

China Business Start-Up A Different Ballgame

Mike Corkran
CEO, China Centric Associates

If you have decided to start a new manufacturing, service, supply chain or sales/distribution business in China, chances are you can't wait to begin. China is the fastest growing large economy in the world, and on a purchase price parity basis, it will be the largest industrial and commercial market in a few short years. Time is ticking and the market opportunity will wait for no one. If this is your first start-up in China, you will be focused on the operations, getting the necessary equipment and infrastructure in place, and hiring your new team in China. You probably don't realize it yet, but those will be the easiest challenges that you will face starting your new China business.

Countless aspects of doing business in China are very different than those in the West. The critical mistake Western companies make frequently is failing to understand and adapt to the differences. Companies mistakenly port their Western business practices to China, subconsciously assuming that they will apply, which consequently gets them into serious trouble. None of China's differences are insurmountable, but every company must adapt their Western business processes to achieve success. If you don't understand this reality, it will either take you longer to achieve your goals, or you will underachieve on your desired outcomes.

Starting a plant in China is not like setting up shop in another state in the U.S. You are starting a new legal corporation in a new country where institutional and governmental support is immature by Western standards. Your new China Company has to perform all the legal, financial, commercial and regulatory compliance functions of an independent company in China.

Your management will need to learn how to manage new concepts and principles unique to China including VAT, tax laws, employment laws and many other differences that are not extraordinary, but require careful understanding and integration into your business processes.

The list of issues to navigate through is long and it includes items that are very different than in the U.S. While starting a business in China is different, it can be approached with

a comprehensive process that asks and answers the questions relevant to each Company's situation to minimize the start-up execution challenges.

The legal filing requirement to start a new company in China is actually the easy part of the process. There are approximately 23 individual actions and document filings that must be executed with various China government agencies in the district where the business is to be located. Essentially all of the filings are standard forms with information filling in pre-formed blanks. In almost all cases, the critical decisions for each of these filings are not legal interpretations, but rather business decisions by client management about a range of operating and financial issues. Each of the issues that must be considered require careful analysis because making a wrong choice during start-up can be difficult to correct later.

Location: Where will you locate? The industrial base, the supply chains and the professional skill sets available vary widely between even the most developed regions such as the Beijing-Tianjin-Bohai Region, the Yangtze River Delta, and the Pearl River Delta. Which one is best for you?

Development Zones: What kind of development zone will best suit your business model? There are high technology zones, free trade zones, industry-specific zones, export processing zones, and bonded logistics centers. There are national, provincial and city level zones. Each has distinct advantages, incentives and restrictions. Which one is best for you? There is a one-time opportunity to make the right location choice because a business license is issued by district within a city. Relocating is just not as simple as it is in the U.S.

Legal Entity: What kind of legal business entity will you establish? Will you need to set up a JV, a WFOE, a foreign trading company (FICE), or a Representative Office? Each type of entity has different capabilities, registration requirements and tax treatments. Picking the right one for your business model also dictates the format of investment commitment, employment structure of your workforce and many other detailed requirements of your new business.

Business Scope: What will be your "business scope"? This is an alien concept to Western professionals. You need to define at a very detailed level, and obtain government approval, for the exact activities your business will conduct. This is your legal Scope of Business and it will both enable and limit what your company can legally do in China. It is carefully worded language that must be negotiated with and approved by the Chinese authorities. You need to consider not just what you want to do when you get started, but also the reasonable range of activities you may

add in the future. This is a very serious step and one that confounds many Western companies.

Organizational Structure: What organizational structure and controls will you use? If you simply transfer your Western model you are asking for trouble. The nature of your Chinese workforce will be different. Internal controls will need to be adjusted due to cultural and experience differences.

Business Processes: How will you modify your business processes for implementation in China? Every manufacturing business can be defined in five functional disciplines (not including sales and marketing): 1) Quality and Business Systems; 2) Finance and IT; 3) Operations; 4) Engineering and Technical Support; and 5) Human Resources. Companies are actually more similar than different across industries. What does vary is how they have to be implemented in China. It needs to be refined for China implementation and then transferred to your new China business. How are you going to do it?

Hiring: What should you expect when hiring employees? The average Western management experience level of Chinese employees will be much less than in the U.S. This is one reason your organizational structure will need to be different in China.

Employee Compensation: How will you structure compensation programs in China? Do you know of “thirteenth month” pay? Will you use it? China is transitioning rapidly to performance-based compensation programs, but they are in their infancy. Creating an effective compensation plan require careful decision with experienced guidance or you risk setting organizational expectations that are harmful to your business model which are difficult to change.

Employment Contracts: What will you have in your employment contracts that are needed for all employees? Chinese Employment Law requires that all employees have a contract filed with the local Labor Bureau. While there are strict employment regulations with which you must comply, you have significant latitude to infuse your Company’s culture and processes into the employment relationship.

Internal Company Policies: Your China Company must comply with local China regulations and some U.S. regulations (e.g. Foreign Corrupt Practices Act and others). Further, your company undoubtedly has specific policies and controls that you will want to have followed at your new China business. Developing those policies that are compliant with China regulations and including them in an Employee Handbook format seems like a minor administrative step, but it is of critical importance. You have only one chance to make a first impression with a

staff that will be to your new company and the precedent you set in the HR policy from day one could not be more important.

Financing: How will you finance your China Company? The concept of capitalizing a China company is very different than in the U.S. Did you know that unlike in the West, you are limited in the amount of capital and sources of capital according to the terms of your business license? Your business license will define the amount of equity you must invest. The license defines the maximum amount of loans that can be obtained from any source. The only other legally permissible source of capital is internally generated cash. To exceed the limits of equity or debt defined in the business license requires re-filing and re-approval of a revised business license. Modeling your capital needs carefully – usually monthly for a multi-year period based on your best assumptions – is a highly recommended approach. It is possible to change capitalization once a business is formed, but that requires filings and can take months to complete. It is advisable to invest the time up front to be as complete as possible in the process

Starting a business anywhere can be approached as a process. Actually filing the documents to obtain your business license is the simple step in the process. Planning and optimizing all of the other issues in an integrated program is the meat of the process and most often the determinant between success and underperformance.