

AUSTRALIA-CHINA AGENDA 2013



Tales from the Trenches: Some Thoughts on Doing Business in China

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THE AUSTRALIAN Centre on China in the World engages with the public and policy discussion of relations with the People's Republic of China and the Chinese world. Australia-China Agenda 2013 is our contribution to this important election year and the on-going consideration of the bilateral relationship.

This is a relationship that touches on virtually every aspect of our national life. A mature and beneficial engagement of such breadth and depth requires the leadership and support of government at all levels, as well as public stewardship, media understanding, educational enhancement and the strategic involvement of the business community.

Australia-China exchanges are also profoundly influenced by regional and bilateral relationships. Australia and China trade in goods as well as culture, politics and people, ideas and education, community and personalities.

Australia-China Agenda: 2013 brings to the attention of the public and the media, politicians and specialists some reflections and policy ideas authored by specialists with a professional interest and involvement in the relationship.

—Geremie R. Barmé
Founding Director, CIW

JANUARY 一月

FEBRUARY 二月

MARCH 三月

APRIL 四月

MAY 五月

JUNE 六月

JULY 七月

AUGUST 八月

SEPTEMBER 九月

OCTOBER 十月

NOVEMBER 十一月

DECEMBER 十二月

二〇一四年

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CHINA'S THIRTY-YEAR run of unprecedented growth and opening to foreign investment is a well known story. Now, the Chinese economy is at a crossroads as it seeks continued economic growth in a shift from an investment-led to a consumption-led economy. At the same time, while the Reform era has left the economy more open than ever to international investment, foreign businesses still face significant barriers – and some new challenges. What are these challenges and what can be done at a policy level to help Australian businesses face them?

Phases of Development of Business in China

To understand the position that foreign businesses find themselves in China today, it is helpful first to look back on the recent history of economic reform and foreign business in China, which has entailed a number of key phases:

- The first phase began with the *Gaige Kaifang* 改革开放 ('Opening up and reform') program, initiated by the Communist Party in late 1978, which along with many domestic reforms, also brought with it the initial opening to foreign investment. In these tentative early years, most investment was in the form of Sino-foreign joint ventures, and the focus was on attracting much-needed technology and foreign exchange. This era came to an abrupt end with the Tiananmen Incident of 1989, following which foreign investment went into a number of years of hibernation.
- The next phase was kicked off by Deng Xiaoping's 1992 'Tour of the South'. While primarily intended to signal to his domestic audience that economic reforms should resume, this also served to reassure foreign investors that China was once again open for business, and throughout the 1990s foreign investors returned to China in greater numbers. This era climaxed with China's accession to the WTO in 2001, and lasted until the end of the rule of Party General Secretary Jiang Zemin and his business-friendly 'Shanghai clique' in 2003. The post-WTO Jiang era in particular saw many developments that facilitated foreign business in China and did much to place foreign businesses on the same competitive footing as domestic enterprises. Foreign investors were allowed to invest in more sectors of the economy with fewer restrictions, and began to be able to – and to favour – investing on a 'wholly foreign owned' basis, dispensing with the need to form joint ventures with a Chinese partner and avoiding the complications those relationships often entailed.

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- Jiang was succeeded by Hu Jintao, and his term from 2003 until 2012 has generally been regarded as an era of conservative rule in many areas – economic, political and social. In business, these years were characterised by a trend known as *guo jin min tui* 国进民退 (‘state-owned business advances and private business retreats’), and domestic Chinese entrepreneurs found little support from a system skewed in favour of state-owned enterprises. Economic and financial reforms essentially came to a standstill in the Hu years, although granted the latter of these years also coincided with the global financial crisis, constraining bold policy moves. At the same time, foreign investors found that doing business in China became more difficult, as will be discussed further below. It was also during this era that China began to promote the *zou chuqu* 走出去 or ‘Go Global’ policy, encouraging Chinese companies to extend themselves internationally through overseas mergers and acquisitions, a trend that has had a clear impact in Australia.
- Now, with the accession to power of President Xi Jinping in 2013, we are in a new phase, and many commentators are speculating that China under Xi will see reforms once again gather momentum.

A Challenging Environment

The view from the trenches at that moment among the foreign business community is that doing business in China has become more difficult, not less. This perception has been widely reported in white papers published annually by organizations such as the American and European Union chambers of commerce in China.

As the government seeks to move from an investment-led to a consumption-led domestic economy, mean that foreign businesses will increasingly be moving from manufacturing in China to selling to China.

A slowing domestic economy, rising labour costs and a stronger Renminbi are the most immediate and obvious challenges, especially to exporters. However, structural changes to the Chinese economy, as the government seeks to move from an investment-led to a consumption-led domestic economy, mean that foreign businesses will increasingly be moving from manufacturing in China to selling to China. This brings foreign businesses into direct competition in the domestic markets with local companies. Now more than ever it will be important to foreign businesses to be treated fairly if they are to succeed in the Chinese market. However, there are many signs that this fair treatment is not currently the case.

The most recent European Union Chamber of Commerce in China ‘Business confidence survey’ (June 2013) showed 53% of respondents citing market access barriers as being a significant challenge to their future business in China, while 47% cited discretionary enforcement of regulations. In the same survey, 30% of respondents said that the regulatory environment has increasingly discriminated against foreign investors or is generally much less fair now than it was two years ago.

Market Access and Reciprocity

The ‘FDI Regulatory Restrictiveness Index’ compiled by the Organisation for Economic Co-operation and Development (OECD) identifies China as having the most ‘closed’ economy among all OECD and G20 nations, having regard to foreign equity limitations, screening or approval mechanisms, restrictions on the employment of foreigners and operational restrictions.

Sectors that remain restricted or wholly closed to foreign investment include key areas where Australian businesses possess particular know-how and competitive advantage: energy and natural resources, and agriculture. These also happen to be the sectors that are most attractive to Chinese investors seeking to invest in Australia.

While this is patently unfair, the gap also presents an opportunity for Australian policy-makers to push their Chinese counterparts for a policy of ‘reciprocity’ to prevail – to highlight that Australia welcomes Chinese investment, but expects the same treatment for its companies in China as it affords Chinese investors in Australia. This reciprocity should extend to market access, approval processes and other restrictions.

More reciprocity would have benefits beyond just those traditional sectors of Australian strength that I have mentioned. Our services industries – including education, tourism, legal services, and other areas where Australia has significant strengths – remain subject to various market access and licensing restrictions that impede Australian business success in China, and would equally benefit from greater reciprocity.

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Fairness and Transparency

Fairness in treatment and consistency in application of regulations and policies is one of the biggest challenges facing foreign investors. This has been manifested in a number of different areas:

Food and health safety and standards

Local officials eager to show that they are serious about tackling food safety issues see foreign operators as easier targets, as they are not entrenched local interests, and lack political protection.

Food safety is an increasingly sensitive political issue in China as numerous food scandals – from melamine-tainted milk powder to diseased pork, from cadmium rice to exploding watermelons – have drawn the ire of the populace, putting pressure on the authorities to investigate and punish offenders and reassure its people that they can eat safely.

However, foreign companies appear to be frequent and public targets of these investigations, as local officials eager to show that they are serious about tackling food safety issues see foreign operators as easier targets, as they are not entrenched local interests, and lack political protection. Such food safety crackdowns are often accompanied by adverse publicity campaigns in state-run media.

Recent targets have included:

- Wal-Mart, which was subject to a number of charges, including mislabelling regular pork as more expensive organic pork, a scandal which led to the temporary closure of thirteen stores and the arrest of two employees, and selling products with hazardous levels of chemicals. Wal-Mart has since agreed to invest RMB100 million to strengthen food safety management at its stores in China.
- KFC, one of the most long-standing and successful Western businesses in China, which faced an online outcry and falling sales after Chinese food regulators announced they had found excessive levels of antibiotics and hormones in chickens from some KFC suppliers, and more recently a CCTV media reported that its ice cubes contained excessive levels of bacteria.

Anti-trust and consumer investigations

Since China introduced its first comprehensive trade practices law in the form of the Anti-Monopoly Law of 2008, much of the focus internationally has been on the role of the Ministry of Commerce ('Mofcom') in overseeing merger control under the new law. Mofcom has made rulings on a number of overseas merger and acquisition transactions, as it seeks to become a globally influential antitrust regulator alongside the US Department of Justice and the European Commission.

However, it is the lesser remarked upon role of the National Development and Reform Commission ('NDRC') as the frontline regulator on pricing practices and anti-competitive behaviour. Its actions in preventing monopolies and unfair pricing practices also serve a political goal that is having an increasing impact on foreign business on the ground in China: pushing down prices for consumers is good public relations for the Chinese government, and at the same time supports Beijing's efforts to boost the consumer-led economy.

Again, foreign companies have been apparently disproportionately subject to the NDRC scrutiny, in a number of recent cases:

- In 2011, global consumer products giant Unilever was fined RMB2 million for announcing to the media that intended to raise prices. Prices were never actually raised, but Unilever was fined in any event for allegedly creating a consumer panic through its public statements.
- A group of the five largest global infant formula manufacturers – including Nestlé and Danone among other prominent global players – agreed to reduce the prices of their infant formula products in China after the NDRC announced it was investigating the companies for alleged price fixing in China. The NDRC subsequently levied significant fines on a number of the companies.
- The latest NDRC investigation has apparently been into foreign pharmaceutical pricing, although that has led to a broader corruption investigation, discussed below.

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Bribery and corruption

- Corruption is endemic in China, affecting all levels of government and business. Foreign companies also find themselves the target of corruption investigations, although again the timing and motivation for such investigations raise some questions.
- In the most notable case for Australia, several Rio Tinto executives were jailed for accepting bribes and stealing commercial secrets. While not questioning the conclusions of the Chinese judicial process that found the Rio employees guilty, it is notable that the investigation came shortly after the collapse of Chinese state-owned mining giant Chinalco's attempted investment in Rio Tinto and during a fraught annual benchmark iron ore price negotiation process.
- Most recently, British pharmaceuticals giant GlaxoSmithKline has been charged with a scheme of bribery involving payments to officials and doctors. In the context of a chronically underfunded health system, rampant counterfeiting of drugs and poorly paid doctors who seek to supplement their salaries – whether with kickbacks from pharmaceutical firms or bribes from patients' families to ensure priority treatment – there is clearly much that needs to be fixed in China's health system. It is curious that a large foreign drug company should be the starting point. Notably, following the charges being laid, GlaxoSmithKline announced price cuts at the same time as confirming that some of its executives appeared to have breached Chinese law.

A way forward

Now, none of the above is intended to excuse foreign companies for their misbehaviour in China. All companies must fully comply with the local law in all countries where they do business, and those that do not should be penalised in accordance with the law. However, concerns remain about the consistency and fairness with which such laws are applied to foreign businesses in China. There are also concerns that the public relations exercises in state-controlled media that generally accompany regulatory investigations appear to be part of a strategy to discredit or constrain foreign businesses in their attempts to compete in the domestic consumer market.

Australian policy-makers should press their Chinese counterparts to ensure that:

- laws and regulations are clearly drafted and publicly disseminated, and do not contain vague pro-

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- visions that can be subject to discretionary interpretation by regulatory authorities;
- foreign and domestic companies are treated fairly and consistently when it comes to the application of laws and regulations; and,
 - investigations are conducted transparently, sound evidence is provided to support allegations of misconduct and state-owned media are not favoured in dissemination of information on regulatory actions.

At the same time, foreign businesses in China need to understand that public relations and active image management is now just as important in China as it is in any other market. There once may have been a perception that China was ‘just’ a developing market, where investors could ignore public relations and take a lax approach to regulatory compliance. This is clearly no longer the case.

Greater fairness and equal treatment is needed in both directions: from foreign companies in operating their businesses in China, and from the Chinese government in regulating foreign business. This would lead to benefits for all involved. Australian governments and businesses should seek to be leaders in this respect, and place themselves at the forefront of a new era of engagement between China and the world.

AUSTRALIAN CENTRE ON CHINA IN THE WORLD

The Australian Centre on China in the World (CIW), College of Asia & the Pacific (CAP), The Australian National University (ANU) is an initiative of the Commonwealth Government of Australia in collaboration with ANU, a university with the most significant concentration of dedicated Chinese Studies expertise and the publisher of the leading Chinese Studies journals in Australia. CIW is a national research centre that is jointly managed by a body of academics that includes scholars of China at universities in Adelaide, Brisbane, Hobart, Melbourne and Sydney.

The Centre is a humanities-led research institution that is engaged with the broad range of social sciences to produce academic work that, while relevant to the full spectrum of demands of international scholarship, also relates meaningfully to those in the public policy community, and to the broader interested public, both in Australia and overseas. It values a New Sinology, that is an intellectual, cultural and personal involvement with the Chinese world (be it in the People’s Republic, Hong Kong, Macau, Taiwan or globally) that is underpinned by traditions of academic independence, local fluency and disciplinary relevance.

CIW sites

<http://ciw.anu.edu.au>
<http://www.thechinastory.org>

CIW publications (also available online)

China Story Yearbook 2013: Civilising China, October 2013
China Story Yearbook 2012: Red Rising, Red Eclipse, August 2012

Stephen FitzGerald, *Australia and China at Forty—Stretch of the Imagination*, 澳大利亚与中国已届四十年—舒展的想象力, February 2013

Australia and China: A Joint Report on the Bilateral Relationship 中国和澳大利亚：关于双边关系的联合报告, with the China Institutes of Contemporary International Relations (CICIR), February 2012

CIW journals

China Heritage Quarterly
(<http://www.chinaheritagequarterly.org>)

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