of 16.5%. Furthermore, you will be able to sell directly from Hong Kong to worldwide clients without involving your headquarters, and without

goods burdening your warehouse. As a result, you can offer lower FOB Asia prices. In addition, you do not require bank credit since your clients would open a transferable Letter of Credit. This frees up your capital and improves cash flow.

To avoid setting up your own office, a service provider in Hong Kong could provide you with the Hong Kong statutory requirements of a registered office address, a corporate secretary and telephone, fax and mailing services. Service professionals are available to handle your company's accounting, auditing and tax filing, as well as trade documentation, order follow up and banking activities if required.

Nevertheless, if you decide to hire mainland Chinese staff in China and you only require liaison activities, we would recommend setting up a **Representative Office (RO)**. There are certain restrictions concerning ROs, such as:

- The parent company must have been established for over two years
- The RO is limited to employing only four foreigners
- And as a rule of thumb the RO can only employ up to six employees

By law the Chinese staff must be employed by a Chinese entity in China. Together with their gross salary, the company must provide social insurance to each employee. As social insurance is owed to the State and not the individual, we recommend that this be done in a legal way so as to not incur any difficulties with the Labor Arbitration Committee and other government bureaus in China.

There are many foreign companies in China that do not monitor the daily business of the local employees in their RO, allowing many of these employees the opportunity to engage in activities not allowed by the RO.

The consequence is often that the parent company becomes blacklisted by the Chinese government. A further advantage of a Hong Kong company would be that

it takes this liability away from the parent company.

A RO is the easiest and most economic way of setting up a legal presence in China. It is an office of a foreign enterprise set up for the purpose of liaising with Chinese businesses and customers on behalf of its parent company. A RO is not considered to be a separate legal entity and it can not carry out direct revenue earning business activities, i.e. it cannot enter into purchase/sales contracts and cannot receive payment for products or services, issue invoices or repatriate monies overseas. A RO is restricted to conduct only "indirect operational activities", such as:

- Business liaison
- Introduction of products
- Market Research
- Technology exchanges

Selling Structure for Import into China

For companies that are looking to sell into the Chinese market a **Limited Company** would be required, especially if you are planning to sell into RMB to your customers.

A **Limited Company** can be in the form of a Wholly Foreign Owned Enterprise (WFOE), Foreign Invested Commercial Enterprise (FICE) or a Joint Venture (JV) structure which are all limited liability companies. A WFOE or a FICE are invested purely by a foreign shareholder(s) whereas a JV has a Chinese party integrated in the shareholder system. These types of entities allow foreign investors to manufacture, process, assemble, trade, distribute or deliver services in China.

Setting up a Limited Company does not necessarily mean that you can engage in any sort of activities, as may be the case in the West and certainly in Hong Kong. These entities can only be operated within the scope of business as approved by the authorities. If, at a later date, the company wishes to add other activities, these are subject to further approval by the relevant government authorities. It is

therefore very important from the onset of your establishment to determine what will be the functions of the company.

Whether you establish a RO or a Limited Company in China, a **Hong Kong Company** can be used as a Holding or as a Trading/Service Company for transactions dealing with China. The Hong Kong Holding Company is fully liable for the China investment and protects your existing company. Also, dividends received by your Hong Kong Holding Company are tax free, but incur a 5% withholding tax in China compared to 10%-20% from other countries and can be used for further investment.

Providing Services in Mainland China

When providing any type of services in Mainland China the issue of whether to establish a Limited Company comes down to whether the customers in China require you to invoice them in Renminbi (RMB). Due to foreign currency regulations in China, it would be needed to have an entity in China in order to be able to issue RMB invoices. Should it be possible to invoice in foreign currency then an alternative could be to open the consulting company in Hong Kong as an Asian regional hub.

Recommendations

Given China's size, diversity and complexity, it may make sense for investors to engage several companies to outsource a series of functions, such as market analysis, administration, finance, law, risk mitigation, logistics, distribution functions, particularly during the start-up of the China operation to make that everything is in compliance. The key to entering China is do your research; make sure there is an actual market place for sourcing, distributing or even providing services. Discover who your prospective suppliers, customers and partners are and begin to establish the necessary "guangxi" to develop and maintain these relationships. ■





INTERVIEW WITH AHMET UYSAL, THE PRESIDENT OF POWER SQUARE HOLDINGS LIMITED OF HONG KONG

We are involved in Mineral trading (mainly boron – a mineral used in Glass, Ceramics, composite materials) through our companies: Power Square Holdings Limited of Hong Kong, Tekpa Inc. of Turkey, and Qingdao Phoenix Resources of China . We serve our customers in two ways: act as their agent or direct sales. Tekpa Inc. serves as the procurement agent of some of the largest Chinese consumers of Boron in Turkey at Eti Maden, which is a world monopoly as Turkey has in excess of 72% of the known world boron reserves. Power Square handles our direct sales which are under annual contracts. Recently, we formed a company in Qingdao (Phoenix Resources) to handle our spot sales for customers in mainland China.

When we started this business in 2002, the total exports to China was less than 5000 mt annually. After we signed the first contract with the largest consumer of Boron in China, which produced borosilicate glass tubes and rods, the market rapidly expanded and now is in the vicinity of 450,000 mt. annually. According to 2011 contracts, we channel almost 25% of the total quantity to China.

We operate through 3 companies to carry out boron trade to Far East which are:

- Power Square Holdings Ltd in Hong Kong
- Tekpa Mining Energy Inc in Turkey and
- Phoenix Resources Trading (Qingdao) Company Ltd in China.

The total number of employees involved varies from 15 to 20 people depending on the market condition. The boron products we sell are mainly borax pentahydrate, borax decahydrate, boric acid, ground colemanite and anhydrous borax. We also help source chrome and manganese to our Chinese customers from Turkey. Our annual volume through these three companies is around 125,000 mt. Our Chinese subsidiary will handle around 20,000 mt. of this amount in the spot market.

Could you tell us briefly about your company's activities in China?

We mainly source boron, chrome and manganese to China. For spot sales, we operate through our Qingdao office and for annual contract for big buyers, our Istanbul office handles the requests. The logistics and operations are mainly handled by our Hong Kong company.

What are your short term objectives, especially in China?

Besides our continuous and reliable boron trade operations, we would like to invest in a Ferroboron factory in China in the short term. We also would like to form a joint venture with a Chinese Glassfiber factory to produce in Turkey as it is becoming extremely difficult to export to

Europe from China due to anti-dumping duties.

What is your competitive selling point? And what is your strategy to stay competitive?

There is a huge imbalance of boron supply and demand in the global markets. This will unfortunately continue in the upcoming years. The most critical factor is to be able to attain annual contracts from Eti Maden, which is rapidly becoming a global monopoly in boron trade. Our sales performance, as recognized by Eti Maden, since the opening of the Chinese market to Turkish boron almost 8 years ago and our performance on contractual obligations to Eti have led us become one of the biggest channels of boron to

China.

What kind of cultural differences have you encountered here where your experience in the US or Europe may not apply or may need to be adjusted?

Establishing trust, even with many credentials, has been the most difficult part in our entry to the market. And, also tendency to defer or avoid a negative reply continues to be a major impediment for us.

How has been your relationship with your China team members and management as well as local employees? Have you had retention issues?

It is too early to comment on this as our activities will start in 2011.



What trends are going to be important in the future for your line of business? What do you hope can be achieved in the next 10 years?

We would like to expand our spot sales during the next 3 years and become a major producer and a one-stop supplier of boron derivatives (Ferroboration, Boron Carbide, Zinc Borate, etc.) in China.

How necessary is guanxi for foreign firms doing business in China?

We think social reputation and connections are one of the most critical success criterias in China. This is the only path to establishing trust, on which all forms of business foundation is laid.

Any “hot” tips for doing business in China?

I think we must understand the cultural differences very well and be conscious of any nuances of Chinese culture within the scope of your business dealings. ■

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