Government relations, regulatory compliance and stakeholder alignment
Observations

1. Foreign businesses cite a lack of access to Chinese government officials as one significant risk.

2. In mature industries, building relationships in government is not as important as that of developing or transforming industries.

3. Securing the right connections in China necessitates a considerable commitment of time and resources.

Recommendations

1. Foreign investors need a strategy that works collaboratively with government regulations. They should continually look for common ground with government officials.

2. Investors should work with officials they are comfortable with, and strive to maintain these relationships. Be persistent and consistent.

3. Local managers cultivating a wide network of local contacts can lower a company’s compliance risks.

4. Foreign investors offering services, goods or strategies that are new or unfamiliar to the Chinese market may need to put even more effort in their communications to ensure all stakeholders are properly appraised.

4. Trusted partners or advisers on the ground with the right knowledge and local connections can also ensure your interests are heard by the appropriate government officials when they need to be.

5. Investors may need to map out their stakeholders when conducting due diligence, and properly gauge their issues and concerns.
Despite the many regulatory issues, regulatory compliance is actually considered a relatively minor risk in the China corporate world, as Chinese businesses have learned to work within the system. Of the 160 China and Hong Kong CEOs surveyed in PwC’s 15th Annual Global CEO Survey, only 44% consider over-regulation a threat to their growth, compared with the global average of 56%. Domestic companies also tend to have more flexibility in the China market than their foreign counterparts, having factored the shifting regulatory environment quite early into their business plans. Only 36% of China CEOs believe that changes in regulation have influenced their anticipated need to change strategy.

For foreign companies in China, however, regulations can be a major concern. In seeking a successful strategy for dealing with government, foreign businesses should seek out constructive avenues of action. Investors should adopt a careful and measured approach in working with the government. They should lobby the government to take a collaborative and progressive outlook towards regulatory reform. And they should be active in engaging relationships with government officials in order to stay informed.

The common ground between both businesses and the government is growing, while the needs of the private and public sectors have become increasingly intertwined. Roughly a third of CEOs in China believe that workforce skills are a top priority for government, and 93% say their business has a role in development of the workforce, other than their own employees. The risks of talent constraints are also well recognised by the government. China’s 12th Five-Year Plan, introduced in 2011, outlines a strategy for finding and nurturing talent, with the idea of bringing home 2,000 skilled Chinese expats.

Foreign companies operating in China should stress their contribution to the development of local “homegrown” talent, and look for ways in which to collaborate better with the Chinese government in the areas of professional development of human capital, as well as improving indigenous innovation and technological capacity. Other issues that are ripe for increased collaboration between China’s public and private sectors include infrastructure development, education, intellectual property protection, health care and regulatory convergence standards. In pushing their efforts on sustainability, Walmart, for instance, is aligning their strategy with the government on issues of people’s health and social stability, as the 12th Five-Year Plan emphasises food safety and domestic consumption.

However, lack of access to government officials is among the risks widely cited by foreign businesses in emerging markets, and overcoming that may require a concerted effort in China. But with the right connections, resources and subject matter expertise, the extra effort to involve themselves in government discussions can often pay off in the end. Effective partnership models with the China government will also result in better communication and opportunities.

2. See also Supply chain strategies chapter for more on food safety concerns in China
Working at the local level

As we’ve seen in other chapters, policy implementation can be subject to local variations in interpretation and enforcement. While regulations are introduced centrally in China, enforcement of these regulations is applied at the provincial and city level, and interpretations often vary.

Therefore, businesses need to focus on cultivating local government relationships. “Different officials have different mindsets when they manage their relationships with investors,” says Cheri Fu, co-founder of Galleria, a US-based home decor importer and wholesaler. “They [local officials] can manage relationships with local employees and with other government departments – environmental, fire etc. – and help communicate with other officials,” says Fu. Putting a consistent effort in working with local government officials whom you are most comfortable with is a strong way of maintaining good relations.

While building connections with an official that goes beyond pleasantries can be helpful for future dealings with the government, companies should also be aware that not all relationships are immediately relevant for their needs. Businesses should not underestimate the value of any one relationship. Different civil servants have different areas of responsibility, and they may come into play at any given time.

Cultivating a large regional network of government contacts in as many provinces and cities as possible can help lower compliance risks associated with entering new markets, cities or provinces. Ideally, locally based Chinese managers should engage in regular communication in a local cultural context with their counterparts in the local government.

China simply can’t be treated as a single market, and local regulations make this case particularly convincing. Businesses must often factor in local government, bureaus and a raft of related stakeholders into their business dealings and market entry strategies.

Anthea Wong, PwC China Tax Partner

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4. See also Tax management: planning and compliance chapter and Finance and treasury chapter for further examples of regulations that differ between central and local governments
Getting a perspective on relationships

In highly restricted markets, relationships can be essential to driving your business. But while government relationships can support the success of businesses operating in highly controlled industries, they are by no means a guarantee to success. For more mature industries in China, with clearly defined rules and expectations, government relationships may be no more beneficial than they are in other economies, particularly in emerging markets.

In such instances, relationships act more as lubricants, easing procedures from day-to-day registration and filings to the inner clockwork of complex approvals processes. But what businesses most often overlook in the China operational environment is the importance of managing a consistent and systematic “group-to-government strategy,” establishing consistent communication channels with all relevant stakeholders, particularly in approaching unfamiliar territory and new markets.

Establishing new relationships

Newcomers may find themselves on unfamiliar ground more often than expected, balancing a legal, tax and regulatory system that’s still developing relative to that of other markets. Even established multinationals such as Yum! Brands need clarity in navigating legal grey areas and sensitive issues. With thousands of outlets across the nation, one of Yum!’s challenges is to triage their responses to the volume of government inquiries and audits they face on an ongoing basis. The company also has a need, for accounting purposes, to value the liabilities of more informal agreements. As certain laws and regulations in many areas have yet to achieve full clarity, consistent and regular dialogue is often needed to resolve ambiguities.

Due to this requirement, multinationals such as Yum! have put ample resources towards well-staffed departments in China focused solely on government and stakeholder relations. But those without the necessary resources and experience will nevertheless need to ensure that their issues are aligned with that of the government and local stakeholders. Time-strapped businesses can opt to work with trusted partners or advisers on the ground with the knowledge and local connections to help ensure that their voice is heard at the right time, and that all stakeholder expectations are met.

Companies who attempt to make these connections without local assistance will also need to map out a systematic process of engagement before taking the plunge. Acquiring the right connections in a complex bureaucracy can be difficult, and a generous amount of time and energy is needed to manage and maintain key relationships. Even businesses with dedicated departments often lack consistency in trying to maintain regular dialogue.

The main challenge here for foreign businesses is that of time and resource commitment. Frequent conversations are needed to smooth out wrinkles and correct mis-steps in the process. Even seemingly clear-cut transactions such as capital injection into China, which does not require heavy discussion, still require an inordinate amount of time for regulatory compliance and filings. For example, representatives will need to present their case, prepare the necessary documents for cash injection, and finally exchange that money into the local currency. Many find the process of following through on such rules and procedures tedious and time consuming. As a result, it is often worthwhile to outsource this type of government networking and relationship management to experts and advisers, in order to concentrate on the actual work of running your business.
**The presentation of special cases**

Note, however, that extra effort in reaching out can be instrumental when attempting something unfamiliar in the China market, be it a new business model, concept or technology. In such cases, regular communication with all stakeholders will help to smooth out the process, while making sure everyone is aware of what you’re trying to do. Make sure you manage government and stakeholder expectations and keep them informed early and often, so that there are no surprises.

At such times, businesses may have to take a careful and deliberate approach when interfacing with authorities, in relation to the scope and nature of the issue in question. Careful consideration should be taken as to the current stage of discussion or negotiation with a government department before each engagement. Should the query be exploratory in nature, an informal conversation by a local staff member with a civil servant will often suffice in obtaining the necessary advice or information. When businesses wish to convey to authorities a more serious intent, an official and formal meeting should be arranged. For example, foreign companies with a special investment or cash injection requirement may ask for a meeting with the Ministry of Commerce.

**Knowing your stakeholders as part of due diligence**

Entrants who do not align their interests with that of governments and local stakeholders may find themselves at a disadvantage during crucial moments in their business. If you’re new to China and don’t have the relationships you need, make sure your local advisers or partners do, as they can be instrumental in helping you take your case to the authorities. Advisers may have the inside track on the workings of a deal, allowing them to help in your due diligence by analysing whom your key stakeholders are, and interfacing with them so that your position is understood and interpreted correctly. In addition, they can also accurately interpret the positions of the government and local stakeholders, so that your business can shift strategies accordingly.

In taking a more holistic approach to due diligence, it may also be helpful to map out all key stakeholders with some level of detail to give yourself an understanding of which organisations have a say in your business interests, while giving you an awareness of their issues and concerns. And there are often more stakeholders on the map than newcomers may have sketched out at the drawing table. For example, businesses trying to repatriate their cash may assume they would only need to deal with the State Administration of Foreign Exchange (SAFE), when in reality tax and customs authorities also come into play.

Other stakeholders may include banks, professional firms and industry associations. At other times, it may be a government organisation such as the local environmental protection bureau. Government authorities may sometimes consult with them when formulating government policies. Try to speak with several investors or local companies who may have experienced similar processes for their feedback on whom the relevant government authorities and stakeholders might be in any particular deal, as well as the potential issues and challenges. This can also help you keep informed of operating realities before plunging into uncertain terrain and markets.

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7. See also Finance and treasury chapter for further details on cash repatriation
Government regulators in China have a sector-specific focus. The following is an alphabetically ordered list of some regulators that may be relevant to your business, depending on your sector and the focus of your activity:

**General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ)** is the in-charge authority supervising quality inspections on imports and exports. AQSIQ promulgates a Catalogue of Goods that are subject to statutory inspection annually. Imports/exports that are not listed in this catalogue may still be subject to random inspection by the local AQSIQ offices.

**China Banking Regulatory Commission (CBRC)** regulates Chinese state-owned commercial banks, joint-stock commercial banks, city commercial banks, urban credit cooperatives, rural credit cooperatives, rural commercial banks, locally incorporated foreign banks, policy banks, postal savings banks, asset management companies, finance companies, trust companies and financial leasing companies.

**China Insurance Regulatory Commission (CIRC)** regulates life insurance, property and casualty insurance companies.

**China Securities Regulatory Commission (CSRC)** regulates securities companies, funds, futures companies, and equity and corporate bond insurance companies.

**Ministry of Commerce (MOFCOM)** and its local subsidiaries are the major government authorities that deal with matters relating to foreign investment in China. They have authority over the approval of enterprises with foreign participation and import of technology. MOFCOM and its local subsidiaries are likely to have the most contact with foreign investors.

**Ministry of Finance (MoF)** is responsible for formulating the accounting practices for foreign-invested enterprises operating in China.

**National Development & Reform Commission (NDRC)** has responsibility for overall macroeconomic planning and policy. It studies and formulates policy for economic development.

**People's Bank of China (PBOC)** has ministry-level status and reports directly to the State Council. Its main responsibilities include drafting and enforcing relevant laws, controlling the money supply, forming monetary policy, and regulating financial markets, including the renminbi exchange, the state foreign exchange and gold reserves.

**Securities Association of China (SAC),** established on 28 August 1991, is a non-profit self-regulatory organisation with “legal person” status subject to the guidance, supervision and administration of the CSRC and the Ministry of Civil Affairs. The members of SAC include securities companies, securities investment fund management companies, financial asset management companies and securities investment consulting agencies.

**State Administration of Foreign Exchange (SAFE)** functions as part of the PBOC, responsible for setting foreign exchange policies, making recommendations, establishing/ regulating current and capital account funds transfer activities, and overseeing the implementation of rules and penalising rules breakers. In practice, SAFE performs a supervisory function for foreign exchange transactions conducted by foreign-invested enterprises.

**Shanghai Stock Exchange** is a non-profit membership institution directly governed by the CSRC. After several years of operation, the exchange has become the dominant stock market in mainland China in terms of the number of listed companies, the number of shares listed, total market value, tradable market value, securities turnover in value, stock turnover in value and the T-bond turnover in value.

**Shenzhen Stock Exchange** has more than 150 members and two trading halls.
State Administration of Industry and Commerce (SAIC) is responsible for regulating domestic day-to-day commercial activities. Representative offices are required to register with SAIC. All commercial entities in China must register with SAIC and submit annual or tri-annual re-registration documents to local SAIC offices as required by law.

State Administration of Taxation (SAT) is responsible for the collection of taxes and enforcing tax laws. These laws are enforced and administered on a day-to-day basis by one tax bureau (local tax bureau) under the local government, and another tax bureau (state tax bureau) under the SAT in Beijing. These tax bureaus are responsible for ensuring that the policies laid down by SAT are implemented in accordance with local conditions as well as for tax assessments, collecting tax payments, performing tax audits and conducting tax negotiations with taxpayers. SAT is responsible for making tax policies for the whole country (including drafting new or revising tax laws and regulations) and for acting as the tax appeal body with respect to disputes between the tax bureaus and taxpayers.

Trademark Office of the SAIC is responsible for trademark registration and administration nationally. The local Administrations for Industry and Commerce (AICs) supervise the use of trademarks and deal with trademark infringements. In most cases, the party to file first will secure rights to that mark in China, so file as early as possible. For instance, a Shanghai snack maker owns the name and logo of the computer game, Angry Birds, while the trademark for Facebook is registered for a variety of products. The office maintains a free, searchable database online. Companies are encouraged to use this resource on a regular basis.

People’s Republic of China government structure

*Relevant to foreign-invested enterprises
The Central Government

The National People’s Congress (NPC) of the People’s Republic of China is the highest organ of state power. The Standing Committee of the NPC is the permanent organ of the NPC. The term of office of the NPC and its Standing Committee is five years. The NPC and its Standing Committee are empowered with the rights of legislation, decision, supervision, election and removal.

The President of the People’s Republic of China is the head of state, as well as the supreme representative of China both internally and externally. The state presidency is an independent state apparatus and a component part of China’s state organisation. China’s system of the head of state is a system of collective leadership. The President is subordinate to the NPC and directly receives instructions from the supreme organ of state power.

The Central Military Commission of the People’s Republic of China is the highest state military organ with the responsibility of commanding the entire armed forces in the country. Led by a chairman and consisting of vice chairmen and members, the Commission is elected for a term of five years and can stand for re-election.

The State Council of the People’s Republic of China, namely the Central People’s Government, is the highest executive organ of state power, as well as the highest organ of state administration. The State Council is made up of a Premier, vice-premiers, state councilors, ministers in charge of ministries and commissions, the auditor-general and the secretary-general. The Premier of the State Council is nominated by the President, reviewed by the NPC, and appointed and removed by the President. Other members of the State Council are nominated by the Premier, reviewed by the NPC or its Standing Committee, and appointed and removed by the President. In the State Council, a single term of office is five years, and incumbents cannot be reappointed after two successive terms.

The Supreme People’s Court is the highest trial organ in the country and exercises its right of trial independently. It is also the highest supervising organ over the trial practices of the local people’s courts and special people’s courts at various levels. It reports its work to the National People’s Congress and its Standing Committee. The right of appointment and removal of the president and vice presidents as well as members of the trial committee of the Supreme People’s Court lies with the National People’s Congress.

The Supreme People’s Procuratorate, local people’s procuratorates and special people’s procuratorates such as the military procuratorate make up the prosecution system. The people’s procuratorates are the legal supervision organs of the state.
Legislation

The National People’s Congress and its Standing Committee are empowered to exercise legislative power. The State Council is also authorised to adopt administrative regulations and measures in accordance with the constitutions and laws. At the local level, the People’s Congress of the provinces, autonomous regions and municipalities directly under the central government may also adopt local regulations, provided they do not contravene the Constitution or the state laws.

China’s tax laws applicable to enterprises are drafted by the State Administration of Taxation and the Ministry of Finance before being submitted to the State Council for discussion and review. Once passed by the State Council, they are then submitted to the National People’s Congress for final approval and promulgation. Implementing rules and regulations are also drafted by the State Administration of Taxation and submitted to the State Council for approval.
The landscape

Businesses should understand that China’s government, while a one-party system, is not a monolithic entity on a linear course of economic development. There are differences in agreement on process, timing and degree of change needed to realise reform.9 Some views are inclined towards more comprehensive reform, while others gravitate towards a firmer ground of promoting “tried and tested” policies. These differences, some of which can be subtle, can have a significant impact on businesses operating in China. CEOs should therefore try to understand the differences and commonalities in the points of view of Chinese leadership and develop strategies that can adapt to this environment in times of political change.

The political landscape in China today cannot be defined by any ideology or the policies of a strong leader like Chairman Mao or Deng Xiaoping. The leadership is becoming increasingly diversified, and the leaders’ views are also becoming more transparent. There is some public debate going on.

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