Organising an investment in China
Prepare for opportunity
A practical guide from the Economist Intelligence Unit

The outlook for China

Foreign companies continue to be attracted by the opportunities offered by China's large and rapidly growing economy. China has a population of over 1.3bn, and the size of the economy is likely to grow to just under US$13trn a year at market exchange rates by 2015. Although GDP per head will still be relatively low by the end of the forecast period, at just under US$10,000 a year, this will represent a substantial improvement from just under US$4,500 in 2010. Significant regional disparities within China will persist. The provinces of the eastern seaboard enjoy standards of living well above the national average. However, there are also markets to be found in inland China, where many large cities are located. To some extent, the size of the population and the pace of economic growth belie the challenges of operating in China. Nationwide distribution networks will increasingly be put in place, but the Chinese market is likely still to be a fragmented one by 2015.

Market opportunities for foreign companies in China are greatest in those sectors where domestic enterprises are weak, markets are underdeveloped and market opening is proceeding fastest. Although the government continues to ban foreign firms from a number of industries—such as broadcasting and armaments—or to restrict their involvement, overseas companies continue to find numerous business opportunities in a wide range of sectors across the economy. Market opportunities are opening up for companies that can advance the government's strategic objectives either within or outside the country. Chinese enterprises are also looking for joint-venture partners in resource exploitation and infrastructure.

The Chinese government encourages both labour-intensive industries, to soak up surplus labour, and capital-intensive enterprises, which can raise the quality of the national industrial base. Foreign companies are also welcome in infrastructure. The government may shy away from imported technology where there is deemed to be a local substitute. Consumer-goods markets are more open and competitive and do not rely on government procurement.

	2010	2011	2012	2013	2014	2015
Population (m)	1,312	1,320	1,328	1,335	1,342	1,349
GDP (US$ bn at market exchange rates)	5,878	6,821	8,090	9,569	11,196	12,973
GDP per head (US$ at market exchange rates)	4,479	5,166	6,092	7,166	8,341	9,618
GDP (US$ bn at PPP)	10,241	11,388	12,724	14,162	15,756	17,533
GDP per head (US$ at PPP)	7,803	8,625	9,582	10,606	11,738	12,999
Household consumption (US$ bn)	2,050.4	2,498.8	2,995.9	3,614.8	4,314.6	5,075.1
Household consumption per head (US$)	1,560	1,890	2,260	2,710	3,210	3,760
Exports of goods & services (% change)	15.8	8.6	9.6	9.0	8.9	9.1
Imports of goods & services (% change)	14.0	10.0	10.5	12.3	12.0	11.1

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Basic investment approval

Entering the Chinese market as a foreign company has gradually become easier, thanks to measures such as the 2004 deregulation meant to reduce the amount of red tape that overseas businesses face (see below). Establishing a joint venture has traditionally involved protracted negotiations, which is one reason why wholly-foreign-owned ventures are becoming more popular. Even so, legislation governing foreign investment can be bewildering and arbitrary, especially as authorities experiment with new regulations.

China often subjects proposed foreign investment to intense scrutiny, to ensure that approvals go only to projects supporting national-development priorities and balancing foreign-exchange flows. Restrictions have eased somewhat in recent years, thanks to the country's entry into the World Trade Organisation in 2001, which led to a loosening of rules on the kinds of investments admitted and how they are regulated. In April 2010 the State Council (Cabinet) issued new rules permitting local governments to approve investment proposals of up to US$300m (up from US$100m) if the projects are in the encouraged or permitted categories of the investment catalogue (see below). But the government still closely checks investment proposals and sometimes intensifies them, motivated by new priorities, such as keeping out polluting enterprises.

China's business environment is still demanding, for both market entry and day-to-day management. Although some aspects of running a business have become easier, such as securing domestic financing, other obstacles have actually worsened, such as recruiting skilled managers and workers—as a result of a tighter labour market.

The three structures most often used for investing in China are the wholly-foreign-owned venture; the equity joint venture, which is typically used for long-term projects and must register as a legal entity; and the contractual, or co-operative, joint venture. The representative office, though technically not an investment vehicle, is often the quickest and easiest way to establish a presence in China. New measures issued in November 2009 explicitly made it possible for foreigners to enter into partnerships with Chinese companies, but interest has so far been modest. Only 16 Sino-foreign partnerships had been registered by August 2010, the most recent data available from the State Administration of Industry and Commerce.

Wholly-foreign-owned enterprises (WFOs). This corporate form is funded entirely with foreign investment and has sole responsibility for profits and losses. It must register as a legal entity, which gives it, among other things, the right to sue other entities or persons in a Chinese court. WFOs are governed by the Law on Wholly-Foreign-Owned Enterprises, amended in October 2000, and by related implementing regulations, amended in April 2001.

The WFO had become the most popular investment vehicle even before China's entry into the WTO because companies realised that it reduced the need for a Chinese partner in many types of operations. The number of approved WFOs rose by 17.8% in 2010 from the year before to 22,085, representing 80.6% of the total number of foreign ventures approved, and accounting for US$81bn, or 76.6%, of total incoming foreign investment during 2010 (not including investments in financial institutions), according to the Ministry of Commerce.

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Equity joint venture (EJV). This corporate form is typically used for long-term projects and must register as a legal entity. EJVs are limited-liability companies, with liabilities limited by investment. Both the foreign and the Chinese investors contribute capital, obtaining equity and subsequently receiving redistributed profits or sharing losses accordingly. The minimum stake that a foreign investor may hold is 25%; there is no maximum. EJVs are governed by the Law on Equity Joint Ventures, amended most recently in March 2001, and by related implementing regulations amended in July 2001.

Although EJVs were once the country's most common investment vehicle, they are now declining in popularity and will probably continue to do so. China approved 4,970 EJVs in 2010, up by 16% from 2009, mainly because of a general recovery of inward investment. They accounted for US$22.5bn of investment in 2010, or 21.3% of the total of incoming FDI.

China has now fulfilled its WTO obligations by allowing 100%-foreign-owned companies to engage in domestic retail and wholesale operations. Nevertheless, a Chinese partner with strong connections and direct knowledge of the market can be invaluable to a foreign company that wants to sell products in China.

Contractual or co-operative joint venture (CJV). Investors often adopt this corporate form for shorter-term projects or build-operate-transfer investments. It may (but does not have to) register as a legal entity with limited liability. If the company does register as a legal entity, the foreign investor must contribute at least 25% of the registered capital. Typically, the foreign investor provides funding and technology, and the Chinese partner provides land, labour, natural resources, and power and water facilities. Profit redistributions or loss-sharing need not reflect the investors' respective contributions; thus, CJVs offer significant flexibility to both parties in negotiating contracts. CJVs are governed by the Law on Co-operative Joint Ventures, amended in October 2000, and related implementing regulations amended in April 2001. China approved 300 CJVs in 2010, down from 390 in 2009. They accounted for US$1.6bn in foreign investment, or 1.5% of the total during 2010.

Apart from these three most-widely-used investment forms, the Chinese authorities have adopted other structures:

Foreign-invested company limited by shares (FICLS) is also known as a foreign-invested joint-stock company. This form requires registered capital of at least Rmb30m, of which foreign shareholders must contribute at least 25%. A separate set of regulations under the Company Law governs FICLS: the Provisional Regulations on Several Issues Concerning the Establishment of Foreign Invested Companies Limited by Shares, implemented in 1995. FICLSs form a subclass of joint-stock companies, a corporate form that, together with limited-liability companies, the Company Law introduced as from July 1st 1994. Joint-stock companies are similar to Western-style public-shareholding companies. China approved 51 FICLSs in 2010, up from 21 in 2009; they accounted for US$600m in investment, or 0.6% of the total.

Limited-liability company. This corporate form, permitted under the Company Law, is essentially the same legal type provided for under the existing laws governing WFOs and JVs.

Investment, or holding, company. This represents a type of investment organisation that can be either a WFO or a Sino-foreign JV. A foreign company can form an investment company when it wishes

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to combine two or more of its JVs or other forms of investment in China into a fully integrated company that can combine sales, procurement, subsidiary investment, manufacturing and maintenance service for a broad range of product lines.

The Ministry of Commerce (MOFCOM) on June 10th 2003 published Provisions on the Establishment of Investment Companies by Foreign Investors. The rules, implemented 30 days later, replaced and codified all previous regulations governing investment companies, including the Regulations Concerning Investment in and Establishment of Investment Companies by Foreign Business Entities of 1995.

The rules stipulate that an investment company may not hold shares in a company limited by shares or a joint-stock company. They also state that investment companies with registered capital of at least US$30m may borrow up to four times the amount of registered capital (up to six times if they have registered capital of at least US$100m).

China took steps in late 2004 to meet its WTO obligations by freeing investment companies to sell domestically without restrictions (but they still must apply to MOFCOM for that right). Previously, they could sell their products within the country only via a special company established for that purpose.

Partnership enterprise. Another investment vehicle developed in recent years is the partnership enterprise. The Law on Partnership Enterprises, implemented in August 1997, sets the rules for establishing, operating, terminating and liquidating such firms. The law defines a partnership enterprise as a profit-making organisation established in China by legal entities that jointly contribute capital, share profits and risks, and undertake unlimited liability for the debts of the enterprise.

The law requires a partnership enterprise to have at least two partners, a written partnership agreement, paid-up contributions from each of the partners and a place of business. Partners must be persons with full capacity for civil acts. They may make capital contributions in currency, in kind, or in the form of land-use rights, intellectual-property or other property rights. The partners share profits and losses of the partnership enterprise in proportion to the ratio stipulated in the partnership agreement or, where the partnership agreement fails to stipulate such a ratio, on an equal basis.

Investment-approval checklist

Wholly-foreign-owned ventures (WFOs)

- A prospective foreign investor must submit a report to the local authorities on the planned project, including its size, purpose, products, technology and land-use requirements. The local authorities normally reply within 30 days.
- If the project exceeds an investment-value threshold (now usually US$300m) or is in an industry in which investment is restricted or considered sensitive, the foreign investor must subsequently submit the local authorities' reply and a new application and feasibility study for approval to the Ministry of Commerce (MOFCOM). The application must include the articles of association, certificate

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of incorporation, letter of creditworthiness issued by the investor's bank, and the identity of the investor's legal representative. MOFCOM normally replies within three months.

- After approval, the foreign investor must register with the State Administration of Industry and Commerce within one month to obtain a business licence.

- WFOs, like joint ventures, must file an environmental-impact assessment, followed by application for land use and construction permits.

Equity joint ventures (EJVs) and co-operative joint ventures (CJVs)

- The Chinese party submits a project proposal, preliminary feasibility study and letter of intent indicating the foreign company's interest in the project to the Chinese agency in charge of approval. Since amendments to the Equity Joint Venture Law and related implementing rules on July 22nd 2001, EJVs no longer need to submit plans for production and operation to the Chinese agency.

- Following approval from the Chinese agency, the two JV partners prepare a joint feasibility study.

- They submit an application, joint feasibility study, the JV contract and articles of association for approval. Other documents may need to be submitted, including contracts on technology transfer and trademark licences.

- For EJVs, authorities must take an approval decision within three months of receipt of the documents; for CJVs, the period is 45 days.

- Both EJVs and CJVs must file an environmental-impact assessment with the local authorities.

- Following the filing of an environmental-impact assessment, the joint venture should apply for land use and construction permits.

Representative offices

- Foreign investors must first seek agreement with a Chinese company that can act as its sponsor.

- An application must be submitted to a local approval authority. A reply is normally given within one month after formal application.

Partnerships

- New partnerships must register with the local branch of the State Administration of Industry and Commerce.

- If special restrictions apply in the industry where the partnership intends to operate, special permission must also be obtained from the relevant authority.

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Acquisition of an existing firm

Acquisitions still make up a comparatively small portion of total foreign-investment flows into China, but their numbers are on the rise. According to Dealogic (an UK-based data provider), the number of acquisitions rose by 17% in 2010 from 2009, to 910; the transaction value increased by 56% to US$48.2bn. There is growing concern, however, in both industry and government in China about the longer-term consequences of foreign acquisitions. Diageo (a beverage company based in the UK) announced in March 2010 that it planned to increase its stake in Shui Jing Fang (a Chinese maker of spirits). Diageo would spend US$935.5m to raise its stake in Chengdu Quanxing Group, which owns 40% of Shui Jing Fang, to 53% from 49%; subsequently, it would seek to purchase the remaining 60% of Shui Jing Fang from other shareholders. At the time of the announcement, the companies involved expected quick approval from Chinese authorities, but they had not yet received approval in January 2011. It was unclear what the exact reason was for this, but observers speculate that China's government is unwilling to yield control of a well-known national brand to a foreign company.

This was similar to China's decision in March 2009 to bar a US$2.4bn bid by Coca-Cola (US) to take over Huiyuan (a juice maker), saying that the merged entity would gain a dominant position in the domestic market and then force consumers to pay higher prices. The announcement, coming at the end of a lengthy investigation by the Ministry of Commerce (MOFCOM), was the first major test of China's new Anti-monopoly Law (see below), but it was also a test of the Chinese public's tolerance towards foreign capital buying up well-known local brands. When Coca-Cola announced in September 2008 its intention to take over Huiyuan, in what would have been its largest-ever acquisition in China, rival soft-drink makers publicly complained about what they described as a monopolistic threat, and members of the public criticised the planned sell-out of an iconic national brand. Foreign observers saw this as a sign of growing "economic nationalism" in the government.

Other deals have failed for different reasons. Charles River Laboratories International (a US medical-services company) in August 2010 announced the cancellation of a planned takeover of Wuxi PharmaTech (a drug-testing company). At US$1.6bn, it would have been the largest-ever takeover of a Chinese company by a foreign enterprise, but the deal foundered on objections from shareholders in the US companies, who were unconvinced about the transaction's strategic value.

The Anti-monopoly Law, passed in August 2007 and implemented in August 2008, orders national-security reviews of foreign-investment proposals if necessary, but it does not specify where it is mandated. Three government agencies are involved in implementing the law. MOFCOM is in charge of merger approvals, the National Development and Reform Commission handles cases on pricing, and the State Administration of Industry and Commerce (SAIC) handles cases involving alleged abuse of dominant market position.

The MOFCOM issued new regulations in July 2010 on the divestiture of assets and businesses of enterprises deemed to be enjoying a dominant position in their industries, as determined on a case-by-case basis. The rules empower MOFCOM to specify a period within which the business must find a buyer of the assets to be divested; they also give MOFCOM the authority to turn down buyers that it

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deems unsuitable. This latter regulation has led to concerns that MOFCOM could favour Chinese buyers, giving them easy access to foreign technologies.

The Chinese government has signalled a desire to expand its anti-monopoly regulatory framework. In May–July 2010, the SAIC released for public comment new draft provisions that will flesh out the rules of the Anti-monopoly Law. For example, the draft provisions target the role played by government in ensuring an even playing field, prohibiting government departments from behaviour that could restrict competition, such as discriminating against individual companies via, for example, onerous inspection requirements. The draft provisions also include a "whistle-blower clause", granting immunity to the first company to report to the government their involvement in cartel behaviour.

During August 2008 to June 2010, the latest date for which statistics are available, MOFCOM accepted 140 merger applications; it had completed review of about 90% of these cases by June 2010. The MOFCOM data revealed a slight bias against mergers involving overseas capital: overall, 95% of all merger proposals were approved without conditions, but the approval rate was 93% for mergers involving US or EU companies.

China's implementation of the law so far has been somewhat controversial. For example, it reserves the right to pass judgment on mergers between two non-Chinese entities if the transaction is deemed to affect their activities in China. In January 2009 MOFCOM started an investigation of a proposal by Mitsubishi Rayon (Japan) to purchase Lucite International (UK), a manufacturer of acrylic-based products. MOFCOM decided in April 2009 that the combined entity would have an overly dominant position in China's market for methyl methacrylate and ordered it to divest some of its capacity and restrict its growth inside China for five years. By contrast, in April 2010 China approved Hewlett-Packard's acquisition of 3Com (both based in the United States).

The China Banking Regulatory Commission (CBRC) in December 2008 issued new rules allowing local companies, including foreign-invested enterprises (FIEs), to use bank loans to finance acquisitions of equity or assets in other companies. The rules do not explicitly state requirements that the borrower must meet, but they call on the lender to consider criteria such as the positive synergies that might emerge from the transaction. It is likely the new rules will mean a significant improvement for FIEs, which have so far relied on complicated crossborder transactions to finance acquisitions.

The Provisional Rules on the Merger and Acquisition of Domestic Enterprises by Foreign Investors, issued in 2003, was updated on August 8th 2006. Article 12 of the updated rules states that transactions involving "major industries", "famous trademarks or traditional Chinese brands" and acquisitions that "may have an impact on state economic security" are subject to MOFCOM review. But the updated regulations failed to define "major industry".

The Provisional Rules on the Merger and Acquisition of Domestic Enterprises by Foreign Investors clarified a legal grey area concerning foreign acquisitions of local companies. The rules were published by MOFCOM, SAIC, the State Administration of Foreign Exchange (SAFE) and the State Administration of Taxation (SAT). The rules cover two types of acquisitions: "equity acquisitions", where foreign investors buy existing shares of a Chinese enterprise or subscribe to new shares issued by a Chinese enterprise, and "asset acquisitions", where foreign investors buy the assets of a Chinese enterprise.

The rules attempt to create strong barriers against foreign investors using mergers and acquisitions

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to dominate the local market. MOFCOM and the SAIC are supposed to scrutinise applications for the following problems:

- the merger or acquisition would lead to a company controlling 25% or more of the Chinese market;
- the foreign investor already controls 20% of the Chinese market;
- the foreign investor has assets in China of more than Rmb3bn; or
- the foreign investor has annual sales in China exceeding Rmb1.5bn.

Such deals are not directly prohibited, but the authorities reserve the right to block those that will lead to one foreign company controlling too large a share of the market.

The maximum permitted investment resulting from any merger or acquisition is based on the following formula:

- companies with registered capital of less than US$2.1m are allowed to invest 1.43 times that amount;
- those with capital of US$2.1m–5m may invest twice that amount;
- those with capital of US$5m–12m may invest 2.5 times that amount; and
- those with capital exceeding US$12m, may invest three times that amount.

The purchase price must be set with reference to a third-party appraisal of the value of the acquired equity.

Apart from these provisions, the rules issued in 2003 reiterated existing Chinese policies on FIEs. They specify that FIEs resulting from a merger or acquisition must involve at least 25% foreign investment. They also state that foreign investors contemplating a merger or acquisition must comply with the Foreign Investment Catalogue (see Foreign investment).

Separate rules published by the Ministry of Finance and the State Economic and Trade Commission on November 4th 2002 abolished a ban, in place since 1995, against foreign investments in listed state-owned enterprises (SOEs). The revised rules allow government-held, non-tradeable shares in listed SOEs to be sold to foreign investors via public tenders. The rules require foreign buyers to hold the shares for at least 12 months. Following acquisition of the shares, the SOEs remain classified as domestic companies.

For wholly-foreign-owned enterprises (WFOs), mergers or major changes in capital structure or form of enterprise are subject to examination and approval by MOFCOM at the local or national level, or by another government ministry based on accounting statements verified by an accountant registered in China. Following approval, changes must be registered with the local SAIC office.

Transferring equity interests in a joint-stock company is more straightforward. It can be undertaken through the sale of shares on one of China's stockmarkets in accordance with the regulations governing securities exchanges. Both the Company Law and the Provisional Regulations on Several Issues Concerning the Establishment of Foreign-Invested Companies Limited by Shares (FICLS) place some restrictions on the transfer of shares in FICLS. First, foreign holdings may not fall below 25% of

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the registered capital of the company as a result of such a transfer, unless there is a sale of the foreign stake in full to a Chinese partner. Second, the Company Law and the provisional regulations state that promoters' share capital may not be transferred until three years after the establishment of a company. (There is no such restriction on the transfer of equity interests in FIEs). Finally, any transfer of promoters' share capital requires the approval of the original examination and approval authority.

The provisional regulations provide that an equity joint venture (EJV) can be reorganised into an FICLS if it has a record of profitability in the immediately preceding three years. After making this conversion, the new company must specify in its articles of association the rights of the original parties to the EJV and any restrictions on the transfer of interests during the term of the JV. These agreements must be submitted to the original examination and approval authority for preliminary consent before going to MOFCOM for final examination and approval.

When a joint-stock company wishes to merge with or acquire another company, it may do so only after a merger or acquisition plan has been drafted by the company's board of directors and a resolution has been passed at a shareholders' general meeting, in accordance with procedures in the Company Law and relevant local or national legislation governing the establishment of companies limited by shares. All parties involved in a merger or acquisition of a listed company must enter into a merger agreement. They must also submit an application to the administrative department in charge of the business and submit the application for examination and approval to the authority that originally approved establishment of the company. (For an FICLS, MOFCOM serves as one of the original examination and approval authorities.)

At present, no SOE may be directly taken over by or merged with an FIE until it has become a company governed by the Company Law (a set of regulations that do not govern SOEs per se, since they are considered to be owned by the entire Chinese people). The State Valuation Bureau conducts an official valuation of an SOE that is put up for sale. If the purchase price is considerably below that valuation, special reports must be filed with the bureau stating the reasons. The State Assets Supervision and Administration Commission (SASAC) must approve a transfer of interest or assets in an SOE, after having approved the valuation report. Companies buying a stake in a Chinese company must pay the full purchase price within three months (sometimes six months) after issuance of the business licence.

Foreign parties were acquiring larger shares in successful JVs through capital expansions even before China's accession to the WTO in December 2001. Foreign investors often find that after a few years the Chinese partner has outlived its usefulness. Management clashes can sometimes be resolved only by buying out the Chinese partner. However, local regulation often makes this a cumbersome procedure, especially if the acquisition takes place onshore.

Chinese regulators have traditionally taken a dim view of such dilutive restructuring, though they have permitted many of them. A document issued jointly by the SAIC and MOFCOM, Several Regulations Concerning Changes in Equity Interest of Investors in Foreign Investment Enterprises, implemented in May 1997, clarifies the conditions under which equity changes may proceed. The document states the following regulations:

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- The foreign partner may not reduce its equity interest to below 25% of the registered capital of the enterprise unless it assigns its entire equity interest to the Chinese investor;

- Enterprises selling mostly to domestic markets or operating in industries where government policy requires a majority-Chinese stake must retain a Chinese shareholding of at least 50%;

- The Chinese party may not reduce its interest in the joint venture to less than 25% unless the venture meets the approval criteria for a WFO;

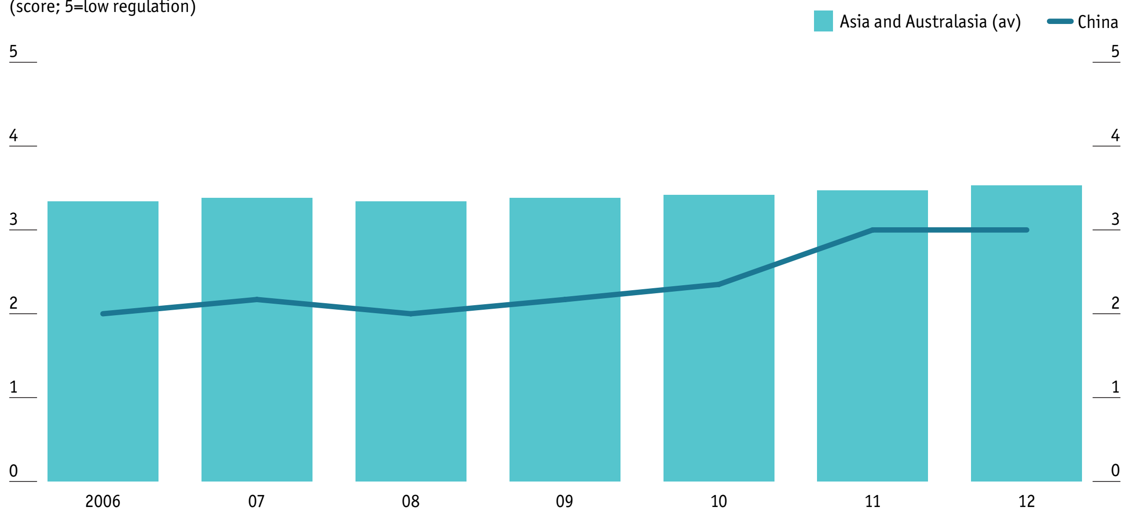
- The venture's assets must be revalued if the capital increase results in a change in the percentage of equity held by the partners. The foreign partner may then increase its equity stake by acquiring assets contributed by the Chinese partner at their new value; and

- The venture contract must be revised if the foreign party moves from a minority to a majority position, in order to protect the rights of the minority shareholder "such as the right to make strategic decisions, the right to carry out operations and management, and the entitlement to profit distribution".

One form of acquisition activity involving FIEs is the sale at a negotiable price of foreign equity to the Chinese partner. The foreign partner sometimes sells the interest to rid itself of a losing investment or because its China strategy has changed. But foreign partners have often found that any attempt to sell their JV stake to a party other than the Chinese partner or any effort to wind down the venture is arduous. Nevertheless, China's ongoing need for foreign capital and technology is prompting authorities to take a more accommodating stance.

Sales that change a JV's management structure or reduce the local partner's control are especially unpopular. Investment authorities may be equally disapproving of changes in ownership brought about by a Chinese entity selling an equity stake to a foreign company. Chinese organisations involved in JVs generally resist dissolving partnerships lest doing so will cost them credibility, as well as the benefits that come with ties to a foreign investor.

Setting up a new business
(score; 5=low regulation)



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Building and related permits

Dealing with building permits is notoriously cumbersome in China. China was ranked 181st among 183 nations in terms of difficulty obtaining construction permits, by the International Finance Corporation (IFC) in its Doing Business 2011 report, published in November 2010. The IFC lists 37 separate procedures that investors must go through in China to obtain a building permit, as opposed to six procedures in a so-called "good practice economy" (such as Denmark).

According to the IFC, applying for and obtaining a building permit from the municipal government takes 21 days. However, the application must be accompanied by 16 individual documents, most of which also require a lengthy application procedure. For example, the land use permit, one of the 16 documents, must be obtained from the municipal planning administration bureau, which usually requires 40 working days to respond.

Given the hassles involved, equity joint ventures (EJVs) and co-operative joint ventures (CJVs) have traditionally obtained their factory buildings and offices from the Chinese partner as part of the latter's investment. The Chinese partner also generally obtains building and related permits. Increasingly, foreign-invested enterprises (FIEs) are buying rights to use a parcel of land for a fixed term (usually in special industry or development zones) and are building their own factories from scratch.

The Construction Law of 1998 specifies that building contracts should be put to tender whenever possible, strengthening a foreign JV's hand when its Chinese partner might otherwise insist on using a specific local construction company. National law requires that Chinese architects participate in all design projects in China.

Under the Urban Real Estate Management Law of 1988, local property-administration departments issue building-ownership certificates on the strength of land-use certificates issued by land-administration departments at the county level or higher. Assignment or modifications of real property must be registered with the local property-administration department, which will issue a new building-ownership certificate and re-issue or amend the land-use-rights certificate, as required.

Holding patterns

Diageo, a beverage company based in the UK, announced in March 2010 that it was planning to hike its stake in Shui Jing Fang, a local maker of spirits, to 53% from 43%, expecting a quick go-ahead from Chinese authorities. But it had not yet received approved in January 2011. Observers speculated that China's government was unwilling to yield control of a well-known national brand to a foreign company, reflecting an economic nationalism many also thought was in play when China rejected a bid by Coca-Cola of the US to take over Huiyuan, a juice maker, in March 2009.

BASF, a German chemical company, has encountered delays in its plans to build a plant producing methylene diphenyl diisocyanate (MDI), an ingredient in the production of thermal insulators used in, for example, buildings and refrigerators. The plant is to be in the municipality of Chongqing in south-

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west China. BASF signed a memorandum of co-operation in June 2007 with Chongqing Chemical and Pharmaceutical Holding (Group) on the Rmb8bn plant, which is to produce 400,000 tonnes of MDI annually and create 300 local jobs. Initially, the plant was to start up in 2010, but the project met with concern among citizens that it will pollute the Yangtze river, which flows by Chongqing. In June 2010 the Chinese government said it would give approval within half a year. But final approval had not yet been given as at January 2011.

Environmental law

Environmental degradation is one of the most pressing long-term issues facing Chinese policymakers. Water and air pollution in particular continue to be major problems. The Ministry of Environmental Protection (MEP), upgraded from the State Environmental Protection Administration (SEPA) in May 2008, has introduced plans to establish a "green GDP" number, to include environmental costs in its calculations of the growth of the Chinese economy. The plan has met with a mixed a reaction from local governments, which are usually more concerned about lifting growth and creating new jobs.

Sulphur-dioxide levels in China's major cities declined by 2.3% in 2010, from 2009, the MEP said in January 2011; it did not report figures for how many tonnes of sulphur dioxide were emitted in either year. The decline was partly a result of new policies offering incentives to power stations, in the form of higher electricity tariffs if they installed desulphurisation equipment. Chemical oxygen demand, a major index for water pollution, was down by 3.9% in 2010 from 2009, the MEP said. Despite these tentative signs of improvement, the overall situation remained grim in 2010. MEP data showed that in the first half of 2010, only 49.3% of the water in major lakes and rivers was considered safe to drink. In addition, major chemical spills continue to be a regular occurrence in China. In July 2010, 1,500 tonnes of crude oil spilled into the Yellow Sea after two pipelines were torn open in an explosion in the north-east Chinese port city of Dalian.

In the 12th five-year plan, for 2011–15, China said it hopes to curb water and air pollution further. Compared with the previous five-year plan, which focused on emissions of sulphur dioxide and organic pollutants as measures of the success its efforts, the government added ammonia nitrogen and nitrogen oxide to the list of emitted substances that it will monitor.

In November 2009 the Chinese government published the 2020 goal of reducing carbon intensity—carbon-dioxide emissions per unit of gross domestic product—by 40–45% from its 2005 level. This is a continuation of the 11th five-year plan, which included targets to improve energy efficiency (defined as the energy cost of each unit of GDP) by 20% and to reduce pollution by 10% during the period. Official data suggest it will not be simple to achieve the ambitious emission targets. The 20% energy-efficiency improvement target over the five-year period implies an annual improvement of 4%. The effort was off to a slow start, with energy efficiency improving by just 1.79% in 2006, but it improved significantly, to 3.66%, in 2007 and 4.20% in 2008; in 2009, it improved by a more moderate 2.20%, and in the first half of 2010 it actually deteriorated by 0.09%. Even so, the National Development and Reform Commission (NDRC), the top planning agency, reported in January 2011 that China had "basically" met its 20% target for 2006–10, saying it would release more-detailed data later.

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In December 2009 China amended the Renewable Energy Law to require electricity-grid companies to buy all power generated by renewable energy producers; this is in line with China's objective to raise the level of renewable energy to 15% of its total energy mix by 2015, up from 9% in 2010. (Renewable energy in China also includes large hydropower projects.)

China is gradually launching new vehicle-emission standards; the exact requirements vary by geographical location. On March 1st 2008, for example, Beijing banned the sale of all new cars failing to meet the Euro IV standard, which among other things calls for no more than 1 gram of carbon monoxide emitted per kilometre. The Beijing government said in December 2010 that it would impose Euro V standard in 2012. Among other things, this calls for a limit of 180 milligrams per kilometre of nitrogen-oxide emission for new diesel cars.

The government has signalled new measures to curb pollution. SEPA (now MEP) issued a notice in October 2007 that strengthened environmental supervision of export industries. The notice requires authorities to suspend export licences and to refuse export-quota applications by companies found to be violating environmental regulations.

The NDRC stated in October 2010 that an environmental tax could possibly be introduced during the 12thfive-year plan (2011–15); the MEP first stated this goal in 2007. The finance ministry's plan for 2010 also instructed local tax departments to select areas suitable for carrying out tests of the environmental tax. Earlier public statements on the tax have suggested three alternative models: taxing companies according to their profits; taxing companies based on the pollution they cause; or levying the tax on the finished products (meaning that consumers would pay).

The government also wants to combat environmental degradation through legal means. The Criminal Law promulgated in 1997 made it possible for the first time to punish environmental infringers with fines, imprisonment or even capital punishment. Enforcement efforts are often weak, however, especially outside the major cities.

Foreign-invested enterprises (FIEs) face the same environmental and building restrictions that apply to domestic enterprises—though many complain that they face more-rigorous enforcement of the rules. Even FIEs in special economic zones, open coastal cities, and economic and technological development zones, where only FIEs are located, face stringent standards. In November 2007 SEPA launched a "post-check-up" of 130 multinational companies that had been found to be breaking environmental law during 2004–07. The follow-up inspection of the 130 enterprises showed that all had ceased the activities initially found to have been in breach of environmental regulations, but three were found guilty of new infringements of environmental rules.

Part of the official rationale behind such double standards is that foreign companies have longer experience with environmental protection and should therefore meet stricter requirements. SOEs generally pose a far greater threat to the environment, but efficient solutions to their problems are perceived as potentially devastating to their economic health. Realistically, SOEs are probably too well connected with local authorities to face strict requirements on a level anywhere near the ones imposed on FIEs.

Environmental issues should be an important concern to foreign investors for purely business reasons. For instance, foreign JV participants should scrutinise any land provided by the Chinese

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partner as part of its capital contribution, since previously polluted or contaminated property could pose a major future financial burden in terms of environmental control and land improvement.

All domestic and foreign investments in China must perform an environmental-impact assessment. A new Environmental Impact Assessment Law, similar to regulations in place since 1998, came into force on September 1st 2003. The new rules contain requirements for reporting on the environmental effects of a project, which grow stiffer with increases in the probable negative effects. They also require submission of new environmental-impact reports if the investor makes important changes to the original construction plans. They specify punishments for non-observance, including fines of up to Rmb200,000, or orders to halt construction. Local agencies have to monitor the building of any environmental-protection facilities that takes place at the same time as the construction of an investment project. Following completion of the project, local agencies are to monitor the facility for a one-year trial period. The rules break new ground by also obliging government construction projects to conduct environmental-impact assessments.

The Cleaner Production Promotion Law, implemented on January 1st 2003, covers aspects of clean production, including labelling and the sale of toxic construction and decoration materials. It provides for fines of up to Rmb100,000 for violations. It also requires the State Council to implement new environmental taxes to make product prices reflect the inherent environmental costs involved in their manufacture. A set of regulations on emission-control charges by SEPA (now MEP) came into force on July 1st 2003.

China is taking strong action on lead emissions. It banned leaded petrol in vehicles in 2000, but allows the use of it for other purposes—though it will phase it out in those other sectors, too. Beginning January 2009, China raised the import tax on leaded-petrol imports fivefold, to Rmb1.4 per litre.

The Law on the Prevention and Control of Air Pollution, implemented on September 1st 2000, covered many areas related to air pollution. It introduced a system of emission fees graded by amount and type of pollution. It set air-quality standards and emission standards for motor vehicles and vessels, by the State Council and provincial agencies, and banned the manufacture and sale of motor vehicles that do not conform to existing emission standards. It placed strict curbs on emissions of dust and waste gases containing toxic substances. It also stipulated detailed assessments of the environmental effect of new construction projects involving building, expanding or renovating air-polluting projects. Moreover, it designated special "air pollution quantity-control zones" in areas where environmental standards are not met by the State Council and provincial-level authorities, and in "key cities" where air quality gets special priority, such as provincial capitals, coastal open cities and well-known tourism cities. There are fines of up to Rmb500,000 for violations of the rules; in particularly severe cases, punishment falls under the Criminal Law.

SEPA, (now MEP) MOFCOM and the General Administration of Customs issued the Regulations Concerning Strengthened Administration of the Import and Export of Ozone-Depleting Substances, in April 2000. These rules are meant to align Chinese legislation with stipulations in the Montreal Protocol, which gave China, along with other developing countries, a January 1st 2010 deadline to phase out ozone-depleting substances. The United Nations Environment Programme said in a statement in June 2010 that China had "closed down all its production plants for CFCs (chloroflurocarbons—chemical

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compounds that contribute to ozone depletion) much ahead of the schedule of the Montreal Protocol". The regulations allowed Chinese companies to trade such substances only with enterprises in a limited group of developing countries allowed by the Montreal Protocol during the phase-out of this trade. Since January 2002, cars sold in China, whether locally manufactured or imported, have not been allowed to have air conditioners that use Freon. China closed five of the six remaining plants producing ozone-depleting substances in July 2007.

Older national laws govern other areas of environmental protection and pollution control. They include the following:

- Land Administration Law, implemented on January 1st 1999, requires developers to reclaim the same amount of arable land that will be occupied by a prospective project.
- Law for the Prevention and Control of Environmental Noise Pollution, implemented on March 1st 1997, gives all enterprises and individuals the right to report or complain to the authorities about any enterprise or individual that creates noise pollution.
- Law on Prevention and Control of Solid Waste Pollution, implemented on April 1st 1996, governs the prevention and control of industrial solid-waste pollution, urban-rubbish pollution and toxic-waste pollution.

China has not yet promulgated a set of tax incentives to adopt production methods that are more environmentally friendly. But the most recent list of industries in which foreign investors are encouraged includes a wider range of environmental-protection technology products than previous lists had included.

Acquisition of real estate

Land sales in China increased by 70% in 2010 to Rmb2.7trn, according to the Ministry of Land and Resources (MLC). The MLC said in January 2011 that although land prices had been relatively steady in the first three quarters of 2010, they had spiked somewhat in the last quarter. This could be a signal of more tightening to come, following a series of restrictions in 2010, including regulations issued in April 2010 requiring mortgage holders who apply for a second housing loan to make a down payment of 50%, up from 40% earlier; the mortgage rate remained at least at 1.1 times the benchmark one-year lending rate at the time the mortgage was arranged. The regulations of April 2010 also demand that first time home buyers make down payments of 30% for homes bigger than 90 square metres.

Access to land is one of the most contentious issues in modern China, since rapid growth has triggered conflicting demands for the scarce resource. For the 12th five-year plan(for 2011–15), China has set a minimum of 1.04m sq km of agricultural land in order to ensure food security, further limiting access to land. All land belongs to the state directly or indirectly, and this is unlikely to change any time soon. But there has been growing willingness recently to experiment with new ways of

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transferring user rights.

In October 2008 the Communist Party Central Committee called for a new system to transfer land-use rights, by means such as subcontracting, lending and swapping. This may have done relatively little to boost the property market in China since then, compared with the huge effect of local governments seeking to boost revenues by selling the right to use land they control.

Real property has become a major issue for foreign-invested enterprises (FIEs) because of soaring demand for land for both residential and commercial uses. In China, where all land is owned by the government, land-use rights for enterprises come in two forms: "allocated" or "granted".

Allocated land-use rights are the more traditional form under which many state-owned enterprises (SOEs) obtained land in the past. It may not be transferred, leased or mortgaged, and an annual land-use fee is levied. By contrast, holders of granted land-use rights have many of the rights of landowners, including the right to transfer, lease and mortgage the land. A relatively large fee is required to obtain granted land-use rights, but annual land-use fees usually do not apply.

A regulation issued in March 1996 (Provisional Measures for the Administration of Registration of Company's Registered Capital) reiterates that allocated land-use rights held by a Chinese company must first be converted to granted land-use rights before being contributed to a joint venture (JV).

The length of time for which land-use rights may be granted to FIEs varies by category of use. For example, land for residential use qualifies for a maximum term of 70 years. Land for industrial, educational, technology, public health and cultural use has a 50-year term. Land for commerce, tourism and entertainment has a 40-year term. Although FIEs have not been active in China long enough to test what happens at the end of these terms, the Property Law that took effect in October 2007 stated that commercial and industrial grants are to be renewed if there is no obvious conflict with the public interest.

Regulations on Granting State-Owned Land-Use Rights by Tenders, Auction or Listing, issued by the Ministry of Land and Resources, took effect on July 1st 2002. The rules seek to introduce a more transparent and rule-based system, requiring strict procedures for invitation for tenders and auctions, and also submission requirements for bidders. Since then, both Beijing and Shanghai have used public auctions to allocate state-owned land.

The Land Administration Law, implemented on January 1st 1999, gives foreign investors less scope for obtaining land, since it tightens controls on the use of arable land for non-agricultural purposes. It also requires the investor to reclaim arable land equal to that occupied by a project.

Most foreign investors acquire land-use rights by negotiated agreement at prices higher than those paid by Chinese companies for comparable land. However, several coastal cities are offering more land-use rights by auction or tender, at the same price for local and foreign purchasers. Obtaining land-use rights by direct tender from a local land bureau also offers greater assurance that the title is in order.

The Urban Real Estate Management Law, implemented in 1995, brought some order to China's chaotic real-property markets. It requires that most land-use rights to government land be granted by auction or open tender rather than acquired by private treaty. The law thus nurtures transparency and includes clearer development guidelines and provisions to discourage land speculation. The Ministry of Internal Trade introduced Measures for the Administration of Auctions, implemented in October

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1994, to help establish a unified nationwide auction system. A sounder system of property leasing, an increasingly popular alternative among FIEs and foreign representative offices, is also developing under the Measures for Administration of the Lease of Urban Real Estate, implemented in June 1995. The measures establish the rights and obligations of lessors and lessees, registration procedures, required contents of lease contracts and penalties for failure to comply with the measures.

For wholly-foreign-owned enterprises (WFOs), land use must be arranged with the government at the county level or higher. The local office of the Ministry of Land and Resources usually handles all land transactions affecting FIEs. The foreign investor must generally search for and decide on a potential land site, making this process part of the feasibility study included in the application to establish the WFO. The procedures for actually obtaining land-use rights are carried out within a few days from the issue date of the business licence. A WFO may not use land without a land-use certificate and may not assign land-use rights without approval. The term of land-use rights granted to a WFO must equal the enterprise's term of operation.

The investor must pay a land-use fee to the Ministry of Land and Resources on collection of the land-use certificate; additional fees may apply. The WFO itself may improve undeveloped land or entrust that task to a Chinese contractor.

For many JVs, the Chinese partner contributes land as part of its registered capital contribution. Foreign partners are generally advised to ensure that the land provided by the Chinese partner has not been contaminated during previous use. The stipulation that Chinese companies can contribute only "granted" land-use rights to JVs is not universally followed. SOEs are often unwilling to pay the premium required to convert the status of their land rights from "allocated" to "granted"; hence, many JVs continue to be formed with land-use rights that are not state approved. JVs formed this way risk official reprisals (including expropriation or fines) for illegal land use, but experts say this punishment is unlikely. The valuation of the venture is another issue, since JVs built on allocated land are generally worth considerably less than similar enterprises built on granted land.

Verifying ownership rights to land is difficult in China. The country lacks even a regional land-registration system, and access to land-transaction records is nearly impossible to obtain. Hence, foreign investors should require the Chinese company holding title to property to demonstrate that a particular parcel of land is approved for transfer to a JV for a particular purpose. One useful technique is to ask the local partner to produce the land-use certificate. Under the Urban Real-Estate Management Law, land-use and building ownership rights must be registered and certified by land-administration departments at the county level or higher. The two types of certificates resulting from the registration—land-use rights certificates and building-ownership certificates—serve as evidence of ownership and are required to complete real-property transactions.

For JVs in which the Chinese partner does not provide land, an alternative is to obtain land from local authorities; the JV must then periodically pay land-use fees. Annual fees vary widely, from a low of Rmb400 per sq metre in some areas to more than Rmb6,000 per sq metre for prime commercial land in Beijing and other booming cities. Some local authorities have been tempted to offer discounted land-use fees as an incentive to attract foreign investors. Hence, the Ministry of Finance issued a notice in April 2001 emphasising that authorities were under obligation to levy the full amount of land-

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use fees; it subsequently initiated a nationwide survey on fee imposition. The government imposes minimum fees for industrial-land use, depending on the quality and value of the location. Land is thus divided into 15 classes, with fees ranging from Rmb60 per sq metre (such as in parts of south-western Yunnan province) to Rmb840 per sq metre (such as in Shanghai's Huangpu district). In May 2009 in a bid to trigger new investment, the government issued a circular that permitted local governments to allow prices at 70% of the minimum.

Other policies took effect in 2006. In December of that year, China published new land-use restrictions on undeveloped farmland, prohibiting construction to build golf courses, racetracks, luxury homes, entertainment centres and theme parks. The China Banking Regulatory Commission issued new regulations in mid-August that put significant limits on loans for property-development projects. The policy requires developers to raise at least 35% of the overall capital needed for new projects before they can obtain loans. The policy also created a system of reviews to identify developers suspected of hoarding property in order to manipulate prices. The construction ministry announced regulations that July 2006 to limit foreign investors, including those from Taiwan, Hong Kong and Macau, to the purchase of one or two residential units. Purchase of residential property by non-mainland residents will require approval from local officials, and the foreign investor is to be restricted from further transactions for an unspecified period of time.

Requirements of the main corporate forms

The following is a summary of the requirements of the main corporate forms for foreign-invested enterprises (FIEs) in China: the wholly-foreign-owned enterprise (WFO); the equity joint venture; the contractual or co-operative joint venture; the joint-stock company (or company limited by shares); and the limited-liability company. Umbrella or holding companies comprising several joint ventures follow the rules pertaining to joint ventures, whereas wholly-foreign-owned holding companies follow the rules for WFOs. Another more recently developed investment vehicle is the partnership enterprise, via the Law of the People's Republic of China on Partnership Enterprises.

Capital

The concepts of authorised and issued capital are not used in China; instead, the authorities recognise registered capital in the capitalisation of joint ventures and joint-stock companies (also known as companies limited by shares). Joint-venture regulations define this as the total amount of capital contributed by the parties and registered with the authorities at the time of the joint venture's formal establishment. For a joint-stock company, registered capital is its total paid-up subscription monies (defined as the total value of the company's shares).

Wholly-foreign-owned enterprise (WFO). No legal minimum or maximum governs the amount of capital contributed by a foreign company to establish a WFO. Capital may be contributed as hard currency or tangible assets or (with approval) renminbi. Valuation must be consistent with international principles. Industrial property and technology may not exceed 20% of the registered capital of the enterprise. Registered capital may not be reduced but may be increased with the

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approval of the proper authorities. When capital is contributed in instalments, the first instalment must be not less than 15% of the total contributed capital and must be delivered within 90 days from the date of issuance of the business licence. The final instalment must be made within three years of the date on the business licence.

Equity joint venture (EJV). The minimum level of foreign participation in an EJV is 25%. There is no upper limit on foreign participation. Capital can be contributed in the form of cash, with foreign currency converted into renminbi at the exchange rate announced by the State Administration for Foreign Exchange (SAFE) on the day the funds are submitted. Under certain conditions, capital may also be contributed in the form of tangible assets (such as equipment, buildings and other material) or intangible assets (such as industrial property rights and know-how). When participants in an EJV contribute either tangible or intangible assets, their value is determined jointly by the participants or by a third party designated jointly by the participants, generally a China-registered accountant.

There is no official upper percentage limit per se on the amount of intangible assets that the foreign partner can provide. But internal government regulations require that the value of industrial property and technology provided by a foreign investor may not exceed 50% of the foreign investor's total capital contribution, or 20% of the total registered capital of the joint venture. Provisions on Several Questions Regarding the Use of High and New Technology Achievements as Capital Contributions to Subscribe for Shares, of July 1997, qualifies this rule. It says that the total value of technology contributed as capital may exceed 20% of the JV's total registered capital if it qualifies as new or high technology under definitions published by the Ministry of Science and Technology.

Partners must pay in their contribution within a timetable fixed in the JV contract. Failure to make capital contributions on time may lead to cancellation and compulsory surrender or revocation of the business licence.

The ratio of registered capital to the total amount of the investment must comply with the following scheme: where total investment is US$3m or less, registered capital must account for 70% of the total; for US$3m–4.2m, registered capital must be at least US$2.1m; for US$4.2m–10m, at least 50%; US$10m–12.5m, at least US$5m; US$12.5m–30m, at least 40%; US$30m–36m, at least US$12m; and more than US$36m, at least 33.3%.

The governance of an EJV is different from corporations in the west. Investors hold equity interest but no shares. Voting authority is vested in the board of directors rather than the shareholders. The directors are appointed by the investors and, in general, reflect the ratio of the capital contributions of the partners. EJVs generally have a limited duration, typically 30 years.

Contractual or co-operative joint venture (CJV). Capital is contributed in a ratio agreed by the parties to the CJV contract. Contributed capital may take the form of cash, land-use rights, technology (patented or unpatented), materials and equipment, trademarks and other property rights—essentially the same forms as for an EJV. As with EJVs, foreign partners' contributions in the form of intangible assets may generally not exceed 50% of the total foreign-capital contribution or 20% of the joint venture's total registered capital, but with the same qualifications contained in the July 1997 provisions.

Both "hybrid" and "true" CJVs are governed by the Law on Co-operative Joint Ventures, amended in

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October 2000, and related implementing regulations amended in April 2001. Under these regulations, CJVs that have obtained the status of a legal person (known as "hybrid" CJVs) are governed by essentially the same regulations on minimum-equity requirements and the timing of capital contributions as EJVs. Under "true" CJV arrangements, contributions by each partner are treated separately rather than as part of the single registered capital of the venture. In contrast to an EJV, parties to a CJV may share profit in a ratio that differs from the ratio of capital contributions.

Joint-stock company. This is the corporate form that most closely resembles western public companies. The Company Law sets the minimum registered capital of a joint-stock limited company at Rmb10m (though joint-stock companies wishing to list shares on a stock exchange must have total share capital of at least Rmb50m). A joint-stock company with foreign investment must have total registered capital of at least Rmb30m. In all cases, the foreign share capital should not be less than 25% of the registered capital. As with WFOs and JVs, capital may be contributed in the form of cash, tangible assets, proprietary technology or land-use rights needed by the company for production and business purposes. Industrial property and proprietary technology may not exceed 20% of the company's total registered capital.

Limited-liability company. The Company Law provides that limited-liability companies may allow contributed capital to be in currency, material goods, industrial property, non-patented technology or land-use rights. The value at which industrial property and non-patented technology are contributed may generally not exceed 20% of registered capital, but with the same qualifications in the July 1997 provisions.

Partnership. Under the Law of the People's Republic of China on Partnership Enterprises, implemented in August 1997, there is no legal minimum or maximum for the capital contributed by the partners to a partnership enterprise. As with WFOs and JVs, capital may be contributed in the form of currency, in kind or in the form of land-use rights, intellectual-property rights or other property rights. Such contributions must be the lawful property of the partner. Contributions other than currency must be appraised at a specific value. Partners may increase their capital contributions to the partnership enterprise, as stipulated in the partnership agreement or as decided by all the partners. Such additional contributions should be used to expand the scale of business or to make up losses.

Founders, shareholders

WFO. If two or more investors jointly apply to establish a WFO, a copy of the contract among the joint investors must be filed with the authorities that examine and approve the investment.

EJV and CJV. There are no specific limits on the number of foreign or Chinese partners. For a CJV, the foreign and Chinese partners control the venture as outlined in the CJV contract.

Joint-stock company. The Company Law and the Provisional Regulations on Several Issues Concerning the Establishment of Foreign Invested Companies Limited by Shares allow joint-stock companies to be established via a sponsorship or share offer. Regulations in Shanghai require companies with foreign investment to be established via a sponsorship (that is, where all the shares to be issued by the company are subscribed to by the sponsors themselves).

Sponsors of a company limited by shares must be legal persons or departments that the state has

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authorised to make investments. Where the sponsor of a company limited by shares is a Chinese-foreign EJV or CJV, the parties to the venture should reach an agreement on their respective rights and obligations following establishment of the company. In Shanghai, for example, before establishing a company limited by shares, the sponsors should reach an agreement and jointly select a sponsor registered in Shanghai municipality to apply for establishment of the company.

Limited-liability company. The Company Law says that the establishment of a limited-liability company requires no fewer than two and no more than 50 shareholders, more than half of whom must be domiciled in China.

Partnership. There are no specific limits on the number of partners to a partnership enterprise. The law gives each partner equal rights in the conduct of routine affairs. The admission of new partners is subject to the approval of the partners and the conclusion of a written partnership agreement in accordance with the law. New partners have the same rights and responsibilities as the original partners.

Directors, management

WFO. There is no mandatory management structure for a WFO, but the articles of association must spell out a structure in considerable detail (including the duties and limits of authority of such personnel as the legal representative, chief accountant, general manager and chief engineer). The articles of association must also specify procedures for termination and liquidation and for amending the articles.

EJV. The management structure of an EJV consists of the board of directors, management, staff and workers. The board of directors must have at least three members, including a chairman and a vice-chairman. Rules in force since July 2001 removed a previous requirement that the Chinese partner appoint the chairman, and the foreign side appoint the vice-chairman. The board of directors, which must meet at least once a year, decides on all major issues (including the appointment of management) in accordance with the articles of association.

The following decisions require the unanimous agreement of the directors: amendment of the articles of association, termination or dissolution of the venture, increase or assignment of the registered capital and merger of the venture with other economic organisations. There is no fixed number for managers of an EJV, but they must include a general manager (no particular nationality required) and a deputy general manager.

CJV. The CJV law requires the venture to have either a board of directors or a joint-management committee. “Hybrid” CJVs tend to adopt management systems resembling those of the EJV, whereas “true” CJVs tend to take the more flexible form of a joint-management office. Under the latter structure, no general manager as such exists, though the parties usually appoint a legal representative. Under revised CJV regulations, implemented in September 1995, the chairman of the board of directors or the head of the management committee serves as legal representative of the CJV.

Chinese law provides that only Chinese legal persons may contract with other Chinese entities to lease land, purchase supplies, etc. Hence, “true” CJVs, which do not have independent legal status in China, usually use the Chinese partner to enter into such contracts, under a grant of power of attorney by the foreign party.

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Joint-stock company. A company limited by shares is governed by its articles of association, which must be approved by the local examination and investment-approval authorities. The articles outline the system of management and control that is to govern the company. They detail the rights and obligations of the shareholders; the official powers and rules of procedure of the shareholders' general meeting; the establishment, official powers and rules of procedure of the board of directors, supervisory board and manager; and the procedure for amending the articles of association.

The board of directors, which should have 5–19 members, is the permanent executive organ of the shareholders' general meeting. Shareholders and non-shareholders may serve as directors. The board of directors generally has one chairman (who is the legal representative of the company) and, when necessary, one or two vice-chairmen. The chairman and vice-chairman are typically appointed by different parties to the joint venture. The manager of the company is appointed and dismissed by the board of directors and is the person in charge of the company under the board of directors. Generally, the chairman of the board of directors may not concurrently hold the position of manager. A supervisory board composed of no fewer than three members (one-third of whom must be staff and workers of the company) supervises the activities of the board of directors and management personnel such as the manager.

Limited-liability company. The Company Law says limited-liability companies must have a board of directors consisting of 3–13 members, whose term of office may not exceed three years. A director may serve consecutive terms if re-elected. The board of directors must have one chairman and one or two vice-chairmen. A limited-liability company must also have a manager who is accountable to the board of directors and is in charge of production, operation and management.

If a limited-liability company's shareholders are few in number and it is small in scale, then it may have an executive director rather than a board of directors. The executive director may concurrently serve as manager. If the scope of a limited-liability company is large, it needs a supervisory board of at least three members, which examines the company's financial affairs, supervises the directors and the manager, and may undertake other functions and powers provided for in the company's articles of association. Supervisors appear at meetings of the board of directors as non-voting attendees.

Partnership. The partners may jointly run the routine affairs of the partnership enterprise, as stipulated in the partnership agreement or as they otherwise decide. One or more partners may be entrusted with running the routine affairs of the partnership enterprise. However, the non-managing partners have the right to supervise managing partners and to inspect these operations. The partnership agreement must outline the methods for distributing profits and sharing losses; the conduct of the routine affairs; admission to and retirement from the partnership; dissolution and liquidation of the partnership; and legal liability.

Disclosure

WFO. Upon completion of initial contacts, the following formal application documents are required: a standard application for establishing the WFO, the feasibility study and proposed articles of association, business-registration certificate and articles of association of the foreign parent, certificate of incorporation, balance sheet for the previous three years, a plan for the balance of

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foreign-exchange receipts and expenditures, a list of equipment to be imported and a letter of creditworthiness issued by the bank with which the foreign investor has opened an account. An accounting system must be established in accordance with Chinese law, with reports subject to approval by the local financial and taxation authorities.

EJV and CJV. Following receipt of a formal certificate of approval, joint ventures must register with the State Administration for Industry and Commerce (SAIC) or its local delegate. Documentation consists of an application for registration; the JV contract and articles of association; approval certificate; project proposal and feasibility study, with relevant approval documents; certificates attesting to lawful commencement of business by the investors; certificates indicating the credit standing of the investors; a list of the board of directors and management; and other relevant documents and certificates. JVs must submit un-audited quarterly and audited annual accounts to the relevant government authorities, with the auditing done by Chinese certified public accountants.

Joint-stock company. The Company Law requires that a joint-stock company's board of directors apply for registration within 30 days after the completed inauguration of the board of directors. Documents that must be submitted in the registration application include an application form signed by the chairman of the board; the approval document from the relevant government department; for a company established by means of a share offer, the approval document from the State Council's securities administration department; minutes of the founding meeting; articles of association; auditing report of the company's establishment; certificate of verification of investment from an official investment-verification organisation; notice of pre-approval of company name; certification that the company has the right to use its place of business; and other documentation relating to the legal status of promoters; and the names and residences of directors and managers, and their election or appointment certificates.

Limited-liability company. The Company Law requires a representative or agent designated by the shareholders to file the registration application. Foreign-investment limited-liability companies, which are subject to examination and approval procedures, must file a registration application within 90 days. The following documents must be included: an application form signed by the chairman of the board; certification of the designated representative or agent; articles of association; certificate of verification of investment issued by official investment-verification organisation; certificate of appointment by the company's legal representative; notice of pre-approval of company name; certification that the company has the right to use its place of business and other documentation relating to the legal status of the shareholders; and the names and residences of directors and managers.

Partnership. An application to register a partnership enterprise goes to the enterprise-registration authority (but the law does not specify which). This must include a written application, the written partnership agreement and documents such as proof of identity of the partners, along with other documents. After receiving approval (issued within 30 days of application), successful applicants will be issued a business licence. If the registered particulars of a partnership enterprise change for any reason or if re-registration is required, the relevant registration procedures must be done with the enterprise-registration authority within 15 days of the date when such decision was made or such

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change occurred.

Taxes and fees on incorporation

All forms. Registration fees are set forth in a 1988 document issued by the SAIC, the Ministry of Finance and the State Bureau of Commodity Prices. Fees payable by ventures are calculated on the following basis: Rmb10m or less, 0.1% of registered capital (with a minimum of Rmb50); portion in excess of Rmb10m, 0.05%; portion in excess of Rmb100m, no fee. With any increase in registered capital, the same fees are payable again on the entire new amount. Fees of Rmb100 each apply to advance registration of a venture's name and to recording ordinary changes in registered items. Companies must also pay an annual registration-inspection fee of Rmb50.

Partnership. The Law on Partnership Enterprises does not outline any taxes or fees on incorporation.

Types of shares

WFOs and CJVs. These types of companies do not issue shares.

EJV and limited-liability company. These types of companies do not issue shares per se in exchange for capital.

Joint-stock company. All the capital must be divided into equal shares represented by share certificates. They may be ordinary or preferred shares (the latter generally have no voting rights). Companies must receive approval from the local branch of the People's Bank of China (the central bank) and other authorities to issue both A-shares (denominated in renminbi and available to Chinese citizens and to qualified foreign institutional investors) and B-shares (denominated in US dollars). A-shares are further divided into shares owned by individuals, legal persons and the state. A-shares owned by individuals may be traded freely through a securities trading house under relevant laws and regulations. A-shares owned by legal persons are traded on a separate electronic network; A-shares owned by the state are not traded.

Partnership. This type of enterprise does not issue shares.

Control

WFO. Control is solely in the hands of the foreign investor contributing capital. Nonetheless, Article 25 of the WFO rules states that the legal representative of a WFO has the power to represent the enterprise. To avoid granting powers that it wishes to reserve to itself, the foreign investor must spell out in detail the scope of the representative's authority in the articles of association.

EJV. The partners of an EJV control management, with the voting power directly proportional to each partner's share of the registered capital.

CJV. The partners in effect control a CJV, though the CJV law permits management to be delegated to a third party, with government approval. This is the standard mode of operation for hotels, which usually appoint an outside hotel-management company.

Joint-stock company. Shareholders of the company or their proxies exercise control via decisions taken at the company's general meetings. When the shareholders' general meeting is in recess, the board of directors is responsible for the company's major policy decisions and is accountable to the shareholders' general meeting. Management is responsible for implementing resolutions of

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the shareholders' general meetings and the board of directors; it is also responsible for the routine administrative, business and financial affairs of the company.

Limited-liability company. The Company Law provides that the shareholders' meeting has authority over a limited-liability company. Shareholders exercise voting rights at shareholders' meetings in proportion to their capital contributions. The board of directors is accountable to the shareholders' meeting and must implement its resolutions; the board also decides on the business and investment plans of the company. The management, which is accountable to the board of directors, is in charge of production, operation and management.

Partnership. The partners to the partnership enterprise exercise control through procedures set out in the partnership agreement. The agreement may set out the term of operation of the partnership enterprise and the method for settling disputes between partners. Certain actions of the partnership enterprise require the consent of all of an enterprise's partners, including the following: disposal of immovable property; change of name; assignment or disposal of intellectual-property or other property rights; application to register changes with the enterprise-registration authority; provision of guarantees for outside parties in the name of the partnership; engagement of persons outside the partnership to serve as business or management personnel; and other relevant matters.

Establishing a local company

Foreign investors may set up wholly-foreign-owned ventures (WFOs), equity joint ventures (EJVs), contractual or co-operative joint ventures (CJVs), joint-stock companies, limited-liability companies, holding companies, representative offices, branches and partnerships.

The WFO continues to outpace the EJV as the favoured investment vehicle, reinforcing a trend that first emerged in 1997. The number of WFOs has risen significantly because of China's efforts to attract foreign technology, coupled with a shortage of potential JV partners with the necessary capital.

WFOs have spread from small-scale, export-focused manufacturing projects to domestic transport, high-tech, and integrated manufacturing and/or investment conglomerates. Their numbers should continue to grow as local officials become more familiar with them and the scope widens for business activities. WFOs have been allowed to operate in the wholesale, retail and trade sectors since December 2004. Some municipalities, such as Qingdao in north-eastern Shandong province, are actually encouraging WFOs as a way to buttress foreign-investment interest and reduce potential disputes.

For foreigners, WFOs offer a simpler approval procedure (with no protracted negotiations with a Chinese partner) and complete management control. Foreign companies also often use the WFO form to protect technology. WFO status permits greater use of the renminbi to pay for business expenses and in receipts for local sales.

In establishing a JV, the selection of an appropriate Chinese partner is generally the most demanding and critically important step. The following are among factors to consider: a potential partner's political influence, its access to domestic financing, its ability to provide a domestic market

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for its products, the skill level of its labour force, and its integrity and strength of management. The wrong partner can lead to innumerable difficulties and possible losses, whereas an effective one can be a guide through China's bureaucracy and a "friend in court" for dealing with official intransigence. Companies in the food and beverage business are known to have sought local JV partners for the connection they provide to the Public Security Bureau, or police.

The holding-company format can offer certain economies of scale in operations and management through its collection of investments under one corporate identity. These include centralised purchasing of production materials, collective training of subsidiary-project personnel, co-ordination of project management and establishment of a single entity to market all subsidiary products.

By contrast, joint-stock companies—or companies limited by shares—offer somewhat different advantages. A foreign-invested enterprise (FIE) opting for this corporate form can invite the participation of shareholders in the company, both to expand capital and to secure links with other legal entities in China. A joint-stock company offers greater liquidity in transferring interests; in contrast, both EJVs and CJVs normally require the prior consent of the other partners, and also of the original examination and approval authority to transfer interests. Companies limited by shares need no prior consent from others to dispose of interests, though the promoters must wait three years from the company's first registration before assigning their shares.

The Provisional Regulations on Several Issues Concerning the Establishment of Foreign Investment Companies Limited by Shares, implemented in January 1995, leave open the possibility that WFOs might at some time be allowed to convert into foreign-invested companies limited by shares (FICLS). Since WFOs are now the form of organisation favoured by investors establishing holding companies in China, this may eventually allow for the financing of large groups of Chinese investments through access to the domestic or international capital markets by one holding company upon its conversion into a foreign-invested joint-stock company.

The most important drawbacks of the shareholding corporate forms are the complex approval process and the relevant legislation that tends to impose more restrictions on an FIE in terms of capital increases, statutory reserves and the level of public disclosure. Other disadvantages include the following:

- stricter definitions of the internal workings of the company, including the functions and powers of shareholders' meetings, and the composition and duties of boards of directors;
- stricter definitions of who may serve as a company officer. Article 57 of the Company Law bars certain individuals from acting as a director, supervisor or manager of a company (such as those with recent criminal records, managers who bore "personal responsibility" for a bankrupt company and persons with large "unsettled" personal debts); and
- greater worker participation in management. Unlike WFOs and JVs, the Company Law requires shareholding companies to obtain the opinion and suggestions of its trade union and workers before deciding on major production and operational issues.

China's domestic economy also permits three additional major forms of business organisation:

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Collective enterprises. Most of these entities, which were originally run by their own workers, were taken under direct state control during the Cultural Revolution. The government has been returning some collectives to their employees, removing them from state-planning targets and subjecting them to collective-enterprise taxes and other levies.

Household enterprises are private concerns, generally managed by one individual or a single family, which may employ as many as five workers and two apprentices at a time. Household enterprises may engage in small-scale industry, commerce or services, particularly retailing, repairs, catering and consultancy. They must be organised as sole proprietorships (with the owner retaining personal liability for all debts) and are governed by regulations that took effect in 1987.

Private enterprises are defined for legal purposes as privately owned, profit-seeking economic organisations employing at least eight persons. Governed by regulations implemented in 1988, they may be organised as sole proprietorships, partnerships or limited-liability companies. Private enterprises may engage in construction projects, commerce, catering and other services. They are specifically excluded from the defence and banking industries, from dealing in goods under state monopoly and in any other areas reserved by the state. After receiving official approval at the 14th Party Congress in 1992, private enterprises have been flourishing in most parts of the country and expanding their range of operations. Some of these enterprises have also been allowed to form conglomerates, contract out and even purchase small state-owned enterprises.

Establishing a branch

Branches. The Company Law of 1994, Articles 199–205, allows investors to create a “branch of a foreign company”. Certain foreign branches were already permitted in China (for example, foreign bank and insurance branches), but they operated under strict restrictions. The Company Law allows any company to set up a branch.

The State Council has not yet released regulations governing examination and approval procedures and the scope of allowable activities for branches of foreign companies. Under the Company Law, however, branches of a foreign company in China remain part of the parent company and thus are not entitled to the rights and protections accorded to Chinese legal entities. Branches must appoint a Chinese legal representative and are liable under civil law for their business activities.

Representative offices. Foreign companies, particularly those in the service industries, continue to rely on representative offices to conduct business (though this is technically illegal). Representative offices offer the advantage that the rules governing their operation are clear-cut and of long standing.

Indeed, representative offices remain the most common vehicle for foreign service companies establishing a presence in China, particularly in banking, accounting, consultancy and import-export trading. Moves by both central and provincial authorities to liberalise banking and insurance have led many foreign banks to set up representative offices in China’s major coastal cities and some inland urban centres.

Although representative offices allow foreign investors to enter the Chinese market with little initial

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investment, they are prohibited from direct profit making under revised regulations published by the Ministry of Commerce (MOFCOM), and implemented in February 1995.

New rules published by the State Administration for Industry and Commerce (SAIC) in February 2010 require applicants to provide documentation that the company has been in operation for at least two years. In reviewing an application, an approval authority assesses whether a "genuine need" exists for the foreign representative office in China. To make this assessment, the authority considers the applicant's current and expected volume of business. The 2010 rules from the SAIC also state that representative offices must apply for renewal of registration certificates every year, compared with every three years previously. Applications for extension must be made 60 days before a term expires. Finally, the rules require representative offices to employ no more than four employees, compared with no restrictions before.

Foreign financial institutions must follow separate rules to establish representative offices. Special rules also apply for representative offices established in the Shenzhen special economic zone, Guangdong province and Shanghai municipality. Despite differences in the details of these provisions and those of the national registration regulations, the basic registration procedure remains the same: (1) obtain formal approval to establish the office and (2) complete formalities with the SAIC to obtain a registration certificate.

The People's Bank of China (the central bank) is responsible for granting registration certificates to representative offices established by foreign banks and insurers. It is costly, however, for foreign banks to use fully the opening permitted by China's entry into the World Trade Organisation in December 2001. Foreign banks wishing to adopt the full scope of business permitted once the last restrictions were abolished in late 2006, including retail banking, face registered-capital requirements of Rmb1bn (US$128m). For each additional branch they open, they must allocate another Rmb100m in operating capital.

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