China Market Entry

White paper

SYMBIO

Trusted with Excellence

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Introduction

Maybe you've been thinking about China for a while. Maybe you've been hearing about all the opportunities China market offers. Or maybe you haven't heard anything, and are just now thinking – is there a market for my product or service in China?

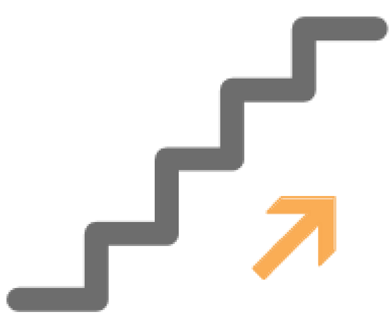
For a long time now, manufacturers and others have thought of China as a place to have goods manufactured inexpensively – as well as a place to offshore software development. However, in the last few years, rising incomes, rapidly changing demographics, increased consumer spending and a slowly opening business environment have all helped to make the Chinese market more attractive to Western businesses. Additionally, rapid urbanization is also a big driver for the growth of consumer spending. At the same time, declining sales in home markets has suggested that US and European companies should place China in their global growth strategy.

With a population nearing 1.5 billion and a land mass similar to the United States, China's sheer size and scale presents challenges distinct from other markets. While China represents a massive potential market for services, understanding where these opportunities lie and how to access them can be very challenging. Both large Western multinationals with established China presence and first-time entrants with no previous China experience may find their China success denied through insufficient lack of local understanding.

This white paper will attempt to introduce some of the steps required in order to not only better understand this huge market, but to succeed in it. We will be describing some of the steps required, the challenges you may face, and the options you may have. In some cases, we will use some examples of companies which we have successfully guided into the China market and are flourishing today.

Summary of Steps:

1. IP Considerations
2. Market Research
3. Government Policies & Regulations
4. Hiring Staff
5. Internationalization & Localization
6. Partnership & Channel Management
7. Legal Entity Considerations
8. Financial and Paid-In Capital Requirements
9. Management Reporting and Corporate Governance
10. Validation Trip



"However, this risk can be greatly mitigated by working with the right trusted partner"

IP Considerations

Foreign companies looking to China often describe IP risk as the single biggest issue keeping them from seriously entering the China market. IP infringement is commonplace in China, and any company entering the market for the first time should work under the assumption that its technology may be compromised at some point. With this in mind, it is generally recommended that foreign companies, and particularly those with large IP inventories, consult with lawyers and IP specialists to formulate an IP strategy for the China market.

However, this risk can be greatly mitigated by working with the right trusted partner. For example, a company such as Lenovo is China based and can be considered highly trustworthy, it would not be in their best interest to steal your IP. During your due diligence period, you can identify similar partnerships.

There is no single IP protection strategy for China, and typically an effective strategy will employ a number of different tools, including legal, practical and technical measures designed to prevent infringement and ensure legal rights are enforced in the event of an infringement.

Thorough due diligence on prospective partners and company employees, signing NDAs with partners and employees, and constantly monitoring the market for infringements are key practical steps you can take to prevent your IP from being compromised. Actively pursuing legal proceedings against any IP infringers as well should act as a deterrent to possible future infringements.

Market Research

There are plenty of English-language publications on China available on the internet, which make it easy for Western companies to carry out some initial internal research on the Chinese market. This research can help firms to determine whether further, more detailed research is required, and can assist with setting goals for that research later on.

An experienced market research company can build upon this initial foundation of knowledge with more detailed information collected via Chinese-language desk research and in-depth interviews with leading industry experts and decision makers. Along with these qualitative techniques, quantitative research can then help with determining more accurately market size, future growth trends, levels of competition, routes to market, key customer requirements etc.

"A business entering China has to be accessible through WeChat – it's simply mandatory"

WeChat phenomenon

WeChat (Chinese: 微信; pinyin: Wēixìn; literally: "micro message") is a mobile text and voice messaging communication service developed by Tencent in China, first released in January 2011. It is one of the largest standalone apps by monthly active users.

The speed at which WeChat has become ubiquitous in China is remarkable. There are more than 900 million people using WeChat – to put these numbers into perspective, the number of WeChat users surpasses EU population (~510 million), and is very close to 972 million people living in the Americas.

WeChat is no longer a messaging app, but includes most, if not all day-to-day essentials through the interface of a single app. With WeChat account linked to a bank card, users can pay in shops, taxis, buy airfare, train, movie tickets, book hotels, pay utility bills, transfer money to other users (particularly in the form of traditional 'red envelope'), top-up cell phone accounts, and manage personal finances.

With unprecedentedly large and engaged user base, these 'mini programs' or 'mini apps' were launched with the intention of channeling the services provided by separate apps inside WeChat. Mini programs are extensions of WeChat official (company/ service) accounts, which allow users to access additional services in seamless way.

Local stores, restaurants and services working through WeChat do not need to design and build the whole app infrastructure, but instead can use WeChat templates and take advantage of the mini program system. QR codes are an important way of driving traffic to mini programs.

The key to any service/ product launched in China is to reach the attractive market volumes. Chinese consumers tend to be more influenced by their peers compared to Western market, in particular the younger demographics. This is the key to potential power of using WeChat for business, when seeking to influence groups and communities.

WeChat's API allows efficient tools to integrate services to immerse followers. It is important for businesses to give motivation to sign up and retain the following – perks like offering prizes and POS promotions are commonly used. Accessing the 'right' WeChat groups can be tough from a marketing perspective, but once successful, it allows far more personal and direct influence than any other platform.

To sum it up – a business entering China has to be accessible through WeChat. No if's, no but's - it is simply mandatory.

"It's important to spend time researching and understanding the regulatory environment prior to making any decision to enter the market."

Government Policies and Regulations

Understanding government policy and regulations is critical to success in the Chinese market. While China's entry to the WTO liberalized some of China's trade environment, many industries remain regulated. There are many industries that remain off-limits to foreign companies, and many industries where severe limitations remain in place. Any foreign company looking to set up local production in China should first consult the China foreign investment catalog, which divides foreign investment projects into 'encouraged', 'restricted' and 'prohibited' categories.

As China's economy develops, it is also accumulating a growing number of industry-specific regulations and standards, which both domestic and foreign companies should conform to. Government regulations can very often impact significantly on the timeline and costs of market entry, and companies are advised to examine the implications of such regulations prior to committing to the market.

It's important to spend time researching and understanding the regulatory environment prior to making any decision to enter the market. Once in, it's essential to monitor for any changes to legislation or regulations and how these could affect your business.

Partnership & Channel Management

One of the key differences between success and failure in the China market is to have strong partners in-country, who would be able to support your brand in manufacturing, technical support, marketing and sales. In-country managers are essential for your success in the China marketplace. A key benefit of hiring a Chinese manager is the local market knowledge, and deeper understanding of Chinese business they bring to the role. Not only are salary and insurance costs lower for local employees, but Chinese employees very often have existing contacts ('guanxi') with suppliers, customers and local government authorities that can be fully utilized. For example, IBM, Microsoft, HP, John Deere, Coca-Cola, KFC, GM, VW and Boeing all leverage local partnerships in any, or all of the above areas. The best way in which to build a trusted partnership is to allow a company, which has already built local sales (and other) channels do the same for you.

"At the bottom line, you will need an initial investment of a minimum of $150,000 USD for the simplest model, which is licensing to a local company."

Legal Entity & Office Infrastructure

Legal Entity Options

Here, there are a large number of options, and the pros and cons are many, and typically based on your product or service, your budget and expected sales volume, and the amount of involvement you wish to have. There are models, which require very little involvement and cost, but are higher risk and provide lower return, models which require high investment and higher return, and models in between.

At the bottom line, you will need an initial investment of a minimum of $150,000 USD for the simplest model, which is licensing to a local company. On the other end, in order to set up and maintain a wholly-owned foreign enterprise (WOFE) office, will likely run you a minimum of $500,000 to $1M USD and beyond, depending on how heavily you would like to staff the operation.

It's important to determine your global corporate vision: will you be entering the China market opportunistically with the least amount of initial commitment, or do you see yourself building a much larger business in China over the long term. These two views are not mutually exclusive. For example, you can easily start with a simpler model with less investment, and then move to a more permanent, long-term solution.

A Summary of the Models

Licensing

The simplest and least expensive model, but the one with the highest risk and lowest ROI is to license your product to a local company. This may be a good model if you are simply testing the waters to see if there is a market for your product in China. However, it carries the biggest risk from an IP perspective, unless you can license to an extremely high quality, well known partner, such as Lenovo, there is a chance that your IP will be infringed. Worst case scenario – your product is copied and you receive nothing. This model can work for hardware and software companies, as well as consumer goods, as long as you find a quality partner. For example, here in Silicon Valley, there are plenty of "fab-less" electronics manufacturers, who simply design their chips and circuit boards here, then license them to Chinese companies for development.

However, while this model is lowest cost, it also provides the lowest rate of return, as basically what you are receiving are royalties on the use of your IP, therefore the overall return is low, typically a small percentage of the cost.

Franchising

The franchising model works extremely well for companies with a pre-existing franchise model that is currently working in your home country. If you already have a well-run franchise model in your home country, this is a good option. However, building a franchise strategy specifically for the China market is likely not a preferred approach, unless you are planning on rolling out a franchise model everywhere, as there are much easier markets to test your franchise model in other than China. Even with a well-run model, specific requirements for franchise operations in China, such as requiring franchises to only use management and ordering systems which directly connect back to your home country, will probably a very good idea. Maintaining systems control from a centralized office is key for managing both revenues and costs. This model is likely best for consumer goods and services, companies such as Yum! Brands (KFC & Pizza Hut) and Holiday Inn Express have used a franchise model in China very successfully.

Representative Offce

A Representative Office is only allowed to promote and co-ordinate your business, but cannot book sales or revenues directly. This entity can market and advertise your product, but cannot accept purchase orders. This model is good for those companies which have a good brand and well run online strategy, and just need boots on the ground in order to market the local market appropriately.

WOFE/VIE

Moving up the flexibility (and cost) chain, there is the WOFE/VIE or Wholly Owned Foreign Enterprise/Variable Interest Entity. This is a 100% owned subsidiary of your company, doing business in China. Hiring and sales are all run locally, and your company is considered a local "Corporate Citizen". Typically, most Fortune 500 multinationals are run as WOFE/VIE.

Joint Venture

There are a few more interesting options which are also available: a joint-venture: 50.1/49.9 ownership split, where the foreign company needs to be a minority owner for "critical industry", such as financial services, media (movie, TV, news agency) and telecom. This requires a separate legal entity.

VC/PE

Finally, there is a VC/PE investment. If there is a firm in China which develops a similar product or service, you can take a large equity stake – as largest shareholder of a local Chinese company, such as Yahoo!, which owned 40% of Alibaba, or Nasper/MIH, which owned 34% of Tencent.

The table below summarizes some of the advantages and disadvantages of the various approaches.

	Advantages	Disadvantages
WFOE	• High level of managerial control • Can employ own people without restrictions • Greater flexibility • Can convert RMB profits into US Dollars • Greater level of IPR protection	• Initial set-up costs high • Long incubation period • No access to JV partner resources • Higher start-up and operating costs (registered capital) • Some industry limitations • Minimum number of staff requirement • Tax and repatriation of profits challenging
Joint Venture (JV)	• Mandatory for some industries • Opportunity to utilize existing sales networks and customer base • Access to partner's existing resources • Production facility • Lower cost base (local management)	• Less managerial control • Finding a trustworthy partner is critical • Challenging to agree terms of the partnership • May be a long negotiation period • Potential risk to IPR • Success may depend on having staff on-the-ground to oversee operations • Partner likely to negotiate terms in their favor
Rep Office	• Quick to set up • Low cost (low overheads) • No registered capital requirement • Good for marketing, partner auditing and admin	• Unable to trade • Staff employed via third party • Limits on number of staff

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Legal, Accounting & Tax, HR/Staffing and Offce/Facility support

From a legal perspective, most major US Law Firms are in China, for example WSGR, Skadden, and Steptoe. so they would be able to assist in most legal matters. Setting up new legal entity requires the board resolution and authorized bank accounts in China. There are complicated US & China tax codes to work with, and the big 4 US Accounting firms (PwC, KPMG, E & Y, Deloitte) can work with you there.

When it comes to human resources and staffing, Chinese employment laws require various withholding. For the first 18 months, we recommend to use FESCO (Foreign Enterprise Services Company), in order to provide the proper support. We can also recommend or provide our offices in Shenzhen and Chengdu or suitable office suite turnkey style.

Financial and Paid-In Capital Requirements

Financial Requirements

In order to move forward from this point, your company would require a board resolution to authorize new bank accounts and financial commitment in order to enter China. One of the things that you will need to consider is that Chinese currency (RMB; CYN) is not freely convertible. All foreign exchange is regulated by SAFE (State Administration of Foreign Exchange). It is very difficult to expatriate cash from China, so most fortune 500 companies keep the money in China for local operation and investment.

Paid-in Capital requirements

If you set up a WOFE, depending on size of company – you will need to fund it to a bank account in China for an amount between $500k to $2m. The specific amount is determined by the SAIC (State Administration of Industry and Commerce). The process is straightforward, simply set up a bank account and put money into it. That money needs to remain in the account. Your partner can assist in locating appropriate banks in China to support your management of capital and deal/comply with SAFE and SAIC.

"Typically a Fortune 500 company would bring an expat manager to China and pair him or her with a local hired Chinese manager."

Hiring Staff

The single biggest determinant of a company's success in China is the quality of staff it employs. The enterprise type (see legal structures above) will likely determine the type of human resources available, and foreign companies will have greater freedom with WFOEs and representative offices than JVs in this respect. The quality of human resources available will also be related to where the company is located, the quality of prospective employees available is much higher in cities such as Shanghai and Beijing.

Another key decision to be made is whether to employ expatriates in senior management positions or whether to localize these roles. Employing expatriates offers greater operational control, however is more costly in terms of salary, relocation costs, insurance etc. In addition, expat managers bring with them the deep domain knowledge of the product/services and the networking relationship with the HQ organization. Typically a Fortune 500 company would bring an expat manager to China and pair him or her with a local hired Chinese manager. In this case, the expat manager's China assignment would run 2-3 years, grooming the local Chinese manager for that period.

Key benefits of hiring a Chinese manager are local market knowledge and much deeper understanding of Chinese business. Not only local employees, but Chinese employees are less expensive, and often they have existing contacts ('guanxi') with suppliers, customers and local government authorities that can be fully utilized.

However, the supply of highly skilled local managers with industry experience is extremely limited; employers may still be forced to pay a premium to attract the right caliber of employees. Additionally, staff turnover rates are extremely high in China so retaining quality managers over the long term is challenging. If you lose your local manager, you also lose access to their guanxi networks and local market knowledge.

Internationalization and Localization

Of course, it is essential that your product or service be properly translated, internationalized and localized. It's a necessary and integral part of your Go-To-Market Program for China Market Entry. At minimum, your website will require a Chinese version or translation. Depending on the results of the market analysis and positioning, you may need to modify certain attributes of your product or service in order to meet specific requirements.

For example, when we guided Evernote into China, our research helped them to determine that they would not be able to use the name Evernote, and instead created a new brand, maintaining some of the look and feel of the US version. Your website, selected links and possibly your product would need to be internationalized and localized into context-correct Chinese linguistics.

"Symbio does have the in-house capability to provide product internationalization and localization services in-country, including on-site technical support and customer services, so we would be more than happy to help guide you into China."

Typically, a local partner will not be able to provide these services, in addition to the actual China Market Entry guidance, so you will need to locate a third party to provide these services.

Symbio, however, does have the in-house capability to provide such product internationalization and localization services in-country, including on-site technical support and customer services, so we would be more than happy to provide that service, should you decide to allow Symbio to help guide you into China.

Management Reporting and Corporate Governance

Management Reporting

Rep Office and WOFE report directly into Corporate HQ in functional reporting line. Board of Directors authorization and approval are needed in order to set up a foreign subsidiary and senior management appointment.

Corporate Governance

Paid-in capital: Regulated by SAIC (State Administration of Industry and Commerce). To be approved and monitored by Corporate HQ CFO. Corporate Governance, such as FGCA need to be communicated to all members of the China operation.

Validation Trip

Once most of the above has been completed, it is essential that you plan a validation trip for at least two of your senior management members.

On this trip you should be able to:

- Interview Channels as candidates for indirect sales,
- Meet with potential strategic and marketing partners,
- Inspect potential office spaces or office suite for your company, and
- Meet with a minimum of 2 selected Law Firms and 2 Accounting/Tax Firms to get acquainted with the operational issues.

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In Conclusion

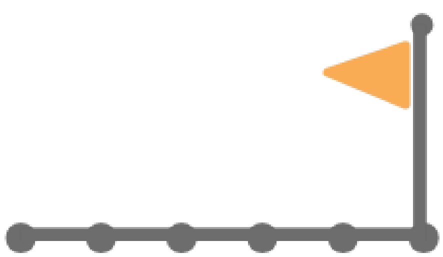
Stepping into the China market is intimidating for many companies in the B2B and B2C arena, with an almost endless series of potential pitfalls to be negotiated. While there may be many obstacles, the rewards of success are immense.

As China's economy continues to grow and become more open to foreign companies, the rewards increasingly outweigh the challenges of doing business in China.

China is a country that is constantly changing and its markets are evolving more rapidly than almost anywhere on earth. There is no single best approach by which foreign companies should enter the China market. Each company's strategy is likely to be influenced by a number of factors such as budget, product/service, company size/revenues and corporate vision.

We've attempted in this white paper to illustrate some of the fundamental considerations that any company must take when approaching the China market for the first time. Here's a quick high-level summary of do's and don'ts.

Do	Don't
• Perform extensive market research • Determine the best entry vehicle • Determine the best routes to market and channel partners • Consult with legal experts to create an IPR strategy for China • Register trademarks in China prior to market entry • Understand the 'WeChat' revolution • Carry out due diligence on prospective partners and employees	• Rely on hearsay, or third-hand market information from Chinese partners • Assume that similar market conditions apply throughout China • Invest in a local presence prior to researching the market thoroughly • Choose partners or employees without proper due diligence • Assume that IP rights are automatically protected under Chinese law



The Symbio Difference

Symbio has deep expertise in entering the China Market, and should be able to provide you with the guidance you need in every step of the way:

1. Your company's product/services competitive analysis and product positioning for the China market will be reviewed and recommended by our experienced team.

2. The Statement of Work (SOW) for product/ service internationalization and localization needed for this China Market Entry will be reviewed. We can execute this I18N/L10N task upon your authorization.

3. The necessary partnership and Channel Management in the China market will be identified. We can assist/ manage such partnership on your behalf upon your agreement. This includes also the ever-present and important WeChat strategy creation.

4. The legal, tax/ accounting, HR/ Staffing, Office support infrastructure will be outlined. We can assist/ manage these functions when authorized.

5. The financial and capital management in your China operation for the first year and its dealing with SAFE (State Administration of Foreign Exchange) and SAIC (State Administration of Industry and Commerce) will be presented. We can serve as your agent when authorized and as appropriate.

6. We can arrange and run an inspection trip to China for your senior management (2-5 members) to verify and validate the findings of our China Market Entry report.

Global HeadquartersSan Jose
marketing@symbio.com
www.symbio.com